

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Islamabad, the 30th June, 2004

NOTIFICATION

S.R.O 541 (I)/2004 In exercise of powers conferred by section 33 read with section 16 of the Securities and Exchange Ordinance, 1969 (XVII of 1969) and also read with clause (b) of section 43 of the Securities and Exchange Commission of Pakistan Act, 1997 (XLII of 1997), the Securities and Exchange Commission of Pakistan, with the approval of the Federal Government, hereby makes the following rules, namely:

The Margin Trading Rules, 2004

1.

(1) These rules may be called the Margin Trading Rules, 2004.

(2) These shall come into force at once.

2.

Definitions. (1) In these rules unless there is any thing repugnant in the subject or context,

(a) "Act" means the Securities and Exchange Commission of Pakistan Act, 1997 (XLII of 1997);

(b) "approved securities" means shares of listed companies and government securities deposited as margin and approved by the Stock Exchange for the purpose of margin trading and financing;

(c) "bank" means a banking company as defined in the Banking Companies Ordinance, 1962 (LVII of 1962);

(d) "broker" means any person engaged in the business of effecting transactions in securities for the account of others and is registered with the Commission;

(e) "central depository" means a central depository as defined in clause (ca) of section 2 of the Securities and Exchange Ordinance, 1969 (XVII of 1969), and registered with the Commission under section 32A of the Ordinance;

(f) "client" means a person who executes margin agreement to borrow money from a broker to buy securities as specified by the Stock Exchange for the purpose of margin trading;

- (g) "Commission" means the Securities and Exchange Commission of Pakistan established under the Securities and Exchange Commission of Pakistan Act, 1997 (XLII of 1997);
- (h) "DFI" means any institution as notified under section 3A of Banking Companies Ordinance 1962 (LVII of 1962);
- (i) "financial institution" means a Bank or DFI or NBFC;
- (j) "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 held in a margin account for the purpose of margin financing and margin trading as provided in these rules;
- (k) "margin account" means an account maintained with the broker, which records transactions of margin trading;
- (l) "margin agreement" means the agreement between the broker and his client for the administration of margin account for the purpose of margin trading;
- (m) "maintenance margin" means the minimum amount of margin that must be maintained by a client in a margin account;
- (n) "margin financing" means financing to the client by the broker for the purpose of margin trading;
- (o) "margin trading" means the buying of securities by the broker for his client through margin financing;
- (p) "margin call" means a notice issued in writing by a broker to his client in the form of a letter by courier or registered post or fax or by hand subject to acknowledgement or by electronic mail (with the onus on the broker to prove issuance of such notice) requiring the client to provide additional margin in order to keep maintenance margin;
- (q) "net capital" means net capital as defined under clause (d) of rule 2 of the Securities and Exchange Rules, 1971;
- (r) "NBFC" means Non Banking Finance Company as defined in the Non Banking Finance Companies (Establishment and Regulation) Rules 2003 notified vide SRO 310(I)/2003 dated the 1st April, 2003;
- (s) "Ordinance" means the Securities and Exchange Ordinance, 1969 (XVII of

1969);

(t) "rules" means the Margin Trading Rules 2004; and

(u) "trustee" means a financial institution or a central depository having legal title to securities, and holding such securities in trust for the benefit of another person or entity and owes a fiduciary duty to that beneficiary.

(2) All other words and expressions used but not defined in these rules shall have the same meanings as are assigned to them in the Companies Ordinance, 1984 (XLVII of 1984) and the Securities and Exchange Ordinance, 1969 (XVII of 1969).

3.

Pre-requisite-(1) Margin financing and margin trading shall be carried out by only those brokers who are registered with the Commission and meet the minimum net capital and capital adequacy requirements.

(2) The Commission may fix from time to time the capital adequacy requirements for margin financing and margin trading as provided in sub-rule (1) of rule 3 in consultation with the Stock Exchanges.

(3) Margin trading shall be permissible only in scrips fixed by the Commission in consultation with the Stock Exchanges and shall be subject to a maintenance margin as fixed by the Commission in consultation with the Stock Exchanges.

