Enclosure to BPRD Circular No.03 Dated 9th April 2008

REGULATONS FOR CONTINUOUS FUNDING SYSTEM (CFS MK II) FINANCING 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, 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 Stock Exchange for the purposes of Continuous Funding System MKII

Authorized financier (AF) means the Banks/DFIs who have acquired status of authorized financier from NCCPL for the purpose of right to offer finance in stock exchange under CFS MK II.

Bank/DFI will have the same meaning as given in Prudential Regulations for Corporate/Commercial Banking

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

CFS means Continuous Funding System MK II (CFS MK II).

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.

Commission means Securities and Exchange Commission of Pakistan.

Equity of the Banks/DFIs will have the same meaning as given in Prudential Regulations for Corporate/Commercial Banking.

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

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 CFS Financing.

NCCPL means National Clearing Company of Pakistan Ltd. incorporated under Companies Ordinance, 1984 for the settlement of contracts and transactions in respect of securities.

Paid up Capital means paid up capital net of losses as disclosed in the last audited annual accounts.

Other terms: The terms not defined in these regulations shall have the same meaning as given in Prudential Regulations for Corporate/Commercial Banking

B. REGULATIONS

Regulation 1

Conditions for extending CFS MK II

1. CFS financing shall be provided by Banks/DFIs only against CFS approved securities through NCCPL only.
2. CFS Financing shall be offered through automated trading terminals installed in Banks/DFIs premises. Banks/DFIs should take necessary steps to ensure that these terminals are manned by authorized persons only and no unauthorized person should have access to it.

Regulation 2

Risk Management and Internal Controls

- **i.** Banks/DFIs will prepare comprehensive policies and procedures for CFS MK II Financing duly approved by their Board of Directors. The policy shall include official line of authority limits for CFS financing. The policy would be formulated within six months time from issuance of these Regulations.
- **ii.** The Banks/DFIs are advised to develop a list of scrips eligible for financing through CFS. The criteria for selection of the scrips shall be approved by the Board of Director or the risk management committee of the Bank/DFI.
- **iii.** Banks/DFIs should identify the risks associated in CFS MK II and take necessary measures to mitigate these risks. While making master agreement with NCCPL, the Banks/DFIs should ensure their interest is fully protected by NCCPL for collection of the required margin and mark to market losses.
- **iv.** Banks/DFIs would be mindful of their exposure towards stock markets and review their investment portfolio in shares whether in equity investment, margin financing, CFS Financing, repo/reverse repo transaction or financing against shares with a view to assess risks due to volatility in share prices. They are required to calculate their total exposure towards equity market and monitor it at least on monthly basis. For the purposes of monitoring and better controls, Banks/DFIs will keep separate records of the following facilities:
    a. CFS Financing

b. Margin Financing
c. Acquisition of shares
d. Direct/strategic investment
e. Financing against the shares of clients.

Regulation 3.

i. Limit of exposure on shares

The total exposure in shares whether in equity investment, margin financing, CFS, repo/reverse repo transaction and financing against shares, etc at any given point of time, should not exceed 50% of the equity of the Bank/DFI and subject to compliance of limits laid down in Regulation R-6 of prudential regulations for Corporate/Commercial Banking. Financing to asset management companies, and their mutual funds shall also be counted towards the aforesaid limit.

ii. Scrip Limit

Total exposure of a Bank/DFI in any scrip whether in the form of equity investment, margin financing, financing against shares, CFS, repo/reverse repo transaction etc. shall not exceed 10% of its total exposure to stock market. Investment in subsidiary companies would be excluded from the limits under this Regulation.

Regulation 4.

Banks/DFIs should ensure compliance at all times with the requirement of subsection (2) of Section 23 of the Banking Companies Ordinance, 1962 which is reproduced below:

"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, whichever is less".

Regulation 5.

Total exposure limit and per scrip limits have been defined above. However, any Bank/DFI desirous of taking exposure beyond prescribed limits may approach State Bank of Pakistan. Their request will be considered keeping in view their risk management system, expertise in investment management, efficacy of internal control etc.

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

The Banks/DFIs who already have exposure over and above the limit/ breach this limit are advised to adjust the same within a period of three months from the date of issuance of these Regulations under intimation to SBP.

****