REGULATIONS FOR FINANCING TO BROKERS BY BANKS / DFIs

A. DEFINITIONS

For the purposes of these regulations, following definitions shall prevail:

Approved Securities mean Government Securities such as Treasury Bills, Pakistan Investment Bonds, etc. Bank Deposits, Certificate of Deposits, NIT Units, Certificates of Mutual Funds, COIs Issued by NBFCs rated at least A by a Credit Rating Agency on the approved panel of State Bank of Pakistan, Listed TFCs rated at least A by a credit rating agency on the panel of State Bank of Pakistan, Certificates of Asset Management Companies for which there is a book maker quoting daily offer and bid rates and there is active secondary market and the shares of listed companies, approved by the Exchange for the purposes of margin financing under Margin Trading Rules 2004 of Securities and Exchange Commission of Pakistan.

Bank means banking company as defined in the Banking Companies Ordinance, 1962.

Broker means any person engaged in the business of effecting transactions in securities for the account of others and registered with the Commission.

Central Depository means a central depository as defined in clause (cc) of section 2 of the Securities and Exchange Ordinance, 1969 and registered with the Commission under section 32A of the Ordinance.

Closing Price means the last quoted price of the securities on the preceding market day as fixed by the Exchange.

Commission means Securities and Exchange Commission of Pakistan.

Current Market Value means for shares, the closing price of the shares quoted at the Exchange on the preceding market day and for other securities (government securities), their encashment or realizable value / last done price on the preceding day.

DFIs means Development Financial Institutions viz. Pak Libya Holding Company Limited, Saudi Pak Industrial and Agricultural Investment Company Limited, Pakistan Kuwait Investment Company Limited, Pak-Oman Investment Company (Pvt.) Limited and Pakistan Industrial Credit and Investment Corporation and any other institution notified under Section 3 A of Banking Companies Ordinance, 1962.

Equity of the bank/DFI means Tier-I Capital or Core Capital and includes paid-up capital, general reserves, balance in share premium account, reserve for issue of bonus shares and retained earnings/accumulated losses as disclosed in latest annual audited financial statements. In case of branches of foreign banks operating in Pakistan, equity will mean capital maintained, free of losses and provisions, under section 13 of the Banking Companies Ordinance, 1962.

Exchange means a Stock Exchange registered under the Securities and Exchange Ordinance 1969.

Financial Institution means a Bank or DFI or NBFC.

Major Shareholder means any person holding 10% or more of the share capital either individually or in concert with family members. Family members have the same meaning as defined in Banking Companies Ordinance, 1962.

Margin Financing means lending by banks/DFIs to Brokers for their clients to purchase of approved shares of joint stock companies listed on Exchange against approved securities with the retention of at least minimum margins prescribed by State Bank of Pakistan.

Margin means the amount of cash and approved securities deposited as security by a client as a percentage of the current market value of the securities purchased with Margin Financing.

NBFC means Non Banking Finance Company as defined in the Non Banking Finance Companies (Establishment and Regulation) Rules 2003 notified vide SRO 310(1)/2003 dated 1st April 2003.

Paid up Capital and Reserves mean paid up capital and reserves as disclosed in the last audited annual accounts.

Person means a member of stock exchange.

B. REGULATIONS

1. Conditions for extending Margin Financing to Brokers

i) Banks/DFIs are advised to encourage the brokers who are availing margin financing facilities from them to obtain credit rating from a credit rating agency on the approved panel of State Bank of Pakistan. State Bank is not making credit rating mandatory or prescribing any minimum credit rating for the eligibility purposes. The purpose is to emphasize the importance of credit rating and encourage the brokers to provide this important information to the lending bank/DFI for their decision-making.

ii) The margin financing shall be provided by banks/DFIs only against approved securities provided that the approved shares should be in dematerialized form in the Central Depository.

iii) The brokers availing the margin financing from banks/DFIs would be prohibited from lending, the funds obtained from banks/DFIs or their own funds, directly or indirectly to lending bank's/DFI's connected entities, directors or major shareholders and relatives of directors or major shareholders.

iv) Margin Financing shall be provided by banks/DFIs from designated branches only. The detail of the existing designated branches will be provided to Banking Inspection Department of State Bank of Pakistan within fifteen days of the issuance of this circular and the detail of branches designated after the issuance of this circular will be provided within fifteen days of the designation of the branch for the purpose of extending margin financing.

