Approval Sheet

LEGAL FRAMEWORK FOR THE REGULATION OF STOCK EXCHANGES IN PAKISTAN IN PERSPECTIVE OF THE INTERNATIONAL LEGAL REGIME

By

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بسم الله الرحمن الرحيم

In the Name of Allāh, the Most Gracious, the Most Merciful

Declaration

I, Muhammad Umair Rehan, hereby declare that this dissertation is original and has never been presented in any other institution. I, moreover, declare that any secondary information used in this dissertation has been duly acknowledged.

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Dedication

MY RESPECTED PARENTS

Who always encourage me in the accomplishment of my goals and

Always sacrifice their needs in front of my career

Acknowledgement

All the Praise is for Almighty Allah, who is the Sustainer of the worlds, the Compassionate, the Merciful, and may His everlasting blessing & peace be on Muhammad, the last of His Messengers!

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Preface

Securities markets are regulated in numerous countries of the world. Though U.S. was not the first country to regulate securities markets, it did introduce a complete framework of securities regulation before other countries, thus, became model for other countries. Currently, the majority of the countries' regulations of securities markets are adapted from the U.S. model. The developing countries like Pakistan and India are also adopting the regulatory model of U.S.

It is also evident that the FSA of U.K. is one of the most powerful regulators in the world. The regulatory regimes for financial services and stock markets in the U.K., under the FMSA, 2000, marked a new phase in the regulation of securities. It marked the decline of an era based on self regulation of a number of business activities, and its replacement with a regime in which the State would take an interest across a major larger range of financial activity, through a regulatory agency with extensive powers enforcement. An increasingly international dimension to securities regulation can be seen in the existence and operation of the IOSCO, while much of the spirit and intendment of the FMSA Act, 2000 can also be seen to mirror the approaches and policies of the U.S. SEC.

The regulation of the stock exchanges of Pakistan is divided between the SECP and the stock exchanges of Pakistan. It is the responsibility of the SECP to provide the framework for the stock market, whereas it is the stock exchanges, which are primarily responsible for ensuring regulatory compliance on the part of the financial intermediaries, in their capacity as (SROs).

The SECP is a statutory body that entrusted with the integrated administration and regulation of; inter alias, the capital markets, corporate sector and financial (non-banking) sectors in Pakistan. Its regulatory domain extends to the Insurance sector, Non Banking Financial Institutions and to the important components of capital markets: Stock Exchanges, Commodity exchange, CDC, NCCP Limited, beside the corporate sector.

SECP, an independent and autonomous regulatory body, was created as statutory body under the SECP Act of 1997, as a successor to the Corporate Law Authority with the mandate to regulate the corporate sector and the stock exchanges of Pakistan.

SECP is energetic and an active securities regulator, functions as Apex regulator of the stock markets of Pakistan. It is also committed to achieve the high regulatory standards in compliance with the principles of IOSCO.

Effective regulations of the stock markets mostly rely on the existence of a sound framework for fair, transparent and effective markets. Lack of this basic framework has extensively affected the country's efforts to develop the stock markets.

Pakistan has definitely improved quite a bit, but when it is compared with the region, it is still lagging far behind and is still substantially low relative to other developing economies. For me this is where we should endeavor to make more inroads.

My research work emphasizes the need to carry out a thorough examination of the Pakistani Securities regulation so as to examine the relevance of its objectives in the current economic environment, the adequacy of its provisions, its capacity to allow for the balanced growth of stock markets, and the extent of its harmonization with international best practices as proposed by the international Organizations especially by IOSCO

For analyzing — Legal Framework for the Regulation of Stock Exchanges in Pakistan in Perspective of the International Legal Regime — this thesis has been divided into Six (06) chapters:

Chapter 1 gives the brief introduction to the Stock Exchanges/Markets, their functions, roles and desirable characteristics, also justifications/ reasons for their regulation, with a brief history.

Chapter 2 discuss the international efforts for the regulation of securities market by international organizations and the umbrella under which national regulators of securities market cooperate and coordinate their activities.

Chapter 3 concerns the developed and developing country's perspective, we will mainly focus on the U.S. system of securities market's regulation and will also study a brief introduction and comparison with British and Indian regulatory system. The reason to mainly focus on U.S system is that, it did introduce a complete framework of stock market's regulation before other countries. At present, most countries' regulation of securities markets is adapted from the U.S. model for example the regulatory framework of India and Pakistan.

Chapter 4 concerns Pakistani legislation - Legal Frameworks of Securities Market Regulations in Pakistan – in this chapter we will discuss the present Pakistani legal regime. The regulation of the stocks markets is divided among the SECP and the stock exchanges; therefore we will discuss the duty of the SECP to provide the framework for the market and, the three stock exchanges of Pakistan, (in their capacity as SROs).

Chapter 5sets out the Reforms and the Recommendations, the reforms which already have been implemented in the last few years by the SECP or its precedent institution (CLA), ongoing reforms, proposed reforms and the recommendations.

Chapter 6 sets out the conclusion with the emphasis that the new model relating to the regulation of Pakistani Stock exchanges should be introduced in the Pakistani legislation, namely, SEO 1969 and SECP 1997.

Acronyms

BATS	Bond Automated Trading System
BOD	Board of Director
CDC	Central Depository Company
CIS	Collective Investment Scheme
CLA	Corporate Law Authority
DBL	Drexel Burnham Lambert
DBLG	Drexel Burnham Lambert Group
EC	European Commission
EU	European Union
F.G	Federal Government
Forex	Foreign Exchange
FSA	Financial Services Authority
FSF	Financial Stability Forum
FSMA	Financial Services and Markets Act
IOSCO	International Organization of Securities Commission
IMF	International Monetary Fund
ISE	Islamabad Stock Exchange
KATS	Karachi Automated Trading System
KSE	Karachi Stock Exchange
LSE	Lahore Stock Exchange
LSX	London Stock Exchange
MOU	Memorandum of Understanding

NASD	National Association of Securities Dealers
NASDAQ	National Association of Securities Dealers Automated Quotations
NBFCs	Non-banking finance companies
NCCP	National Clearing Company Of Pakistan
NYSE	New York Stock Exchange
OTC	Over-The-Counter
SBP	State Bank of Pakistan
SEA	Securities Exchange Act
SEBI	Securities and Exchange Board of India
SEC	Securities and Exchange Commission
SECP	Securities and Exchange Commission of Pakistan
SEO	Securities and Exchange Ordinance
SEPB	Securities and Exchange Policy Board
SIPC	Securities Investor Protection Corporation
SME	Small and Medium Enterprise
SROs	Self-Regulatory Organizations
TFC	Term Finance Certificate
U.K.	United Kingdom
U.S.	United states
UIN	Unique Identification Number
UKLA	United kingdom Listing Authority
UNCITRAL	United Nations Commission on International Trade Law
UTS	Unified Trading System
VAR	Value at Risk

Abstract

The concept of — Legal Framework for the Regulation of Stock Exchanges in Pakistan in Perspective of the International Legal Regime — is need of the hour as the SEO, 1969 of Pakistan does not fulfill the requirement of the securities market and is decades old, which results in sketchy and cumbersome regulation for the capital market particularly for the three stock exchanges of Pakistan.

U.S. is one of the pioneers which marked distinction in the regulation regarding stock exchange in excellent fashion and presented its legislation as model for rest of the jurisdictions. Therefore, most of the stock markets regulations of the world are adapted from the U.S. model.

India, while considering the needs in the present time and also for the times to come, has also taken effective steps towards this significant matter. It is high time for Pakistan to bring radical change in its regulatory framework.

Pakistan's stock market is fragile, it lacks depth. SECP should work hard to bring fresh regulations of the stock market to increase depth. Lack of depth enables unscrupulous persons to corner the market and thus manipulate. SECP should play a positive role as an intermediary and a feedback channel for exchange of views to bring government and business community close so that they can work in harmony and in close proximity for creating and implementing economic friendly policies and regulations. It should also be committed to engendering investor's confidence and undertaking necessary measures for effective regulation and development of the stock market in Pakistan.

The criteria for determining the rules and regulations for the stock markets must be consistent with the international standards not only in order to compete with the international markets but also to attract the foreign investors to promote the efficiency thereof, therefore, the rules and regulations of stock markets must be perused to have the desirable objectives.

There is need to give jolt to the system and broaden, deepen and enhance the reforms through regulations. All over the globe, the regulatory bodies effort to achieve the maximum efficiency in the stock markets. Only in the presence of fairness, efficiency and transparency, a stock market can reflect the real picture of the economy.

CHAPTER # 1 INTRODUCTION

1.1 Legal and Regulatory Framework

A comprehensive legal and regulatory framework has its basis in the principles of justice and equity; a system that treats everyone equally[1]. It is also a dynamic system which evolves in a consistent manner and is based upon precedence; to meet the needs and aspirations of the people. Regulatory framework cannot be erected unless backed by an efficient legal structure, which alone facilitates regulation to take place.

At another level, the legal framework must define the rights and obligations of parties to debt contracts in the primary and secondary markets for issuers, investors, and intermediaries[2].

The complexity and dynamism of stock markets requires laws, rules and norms based on transparency and openness that encourage and facilitate investors and economic growth[3]. It is, therefore, very critical that a progressive legal framework is in place to encourage participation in economic growth and to effectively execute organization policy.

Laws and regulations have a direct bearing on the development of stock market. A legal and regulatory framework that stifles market expansion, innovation and competitiveness translates into a shrinking economic base. Uneven regulations and vague laws across shareholders and investors fabricate institutional uncertainty, which constrains market's development. This uncertainty is further compounded by cumbersome procedures, discretionary and arbitrary decision-making and enforcement practices, or by repeated changes in the regulation.

Laws, rules and regulations promoting accountability are most successful in creating conditions that ensure transparency and probity. Greater transparency, objectivity, predictability and legitimacy in the organizational environment lowers transaction costs, increase contracting efficiencies and lengthen time horizons. It also encourages open and formal business transactions and enhances credibility of the organization and its policies. All these factors provide impetus to the development of stock market.

Hence, it can be inferred that an essential element of a sound regulatory and legal system is to ensure doctrine of checks and balances.

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[1] Legal and Regulatory Framework: Introduction, page 1
http://www.pakistan.gov.pk/ministries/planninganddevelopment-ministry/mtdf/35-Legal%20&%20Regulatory%20Framework/35-Legal%20&%20Regulatory%20Framework.pdf

[2] Legal and regulatory framework for developing government bond markets - suggested issues for Discussion By Hans Blommestein
http://www.oecd.org/dataoecd/35/55/35325278.pdf

[3] Ibid.

1.1.1 Meaning of Regulation

Regulation has been defined as the law which implements a system where the state seeks to direct or encourage behavior which is assumed would not occur without such intervention[4]. However, regulation is a vast term by which the Government, organizations/institutions or other responsible bodies set requirements of compliance for individuals as well as corporations. Institutions that are free from political influence, bureaucratic and other pressures tend to be more productive than the others[5]. This ensures that policies should be made on merit and matters be dealt on best possible criteria, whatever may be the political or bureaucratic structure. This principle of non-interference is necessary for regulatory bodies to be provided so that they could perform their functions properly[6].

1.1.2 Justifications for Regulation

Market failure is presumed to be the most significant justification for regulation. Much of our existing regulation appears to be premised on the assumption that the market has failed to produce satisfactory outcomes. There are other justifications for regulation besides market failure which are indicated below:

1.1.2.1 Reducing Risks

Regulation may be justified on the ground that it ensures proper risk management procedures in the capital market and protects investors through responsive policy measures and effective enforcement practices[7].

1.1.2.2 Fairness and Justice

Regulation may be justified on the ground that it develops a fair, just and transparent practices, based on international legal standards, for the protection of investors and mitigation of systemic risk aimed at fostering growth of a robust corporate sector and broad based capital market[8].