4.

Margin agreement (1) The broker shall execute a margin agreement with a person who intends to be his client for the purpose of margin financing and margin trading.

(2) The margin agreement shall contain, inter alia, provisions which authorize the broker to :-

(a) mortgage, pledge or hypothecate the securities deposited or bought on behalf of client by the broker, for a sum not exceeding the outstanding balance in the margin account;

(b) use his discretion and on best effort basis to sell or dispose of any or all the collateral, in any lawful manner in order to meet the fixed margin requirements as are specified in rule 6; and

(c) extend margin trading and margin financing facilities to the client up to an approved limit subject to the range fixed by the Commission in consultation

with the Stock Exchanges under sub rule (3) of rule 6.

5.

Restrictions .-No broker shall extend margin trading and margin financing facilities to the following persons, namely:

- (i) any of its partners, directors, agents or employees;
- (ii) any firm in which any of its partners, directors, agents or employees is interested as a partner, director, agent, employee or guarantor;
- (iii) any company in which any of its partners, directors, agents or employees is interested as partner, director, agent, employee or guarantor;
- (iv) any company in which any of its partners, directors, agents or employees hold shares except: -
 - a) where its partners, directors, agents or employees hold less than five per cent of the issued share capital of that company; and
 - b) in respect of any listed company, where a partner, director, agent or employee of the broker holds directly or indirectly less than five per cent of the issued share capital of that company;
 - (v) any individual on whose behalf any of its partners, directors, agents or employees has provided a guarantee; and (vi) any other person as may be fixed by the Commission.

Explanation.-For the purposes of this clause the term "director" or "employee" shall include the spouses, parents or children of the director or employee or partner or agent.

6.

Margin maintenance requirements.- (1) The broker and client shall ensure that maintenance margin in the margin account shall be maintained at all times. If as a result of market fluctuations, the value of the deposited margin falls below the maintenance margin level, the broker shall be required to give his client a margin call.

(2) If the client fails to deposit additional cash or securities as a margin within one business day of the margin call, the broker shall have absolute discretion without notice to such client to liquidate his margin account, including the securities deposited or purchased and carried in such account, to the extent that the margin is maintained at the required level.

(3) Limit of margin financing: The amount of margin financing facility that a broker may extend to any single client shall not be more than a range fixed by the Commission in consultation with the Stock Exchanges.

(4) The Commission may specify in consultation with the Stock Exchanges a range within which separate limits may be fixed for individual and corporate clients.

Explanation.—For the purposes of this clause in computing the total amount of margin financing and margin trading facilities given to any single client the term "single client " is defined as follows:

(a) where such single client is an individual, the margin financing and margin trading facilities shall be deemed to include the margin financing and margin trading facilities given to the individual, spouse, parents or children of the individual, the partnership firm of which he is a partner, any partner of the individual, the spouse parents or children of that partner and all the companies over which the individual exercises control.

Furthermore, for the purpose of this clause, an individual is deemed to exercise "control" over a company if the individual or the individual's spouse, severally or jointly:

(i) holds, directly or indirectly, more than fifty one per cent of the shares of that company;

(ii) has the power to appoint, or cause to be appointed, a majority of the directors'; or

(iii) has the power to make, or cause to be made, decisions in respect of the business or administration of that company, and to give effect to such decisions, or cause them to be given effect to; and

(b) where such single client is a company, any financing and margin trading facilities extended to the company and its associated companies shall be deemed to be margin financing and margin trading facility extended to such a single client.

7.

Deposit of margin.—(1) The credit amount of margin accounts of clients shall be kept by the broker in his separate bank account titled "Client Margin Account" and shall not be used by the broker for his own business.

(2) The securities either deposited as margin or purchased on margin financing shall be kept by the broker in a separate central depository account and may

be deposited, pledged in favour of the financial institution in accordance with sub rule (2) of rule 4 of the Rules and this central depository account shall be used only for the purpose of margin trading.

