



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
Market Supervision and Registration Department

File No. SMD-/MSRD-C&IW/22-1(132)/2013

July 3, 2013

Mr. Nadeem Naqvi,
Managing Director,
Karachi Stock Exchange Limited,
Karachi Stock Exchange Building,
Stock Exchange Road,
Karachi.

Mr. Aftab Ahmed,
Managing Director,
Lahore Stock Exchange Limited,
19, Khayaban-e-Aiwan-e-Iqbal,
Lahore.

Mian Ayyaz Afzal,
Managing Director,
Islamabad Stock Exchange Limited,
ISE Towers, 55-B, Jinnah Avenue,
Islamabad.

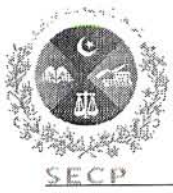
SUBJECT: CLARIFICATIONS/GUIDELINES IN RESPECT OF THIRD SCHEDULE OF SECURITIES AND EXCHANGE RULES, 1971

Dear Sir(s),

Securities and Exchange Commission of Pakistan (“the Commission”), during the course of inspections of the brokerage houses, observed various non-compliances of applicable laws and shortcomings on the part of the brokerage houses. The major irregularities include miscalculation and misinterpretation of the requirements regarding Net Capital Balance (“NCB”) as prescribed in the Third Schedule read with Rule 2(d) of the Securities and Exchange Rules, 1971 (“SEC Rules”).

In view of inconsistent approach and misinterpretation of the requirements prescribed in Third Schedule of SEC Rules resulting in miscalculation of NCB and in the light of the queries and suggestions received from different market participants from time to time, the Commission deems it appropriate and expedient to issue certain clarifications/guidelines in respect of Third Schedule of SEC Rules to ensure clarity and consistency. Moreover, inconsistency has also been observed on the part of Auditors with regard to format for certification of NCB.

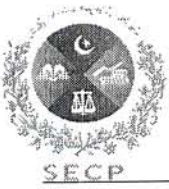
Furthermore, in order to monitor the NCB of brokerage houses and to protect the interest of investors, the Commission considers it necessary that the brokerage houses to submit their NCB under regulatory requirements after taking into consideration information and details as mentioned in these guidelines. Accordingly, the following clarifications/guidelines are hereby issued with respect to Third Schedule read with Rule 2(d) of the SEC Rules including certification of NCB under regulatory framework.



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
Market Supervision and Registration Department

1. CASH IN HAND AND BANK BALANCES:

Subject Matter	Clarification
1.1 Cash deposited as margins with Stock Exchanges and National Clearing Company of Pakistan Limited	Cash deposited with the Stock Exchanges and National Clearing Company of Pakistan Limited (NCCPL) as margins may be incorporated as Cash and Cash Equivalent for the purpose of calculation of NCB.
1.2 Cash Deposited as Basic Deposits with Stock Exchanges and NCCPL	Cash deposited with the Stock Exchanges and NCCPL as basic deposits by the brokerage houses may not be incorporated as Cash and Cash Equivalent.
1.3 Cash Deposited as Base Minimum Capital (BMC) with Stock Exchanges	Cash deposited as part of BMC may not be incorporated as Cash and Cash Equivalents for calculation of NCB.
1.4 Term Deposit/Other Deposit Receipts with Banks	Both items are in nature of cash equivalent and TDR/DR upto one year maturity may be included under the head "cash in hand and with Bank", provided the said deposit is free from any third party interest and free from any lien.
1.5 Clients' Bank Account Balance	<p>Balances of all bank accounts being maintained by the brokerage house including bank account for clients' funds would be included for NCB. However, in the working of NCB following details are required to be specified:</p> <ul style="list-style-type: none">a) Bank balance(s) pertaining to brokerage houseb) Bank balance(s) pertaining to clientsc) Total bank balances <p>However, with regard to bank balance pertaining to clients, brokerage houses are required to have client wise break up. The brokerage houses will be required to ensure that corresponding liability in respect of each such client has been reported in trade payables as on that reporting date for NCB, clients bank balance should not exceed the corresponding trade payable client wise and/or overall basis as reported in NCB.</p> <p>Moreover, bank balance pertaining to clients of Pakistan Mercantile Exchange Limited (PMEX) may also be excluded.</p>



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
Market Supervision and Registration Department