1.1.2.3 Defining Boundaries

Regulation may be justified on the ground that it sets reasonable limits between prohibiting an activity and leaving it unfettered. By choosing regulation over prohibition, the state can reduce the risks associated with ill-monitored practices and

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[4] A I Ogus, *Regulation: Legal Form and Economic Theory*, 1994, at 1-2

[5] Has Economic Analysis Improved Regulatory Decisions? Robert W. Hahn and Paul C. Tetlock: Journal of Economic Perspectives—Volume 22, Number 1—Winter 2008: http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.22.1.67?cookieSet=1

[6] Legal and Regulatory Framework: www.pakistan.gov.pk/...Legal Regulatory Framework/.pdf

[7] J Francis, *The Politics of Regulation: A Comparative Perspective*, 1993. See also A I Ogus, *Regulation: Legal Form and Economic Theory*, 1994, Chapters 2 and 3

[8] Corporate personality in the 20th century By Ross Grantham, C. E. F. Rickett, page 220

secure the co-operation of many more members of the community in allowing the practice within generally accepted limits[9].

1.1.2.4 Maintaining Equilibrium

Regulation is seen as means of establishing stability and confidence[10]. Confidence borne of equilibrium is the working assumption of much financial regulation. The cycles of panics characteristic of financial markets in the nineteenth and certainly through the first third of twentieth-century contributed to the successful demands for state regulation of stock-markets and financial institutions to institutionalize stability over time[11].

1.2 Securities Regulation

Securities regulations comprise the regulation of stock exchange, secondary markets, market intermediaries, asset management products and public issuers of securities. Regulation is designed to address asymmetries of information between issuers and investors, clients and financial intermediaries and between counterparties to transactions; and to ensure smooth functioning of trading and clearing and settlement mechanisms that will prevent market disruption and foster investor confidence[12].

Securities exchanges are regulated to ensure market integrity[13]. The regulation and supervision of securities markets is important for Investor protection, the safeguarding and maintenance of a functioning competitive framework and the prevention of potential systemic risks. In addition to that, regulatory neutrality is an important element in the design of any regulatory framework[14]

1.3 Different Perspectives of Securities Markets/ Overview of Financial Markets

The financial markets can be divided into different sub-types:

1.3.1 Capital Markets

Capital Markets which consist of:

a. Stock Markets

b. Bond Markets

[9] J Francis, *the Politics of Regulation: A Comparative Perspective*, 1993page- 20.
[10]Corporate personality in the 20th century By Ross Grantham, C. E. F. Rickett, page 221
[11] See supra[10], page- 21.
[12] A good overview of the approach to securities regulation can be found in Bernard Black, 2001 The Legal and Institutional Preconditions for Strong Securities Markets, UCLA Law Review, vol. 48, (Los Angeles, California: University of California at Los Angeles), pp. 781-855
[13]The UK FSA: Unified Regulation in the new Market Environment by Richard Dale & Simon Wolfe University of Southampton, Southampton, SO17 1BJ, UK Highfield, page-6
[14]See supra[13]. Page-35

Stock Markets; which provide financing through the issuance of shares or common stock, and enable the subsequent trading thereof

Bond Markets; which provide financing through the issuance of bonds, and enable the subsequent trading, thereof.

1.3.2 Commodity Market

A commodity market is which facilitate the trading of commodities[15]. It is similar to an Equity market, but instead of buying or selling shares one buys or sells commodities[16]

1.3.3 Money markets

Money markets provide short term investment and debt financing. The money market is therefore different from the capital market; which is concerned with medium- and long-term credit. The transactions that occur on the money market involve not only banknotes but assets that can be turned into cash at short notice, such as short-term Government securities and bills of exchange[17].

1.3.4 Derivatives markets

Derivatives markets provide mechanism for the management of financial risk.

1.3.5 Futures Markets (Forward Market)

Futures markets (forward market) provide standardized forward contracts for trading products at some future date. Futures markets and forward markets trade contracts that determine a current price for a commodity transaction designated to take place at a later date[18]

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[15]World-over one will find that a market exits for almost all the commodities known to us. These commodities can be broadly classified into the following:
PRECIOUS METALS: Gold, Silver, Platinum etc :
OTHER METALS: Nickel, Aluminum, Copper etc
AGRO-BASED COMMODITIES: Wheat, Corn, Cotton, Oils, Oilseeds, etc.
SOFT COMMODITIES: Coffee, Cocoa, Sugar etc
LIVE-STOCK: Live Cattle, Pork Bellies etc
ENERGY: Crude Oil, Natural Gas, Gasoline etc

[16]What is a commodity market?
http://www.commodityonline.com/learning_sub.php?id=5

[17]Britannica Concise Encyclopedia: Definition of Money Market
http://www.Britannica.com/money-market
http://www.answers.com/topic/money-market

[18] Futures Markets and Forward Markets Nov. 15, 2006 by Geoffrey Poitras, Professor of Finance, Faculty of Business Administration, Simon Fraser University
http://www.sfu.ca/~poitras/futures.pdf

1.3.6 Insurance Markets

Insurance markets, which facilitate the redistribution of various risks[19].

1.3.7 Forex Markets

Forex markets facilitate the trading of Forex. The purpose of the Forex market is to assist international trade and investment. The Forex market allows businesses to convert one currency to another foreign currency[20].

Example; Forex market permit a U.K. business to import American goods pay U.S Dollars, even though the business's income is in U.K. Pounds/ Euros.

1.4 Stock Market/ Stock Exchange

1.4.1 Definitions

Stock exchange means any person who maintains or provides a market place or facilities for bringing together buyers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a Stock Exchange, as that term is generally understood, and includes such market place and facilities[21].

The simple definition calls the stock market as the public market where stocks and derivatives[22] are traded at the set price[23].

In another definition stock exchange may be defined, an exchange[24] on which shares of stock and common stock equivalents are bought and sold[25].

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[19] An Introduction to Global Financial Markets, by Steven Valdez, Macmillan Press Ltd http://www.eoft.com/financial_markets.html

[20] Forex market From Wikipedia, the free encyclopedia http://en.wikipedia.org/wiki/Foreign_exchange_market

[21] S- 2(1) (m) OF SEO, 1969 NO. XVII OF 1969

[22] Derivatives are financial instruments that have no direct value in and of them selves but derive their value from other things that do. Derivatives comprise of exotic trading products including forwards, futures, options, and swaps. Until recently, most people had never even heard of derivatives; but in terms of money traded, these investments represent the biggest financial market in the world

[23] Beginners Guide to the Stock Market http://www.learn-how-to-invest.com/stock-market-for-beginners

[24] Exchanges can be considered as physical locations and there is also the virtual exchange. In physical exchanges, trades are carried out on the trading floor and trades are done through open outcry. In this way, traders cry out and enter their trades verbally. The other kind of stock exchange is the virtual kind, and this is linked by a network of computers and the trades are made electronically. World's-largest-*NYSE* is considered as a physical and a listed exchange where listed securities can be traded. The typical orders will start from traders going to the floor broker up to the floor trading post specialist that trades the order. This specialist matches any buy and sells orders, and when trades are made this is reported on the tape and is sent to the brokerage firm. An example of a virtual exchange is NASDAQ in the US, where trading is done online.

1.4.2 Introduction to Stock Exchange

The trading of Securities such as stocks and bonds is conducted in stock exchanges, which are grouped under the general term stock market. The stock market is an important institution for capitalist countries because it encourages investment in corporate securities, providing capital for new businesses and income for investors[26].

The Stock Exchange acts at two levels:

A. *Primary Market*

B. *Secondary Market*

As a ***Primary Market***, the Stock Exchange will liaise with investment banks and businesses that look forward to raising capital by selling shares. This process involves the business being 'listed' on the Stock Exchange or 'floating'. In this case, the business will effectively get its capital through the initial sale of its shares[27].

To a large extent of the Stock Exchange's work, however, is as a ***Secondary Market***. People, buying shares, may desire to do so for a variety of reasons i.e. to see the price of the shares rise or to secure dividends.

Example;

People if desire to trade their shares then it would be not opportune for the business itself to get the shares back and vend them to someone else. Such a process would be very disruptive and hinder planning. Therefore, the Stock Exchanges acts as a ***market*** that put those wanting to vend shares in touch with those seeking to purchase.

Stock Exchanges present a more organized way to trade shares. They are usually superior to the OTC[28] market for numerous reasons which are as under:

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[25] Stock exchange:
http://www.investorwords.com/4733/stock_exchange.html

[26] Stock market;
http://legal-dictionary.thefreedictionary.com/stock+market

[27] Stock market;
http://legal-dictionary.thefreedictionary.com/stock+market

[28] *A security which is not traded on an exchange, usually due to an inability to meet listing requirements* For such securities, broker/dealers negotiate directly with one another over computer networks and by phone, and their activities are monitored by the NASD. OTC stocks are usually very risky since they are the stocks that are not considered large or stable enough to trade on a major exchange. They also tend to trade infrequently, making the bid-ask spread larger. Also, research about these stocks is more difficult to obtain, also called unlisted. In Pakistan and India until recently some versions of a unique form of financing instrument of securities in the over the counter market was prevailing which is termed as *badla* which literally means *in return*. Investor or broker buys shares with the intention to make a profit but without committing money directly. That is the investor can carry forward his position from one settlement date to another in a speculative trade with an agreed interest rate called the *badla rate* which is determined by supply and demand. Thus while the investor (the speculator) enjoys the deferment of payment, the financier earns interest at a rate considerably higher than the

First, they bring many investors together, offer greater liquidity, therefore making it possible to get better prices.

Second, they are able get and publish the prices at which trades are being offered or have occurred, giving investor significant source of information which is not available on the OTC market.

Third and the most important is that the exchanges have rules and procedures to ensure that parties live up to their commitments. All well-known companies whose shares are traded publicly list their shares on exchanges. Exchanges set requirements for listing, and very small firms or firms whose shares seldom trade will not qualify[29].

1.4.3 Popular Investing Instruments

Most popular investing instruments in world's stock markets are[30]:

1. Stocks and shares
2. Bonus issues
3. Rights issues

1.4.4 Stocks and Shares

It is desirable to understand the stock market by understanding stocks first. A typical dictionary definition for stock is the capital raise by a corporation through the issue of shares entitling holders to an ownership interest (equity), he owns a controlling share of the company's stock[31]. A share of stock is the smallest unit of ownership in a company. If you own a share of a company's stock, you are a part owner of the company[32].

Stocks are generally explained to be a collection of shares in a company, and are also referred to as stock shares. A stock is a certificate, a sheet of paper, which declares a person on a small fraction of that company[33]. For better understanding, it is significant to look at several reasons why a company might want to issue stock. The reason is

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prevailing market interest rate. Badla-rates are higher due to the fact that trading is relatively insecure as the exchange does not guarantee this transaction and also because of the added uncertainty that share-price in the market may go down. This is essentially a carry forward trade through a repurchase agreement but is different from futures trade since the badla rate is considerably higher than the risk-free rate which applies in the case of futures trading.

[29] The Economist Guide to Financial Markets by Marc Levinson: Stock exchanges, p 150.

[30] The Role and Function of a Stock Exchange By Enid E Bissember http://www.gasci.com/eeb%20presentation%20to%20gASCI.ppt

[31] Stock Market - Explained in Brief; http://www.stockmarketinvestinginfo.com/smi_stockmarket.html

[32] Introduction to Stocks Basic Stock Information to Get You Started By Ken Little, http//About.com Guide

[33] Stock Market investing Guide :A Brief Overview to Basics of Investing in Stock market, http://www.stockmarketinvestinginfo.com/smi_stockmarket.html

because the company might use the capital from a stock offering to buy equipment, advertise, expand facilities or hire people.

