PART II

Statutory Notifications (S. R. O.)

GOVERNMENT OF PAKISTAN
SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
NOTIFICATION

Islamabad, the 3rd February, 2020

S. R. O. 77 (I)/2020.—In exercise of the powers conferred by section 169 of the Securities Act, 2015 (III of 2015) and section 114 of the Futures Market Act, 2016 (XIV of 2016), the Securities and Exchange Commission of Pakistan hereby makes the following amendments to the Securities Brokers (Licensing and Operations) Regulations, 2016, the same having been previously published in the official Gazette vide S.R.O. 26(I)/2020, dated January 10, 2020, and also placed on its website as required under sub-section (4) of section 169 of the Securities Act, 2015 and sub-section (4) of section 114 of the Futures Market Act, 2016, namely:—

In the aforesaid Regulations,—

(1) After regulation 5, the following new regulation 5A shall be inserted, namely:—

“5A. Categorization of securities brokers.—(1) The application for licence under these regulations may be made for any one of the following categories of securities brokers—

219 (1—13)

Price: Rs. 20.00

[5125(2020)/Ex.Gaz.]
(a) “Trading Only” category shall mean that a securities broker can only execute its proprietary trades and trades on behalf of its customers but cannot settle executed trades or keep custody of securities or money owned by it and its customers:

Provided that a Trading Only broker may keep custody of securities and money owned by it and its sponsors and directors and their close relatives and can settle its proprietary trades and trades executed on behalf of its sponsors and directors and their close relatives till such time as may be allowed by the Commission:

Provided further that the number of accounts permitted to a Trading Only broker for its sponsors and directors and their close relatives shall be specified by the Commission.

Explanation: close relative means spouse(s), lineal ascendants and descendants and siblings;

(b) “Trading and Self-Clearing” category shall mean that a securities broker can execute as well as settle its proprietary trades and trades executed on behalf of its customers and can keep custody of securities and money owned by it and its customers subject to such conditions as may be imposed by the Commission.

(c) “Trading and Clearing” category shall mean that a securities broker can execute as well as settle its proprietary trades and trades executed on behalf of its customers and can keep custody of securities and cash owned by it and its customers subject to such conditions as imposed by the Commission and, in addition, such securities broker can settle trades of other securities brokers and their customers and keep custody of the securities and cash owned by such other securities brokers and their customers.

(2) Securities brokers already licensed under these regulations shall be required to convert to any one of the categories mentioned in sub-regulation (1) through submitting an application for conversion to a specific category on or before July 15, 2020 along with an affidavit that securities broker
shall comply with the financial resource requirement of the respective category till September 30, 2020:

Provided that a securities broker which wants to convert to Trading and Clearing Broker shall submit an expression of interest within the time specified by the Commission. The expression of interest shall include the feasibility study, system and human resource requirements, operational and risk management model, legal documentation requirements, arrangement to ensure confidentiality of trading and customer related information of Trading Only brokers and proposed fee structure.

(3) A securities broker licensed under these regulations, which does not comply with financial resource requirements for Trading and Self-Clearing category specified under these regulations, shall apply for conversion to “Trading Only” category by July 15, 2020, subject to compliance with financial resource requirements of the respective category, and shall be required to transfer the clearing, settlement and custody functions to the extent of its customers till November 30, 2020 or such extended date as may be specified by the Commission:

Provided further that till the time at least three securities brokers have obtained licence as, or converted into Trading and Clearing Broker, or a professional clearing member is available the Trading Only Brokers shall be allowed to keep custody and settle trades of their customers.”

(2) In regulation 6, sub-regulation (1) shall be substituted with the following, namely:

“6. Financial Resources Requirement.—(1) An applicant for a licence as a securities broker shall comply with and ensure ongoing compliance with minimum paid up capital and net worth of Rupees thirty five (35) million and net capital balance of Rupees five (5) million:

Provided that from October 1, 2020 or such extended date as may be allowed by the Commission the financial resource requirements as provided under sub-regulation 1(A) shall be applicable on securities brokers:
Provided further that existing securities brokers who are non-compliant with the above prescribed financial resource requirements in respect of paid up capital and net worth shall be deemed compliant with the financial resource requirements till October 1, 2020 subject to submission of application for conversion to new category of securities brokers under regulation 5A."