(3) The deposit of any government security as margin of a client shall be used only for the purpose of margin trading.

Provided, that the provisions of rule 7 above shall not apply in the case of a financial institution providing financing directly to clients.

However, if the financial institution is a member of a Stock Exchange and registered with the Commission as a broker, it shall comply with sub rule (1) and (2) of rule 7.

8.

Withdrawal.—A client may only withdraw from his margin account, sales proceeds or any part thereof in cash and any collateral for the time being deposited into his margin account, provided that the value of the margin deposit in the said margin account does not fall below the maintenance margin after such withdrawal.

9.

Valuation of collaterals.—The collateral that a client may deposit into his margin account and the method of valuation thereof shall be limited to the following, namely :

(a) for securities quoted on the Stock Exchange the value shall be based on the last quoted price of the securities on the preceding market day at the Exchange; and

(b) for government securities the value shall be based at the last done price on the preceding day.

10.

Limit of collective outstanding balances.—(1) The broker shall ensure that the aggregate outstanding balances, in the margin accounts maintained by all clients of a broker shall not exceed collectively the fixed level as provided in sub rule (2).

(2) The aggregate outstanding balances in the margin accounts maintained by all clients of a broker shall not exceed collectively a level as may be fixed by the Exchange and shall be linked to the capital adequacy requirements with the approval of the Commission.

11.

Administrative, operational and reporting requirements.— (1) The broker shall

ensure that the margin maintenance requirements specified under these rules are complied with at all times.

(2) The broker shall report and disclose the value of margin transactions to the Stock Exchange as under:

(a) Daily: number of shares traded daily on margin, traded value, amount of margin financing provided to clients, value of collateral against margin financing; and

(b) Weekly: client wise weekly report (indicating clients codes only) of total shares traded on margin, traded value, amount of margin financing provided to clients, value of collateral against margin financing, loans taken from banks by the broker for margin trading.

(3) If the Stock Exchange is of the opinion that the broker has extended margin financing to its client to a level which may cause problems for the broker to honour its obligation to the Exchange or cause systemic risk for the market, the Stock Exchange may order the broker to do inter alia the following, namely:

(a) reduce the outstanding position of client to a level within the time specified by the Exchange;

(b) prohibit the broker from allowing client to trade on margin; and

(c) any other action the Stock Exchange may deem fit and appropriate.

12.

Enhancement and reduction of margin maintenance requirements.—The Commission may enhance or reduce the margin maintenance requirements in consultation with the Stock Exchanges as deemed necessary and appropriate for reasons to be recorded in writing on a case-to-case basis.

13.

Internal procedures for granting margin financing and margin trading facilities by Broker .— (1) The Stock Exchanges shall make the detailed regulations subject to prior approval of the Commission for the brokers relating to grant of margin financing and margin trading facilities in relation to any margin account.

(2) The Stock Exchanges shall ensure implementation of the regulations as specified in sub-rule (1) of rule 13.

(3) In particular and without prejudice to the generality of the foregoing

powers, such regulations may provide inter alia for any of the following matters, namely:

- a) detailed procedures to process applications for margin financing facilities (application forms for margin financing to be specified by the Stock Exchanges with the prior approval of the Commission);
- b) criteria to assess the credit risk of a client;
- c) documentation in respect of margin financing and margin trading facilities extended to a client;
- d) an effective monitoring system; and
- e) taking disciplinary action and fixation of penalty in case of violation of the regulations.

14.

Non compliance of margin trading requirements.- (1) If a broker does not comply with any provision of the Ordinance, these Rules or any direction of the Commission under the Ordinance or the Act relating to margin trading, the Commission, may suo moto or on a complaint from the Stock Exchange or any person and after giving him an opportunity of hearing, by order,

- (a) direct the broker to pay a fine not exceeding hundred thousand rupees per default ; and
- (b) Suspend the membership of the broker.

[No. SMD/SE/2 (72) 2003]

(Mohammad Hayat Jasra)
Executive Director