Trading in stocks is characteristically/ typically driven by rumors and speculation, based on company performance factors and news. There are two ways to find the market value of a stock.

a. The Stock value may be determined by using some type of earning analysis, cash flow or sales. This type of stock valuation is based on historic statistics and ratios.

b. Another way a stock market can be explained is to ask someone to look at how much investor is willing to pay for a particular share of stock and by how much other investors are willing to sell a stock for[34]. We can say it that, it explains the supply and demand of the market. This form of stock valuation is very tough to predict.

1.4.5 Participants in Stock Exchange

Participants in stock Exchange are the people; who purchase and vend stocks, who run the stock exchange, who run stock brokerages and those who serve as market makers. Participants in the stock exchange are varied. Some of them representing large financial institutions and others considered as small/individual investors. Around the world, business organizations, small to large investors, financial organizations, and Governments of different nations are all major participants in stock market trading activities. While every stock market participant is important, the following groups are key players in making the stock market function properly[35]:

a. Companies who issue Stock Shares

b. Stock exchanges who list the Stock Shares

c. Stock brokerages who give the buyers and sellers access to the exchanges

d. Market makers who line up the buyers with sellers

e. Buyers and sellers who trade the Stock[36]

It is worthwhile to have cognizance of the above-mentioned participants. Therefore, they are elaborated below.

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[34] Stock Valuation Methods
http://www.abcstockinvesting.com/stock-valuation.html
[35] World Stock Markets and Exchanges:
http://www.economywatch.com/stock-markets-in-world
[36] http://www.learningmarkets.com/Stocks-Investing-Basics/20080618178/stock-market-participants.html

1.4.5.1 Shareholders

Owner of one-or-more shares of stock in a corporation, commonly-also called a shareholder. It should have his/her name registered with corporation, but may hold a stock certificate which has been signed over to him/her. Before registration, new shareholder may not be able to cast votes represented by the shares[37]. The advantages of being a shareholder contain receiving the dividends against each share as determined by the BODs, to contribute in the division of value of assets upon winding up and winding up of the company/corporation, if there is any value, and the right to vote for members of the BODs. A share of common stock is ownership in a company. It entitles the holder to a claim on assets as well as a fraction of profits that the company generates. In the stock market, investors are constantly trying to assess the profit that will be left over for shareholders[38]. This is why stock prices fluctuate.

1.4.5.2 Market Makers

Market makers trade shares on their own account and generate their money on the difference between the price of buying shares and selling and the difference is called as 'spread' They do not earn a commission from the activity of buying and selling.

Example;

A Market maker when purchase four thousand shares in P.S.O for two ninety Rupees each and later on he vend them for three hundred Rupees each; he would have earn forty thousand rupees-.

The market makers will be approached by the Stockbrokers for buying and selling the shares. The contemporary Stock Exchange operates through computer based trading. The market makers and stockbrokers, both are able to observe a clear view that what is happening to prices in shares that they are interested in and who is interested to sell or buy.

1.4.5.3 Members

Member is a person, normally a broker, who has membership on a stock exchange. This means that he/she is allowed to make trades on the floor of that exchange. Most exchanges do not allow firms to be members, so the membership for a member firm formally belongs to one or more of its employees.

Those Stock exchanges, which originated as '*mutual organizations*', are owned by its member stock brokers. There has been a recent trend for stock exchanges to demutualize, where the members sell their shares in an initial public offering. In this way the mutual organization becomes a corporation, with shares that are listed on a stock exchange.

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[37] Shareholders:
http://legal-dictionary.thefreedictionary.com

[38] The 5 Biggest Stock Market Myths by Investopedia Staff, (Investopedia.com)
http://www.investopedia.com/articles/02/061902.asp

1.4.5.4 Issuers

Issuer means any person who issue or proposes to issue any security[39].

1.4.5.5 Agent

A person selected by a member to act on the behalf of that member, for the reason recognized by the stock exchange is known as an Agent.

1.4.5.6 Intermediaries

An intermediary is a third party that offers Intermediation services between two trading parties. They play an important role on the stock exchange market; they put together the demands of the buyers with the offers of the security sellers. We can distinguish two-types of intermediaries: those who act on account of others (Brokers) and those who act on heir own account and of others (broker-and-dealer)[40]. Securities market intermediaries (brokers and agents) are also regulated by the SECP.

1.4.5.7 Brokers

No person shall act as broker or agent to deal in the business of effecting transactions in securities unless he is registered with the Commission in such manner, on payment of such fees and charges and on such conditions as may be prescribed[41]. People who buy or sell stock on an exchange do so through a broker. The broker takes your order to the floor of the exchange looks for a broker representing someone wanting to buy/sell, if a mutually agreeable price is found the trade is made[42].

A good broker knows when to put your order and can intermittently stop you from making any mistake. He notices when your order is running against the tide and will know when to apply his own prudence to save your cash. A bad broker will be proactive at the wrong times, will not get the best price available, will not always try and contact you if something relevant happens that may affect your order and will generally cost you money that a good broker would have saved[43].

SECP annually analyzes the compliance of brokers and agents while renewing their registrations, Brokers and agents are required to provide net capital balance, change in directors, and change of address or any other information to the SECP from time to time[44].

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[39] S 2(1)(g) SEO, 1969 (Ordinance No. XVII of 1969)

[40] http://www.beginnermoneyinvesting.com/html/the_market_intermediaries.htm

[41] S-5 (a) SEO, 1969 (Ordinance No. XVII of 1969)

[42] The role and function of a stock exchange by enid e bissember http://www.gasci.com/eeb%20presentation%20to%20gasci.ppt

[43] Stock brokers; http://www.stockmarketinvestinginfo.com/smi_stockmarket_add_3.html

[44] Securities & Exchange Commission of Pakistan:Actively Monitor The Stock Market http://www.cmda.gov.mv/docs/Anx-IV%20Pakistan%20-%20presentaiton%20SEC.pdf

1.4.5.8 Sub-Broker

A sub-broker means that have either made an application for registration or is registered as a sub broker in accordance with the rules and regulations[45].

Trading in shares, have to approach a broker. However, since most brokers deal in very high volumes, they generally do not entertain small investors. These brokers have a network of sub-brokers who provide them with orders. The sub-broker will transmit the order to his broker who will then execute it[46].

The general investors must identify a sub-broker for regular trading-in-shares and put their orders for trading through the sub-broker.

1.4.5.9 Stockbrokers

A stockbroker is referred to as the retail part of the market. Stockbrokers act on behalf of clients and buy and sell shares on their behalf and generally belong to firms who are members of the Stock-Exchange. They earn their money from charging a commission on each transaction[47]. They might suggest their clients about the shares, the clients might be thinking of buying and selling. The rules are very tight and strictly observed and enforced. The process of buying-and-selling for the purpose of generating commission is called 'churning'. Some stockbrokers may act as 'execution only'. This means that they merely buy and sell shares at low commission rates but do not offer any advice[48].

1.4.5.10 Brokerage Houses /Brokerage Firm

The word/ term brokerage house or brokerage firm may be used interchangeably with broker when referring to a firm rather than an individual also called brokerage or brokerage firm. A brokerage house is a company licensed to buy and sell stocks or securities[49]. Acting as an intermediary between buyers and sellers, a brokerage house typically employs brokers who carry out the wishes of the firm's clients as they pertain to the trading of stocks. Broker services are usually provided on a commission basis. Commission amounts charged for the buying and selling of securities vary with each brokerage house[50].A brokerage firm/brokerage house can charge several other fees and that fees may include charges for closing an account, transferring assets etc.

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[45] http://www.shvoong.com/internet-and-technologies/commercial-companies/1650255-www-shvoong-com/ , Internet from 6/27/10

[46] http://www.wealthcity.in/investments/faq.html, Internet from 9/21/10

[47] Internet from 2/17/10 http://www.bized.co.uk/learn/economics/markets/stockexchange/role.htm

[48] Ibid.

[49] Brokerage house; http://www.investorwords.com/588/brokerage_house.html

[50] *What is a Brokerage House?* Internet from 11/24/09 http://www.wisegeek.com/what-is-a-brokerage-house.htm

1.4.6 The Role and Functions of a Stock Exchange

Stock exchanges have numerous roles and functions. This may possibly consist of the following.

1.4.6.1 Basic Role

The basic role is to assist, regulate and control business of buying, selling and dealing in securities.

1.4.6.2 Raising capital for businesses

The Stock Exchange provides companies with the facility to raise capital for expansion through selling shares to the investing public[51].

1.4.6.3 Provides a physical location

It provides a physical location for buying and selling securities that have been listed for trading on that exchange.

1.4.6.4 Mobilizing savings for investment

When people draw their savings and invest in shares, it leads to a more lucid allocation of resources because funds are mobilized and redirected to promote business activity with benefits for several economic sectors for-example industry, agriculture and commerce resulting in stronger economic growth and higher productivity-levels of firms[52].

1.4.6.5 Assisting individuals to invest

It provides a market for the trading of securities to individuals and organizations seeking to invest their saving or excess funds through the purchase of securities.

1.4.6.6 Facilitating company growth

Companies view acquisitions as an opportunity to expand product lines, increase distribution channels, hedge against volatility, increase its market share, and acquire other necessary business assets. Takeover-bid or merger-agreement through stock-exchange is most common and one of the simplest ways for a company to grow by acquisition or fusion[53].

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[51] Gilson, Ronald J.; Black, Bernard S. (1998) Venture Capital and the Structure of Capital Markets: Banks versus Stock Markets. *Journal of Financial Economics* 47: 243–277.

[52] Diamond, Peter A. (1967). The Role of a Stock Market in a General Equilibrium Model with Technological Uncertainty, American Economic Review 57 (4): 759–776. http://www.jstor.org/pss/1815367.

[53] Successful Stock Exchange Market;
The role of stock exchanges, Posted by Waleed Ahmed, dated October 20, 2009
http://www.hum9.co.cc/

1.4.6.7 Supervision

The exchange assures that no investor will have an undue advantage over other market participants[54].

1.4.6.8 Profit sharing

Both casual and professional stock investors, through dividends and stock price increases that may result in capital gains, will share in the wealth of profitable businesses.

1.4.6.9 Establishes rules

It establishes rules for fair trading practices and regulates the trading activities of its members according to those rules.

1.4.6.10 Corporate governance

By having a wide and varied scope of owners, companies generally tend to improve on their management standards and efficiency in order to satisfy the demands of these shareholders and the more stringent rules for public corporations imposed by stock exchanges and the Government[55]. Thus, it is alleged that public-companies[56]be inclined to have improved management records than privately-held-companies[57]. Notwithstanding this claim, some well-documented cases[58] are famous where it is alleged that there has been significant slippage in corporate-governance on the part of some public-companies. However, when poor financial, ethical or managerial records are known by the stock investors, the stock and the company tend to lose value. In the stock exchanges, shareholders of underperforming firms are often penalized by significant share price decline, and they tend to dismiss incompetent management teams[59].

1.4.6.11 Price Discovery

The markets role in price discovery is particularly important for efficiency under optimum conditions, a price that establishes equilibrium between the supply of and

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[54] Available on Internet from 3/17/11
http://www.scribd.com/doc/15504271/Functions-of-stock-exchange-by-hummad-Ahmed

[55] Publications; *Stock exchange*, University/Business and Administrative studies/Human Resource Management, 2010-10-05

[56]Companies that are owned by shareholders who are members of the general public and trade shares on public exchanges

[57]Those companies where shares are not publicly traded, often owned by the company founders and/or their families and heirs, or otherwise by a small group of investors

[58]The dot-com bubble in the early 2000s, and the subprime mortgage crisis in 2007-08 are classical examples of corporate mismanagement. Companies like Pets.com (2000), Enron Corporation (2001), One.Tel (2001), Sunbeam (2001), Webvan (2001), Adelphia (2002), MCI WorldCom (2002), Parmalat (2003), American International Group (2008), Bear Stearns (2008), Lehman Brothers (2008), General Motors (2009) and Satyam Computer Services (2009) were among the most widely scrutinized by the media.