2. TRADE RECEIVABLES:

Subject Matter	Clarification
2.1 Charging Mark up on Trade Receivable Balances	Charging markup, late payment charges or any charges with any other name on the balance of Trade Receivable is strictly prohibited if the same are charged for arranging/extending credits for/to the clients other than allowed under Section 16 of the Securities and Exchange Ordinance, 1969 (“SE Ordinance”) i.e. Securities (Leverage Markets and Pledging) Rules, 2011 and Regulation 41(c) of General Regulations.
2.2 Receivables from NCCPL	Balance receivable from NCCPL as on reporting date against unsettled trade to be included in Trade Receivable for NCB purposes.
2.3 Aging and break up of Trade Receivables	<p>Receivables in respect of Margin Trading System (MTS), Margin Financing (MF) and Securities Lending and Borrowing (SLB) may also be included in trade receivables for the purpose of NCB as explained below:</p> <p>a) Aging of Trade Receivables</p> <p>Break up of trade receivables showing separately</p> <ul style="list-style-type: none">i) Total receivablesii) Outstanding for more than 14 daysiii) Balance generated within 14 days and/or not yet due <p>However, working of aging in respect of trade receivables should be made on transaction wise basis and not on overall basis and should be calculated on First-in-First-out (FIFO) basis reflecting the outstanding position against most recent transactions upto and/or 14 days of the reporting date of NCB.</p> <p>b) Receivables from clients under MTS</p> <p>Receivable from client in respect of MTS transaction against which MT release transaction has been executed, however, payment has been made by the brokerage houses on behalf of its client. The related receivable may be included within 14 days. After expiry of 14 days from the date of release the securities purchased for client should be</p>



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
Market Supervision and Registration Department

	<p>taken into account as “Securities Purchased for clients” (Item No.4 of Schedule-III). If the securities released from the MTS blocked account is sold in the market then the same should be adjusted from the receivable balance.</p> <p>c) Receivables from clients under MF The amount receivable from the client which is not yet due as per the contract period can be included. Any amount overdue after expiry of contract term but overdue for less than 14 days is allowed. If an amount is overdue for more than 14 days then the corresponding securities of clients should be taken into account. It must be clarified that if the brokerage houses liquidates the securities financed and previously held in the MF blocked account the same should be adjusted from the receivable balance.</p> <p>d) Receivables from clients under SLB The amount receivable from the client which is not yet due as per the contract period can be included. Any amount overdue after expiry of contract term but overdue for less than 14 days is allowed. If an amount is overdue for more than 14 days then the corresponding securities of clients should be taken into account as “Securities Purchased for clients”.</p> <p>e) Mark up receivables against MTS, MF and SLB Mark up receivable against MTS, MF and SLB may be included in trade receivables. However, aging is also required in this case, if the markup is overdue for more than 14 days, it should be excluded.</p>
2.4 Receivables pertaining to Pakistan Mercantile Exchange Limited (PMEX)	These receivables should not be included in calculating NCB of the brokerage house of a Stock Exchange.
2.5 Deposits with PMEX	These deposits should not be included in calculating NCB of the brokerage house of a Stock Exchange.
2.6 Receivables against margin financing in the books of Financer	Balance receivable and not yet due against margin financing appearing in the books of brokerage house (Financier) may be included as Trade Receivable for the purpose of NCB.
2.7 Amount receivable other than brokerage business	Amount receivable other than brokerage business such as consultancy income receivable should not be included for the purpose of calculation of NCB.



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

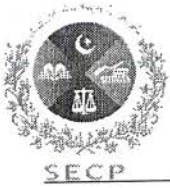
Securities Market Division

Market Supervision and Registration Department

2.8 Other assets	The current assets item not prescribed in Third Schedule of SEC Rules should not be included for the purpose of calculation of NCB, for instance: 1) Loan and Advance to employees 2) Loan and Advances to associated companies 3) Income tax receivable/refundable 4) Commission receivable 5) Advance to suppliers or advance to customers 6) Mark up or interest receivable on loan balance 7) Prepayments 8) Deposits for office rent, telephone etc.
2.9 Mark up charged due to shares pledged through Collateral account due to default of payment	Such markup will be allowed only up to 3 days for shares pledged through Collateral Account as specified in General Regulations of the Exchange and may be classified in trade receivables.
2.10 Receivables against Repo or reverse Repo	Receivables against Repo and/or reverse Repo may not be included in trade receivable, therefore, may not be included in NCB.