(3) In regulation 6, after sub-regulation (1) the following new sub-regulation (1A) and (1B) shall be inserted, namely:

“(1A) With effect from October 1, 2020 or such extended date as may be allowed by the Commission, each securities broker shall be required to comply with and ensure ongoing compliance with the following levels of minimum net worth and net capital balance for each category:

<table>
<thead>
<tr>
<th>Category of securities broker</th>
<th>Minimum Net worth -PKR million-</th>
<th>Minimum Net Capital Balance -PKR million-</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trading Only</td>
<td>15</td>
<td>Not applicable</td>
</tr>
<tr>
<td>Trading and Self Clearing</td>
<td>75</td>
<td>10</td>
</tr>
<tr>
<td>Trading and Clearing</td>
<td>500</td>
<td>15</td>
</tr>
</tbody>
</table>

Provided that the minimum net worth requirement for Trading and Self Clearing category shall be increased to rupees 100 million with effect from October 1, 2021:

Provided further that the Trading Only category shall be required to maintain net capital balance of rupees 5 million till the time it has completely transferred its custody and clearing functions including proprietary:

Provided further that a securities broker with minimum net worth of rupees 250 million, which is a subsidiary of a bank with minimum long term credit rating of AA- and is compliant with the minimum capital requirements of the State Bank of Pakistan, may be issued licence for the Trading and Clearing category if it is in compliance with all other conditions applicable on the Trading and Clearing category.

(1B) Securities brokers which convert into or obtain licence as Trading Only, Trading and Self Clearing or Trading and Clearing category shall be permitted to retain custody of proprietary and customer assets as follows:
<table>
<thead>
<tr>
<th>Category of securities broker</th>
<th>Assets Under Custody Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trading Only</td>
<td>2 times of net worth of securities broker</td>
</tr>
<tr>
<td>Trading and Self Clearing</td>
<td>25 times of net worth of securities broker</td>
</tr>
<tr>
<td>Trading and Clearing</td>
<td>35 times of net worth of securities broker</td>
</tr>
</tbody>
</table>

Provided that a Trading Only broker shall only be allowed to keep custody of securities and money owned by it and its sponsors and directors till such time as may be allowed by the Commission:

Provided further that during the transition period, till the time the Trading Only Broker has transferred its custody and clearing functions to the extent of its customers in accordance with these regulations, the limit of assets under custody of Trading Only Broker shall be 25 times of its net worth:

Provided further that Commission may specify limit of assets under custody with respect to Liquid Capital in place of net worth of securities broker in accordance with such maximum limits and timeframe as may be specified by the Commission:

Provided further that where a Trading and Clearing broker, which is keeping custody of the securities and cash owned by other securities brokers and their customers, is facing difficulty in complying with the asset under custody limit, the Commission may, on an application made by such Trading and Clearing category securities broker to the Commission, enhance the asset under custody limit for such securities broker to such number of times of net worth of such securities broker as deemed appropriate by the Commission on case to case basis, subject to following conditions:

(i) Such securities broker has a satisfactory compliance track record;

(ii) No significant investor claims are outstanding against such securities broker;

(iii) Such securities broker has entered into arrangement for providing custodial and clearing services to at least ten Trading Only brokers; and

(iv) Such other conditions as may be prescribed by the Commission."
(4) In regulation 6, sub-regulation (3) shall be substituted by the following, namely,—

“(3) A securities broker shall file monthly statements of net capital balance and liquid capital with the securities exchange and clearing house computed in a manner specified in Schedule II and III respectively, immediately after coming into force of these regulations, and shall also submit reviewed statement of net capital balance as on close of second quarter of its year of accounts and shall also disclose the net capital balance in its annual audited financial statements in accordance with regulation 34.”

(5) In regulation 6, sub-regulation (4) shall be substituted by the following, namely,—

“(4) The securities broker shall start maintaining minimum liquid capital as per such amounts and/or ratios and after such period of time as may be specified by the Commission and upon such specification by the Commission, the securities broker shall be required to disclose the calculation of liquid capital in its annual financial statements and shall be required to submit reviewed statement of liquid capital as on close of second quarter of its year of accounts, and the requirement to maintain net capital balance, the requirement to submit monthly statements of net capital balance and the requirement to submit half yearly reviewed statements of net capital balance shall be discontinued:

Provided that the above requirements to maintain the net capital balance or the liquid capital and to submit the statements of net capital balance and liquid capital shall not be applicable on a securities broker which has converted to Trading Only broker and has completely transferred its custody and clearing functions including proprietary.”

(6) After regulation 6, the following new regulation 7 shall be inserted, namely,—

“7. Requirements for licence under Trading and Self-Clearing and Trading and Clearing categories.—(1) Licence for Trading and Self-Clearing or Trading and Clearing categories shall only be granted to an applicant which has also been admitted as a clearing member by the clearing house and a participant by the central depository.
(2) From the conversion of licence under new categories of brokers after October 01, 2020, the requirements under sub-regulation (12) of regulation 16, sub-regulation (3) of regulation 25, sub-regulation (2) of regulation 29 and regulation 37 shall not be applicable to the Trading Only category which has completely transferred its custody and clearing functions including proprietary.