[59]Internet from 12/8/10
http://www.absoluteastronomy.com/topics/Stock_exchange

demand for financial assets reflects all the information relevant to its assessment[60]. If all market players are price takers (i.e. do not have any market power) and markets exist for all goods or environmental conditions, decentralized management through relative prices is able to bring about the optimum coordination of all activities[61].

1.4.6.12 Creating investment opportunities for small investors

As disparate to other businesses that necessitate huge capital outlay, investing in shares is open to both the large and small stock investors because a person buys the number of shares he can afford. Therefore, the Stock Exchange provides the opportunity for small investors to own shares of the same companies as large investors[62].

1.4.6.13 Government capital-raising for development projects

Governments at various levels may decide to borrow money in order to finance infrastructure projects such-as sewage-and-water treatment works or housing estates by selling another category of securities known-as bonds. These bonds can be raised through stock-exchange whereby members of public buy them, thus loaning money to the Government[63]. The issuance of these bonds can end the need to directly tax the citizens in-order-to finance development, although by securing such bonds with the full faith and credit of the Government instead of with collateral, the result is that the Government must tax the citizens or otherwise raise additional funds to make any regular coupon payments and refund the principal when the bonds mature.

1.4.6.14 Barometer of the Economy

At the stock exchange, share prices rise and fall depending, largely, on market forces. Share prices tend to rise or remain stable when companies and the economy in general show signs of stability and growth. An economic recession, depression, or financial crisis could eventually lead to a stock market crash. Therefore, the movement of share prices and in general of the stock indexes can be an indicator of the general trend in the economy[64].

1.4.7 Desirable Characteristics of a Stock Market

It is enviable to detail the characteristic of a stock-market which is identified as follows:

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[60] Role of markets: DEUTSCHE BUNDES BANK Monthly Report January 2006, p 36.

[61] Internet from 9/13/10 http://commerceplus.blogspot.com/2010/07/project-on-stock-exchange.html

[62] Creating Investment Opportunities for Small Investors, Article | Posted: Aug 13, 2007 http://www.articlesbase.com/investing-articles/creating-investment-opportunities-for-small-investors-197522.html

[63] Internet from 9/13/10 http://commerceplus.blogspot.com/2010/07/project-on-stock-exchange.html

[64]The role of stock exchanges; http://en.wikipedia.org/wiki/Stock_exchange#The_role_of_stock_exchanges

1.4.7.1 Liquidity

Liquidity is a desirable characteristic of a stock-market, it means Ability to sell an asset quickly at a fairly known price low transactions costs[65]. Shares of small-companies might not trade frequently, whereas the larger company's trade daily creates an opportunity to trade shares.

1.4.7.2 Other Desirable Characteristics

Other Desirable Characteristics of a stock-market includes:

a. Availability of information

b. Market efficiency

c. Prices react quickly to new information

d. Small price fluctuations

e. Narrow price spread

f. Regulation and Supervision[66]

1.4.8 Financing modes of the Stock Exchange

These are the following ways through which exchanges are financed:-

a. Transaction fees paid by members for each order executed

b. Fees paid by firms when their securities are originally listed

c. Annual fees by firms

d. Entrance fees from new members[67]

1.4.9 Listing and Delisting Requirements

1.4.9.1 Listing Requirements

Listing requirements are specific requirements and set of conditions imposed by a given stock exchange upon companies to list its securities on the stock exchange. Such requirements sometimes include minimum number of shares outstanding,

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[65] Internet from 6/17/11 http://www.authorstream.com/Presentation/nazeer_bhai-212244-stock-exchange-repair-bikes-eeb-presentation-gasci-entertainment-ppt-powerpoint

[66] The Role and Function of a Stock Exchange By Enid E Bissember http://www.gasci.com/eeb%20presentation%20to%20gASCI.ppt

[67] Internet from 6/17/11 http://www.authorstream.com/Presentation/nazeer_bhai-212244-stock-exchange-repair-bikes-eeb-presentation-gasci-entertainment-ppt-powerpoint

minimum market capitalization, and minimum annual income[68]. Companies have to meet the requirements of the stock-exchange in order to have their shares listed or traded there. These are set out in the legislation. In Pakistan, The major requirements of listing on the ready market are:

a. Minimum paid-up-capital of Rs.200/-million.

b. Minimum public offer as required under the Listing Regulations and the Companies (Issue-of-Capital) Rules, 1996.

c. Public offer of equity has to be subscribed by at least 500 applicants.

1.4.9.2 Benefits of listing

a. Major benefits of listing are;

b. Visibility

c. Market support

d. Investors confidence

e. Increased demand for products and services

f. Overall increase in profitability

Once traded

g. Aura of reliability

h. Accuracy in reporting financial data

i. Reputation and Strength

1.4.9.3 Delisting Requirements

Stock exchange can delist companies for a number of reasons including:

a. Merger with another company

b. Solvency problems

c. Name change company asked to be removed

d. Failure to comply with exchange rules

[68] Listing requirements: Successful Stock Exchange Market, October 20, 2009 http://www.hum9.co.cc

1.5 Major Stock Exchanges of the World

The number of stock-exchanges at the globe is rising speedily. Amongst the most important stock-exchanges of the globe are the NYSE[69], the NASDAQ[70], the LSX[71], the Bombay Stock Exchange[72], the Toronto Stock Exchange[73], the Hong Kong Stock Exchange[74], and the Australian Stock Exchange[75], among others.

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[69] The NYSE is a stock exchange located at 11 Wall Street in lower Manhattan, New York City, New York, U.S.. It is the world's largest stock exchange by market capitalization of its listed companies at US$28.5 trillion as of May 2008.

[70] The NASDAQ Stock Market, known as NASDAQ, is an American stock exchange. NASDAQ originally stood for NASDAQ. It is the largest electronic screen-based equity securities trading market in the U.S. When trading began in February 1971, the NASDAQ became the world's first completely electronic stock exchange. Today it is arguably the largest of the US stock markets .the NASDAQ Stock Market consists of around 3,200 listed companies and it now has surpassed even the NYSE in terms of shares traded daily. With its high-tech image, the NASDAQ is home to many prestigious retailers, media, communication, financial institutions, and biotechnology companies. It began trading on February 8, 1971 as the world's first electronic stock market. Fueled by the growth of internet stock trading, NASDAQ became the largest American stock exchange by 1999, with over half the companies traded in the U.S. listed. NASDAQ is made up of the NASDAQ National Market and the NASDAQ Small Cap Market. Although the market is based primarily in the U.S., NASDAQ has many alliances worldwide, so that today investing in the stock market is a global activity. NASDAQ allows multiple stock market participants to trade through its electronic communications networks (ECNs) structure.

[71] The LSX is a stock exchange located in London, U.K. Founded in 1801; it is one of the largest stock exchanges in the world, with many overseas listings as well as British companies. It is arguably the oldest of the world's major stock exchanges. The LSX can trace its history back to 1698 when its founder - John Castaing - began to organize the market in Jonathan's Coffee-house via a simple list of stock and commodity prices. Today, this exchange lists 3,500 companies representing 84 countries.

[72] The Bombay Stock Exchange Limited (formerly, The Stock Exchange, Mumbai) is the oldest stock exchange in Asia and has the greatest number of listed companies in the world, with 4700 listed as of August 2007. It is located at Dalal Street, Mumbai, India. On 31 December 2007, the equity market capitalization of the companies listed on the BSE was US$ 1.79 trillion, making it the largest stock exchange in South Asia and the 12th largest in the world. With over 4700 Indian companies listed on the stock exchange, it has a significant trading volume. Though many other exchanges exist, BSE and the National Stock Exchange of India account for most of the trading in shares in India.

[73] The Toronto Stock Exchange is the largest stock exchange in Canada, the third largest in North America and the eighth largest in the world by market capitalization. Based in Canada's largest city, Toronto, it is owned and operated by TMX Group for the trading of senior equities. A broad range of businesses from Canada, the U.S., Europe, and other countries are represented on the exchange. In addition to conventional securities, the exchange lists various exchange-traded funds, split share corporations, income trusts and investment funds. The Toronto Stock Exchange is the leader in the mining and oil & gas sector; more mining and oil & gas companies are listed on the Toronto Stock Exchange than any other exchange in the world.

[74] The Hong Kong Stock Exchange is the stock exchange of Hong Kong. The exchange has predominantly been the main exchange for Hong Kong where shares of listed companies are traded. It is Asia's third largest stock exchange in terms of market capitalization, behind the Tokyo Stock Exchange and the Shanghai Stock Exchange. As of 31 December 2007, the Hong Kong Stock Exchange had 1,241 listed companies with a combined market capitalization of $2.7 trillion. Hong Kong Exchanges and Clearing is the holding company for the exchange.

[75] The Australian Securities Exchange is the primary stock exchange in Australia. The Australian Stock Exchange began as separate state-based exchanges established as early as 1861.

1.6 Historical Background of Stock Markets

Historian Fernand Braudel[76] suggests that in Cairo, in the 11th century, Muslim and Jewish merchants had already set up every form of trade association and had knowledge of many methods of credit and payment, disproving the belief that these were originally invented later by Italians[77]. If we look back upon the 12th-century of France, the *courratiers de change* (means: Exchange-Broker, French-English-Dictionary) was worried about handling and regulating the debts on the bank's behalf of the agricultural professions. As these men used to deal with debt they can also be called as Originators of brokerage-business in the History of Stock-Market[78]. As these men also traded with debts, they might be called as first-brokers.

A common misbelieve is that in late 13th-century, Bruges commodity traders gathered inside the house of a man called *Van-der-Beurze,* and in 1309 they became *Brugse-Beurse*, institutionalizing what had been, until then, an informal meeting, but actually, the family *Van-der-Beurze* had a building in Antwerp where those gatherings occurred[79]; the *Van-der-Beurze* had Antwerp, as most of the merchants of that period, as their primary place for trading. The idea quickly spread around Flanders and neighboring counties and Beurzen soon opened in Ghent and Amsterdam[80].

In the middle of the 13th century, Venetian bankers began to trade in Government securities. In 1351 the Venetian Government outlawed spreading rumors intended to lower the price of Government funds. Bankers in Pisa, Verona, Genoa and Florence also began trading in Government securities during the 14th century[81].

Today trading is all-electronic and the exchange is a public company, listed on the exchange itself. The Australian Securities Exchange as it is now known resulted from the merger of the Australian Stock Exchange and the Sydney Futures Exchange in December 2006, becoming the 9th largest stock exchange in the world

[76] Fernand Braudel (24 August 1902 - 27 November 1985) was a French historian and a leader of the Annales School. His scholarship focused on three main projects, each representing several decades of intense study: The Mediterranean (1923-49, then 1949-66), Civilization and Capitalism (1955-79), and the unfinished Identity of France (1970-85). His reputation stems in part from his writings, but even more from his success in making the Annales School the most important engine of historical research in France and much of the world after 1950. As the dominant leader of the Annales School of historiography in the 1950s and 1960s, he exerted enormous influence on historical writing in France and other countries. Braudel has been considered one of the greatest of the modern historians who have emphasized the role of large-scale socioeconomic factors in the making and writing of history

[77] What does Dow mean and how did the stock market start.?
http://answers.yahoo.com/question/index?qid=20080923074600AAwrTUB

[78] History of Stock Market:
http://www.economywatch.com/stock-markets-in-world/history.html

[79] http://www.bis.org/publ/qtrpdf/r_qa0812.pdf

[80] http://en.wikipedia.org/wiki/Stock_market#History

[81] http://www.dowjones.com/Products_Services/ElectronicPublishing/DJIndexes.htm

The world's first stock-exchange was established in Antwerp, Belgium in 1460 under the rule of Philip the Good[82]. The Antwerp exchange traded financial securities, primarily bonds83.

