Press Release

SECP-KSE Meeting Held in Islamabad

Islamabad 2 November 2006: The members of the three stock exchanges had requested the Chairman SECP to meet with them to listen to their concerns and provide guidance on various perceived difficulties emanating from the new risk management measures being introduced at the exchanges w.e.f 6th November 2006. The major concern highlighted by the members was that they were given a presentation by the KSE management on the implications of the new regime on 31st October 2006 and in their view further time was needed by them to fully understand the mechanism/ modalities of the new risk management measures.

The Chairman SECP at the onset pointed out to the participants that these measures were discussed in detail with the exchanges at various forums since February 2006 and matters pertaining to these measures were circulated to the members from time to time. On June 18, 2006 a complete detailed paper on the proposed risk management measures was presented to the stock exchanges and conveyed to all the members. Thereafter, a series of meetings were held with each of the three stock exchanges, i.e. the directors, members and the management of the three stock exchanges.

On 30th August 2006 a revised paper was again issued incorporating all the suggestions, recommendations and feed back from the market. On September 13, 2006 a final paper after detailed discussion was issued. In this way SECP made abundantly sure that its proposals were transmitted to the members and to the exchanges completely and the proposals modified to take into account market realities. It is, therefore, surprising for the Commission to hear newspaper reports and electronic media programmes complaining about lack of coordination and information and for not providing sufficient time to the market participants to understand and react to the new proposals to enable them to adopt the same with ease. Furthermore, he emphasized that the last meeting with the KSE management was held on September 29, 2006 in which the final version of the new risk management framework were agreed upon. In short, the exchanges as well as the members should have been fully conversant with the new regime to be introduced, well in advance of the implementation date. However, since it became apparent that the members were still not fully aware of the new system and the KSE management had not conducted mock trials of the new system, SECP deferred the new system to 4th December 2006.

After detailed deliberations the following decisions were reached during the meeting:

1. CFS limit to be enhanced to Rs. 55 billion for KSE, Rs. 10 billion for LSE and Rs. 5 billion for ISE with effect from November 6, 2006. It was agreed that should the limit be exceeded the same shall be reviewed sympathetically;

2. Existing timeline for the abolition of in-house badla and its conversion to CFS to be completed by November 30, 2006 as already notified and the shares

shall be transferred to CDC blocked account of the members by the said date. The Exchanges would come-up with the mechanism for the same by Friday November 10, 2006. As result of the conversion of in-house badla to CFS and the consequential impact on the capital adequacy of the members, it was agreed that any excess limit shall be brought within approved limits by November 30, 2006 by each respective members;

3. Mock trials runs in respect of (i) separation of CFS and Ready market, (ii) introduction of CFS market margins, (ii) new netting regime for all the markets, (iv) removal of across settlement netting from the ready market, (v) new VAR based margins and haircut regime, and (vi) introduction of special margins for CFS & deliverable futures to start at the earliest and shall continue by end November 2006. In case of any problems/observations, the exchanges shall revert back to the Commission latest by November 25, 2006;

4. SECP has proposed, and is working with mutual funds and banks/financial institutions, to exempt the ready market trade on behalf of banks/mutual funds/financial institutions from payment of margins, provided that financial institutions meet certain conditions. Furthermore, with regard to trades by financial institutions on CFS/futures market, the margins shall be paid directly by the institutions to the exchanges, if any.

5. In any case the entire new risk management system as directed by the Commission shall be implemented with effect from December 4, 2006;

6. 100% VAR based margins applicable on illiquid scrips as determined by the Commission to be reduced to 60% and implemented from December 04, 2006.

7. The maximum cap on CFS financing rate to be 10% plus one month KIBOR. The rate will be determined on the last Friday/working day of the month and will be applicable from the next trading day;

8. All scrips that meet with the following criteria will be eligible for CFS:

   - Companies that have average daily Impact Cost of less than one percent, based on previous three months daily impact cost and on an order size of Rs. 500,000;
   - Companies should have traded on more than 90% of the trading days during last three months;
   - Companies with free float of more than 20% of issued capital or 45 million free float shares;
   - Mutual Funds units/securities are not eligible for CFS financing.

9. The deposit against exposure i.e 50% in cash for the deliverable futures contract to be implemented with effect from November 2006 futures contract.

The exchanges agreed to pay appropriate return to the members against the deposited cash margins after deducting 1% service charges.

10. No further extension shall be sought by the exchanges for the implementation of the proposed risk management measures.

SECP wishes to emphasize that the reform process is not being derailed or rolled back. All major risk management measures which were being proposed from early 2006 have now been adopted unanimously by the stock exchanges. The implementation has been slightly delayed in order to smoothen the transition and to take all market participants along. It is pertinent to point out that excessive netting which distorted market exposure has now been abolished completely under the new regime. Client level netting would be abolished from 1st February 2006. Value at risk based margining system has been introduced, which has been under discussion since early 2005. In-house badla has been the bane of a transparent and orderly market and this has been abolished. This non-transparent method of financing weak holders' thus stands abolished. Margin financing is being promoted, rather than curtailed, as in-house badla is no longer possible and market participants would be forced to go the margin financing route.

SECP believes that various funding mechanism should be made available to the market place and the market should decide and adopt the best option available to it. Furthermore, special margin (old COT II) has been reinstated not only in CFS market but for the futures market as well. COT II was abolished arbitrarily by KSE in June 2005. This is an important instrument for the market to correct itself from unidirectional movements. The most significant reform from the market's point of view is that UIN has been successfully implemented, which is an important measure to ensure transparency and good governance in the market place. KSE 30 Free Float Index has also been introduced to provide a more realistic benchmark to the market. Furthermore, Cash Settled Future product has been developed and provided to the KSE on 24th August 2006. It shall hopefully be implemented by KSE management shortly. National Commodity Exchange is now in the final stages of going live.