(3) Applicants for the Trading Only Broker category shall comply with the following minimum requirements:

(a) The list of directors and sponsors along with the latest Form A and subsequent Form 29 and pattern of shareholding along with the list of close relatives of such directors and sponsors shall be submitted along with the application for licence and with application for renewal of licence;

(b) Trading Only Broker shall only open and maintain trading accounts and CDC sub-accounts of its directors and sponsors in addition to its proprietary account; and

(c) In the case of any change in the director or sponsor, the Trading Only Broker shall immediately inform the Commission, securities exchange, clearing house and the central depository and close the trading account and CDC sub-account of outgoing director and/or sponsor.

(4) Applicants opting for the Trading and Self-Clearing category shall comply with the following minimum requirements-

(a) it must have at least one independent director on its board who shall also be the head of audit committee.

Explanation: “Independent director” in relation to the securities broker means such director who is not connected or does not have any other relationship, whether pecuniary or otherwise, with the securities broker, its associated companies, subsidiaries, holding company, sponsors or directors. The test of independence principally emanates from the fact whether such person can be reasonably perceived as being able to exercise independent business judgment without being subservient to any form of conflict of interest:
Provided further that in case of any ambiguity in determining independence of a person for the purposes of these regulations, the decision of the Commission shall be final and binding upon the securities broker.

(b) It must have an audit committee which shall be formed and shall function in accordance with the requirements specified by the Commission.

(c) It must maintain a minimum Broker Fiduciary Rating, as may be specified by the Commission, from a credit rating company licensed by the Commission and disclose such rating at all times on its website and all advertisements.

(d) It must appoint its statutory auditor from category A or B of the panel of auditors maintained by the State Bank of Pakistan; and

(e) it must comply with such additional requirements for submission of returns and statements in relation to segregation of customers’ assets including reconciliations of customer assets as specified by the Commission from time to time.

(5) Applicants opting for the Trading and Clearing category shall comply with the following minimum requirements:

(a) compliance with the Listed Companies (Code of Corporate Governance) Regulations, 2019 and shall mandatorily comply with the following requirements:

(i) It must have at least 2 or one-third members of the board, whichever is higher, as independent director;

(ii) The Chief Financial Officer must meet the minimum qualification requirements;

(iii) The Head of Internal Audit must meet the minimum qualification requirements;

(iv) Audit Committee must be constituted by the Board as per the requirements of regulation 17 of the Listed Companies (Code of Corporate Governance) Regulations, 2019;
(v) Compliance with the regulation 14 of the Listed Companies (Code of Corporate Governance) Regulations, 2019 relating to the placement of significant issues before the board and/or committees; and

(vi) Compliance with regulation 35 of the Listed Companies (Code of Corporate Governance) Regulations, 2019 relating to the disclosure of significant policies on the website.

(b) it is a public company;

(c) it maintains a minimum long term entity rating of (A-) or equivalent from a credit rating company licensed by the Commission and disclose such rating at all times on its website and all advertisements;

(d) it maintains a minimum Broker Fiduciary Rating, as may be specified by the Commission, from a credit rating company licensed by the Commission and disclose such rating at all times on its website and all advertisements;

(e) it has an acceptable track record in compliance with the applicable laws and handling of customer complaints; and

(f) it must comply with such additional requirements for submission of returns and statements in relation to segregation of customers’ assets including reconciliations of customer assets as specified by the Commission from time to time.”

(7) After regulation 16, the following new regulation 16A shall be inserted, namely,—

“16A. Additional requirements for Trading and Clearing broker.- A Trading and Clearing broker shall comply with following additional requirements:

(a) within three months of the grant of licence, it has —

(i) developed an operational model inter alia covering therein, transactions flow, manner of execution of transactions, roles and responsibilities of Trading
and Clearing broker and customers, risk management parameters, default handing mechanism, dispute and grievance handing mechanism;

(ii) developed and implemented an automatic order routing mechanism;

(iii) employed personnel with sufficient education, experience and expertise to allow it to carry out its obligations in accordance with the applicable regulatory framework;

(iv) developed and implemented risk management system, internal control and policies and procedures to ensure effective compliance with the applicable regulatory framework;

(v) put in place infrastructure including but not limited to adequate office space, equipment and technical aspects including appropriate arrangement for clearing, settlement and custodian services, to effectively and efficiently discharge its responsibilities with capacity for ongoing maintenance of the same;