Later on, the Dutch, started joint-stock-companies, which let shareholders invest in business ventures and get a share of their profits-or losses. In 1602, the Dutch East India Company issued the first share on the Amsterdam Stock Exchange. It was the first company to issue stocks and bonds[84].

The Amsterdam-Stock-Exchange (Amsterdam-Beurs) is also said to have been the first stock exchange to introduce continuous trade in the early 17th century. It was the first to formally begin trading in securities. It was established in 1602 by the Company for dealings in its printed stocks and bonds[85]. The Dutch pioneered short selling, option trading, debt-equity swaps, merchant banking, unit trusts and other speculative instruments, much as we know them[86].

The LSX opened in 1773, and the Philadelphia Stock Exchange, the first in the New World, began trading in 1790. By the middle of the 19th century, with industry hungry for capital, almost every major city had its own bourse. The UK alone had 20 different stock exchanges[87]. This was necessary because most listed firms were unknown outside their home region and so preferred to list their shares locally, and most investors were individuals who preferred to buy the shares of firms that they knew.

Many of these exchanges disappeared as capital markets became national and then international. Now most countries (the U.S. being the main exception) have a single dominant stock exchange. It is increasingly common for companies to list their shares on Forex as well as domestically, giving them access to a wider array of investors[88].

There are nowadays stock markets in virtually every developed and most developing economy, with the world's biggest markets being in the U.S., U.K., Japan, India, China, Canada, Germany, France and the Netherlands[89].

1.7 Historical background of Stocks Markets Regulations

The Stock Markets are regulated in most of the countries in the world. Although the U.S. was not the first country to regulate securities markets, it did introduce a comprehensive

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[82] Philip the Good was Duke of Burgundy from 1419 until his death. He was a member of a cadet line of the Valois dynasty (the then Royal family of France). During his reign Burgundy reached the height of its prosperity and prestige and became a leading center of the arts. He is known in history for his administrative reform.

[83]Which is the world's first stock exchange? The biz quiz: http://www.rediff.com/money/2003/nov/04quiz.htm

[84] http://en.wikipedia.org/wiki/Stock_market#History

[85] History of Amsterdam Stock Exchange http://en.wikipedia.org/wiki/Amsterdam_Stock_Exchange

[86] Murray Sayle, Japan Goes Dutch, London Review of Books XXIII.7, April 5, 2001

[87] Publications; *Guide to the Financial Markets*, Chapter 7: Equity markets

[88] Ibid.

[89] Internet from 9/13/11 http://commerceplus.blogspot.com/2010/07/project-on-stock-exchange.html

framework of security regulation before other countries[90]. The Great Depression, in addition to initiating a large amount of banking-regulation, led to regulation of the securities market as well. This securities regulation had precedents in U.K. law and in U.S. state law.

In U.K., the Bubble Act of 1720 put prohibitions on the formation of joint-stock-companies. The Act was passed in the midst of the South Sea Bubble when the stock of the South-Sea-Company[91] rose by a factor of seven in the first half of 1720 and then collapsed back to somewhat above its initial level by the end of the year[92]. The South-Sea-Company hunted to stop other companies being formed and diverting capital away from the bubble, in their stock. The statute's narration referred to persons who endeavor such risky/mischievous undertakings or projects, under false-pretences of public good, and sketch in many unwary persons to subscribe therein towards raising great sums of money. The Act barred such sort of scheme and imposed penalties for those involved in the issue and trading of such shares.

The Parliament of the U.K. passed the Companies-Act-1844, by following a report by a Select-Committee on Joint-Stock-Companies. This brings in the principle of compulsory-disclosure by registering of the prospectuses inviting subscriptions to corporate shares. The Directors-Liability-Act-1890 and Companies-Act-1900 followed it. The first exposed directors and promoters to civil liability for untrue statements in the prospectus. The second required companies to provide a considerable amount of information in prospectus. These Acts established the principle of affirmative disclosure and went considerably beyond the prohibition of fraud[93].

In U.S., the 01st-state to pass a *blue-sky-law* was Kansas, in 1911, and the other states followed it. These laws were designed to protect investors through anti-fraud provisions, regulation of brokers, dealers and registration of securities. In addition to state *blue-sky-laws*, there were other instances of securities-regulation in U.S. prior to legislation triggered by Great-Depression. The Transportation-Act-1920 required railroad issues to be authorized by the Interstate Commerce Commission[94]. The Federal Water Power Act of 1920 allowed the Federal Power Commission to regulate securities issued by public service licensees.

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[90] Internet from 4/14/10, http://knowledge.wharton.upenn.edu/papers/1174.pdf

[91] South-Sea-Company was a British joint-stock-company that traded in South-America during the 18th-Century. Founded in 1711, the company was granted a monopoly to trade in Spain's South-American colonies as part of treaty during War of Spanish Succession. In-return, the company assumed the national debt England had incurred during war. Speculation in the company's stock led to a great economic bubble known as the South-Sea-Bubble in 1720, which caused financial ruin for many. In spite of this it was restructured and continued to operate for more than a century after the Bubble.

[92] *Banking Regulation versus Securities Market Regulation* By Franklin Allen Richard Herring page-19

[93] Internet from 4/14/10, http://knowledge.wharton.upenn.edu/papers/1174.pdf

[94] Ibid.

CHAPTER # 2

INTERNATIONAL LEGAL REGIMES FOR SECURITIES MARKET

In this chapter, we will discuss the international efforts for the regulation of securities market by international organizations and the umbrella under which national regulators of securities market co-ordinate and co-operate their activities.

2.1 Securities Markets Regulation at International Level

Securities-market relies on legal institutions. Law and regulation ensure that financial transactions are carried out within a clear, predictable and enforceable legal framework. Economists have long stressed the importance of institutions for the well functioning of market economies. Economists, of course, write about 'institutions', but what they primarily mean is law or regulation[95]. Therefore, the concept of securities regulation denote the set of rules, controls and processes, established by Government or state authorities, with the aim to shape or prohibit certain behavior, decision-making and transactions in securities markets and securities institutions[96]. This establishment of securities-regulation is extremely influenced by a huge number of inter-Governmental and international organizations/institutions and private-sector, which is actively, concerned in the area of International Securities Market Regulations. The increasingly international nature of securities-markets, regulatory-authorities are progressively more coordinating and cooperating at international-organizations level. Only, the European-Community has achieved a supranational legislative *Umbrella* for international market operations, and such an arrangement is highly unlikely to be duplicated by other regional groupings or extended into a multilateral setting for the foreseeable future. Formal cooperation among national regulators is slowly being advanced, however, through the IOSCO[97].

2.2 IOSCO

IOSCO is an international-organization of stock exchanges, SROs and the national securities regulators, from all over the globe. It is an international association of securities regulators that are formed in 1983. Its General secretariat is based in Madrid, Spain[98]. In September 1998, IOSCO adopted and published the Objectives and Principles of Securities Regulation[99].

IOSCO is an international organization that brings together the regulators of the world's securities and futures markets. It, along with its sister organizations, the Basel

[95]The Importance of Law for Financial Markets
http://www.cefims.ac.uk/documents/sample-83.pdf
[96]The concept of financial regulation
http://www.cefims.ac.uk/documents/sample-87.pdf
[97]Internet from 10/31/10
http://www.mof.go.jp/f-review/r32/r_32_151_186.pdf
[98] IOSCO ANNUAL REPORT 2009
http://www.iosco.org/annual_reports/annual_report_2009/generalInformation1.html
[99] These were modelled on the IOSCO Principles for the Oversight of Screen-Based Trading Systems of 1990

Committee on Banking Supervision and the International Association of Insurance Supervisors, together make up the Joint Forum of international financial regulators[100].

Currently, IOSCO is renowned as the international-standard-setter for stock markets. Its membership regulates more than 95 percent of the world's securities markets and it is the primary international cooperative forum for securities market regulatory agencies. IOSCO members are drawn from, and regulate, over 100 jurisdictions and its membership continues to grow[101].

It also provides technical-aid/assistance to its members, especially those who regulate the emerging securities-markets.

2.2.1 History of IOSCO

IOSCO was born in 1983 from the transformation of its ancestor inter-American regional association (created in 1974) into a truly international cooperative body. Eleven securities regulatory agencies from North and South America gathered in Quito, Ecuador in April 1983 to take that important decision[102].

In 1984, Securities-regulators from U.K., Korea, France and the Indonesia were the 1st agencies to connect with IOSCO from outside the Americas. The IOSCO Annual Conference which was held at Paris, in July 1986 was the 1st to occur outside of the continent of the America. The then, a decision was prepared to create a permanent General-Secretariat for IOSCO.

At present, this organization is recognized as the international-standard-setter for securities-markets. The Organization's wide membership regulates more than 95% of the world's securities markets and IOSCO is the world's most important international cooperative forum for securities regulatory agencies. IOSCO members regulate more than one hundred jurisdictions and the Organization's membership is steadily growing[103].

It adopted an inclusive set of Objectives and Principles of Securities Regulation (IOSCO-Principles) in 1998, which are nowadays, acknowledged as the international regulatory benchmarks for all the securities-markets. It also endorsed a complete methodology IOSCO Principles Assessment Methodology in 2003, which facilitates an objective-assessment of the level of implementation of the IOSCO-Principles and the progress of practical-action-plans to correct the identified deficiencies.

It also adopted a multilateral MOU (IOSCO-MOU) in 2002, which was planned to assist cross-border exchange of information and enforcement, amid the international-community of securities-regulators.

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[100] Wikipedia, the free encyclopedia: IOSCO
http://freerisk.org/wiki/index.php/IOSCO

[101] IOSCO Historical Background
http://www.iosco.org/about/index.cfm?section=background

[102] Internet from 8/27/11
http://www.knf.gov.pl/en/About_us/International_Cooperation/internationals/iosco.html

[103] ibid.

In 2005, it endorsed the IOSCO-MOU as the benchmark for international coordination and cooperation amid the securities regulators of its member countries and defines comprehensible strategic objectives to expand rapidly the network of IOSCO-MOU signatories by 2010. It approved as an unambiguous operational priority the effective implementation - in particular within its wide membership - of the IOSCO Principles and of the IOSCO MOU, which are considered as primary instruments to facilitate cross-border cooperation, reduce global systemic risk, protect investors and ensure fair and efficient securities markets[104].

It also adopted an inclusive consultation-policy planned to assist its uninterrupted communication with the international-financial-community.