3. INVESTMENT IN LISTED SECURITIES IN THE NAME OF BROKERAGE HOUSE

Subject Matter	Clarification
3.1 Details regarding securities on exposure list	To calculate value of investment in listed securities in the name of brokerage house, the investment made in tradable listed securities is to be included.
3.2 Investment classified in books of account as long term	Where investment in listed securities has been made for more than one year or an investment has been classified as long term in books of accounts such investment should not be included for the purpose of calculation of NCB.
3.3 Investment in listed securities classified by the brokerage house but not appearing in its House Account	Only shares appearing in House account of the reporting brokerage house and owned by it should be classified as investment in listed securities in the name of brokerage house, however shares transferred to any third party as per REPO Agreement should not be included. Where shares owned by the brokerage house but not appearing in its House Account, disclosure will be required regarding sub account/investor account in the name of brokerage houses where said shares are available.



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
Market Supervision and Registration Department

4. SECURITIES PURCHASED FOR CLIENT

Subject Matter	Clarification
4.1 Basis and valuation of securities	Value of shares appearing in clients respective sub account may be included for NCB purpose to the extent of overdue balance for more than 14 days or value of securities, whichever is less provided such overdue is not in contravention with the requirements of Section 16 of the SE Ordinance and Regulation 41(c) of General Regulations.

5. VALUATION OF FIBS AND PIBS

Subject Matter	Clarification
5.1 PIBS	The State Bank of Pakistan has replaced FIBs with PIBs. Accordingly, PIB may be allowed to be included while calculating NCB after applying prescribed haircut.

6. VALUATION OF TRADE PAYABLES

Subject Matter	Clarification
6.1 Overdue trade payables	All 30 days overdue balance of trade payables which have been deducted from the balance of total trade payables should be classified as other liabilities for the purpose of NCB calculation. However, all the liabilities relating to PMEX may be excluded if the current assets items such as trade receivables, deposit and bank balances pertaining to PMEX have been excluded.
6.2 Amount payable under Leverage Market transaction in the books of Finance	Balance amount payable under Leverage Market transactions not yet due which are appearing in the books of Financee may be accounted for as trade payables for the purpose of calculation of NCB. However, the working of NCB should disclose the following details: (i) Balance payable within 30 days (ii) Balance payable for more than 30 days
6.3 Loan account	List of trade creditors should not include such account in which only receipts and payments are appearing, and no transaction relating to products traded on the Exchange are recorded. All such accounts should be classified as loan account and will be included in other liabilities section of NCB.



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
Market Supervision and Registration Department

7. VALUATION OF OTHER PAYABLES:

Subject Matter	Clarification
7.1 Loan from Director(s)	The balance of director's loan account in which receipts/payments transactions pertaining to one year period till the date of reporting period of NCB are recorded should be classified as short term loan for NCB purpose irrespective of its classification/disclosure in the books of accounts of the brokerage house.
7.2 Accruals of all current liabilities	All current liabilities as on reporting date of NCB are required to be accounted for in the books of accounts. The NCB should include the entire current liabilities as on reporting date of NCB.

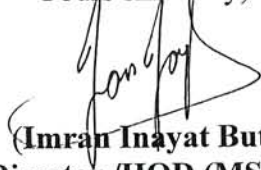
8. FORMAT OF CERTIFICATION:

Subject Matter	Clarification
8.1 Format for Certification of NCB	Certification of NCB is a regulatory requirement. The auditors are required to perform appropriate assurance procedures to enable them to issue the required certificate on the format notified by the Exchange. It is a regulatory requirement that the certificate should specify that the NCB have calculated duly verified/audited by the Auditors.

All the brokerage houses of the Stock Exchanges and their Auditors, appointed for certification of NCB, shall ensure meticulous compliance of these clarifications/guidelines in letter and spirit. Any violation or circumvention in calculation of NCB shall be dealt with under the provisions of the applicable laws.

Stock Exchanges are requested to disseminate this letter to all the Members/Brokerage Houses/TREC Holders for information and record.

Yours sincerely,


(Imran Inayat Butt)
Director /HOD (MSRD)

C.C.

1. The Institute of Chartered Accountants of Pakistan, Karachi
2. The Institute of Cost and Management Accountants of Pakistan, Karachi