(vi) within six months of the grant of license it has submitted a report from an independent chartered accountant firm from category A of the panel of auditors maintained by the State Bank of Pakistan for appropriateness of controls and safeguards to ensure cyber security, access to confidential information and alteration, destruction, disclosure or dissemination of records and data;

(vii) it must put in place adequate internal controls, clearly documented policies and procedures and Chinese walls between its brokerage business and custodial services to Trading Only category securities brokers to manage conflict of interest and ensure confidentiality of trading and customer information of Trading Only category securities brokers;

(viii) ensure fair treatment of the Trading Only category securities brokers it is providing services to and not discriminate amongst them;
(ix) it must have documented business continuity plan including a disaster recovery site or shall develop the disaster recovery site within the time limit specified by the Commission;

(x) it shall continuously improve the quality and efficiency of its systems and procedures, including the attainment of relevant internationally recognized certifications;

(xi) it has put in place necessary controls and safeguards to ensure cyber security, access to confidential information and alteration, destruction, disclosure or dissemination of records and data;

(xii) it has put in place necessary arrangements for resolving disputes and redressal of grievances arising out of clearing and settlement of trades and custody of customer assets; and

(xiii) it must not solicit as customer any person who was within last two years a customer of the Trading Only Broker which has entered into arrangement with such Trading and Clearing Broker for custody and clearing services. Provided that this condition shall not be applicable in the case of any person who was the customer of such Trading and Clearing Broker in the past.

The Commission may at any time inspect the above requirements.”

(8) In Form A, in clause 1, after the words “apply for licence of securities broker under” the following shall be inserted, namely, -

“the……Trading Only/Trading and Self-Clearing/Trading and Clearing……..Category”

(9) In Form A, after clause 3, the following new clause 4 shall be inserted namely,—

“4. We are interested in offering the following additional services and hereby apply for the requisite licenses (tick the appropriate box(es)):

Securities and futures advisor
Consultant to the issue
Underwriter”
(10) In Annexure A under clause 4 titled “List of documents to be provided along with application”, after sub-clause 4.12, the following new clauses shall be inserted, namely, -

“4.12A Entity rating of the applicant, where applicable.
4.12B Broker Fiduciary Rating of the applicant, as may be applicable.
4.12C Name of statutory auditor of the applicant.”

(11) In Form B, after the words, “the application for licence by..... (Name of the company). for” the following words shall be inserted, namely,—

“.......Trading Only/Trading and Self-Clearing/Trading and Clearing............ category of”

(12) In Form C, in clause 1, after the words, “hereby apply for the renewal of the licence of securities broker” the following words shall be inserted namely,—

“under the............Trading Only/Trading and Self-Clearing/Trading and Clearing............ Category”

(13) In Form C, after clause 5, the following new clause 6 shall be inserted namely,—

“6. It is requested that our licenses for the following regulated securities activity may also be renewed (tick the appropriate box(es)):

Securities and futures advisor
Consultant to the issue
Underwriter”

(14) In Annexure D, in sub-clause (a) of clause 3, the following new proviso shall be inserted, namely,—

“Provided that a securities broker licensed under the Trading Only category and which has transferred its custody and clearing functions completely or to the extent of its customers may comply with the above requirement on a voluntary basis.”

(15) In Annexure D, clause 7 shall be substituted by the following, namely,—

“A Trading and Clearing category securities broker shall have its statutory audit conducted from an auditor enlisted within Category “A” of the State Bank of Pakistan’s Panel of Auditors. A Trading
and Self-Clearing category securities broker shall have its statutory audit conducted from an auditor enlisted within Category “A” or “B” of the State Bank of Pakistan’s Panel of auditors. Trading Only category securities broker which has transferred its custody and clearing functions completely including proprietary shall have its statutory audit conducted from an auditor which is in the list, maintained by the Institute of Chartered Accountants of Pakistan, of practicing firms having Satisfactory QCR Rating, otherwise shall have its statutory audit conducted from an auditor enlisted within Category “A” or “B” of the State Bank of Pakistan’s Panel of Auditors.”

(16) In Annexure D, after point (iii) in sub-clause (a) of clause 9, the following new proviso shall be inserted, namely,—

“Provided that a securities broker licensed under the Trading Only category which has transferred its custody and clearing functions completely or to the extent of its customers may comply with the requirement of inclusion of Directors’ Report in its Annual Report on a voluntary basis.”

(17) In Annexure D, in sub-clause (b) of clause 9, the following new proviso shall be inserted, namely,—

“Provided that a securities broker licensed under the Trading Only category which has transferred its custody and clearing functions completely or to the extent of its customers may comply with the above requirement in respect of quarterly financial statements on a voluntary basis.”

[File No. SMD/SE/2(267)/2016.]

BILAL RASUL,
Secretary to the Commission.