2.2.2 Significant Recent Work

Recently, and especially after 11th of September, 2001, which underscored how interlinked global securities-markets are, and the sequence of large, worldwide financial scandals that happened with Enron[105]and followed to include Worldcom[106], Royal Dutch Shell[107], Parmalat[108] and others, IOSCO issued a series of significant

[104] Internet from 10/29/10
http://freerisk.org/wiki/index.php/IOSCO

[105]Enron was charged with securities fraud.
(Enron Corporation was an American energy company based in Houston, Texas. Enron employed around 21,000 people and was one of the world's leading electricity, natural gas, pulp and paper, and communications companies, with claimed revenues of $111 billion in 2000. Fortune named Enron *America's Most Innovative Company* for 6 consecutive years. It was formed in 1985 when Houston Natural Gas merged with Inter North. After several years of international and domestic expansion involving complicated deals and contracts, Enron was billions of dollars into debt. All of this debt was concealed from shareholders through partnerships with other companies, fraudulent accounting, and illegal loans.
http://www.scribd.com/doc/15797725/Enron-Case-Study
http://www2.econ.iastate.edu/classes/econ353/tesfatsion/enron.pdf

[106]The company began as Long Distance Discount Services, Inc. (LDDS) in 1983. The company's name was changed to LDDS WorldCom in 1995, and later just WorldCom. On July 21, 2002, WorldCom filed for Chapter 11 bankruptcy protection in the largest such filing in United States history at the time (since overtaken by the collapses of both Lehman Brothers and Washington Mutual in a span of eleven days in September 2008). The WorldCom bankruptcy proceedings were held before U.S. Federal Bankruptcy Judge Arthur J. Gonzalez who simultaneously heard the Enron bankruptcy proceedings which were the second largest bankruptcy case resulting from one of the largest corporate fraud scandals.

[107]The Royal Dutch Shell Group was created in February 1907 when the Royal Dutch Petroleum Company (legal name in Dutch, N.V. Koninklijke Nederlandsche Petroleum Maatschappij) and the Shell Transport and Trading Company Ltd of the United Kingdom merged their operations.
In November 2004, following a period of turmoil caused by the revelation that Shell had been overstating its oil reserves, it was announced that the Shell Group would move to a single capital structure, creating a new parent company to be named Royal Dutch Shell plc
In March 2010, Shell announced the sale of some of its assets, including its liquid petroleum gas (LPG) business, to meet the cost of a planned $28bn capital spending programme.

[108] Parmalat SpA is a multinational Italian dairy and food corporation. Having become the leading global company in the production of ultra high temperature (UHT) milk, the company collapsed in 2003 with a €14 billion ($20bn; £13bn) hole in its accounts in what remains Europe's biggest bankruptcy

principles and best practices that heralded its evolution from an international *talk-shop* (where little of substance was accomplished) to a serious international organization with a real impact on the securities regulation in its constituent members[109]. This recent work includes:

a. Regulatory principles designed to improve auditor independence and auditor oversight[110]

b. Regulatory principles for corporate financial disclosure and transparency[111]

c. Regulatory principles regarding conflicts of interest for financial analysts[112]

d. A Code of Conduct for credit rating agencies[113]

e. A set of Core Principles for securities regulation designed to outline for IOSCO members what makes up *good* securities regulation; and, perhaps most significantly[114]

f. A Multilateral MOU on enforcement cooperation, through which IOSCO members pledge to provide each other with collecting information and witness statements in an enforcement investigation[115].

2.2.2.1 MOU's between Regulators

For the purpose of cooperation in regulation, IOSCO has suggested that cooperative mechanisms should be put into place at the international level to facilitate the detection and deterrence of cross border misconduct and to assist in the discharge of licensing and supervisory responsibilities. Among these are MOU between regulators[116].

In order with this mechanism projected by IOSCO, the SECP has signed a MOU with the SEC of Sri Lanka for the purpose of establishing a framework for mutual

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109 Internet from 10/29/10 http://freerisk.org/wiki/index.php/IOSCO

110 http://www.iosco.org/library/pubdocs/pdf/IOSCOPD134.pdf

111 Principles for Ongoing Disclosure Material Development Reporting by Listed Entities http://www.iosco.org/library/pubdocs/pdf/IOSCOPD132.pdf

112 IOSCO statement of principles for addressing sell-side securities analyst conflicts of interest http://www.iosco.org/library/pubdocs/pdf/IOSCOPD150.pdf

113 CODE OF CONDUCT FUNDAMENTALS FOR CREDIT RATING AGENCIES http://www.iosco.org/library/pubdocs/pdf/IOSCOPD180.pdf

114 Objectives and Principles of Securities Regulation http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf

115 MULTILATERAL MOU CONCERNING CONSULTATION AND COOPERATION AND THE EXCHANGE OF INFORMATION http://www.iosco.org/library/pubdocs/pdf/IOSCOPD126.pdf

116 http://icai.org/announ/papers_presn_safa.html

assistance and facilitating the exchange of information in order to ensure compliance with their respective securities and futures laws and regulatory requirements[117].

Furthermore, all the three stock-exchanges of Pakistan have, jointly, signed MOU's with the Chittagong and Colombo stock-exchanges to launch a mechanism for information sharing and mutual-assistance.

2.2.3 IOSCO Assessments; Weaknesses of Regulatory Systems

Study of the IOSCO-assessments in seventy four countries provides an outstandingly reliable picture of the strengths and weaknesses of regulatory-systems across the world.

2.2.3.1 Main Areas of Concern

Four main areas of concern became known from the analysis:

a. Weaknesses in supervisory practices, including inspections

b. Weaknesses in enforcement

c. Poor valuation rules for investment funds, and

d. A lack of understanding and oversight of risk management and internal control practices in market participants[118].

These findings enhance understanding of financial sector regulation and challenges facing policy makers in improving conditions in local markets. The findings will be immediately useful as guidance to financial sector surveillance work being undertaken by the IMF, WB and others, pointing in direction of areas that require particular scrutiny[119].

Adding up, the findings can be used as a tool to prioritize technical-assistance that the IMF offers to members and as positive contribution to other technical-assistance-providers and IOSCO in planning work programs. In the development of its technical-assistance program, IMF ought to focus on the practice areas of inspection and enforcement, valuation of portfolios in investment funds and the technical areas of risk-management. The findings are potentially valuable to understanding the source of vulnerabilities in the financial sector and providing countries with policy advice in addressing these vulnerabilities, although much work remains to be done in connecting the weaknesses in securities markets regulation to crisis or potential crisis events[120].

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[117] .Ibid.

[118] Strengths and Weaknesses in Securities Market Regulation: A Global Analysis Ana Carvajal and Jennifer Elliott.
www.imf.org/external/pubs/ft/wp/2007/wp07259.pdf

[119] Ibid.

[120] Ibid.

2.3 Objectives and principles of Securities Regulation

Here we will talk about the objectives of securities-regulation and than set of Core Principles for securities-regulation designed to draft for the members of IOSCO what makes up good securities-regulation and perhaps the most significantly.

2.3.1 Objectives of Securities Regulation

The three core objectives of securities regulation are

1. The protection of investors
2. Ensuring that markets are fair, efficient and transparent
3. The reduction of systemic risk[121]

2.3.1.1 The Protection of Investors

The Investors ought to be protected from manipulative, misleading or fraudulent-practices, including the misuse of client assets, front running or trading ahead of customers and insider trading. Full disclosure of information fabric to investors' decisions is the most important means for ensuring the protection of the investor. Investors are, thereby, better able to assess the potential risks and rewards of their investments and, thus, to protect their own interests. As key components of disclosure requirements, accounting and auditing standards should be in place and they should be of a high and internationally acceptable quality[122]. Only the authorized persons or the duly licensed should be allowable to hold themselves out to the public as providing investment services, for example, the operators of exchanges or as market intermediaries. Initial and ongoing capital requirements imposed upon those license holders and authorized persons should be designed to achieve an environment in which a securities firm can meet the current demands of its counter parties and, if necessary, wind down its business without loss to its customers[123].

By setting minimum standards for market participants, supervision of market intermediaries should achieve the protection of the investor. Investors should be treated in a just and equitable manner by market intermediaries according to standards which should be set out in rules of business conduct. There should be a comprehensive system of inspection, surveillance and compliance programs[124].

The Investors in securities-markets are mostly vulnerable to misdemeanors by intermediaries and others; however the ability of individual investor to take action

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[121] Internet from 10/17/10 http://www.fsround.org/publications/pdfs/ComplianceFunctioninDiversifiedFinancialInstitutions.pdf

[122] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf

[123] The Protection of Investors: Objectives of Securities Regulation, page-5 http://www.sc.com.my/eng/html/iaffairs/ioscoreport/ObjectivesPrinciples.pdf

[124] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf

may be limited. Moreover, strong enforcement of securities laws is required for the complex character of securities transactions and of fraudulent schemes. Where a breach of law does occur, investors should be protected through the strong enforcement of the law. Investors should have access to a neutral mechanism (such as courts or other mechanisms of dispute resolution) or means of redress and compensation for improper behavior[125]. Effective enforcement and supervision depend upon close cooperation between regulators at the international and the domestic levels.

2.3.1.2 Ensuring That Markets are Fair, Efficient and Transparent

The fairness of the stock markets is directly proportional to the protection of the investor and, especially, to the deterrence of offensive trading practices. The stock-market structures should not disproportionately favor for some market users over others. Regulation should detect, deter and penalize the market-manipulation and other unfair-trading practices. Regulation should aim to ensure that investors are given fair access to market facilities and market or price information. Regulation should promote market practices that ensure fair treatment of orders and a price formation process that is reliable. In an efficient-market, dissemination of relevant information is timely and widespread[126]. Regulation should also advance the market efficiency.

Trading Information, both pre-trade and post-trade, are made publicly accessible on a real-time basis, may lead to transparency in the market. Pre-trade information concerns the posting of firm bids and offers as a means to enable investors to know, with some degree of certainty, whether and at what prices they can deal. Post-trade information is related to the prices and the volume of all individual transactions actually concluded[127]. Regulation should also guarantee the maximum level of transparency.

2.3.1.3 The Reduction of Systemic Risk

Even though the regulators cannot be expected to prevent the financial-failure of market-intermediaries, regulation should aim to reduce the risk of failure. Where financial failure nonetheless does occur; regulation should seek to reduce the impact of that failure, and, in particular, attempt to isolate the risk to the failing institution. Market intermediaries should, therefore, be subject to adequate and ongoing capital and other prudential requirements[128]. If essential, an intermediary is supposed to be able to unwind its business with no loss to its counterparties/customers or systemic damage. Risk-taking is essential to an active market and regulation must not unreasonably stifle legitimate risk taking. To a certain extent, regulators ought to

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[125] Objectives and Principles of Securities Regulation
http://riskinstitute.ch/144460.htm

[126] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf

[127] Ibid

[128] Principles for Market Intermediaries; Foreword and Executive Summary of Objectives and Principles of Securities Regulation
http://riskinstitute.ch/145100.htm

encourage and permit for the effective-management of risk and make sure that capital and other prudential requirements are adequate to address appropriate risk taking. An efficient and accurate clearing and settlement process that is properly supervised and utilizes effective risk management tools is essential. There must be effective and legally secure arrangements for default handling. This is a matter that extends beyond securities law to the insolvency provisions of a jurisdiction[129].

Instability and insecurity may be the outcome from events in another jurisdiction, or take place across several jurisdictions; therefore the responses of the regulators, to market disruption should seek to facilitate stability domestically and globally through information sharing and cooperation.

2.3.1.4 IOSCO's Other Objective

IOSCO's further objectives are to support its members, to:

1. Cooperate together to promote high standards of regulation in order to maintain just, efficient and sound markets;

2. Exchange information on their respective experiences in order to promote the development of domestic markets;

3. Unite their efforts to establish standards and an effective surveillance of international securities transactions[130];

4. Provide mutual assistance to promote the integrity of the markets by a rigorous application of the standards and by effective enforcement against offenses[131].

IOSCO emphasized also, the necessitate for international and integrated regulators who are in a position to judge the nature of cross-border behavior in order to make sure the existence of efficient, transparent and fair markets. Domestic securities markets are being increasingly integrated into a global market. Emerging securities markets, which have seen much growth in recent years, are likely to be absorbed in the process of globalization. The increasing importance of cross-border operations in today's capital markets cannot, therefore, be overlooked[132].