2. Risk Management and Internal Controls

i) Before undertaking margin financing, the banks/DFIs will prepare comprehensive policies and procedures for the purpose. The policies in this respect will be duly approved by the Board of Directors, if not already covered appropriately in the current credit policy.

ii) The banks/DFIs will obtain legal opinions to ensure that the manner in which they are accepting shares (especially those of the clients/customers of the broker) as collateral is legally sound, the documentation (including the authority/consent of the clients/customers of the broker in case their shares are being pledged) is sufficient to create an effective pledge over the collateral and they are fulfilling all the legal requirements appropriately. In this context, Pakistan Banks Association may encourage banks/DFIs to prepare uniform legal documents for the purposes of extending margin financing to brokers.

iii) Banks/DFIs will put in place an effective system for monitoring margins and their exposures on the shares of various companies and brokers, keeping in view the quantum of their margin financing.

iv) Banks/DFIs would review, on an ongoing basis, their exposure in margin financing with a view to assess the risks due to volatility in assets prices.

v) The bank/DFI should be mindful of their exposure towards stock markets and should make necessary arrangements to monitor their exposure on continuous basis. In this regard, Risk Management Guidelines issued by State Bank of Pakistan may be meticulously followed.

3. **<u>Margin Requirements</u>**

i) The banks/DFIs will maintain at least minimum margins as prescribed by State Bank of Pakistan from time to time. Banks/DFIs may, however, set higher margin, if they so desire. Banks/DFIs will monitor the margin on at least daily basis and will take appropriate steps for top-up and sell-out on the basis of their approved policy in this respect and agreements with their customers (brokers). For the purpose of this regulation, value of the shares held as collateral shall be based on the last closing price of the share on the preceding market day.

ii) The financing to brokers against their receivable will however be subject to a minimum margin of 30%. Such receivables should appropriately assigned to the lending bank/DFI and should be verified from the respective clients of the brokers.

4. **<u>Per Party Limit</u>**

i) Banks/DFIs must make efforts to avoid concentration of margin financing to a few brokers. In this respect, they may prescribe internal limit for margin financing to a single broker. It is expected that the margin financing would be spread out by a bank/DFI amongst a reasonable number of brokers.

ii) A bank/DFI shall not extend financing to any broker in excess of its per party limit under Regulation R-1 of Prudential Regulations for Corporate and Commercial Banking. The total margin financing portfolio, at any given point in time, should not exceed the equity of the bank/DFI.

iii) The total financing, including margin financing, availed by a broker from the financial institutions should not exceed the limits prescribed in Regulation R-5 of Prudential Regulations for Corporate and Commercial Banking.

5. Banks are cautioned that they should keep in mind and ensure compliance at all times with the requirement of subsection (2) of Section 23 of the Banking Companies Ordinance, 1962 which is reproduced here for reference purposes:

> "Save as provided in subsection (1), no banking company shall hold shares in any company whether as pledgee, mortgagee or absolute owner, of an amount exceeding thirty percent of the paid-up share capital of that company or thirty percent of its own paid up share capital and reserves, which ever is less".

DFIs are also advised to ensure compliance with this requirement.

6. The financing extended to the directors or major shareholders of a broker shall be considered a part of the over all financing allowed to the broker for the purposes of these regulations.

7. The limits mentioned above are overall financing limits and total financing facilities to brokers (e.g. working capital financing, financing against receivables of brokers, financing to brokers for their proprietary trading, or any other financing to brokers by whatever name called) should not exceed the limits prescribed above. Further, for the purposes of monitoring and better controls, banks will keep separate records of the following facilities:

a. Financing against the shares of clients of brokers.
b. Financing against own shares of brokers.
c. Financing against receivables of brokers.
d. Working capital finance against any other security.
e. Any other financing facility to brokers.

8. The areas not covered under these regulations will be governed by Prudential Regulations for Corporate and Commercial Banking.

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