2.3.2 Principles of Securities Regulation

There are 38 IOSCO-Principles to achieve the objectives of IOSCO,[133], which are categorized under nine headings. These principles are relating to:

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[129] Internet from 5/5/10
http://www.iosco.org/library/pubdocs/pdf/IOSCOPD82.pdf

[130] http://www.iosco.org/annual_reports/annual_report_2009/generalInformation1.html

[131] Wikipedia, the free encyclopedia: IOSCO

[132] *Integration Of Capital Markets In SAARC Region – Current Issues And Perspective,* By Dr. Tariq Hassan

[133] Objectives and Principles of Securities Regulation
http://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf

1. Regulator
2. Enforcement of Securities-Regulation
3. Cooperation in Regulation
4. Self-Regulation
5. Issuers
6. Auditors, Credit Rating Agencies, and other information providers
7. CISs
8. Market Intermediaries
9. Secondary Market

2.3.2.1 *Principles Relating to the Regulator*

The Regulator should;

1. Have responsibilities, clear and objectively.
2. Operationally accountable and independent in exercise of its powers and functions.
3. Have enough powers, appropriate resources and the ability to perform its functions and exercise its powers.
4. Adopt clear and consistent regulatory processes.
5. Observe the maximum professional-standards, with appropriate standards of confidentiality, by its staff.
6. Contribute to a process to mitigate, manage and monitor systemic-risk, appropriate to its mandate.
7. Contribute to a process to review the perimeter of regulation regularly.
8. Seek to make sure that clash of interest and misalignment of incentives are disclosed, eliminated, avoided or otherwise managed.

2.3.2.2 *Principles for Self-Regulation*

9. Where the regulatory system makes use of SROs that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe

standards of fairness and confidentiality when exercising powers and delegated responsibilities[134].

2.3.2.3 Principles for the Enforcement of Securities Regulation

10. The Regulator should have comprehensive inspection, investigation and surveillance powers.

11. The Regulator should have comprehensive enforcement powers.

12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.

2.3.2.4 Principles for Cooperation in Regulation

13. The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.

14. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts[135]

15. The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their powers.

2.3.2.5 Principles for Issuers

16. There should be full, accurate and timely disclosure of financial results, risk and other information which is material to investors' decisions.

17. Holders of securities in a company should be treated in a fair and equitable manner.

18. Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality[136]

2.3.2.6 Principles for Auditors, Credit Ratings Agencies, and other information service providers

19. Auditors ought to be subject to adequate level of oversight.

[134] Internet from 9/10/11 http://www.financialmarketsjournal.co.za/13thedition/printedarticles/iosco.htm

[135] http://www.iosco.org/pubdocs/pdf/IOSCOPD154.pdf

[136] Internet from 3/16/11 http://www.proshareng.com/download.php?item=reports/IOSCO%20principles%20-%20June%202010.pdf

20. Audit standards should be of a high and internationally acceptable quality.

21. Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.

22. Auditors should be independent of the issuing entity that they audit.

23. Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or degree to which the regulatory system relies on them[137].

2.3.2.7 Principles for CISs

24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a CIS.

25. The regulatory system should provide for rules governing the legal form and structure of CISs and the segregation and protection of client assets[138].

26. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a CIS for a particular investor and the value of the investor's interest in the scheme.

27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a CIS.

28. Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight

2.3.2.8 Principles for Market-Intermediaries

29. Regulation should provide for minimum entry standards for market intermediaries.

30. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake[139]

31. Market-intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational

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[137] Strengths and Weaknesses in Securities Market Regulation: A Global Analysis Ana Carvajal and Jennifer Elliott.
www.imf.org/external/pubs/ft/wp/2007/wp07259.pdf

[138] Ibid

[139] Internet from 9/10/11
http://www.financialmarketsjournal.co.za/13thedition/printedarticles/iosco.htm

conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of intermediary accepts primary responsibility for these matters[140]

32. There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk[141]

2.3.2.9 Principles for Secondary-Markets

33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight

34. Regulation should promote transparency of trading

35. Regulation should be designed to detect and deter manipulation and other unfair trading practices[142]

36. There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants

37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.

38. Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic-risk

2.3.3 Applicability of These Principles

The above mentioned IOSCO principles are relevant to rule-making supervisory-authorities, and to self-regulatory bodies, where nationally applicable. They relate to the enforcement of rules (by supervisors), cooperation and the exchange of information between supervisory authorities, the obligations of securities issuers, fund business, the requirements for market participants and intermediaries, and the licensing and monitoring of exchanges and other trading systems[143]. These principles and objectives stipulate, for example, that rule making supervisory authorities should be independent of external political and economic influences and should be individually accountable and they should also be given extensive powers of investigation and supervision.

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[140] Ibid
[141] Ibid
[142] Internet from 3/16/11
http://www.prosharenq.com/download.php?item=reports/IOSCO%20principles%20-%20June%202010.pdf
[143] Internet from 8/31/10
www.bundesbank.de/download/volkswirtschaft/mba/2006/200601mba_en_securities.pdf

2.3.4 Implementation and Assessment Methodology

2.3.4.1 Implementation of IOSCO Objectives and Principles

The members of IOSCO express their loyalty and commitment to the objectives and principles it sets out, through their endorsement. Insofar as it is within their authority, they intend to use their best endeavors within their jurisdiction to ensure adherence to those principles. To the extent that current legislation, policy or regulatory arrangements may impede adherence to these principles, they intend that changes should be sought[144].

Legislation and regulatory structures vary between jurisdictions and reflect local market conditions and historical development. The particular manner in which a jurisdiction implements the objectives and principles described in this document must have regard to the entire domestic context, including the relevant legal and commercial framework[145].

Depending upon the matter in question and the arrangements within a particular jurisdiction, implementation may require any or all of: a change in legislation or regulation; a change in policy or practice by the regulatory authority; or a bilateral or multilateral agreement[146].

The regulator is supposed to regularly review the particular way in which securities-regulation is carried out in its market. This document is not exhaustive in its treatment of all areas of market activity, the markets themselves are in a constant state of development and the content of regulation must also change if it is to facilitate and properly regulate those changing markets[147]. The means to give effect to the principles illustrated in this document ought to, thus, be expected to change over time.

2.3.4.2 IOSCO Principles Assessment Methodology

The IOSCO-principles did not have any assessment-methodology for their implementation, initially. For the reason, IOSCO accepted the assessment methodology for the Implementation of IOSCO Objectives-and-Principles of Securities-Regulation, in 2003, which are called as IOSCO Principles Assessments Methodology. These facilitate an objective assessment of the level of IOSCO Principles' implementation in the jurisdictions of its members.

The Assessment methodology presents a wide-ranging framework for implementation-analyzes of the IOSCO-Principles and the improvement of practical action-plans to accurate identified deficiencies. It has shaped the origin of an IOSCO-directed, widespread and complete self-assessment exercise.

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144 *See* IOSCO Resolution No. 41: *Resolution on IOSCO Adoption of the Objectives and Principles of Securities Regulation* (P.C.), September 1998:

145 Ibid

146 http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf

147 *See* IOSCO Public Document No. 83, *Securities Activity on the Internet*, IOSCO Technical Committee, September 1998 and IOSCO Public Document No. 120, *Securities Activity on the Internet II*, IOSCO Technical Committee, June 2001

CHAPTER 3

REGULATION OF THE SECURITIES MARKET IN THE U.S., U.K. AND INDIA

(DEVELOPED AND DEVELOPING COUNTRY'S PERSPECTIVE)

The Securities-markets are regulated across the globe. Even though the U.S. was not the first one to regulate its securities-markets, but it introduced an inclusive framework for the regulation of securities earlier than other countries. At present the majority of the countries adopt their securities regulation from U.S. model for example India and Pakistan. For the reason, we will mainly focus on the U.S. system of securities market regulation and will also study a brief introduction and comparison with British and Indian regulatory system, in this chapter.

PART-(A);

U.S. SYSTEM OF SECURITIES REGULATION

3.1 Securities regulation in U.S.; an Introduction

U.S. securities markets' regulation, by tradition, stresses the principle of self-regulation. However, since 1930s, following the banking and stock-exchange crisis, Government has also issued distinct framework regulations. The leitmotif of securities-regulation in the U.S. is to ensure that an investor has all the information about the issuing company and the markets that he needs to make an independent investment decision. Another feature that is distinctive of U.S. is large number of agencies involved in the regulation and supervision of the securities markets. Exchanges in the U.S. –against the background of the framework rules laid down by the SEC and the Commodity Futures Trading Commission– are SROs which are responsible for laying down the specific rules and regulations under which exchanges and market players operate. They are also responsible for the proper conduct of securities trading and for sanctioning violations of the stock exchange rules and regulations. Along with the registered exchanges as SROs, the NASD also plays a key role[148]. The NASD oversees the NASDAQ electronic-exchange, - until 2000, it was closely linked to which-, and the OTC markets as well as the person's active in the industry relating to securities, as a self-administrative body. It monitors brokers and dealers and also describes standard trading practices.

The task of the SEC, which is a federal supervisory agency with a mandate from the US Congress, is to constantly monitor the functioning of this self-supervision and, if necessary, to intervene in stock-exchange activities for regulatory purposes. The SROs are responsible for fleshing out the details of what constitutes permissible

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[148] Regulation in the USA: Page # 44: Securities market regulation: international approaches DEUTSCHE BUNDESBANK Monthly Report January 2006
http://www.bundesbank.de/download/volkswirtschaft/mba/2006/200601mba_en_securities.pdf

trading practices. Although the SEC has thereby delegated part of its control and steering functions, it still reserves the right to supplement or amend existing trading rules. If an SRO wants to amend any rules, these amendments have to be submitted to the SEC for approval. New securities have to be registered with the SEC prior to issue and the SEC checks for compliance with the formal rules regarding the information to be disclosed. Securities traders (brokers and dealers) are also required to register with the SEC before they are permitted to conduct securities transactions[149]. As a Congressional commission, the SEC is also required to report to Congress on a regular basis and to apply for a renewal of its mandate.

Additionally, each US state has its own securities supervisory authority, which regulates intra-state securities trading and has its own regulatory and sanctioning powers.

However, the provisions of an individual state apply only to securities trading within that state, not to trading between states. The financial and commodity futures markets and exchanges are regulated and supervised by the Commodity Futures Trading Commission, which is a federal commission comparable to the SEC; the SRO approach is pursued here as well[150].

3.2 Brief History

In U.S., until great depression, there was very little regulation of the securities by the F.G. The lack of federal securities regulation in the U.S. is thought to have led directly to the Wall Street Crash of 1929. The body of law concerning the trading of securities in the U.S. has been developing steadily since the Great Depression. Congress passed the Securities Act of 1933 and the SEA of 1934 to remedy perceived systemic problems that were thought to have led to the Great Depression. Four more major pieces of securities legislation were passed by 1940, after which point little major new securities regulation occurred for several decades. In the late 1980s major legislation was introduced to fight insider trading, and in 2002 new legislation was passed to require greater accountability for public corporations[151]. Throughout this period, however, federal regulators have been busy enhancing the board strokes of legislation with extensive regulation designed to fill in the details.

3.3 The Laws That Govern the U.S. Securities Industry

In U.S. the framework of securities-legislation consists of number of related but separate statutes that are administered by the SEC. These are;

1. The Securities Act of 1933
2. The SEA of 1934

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[149] Ibid

[150] Ibid

[151] History: Stock Exchange Regulations *By* David Carnes, *eHow Contributor* http://www.ehow.com/about_5150414_stock-exchange-regulations.html

3. The Public Utility Holding Act of 1935
4. Trust Indenture Act of 1939
5. The Investment Company Act of 1940
6. The Investment Advisers Act of 1940
7. The Securities Investor Protection Act of 1970
8. Insider Trading Laws
9. The Insider Trading Sanctions Act of 1984
10. The Insider Trading and Securities Fraud Enforcement Act of 1988
11. National Securities Markets Improvement Act of 1996
12. Securities Litigation Uniform Standards Act of 1998
13. Sarbanes-Oxley Act of 2002
14. Blue Sky Laws[152]
15. Rules and Regulations

3.3.1 Securities Act of 1933

The Securities Act of 1933[153] was concerned with the distributions of securities. It specified what information companies must provide when issuing securities in the public markets. It requires prospectuses with a significant amount of affirmative disclosure.

3.3.1.1 Two basic objectives

The Securities Act of 1933 has two basic objectives:

1. Require that investors receive financial and other significant information concerning securities being offered for public sale ; and
2. Prohibit deceit, misrepresentations, and other fraud in the sale of securities.

3.3.1.2 Purpose of Registration

A primary means of accomplishing these goals is the disclosure of important financial information through the registration of securities. This information enables investors,

[152]Internet from 9/3/10
http://www.mentorcle.com/courses/written/WrittenMaterials-Course1045.doc
[153] The full text of this Act is available at:
http://www.sec.gov/about/laws/sa33.pdf

not the Government, to make informed judgments about whether to purchase a company's securities. While the SEC requires that the information provided be accurate, it does not guarantee it. Investors who purchase securities and suffer losses have important recovery rights if they can prove that there was incomplete or inaccurate disclosure of important information[154].

3.3.2 Securities Exchange Act (SEA) of 1934[155]

With this Act, Congress created the SEC. The Act empowers the SEC with broad authority over all aspects of the securities industry. This includes the power to register, regulate, and oversee brokerage firms, transfer agents, and clearing agencies as well as the nation's SROs[156]. The various stock exchanges, such as the NYSE, and American Stock Exchange are SROs. The NASD, which operates the NASDAQ system, is also an SRO.

The 1934 Act permits the SEC to promulgate rules and regulations to protect the public and investors by prohibiting manipulative or deceptive devices or contrivances.

3.3.2.1 Focus of Regulation

The Act:

a. Identifies and prohibits certain types of conduct in the markets

b. Provides the Commission with disciplinary powers over regulated entities and persons associated with them, and also

c. Empowers the SEC to require periodic reporting of information by companies with publicly traded securities[157].

The SEA 1934 was concerned with the publicly traded stocks after they were issued and it has been amended on numerous occasions.

3.3.2.2 Main Regulations are concerned with;

The main regulations are concerned with the following.

a. Publicly traded firms are required to file accounting returns periodically.

b. Directors, officers and holders of ten percent or more of the shares are also required to provide information on a regular basis.

c. Solicitation of proxies is controlled.

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[154] http://www.sec.gov/about/laws.shtml#secact1933

[155] The full text of this Act can be read at: http://www.sec.gov/about/laws/sea34.pdf

[156] Securities Lawyer's Deskbook published by The University of Cincinnati College of Law; http://www.law.uc.edu/CCL/34Act

[157] What provisions are provided under the Securities Exchange Act of 1934 Available at; http://www.statelawyers.com/Practice/Practice_Detail.cfm/PracticeTypeID:85

d. Regulation of tender offers was added in 1968.

e. Oversight of the stock exchanges and over the counter markets. Self-regulation is encouraged through SROs such as the NYSE, the NASD, registered clearing agencies and the Municipal Securities Rulemaking Board.

f. Prevention of market manipulation

g. Prevention of insider trading

h. Control of credit to purchase securities by the Federal Reserve System

i. Regulation of clearance and settlement processes

j. Regulation of markets in municipal securities[158]

3.3.2.3 Registration of Exchanges, Associations, and Others

The Act requires a variety of market participants to register with the Commission, including exchanges, brokers and dealers, transfer agents, and clearing agencies. Registration for these organizations involves filing disclosure documents that are updated on a regular basis.

The exchanges and the NASD are identified as SROs. SROs must create rules that allow for disciplining members for improper conduct and for establishing measures to ensure market integrity and investor protection[159]. SRO proposed rules are published for comment before final SEC review and approval.

3.3.3 The Public Utility Holding Act of 1935

The Public Utility Holding Company Act of 1935 authorized SEC to study investment trusts. The thrust of this study, which led to the passage of the Investment Company Act of 1940 and the Investment Advisers Act, was to provide a closer look at investment trusts and investment companies[160].

3.3.4 Trust Indenture Act of 1939[161]

The Trust Indenture Act of 1939 supplemented the Securities Act of 1933 for situations where debt is being issued. It required the filing of an indenture with the SEC. This Act applies to debt securities such as bonds, debentures, and notes that are offered for public sale. Even though such securities may be registered under the

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[158] *Banking Regulation versus Securities Market Regulation*
By Franklin Allen Richard Herring page-21

[159] The Laws That Govern the Securities Industry; U.S. SEC
http://www.sec.gov/about/laws.shtml

[160] Reference for Business; Encyclopedia of Business, 2nd ed.; Int-Jun ; Investment Advisers Act of 1940
http://www.referenceforbusiness.com/encyclopedia/Int-Jun/Investment-Advisers-Act-of-1940.html

[161] The full text of this Act is available at: http://www.sec.gov/about/laws/tia39.pdf.

Securities Act, they may not be offered for sale to the public unless a formal agreement between the issuer of bonds and the bondholder, known as the trust indenture, conforms to the standards of this Act[162].

The indenture provides information on the obligations of the trustee in the event of default and various other situations.

3.3.5 Investment Company Act of 1940[163]

This Act regulates the organization of companies, including mutual funds, that engage primarily in investing, reinvesting, and trading in securities, and whose own securities are offered to the investing public.

Investment Company Act of 1940, which was subsequently amended both in 1970 and 1980, was designed to prevent some of these abuses[164].

3.3.5.1 Focus of regulation;

The regulation is designed to

a. Minimize conflicts of interest that arise in these complex operations.

b. Disclose companies financial condition and investment policies to investors when stock is initially sold and, subsequently, on a regular basis.

c. Disclose the investing public of information about the fund and its investment objectives, as well as on investment company structure and operations.

The Regulatory provisions were also designed to ensure the;

a. Honest management

b. Participation in management by security holders

c. Adequate and feasible capital structures

d. Effective financial disclosure

e. Prevention of selling abuses

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[162] Banking Regulation versus Securities Market Regulation by Franklin Allen and Richard Herring; Wharton School, University of Pennsylvania; July 11, 2001
http://escal.free.fr/docs/finance/bankingregulation.pdf

[163] The full text of this Act is available at:
http://www.sec.gov/about/laws/ica40.pdf

[164] *Banking Regulation versus Securities Market Regulation* by Franklin Allen and Richard Herring; Wharton School, University of Pennsylvania July 11, 2001
available at: http://escal.free.fr/docs/finance/bankingregulation.pdf

3.3.11 Sarbanes-Oxley Act of 2002[177]

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002, which he characterized as the most far reaching reforms of American business practices since the time of Franklin Delano Roosevelt. The Act mandated a number of reforms to enhance corporate responsibility, enhance financial disclosures and combat corporate and accounting fraud, and created the Public Company Accounting Oversight Board, also known as the PCAOB, to oversee the activities of the auditing profession[178].

3.3.12 Blue Sky Laws

In addition to the federal laws, there are also state laws that govern securities. These laws are commonly known as Blue Sky Laws, which typically give the investor who loses money or is defrauded in the securities markets far greater protections than are available under the federal laws[179]. It varies from state to state. Each state has a regulatory agency which administers the respective laws with regard to the registration of securities offerings and the registration of brokerage firms and individual brokers. Before a security is allowed to be bought or sold in any given state, there must be a registration (or an exemption from registration requirements) in place to cover that transaction. Furthermore, the brokerage firm and the individual representative must be either registered in the state, or exempt from the registration requirements.

Typical provisions of the state securities *Blue Sky Laws* include prohibition against fraud in the sale of securities, registration requirements for brokers and dealers, registration requirements for securities to be sold within the state, and sanctions and civil liability[180].

Majority of states (exception New-York and California) have adopted the uniform securities Act, at least in part.

[177] The full text of the Act is available at:
http://uscode.house.gov/download/pls/15C98.txt.
It can also be find links to all Commission rulemaking and reports issued under the Sarbanes-Oxley Act at:
http://www.sec.gov/spotlight/sarbanes-oxley.htm

[178] Internet from 12/17/05
http://ftp.sec.gov/about/whatwedo.shtml

[179] Practice Definitions - Securities Law
http://www.statelawyers.com/Practice/Practice_Detail.cfm/PracticeTypeID:85

[180] What provisions are provided under the state securities laws?
http://www.statelawyers.com/Practice/Practice_Detail.cfm/PracticeTypeID:85

3.4 Main Parties Involved in the Regulation of U.S. Securities-Market

There are three main parties who are involved in the regulation of U.S. securities market

1. The SEC – (Market Regulator And Overseer Of SRO's)
2. SRO's – (Self-Regulators Overseen By SEC)
3. The Executive Branch And The Legislature

3.4.1 The SEC - market regulator and overseer of SROs

The SEC was established by the SEA, which was adopted in 1934 in response to the Great Depression and numerous cases of securities fraud. It is vested with the primary responsibility for the regulation of traded securities.

3.4.1.1 SEC as Major Regulator

The U.S. securities market is regulated by the SEC, which are the primary overseer and regulator of the U.S. securities market[181]. Its mission is to protect investors and maintain the integrity of the securities market.

3.4.1.2 Organizational structure

The SEC is comprised of five presidentially-appointed Commissioners, four Divisions and 18 Offices. It is based in Washington, DC and has 11 regional and district offices throughout the country.

The five Commissioners are appointed by the President with the advice and consent of the Senate[182]. Their terms last five years and are staggered with one Commissioner's term ending on 5 June each year. To ensure that the Commission remains non-partisan, no more than three Commissioners may belong to the same political party. The President designates one of the Commissioners as Chairman, who is the Commission's top executive.

The Commissioners meet to discuss and resolve a variety of issues brought to their attention by staff of the Commission. At these meetings the Commissioners;

a. Interpret federal securities laws;

b. Amend existing rules;

[181] THE SEC; THE STOCK ADVISOR http://www.thestockadvisor.com/sec.htm

[182] Organizational structure; U.S. SEC http://en.wikipedia.org/wiki/U.S._Securities_and_Exchange_Commission#Chairs_and_commissioners

c. Propose new rules to address changing market conditions; and

d. Enforce rules and laws[183].

3.4.1.3 Divisions of SEC

The SEC's five main divisions are:

1. Corporation Finance,
2. Trading and Markets,
3. Investment Management,
4. Enforcement, and
5. Risk, Strategy, and Financial Innovation

Corporation Finance; Corporation Finance is the division that oversees the disclosure made by public companies as well as the registration of transactions, such as mergers, made by companies[184].

The Trading and Markets division; The Trading and Markets division oversees SROs such as the Financial Industry Regulatory Authority and the Municipal Securities Rulemaking Board, and all broker-dealer firms and investment houses. This division also interprets proposed changes to regulations and monitors operations of the industry.

Major activities:

Its major activities include –

a. Carrying out the Commission's financial integrity program for stockbrokers;
b. Reviewing and approving proposed new rules and proposed changes to existing rules filed by SROs;
c. Establishing rules and issuing interpretations on matters affecting the operation of the securities market[185]; and

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[183] There is a statutory framework, including the Securities Act of 1933, which provides for the SEC's oversight of the securities market. As the statutory regulator, the SEC engages in rule-making to maintain fair and orderly market and to protect investors by altering regulations or creating new ones.

[184] Internet from 11/18/09
http://en.wikipedia.org/wiki/United_States_Securities_and_Exchange_Commission

[185] Internet from 10/9/11
http://www.info.gov.hk/info/expert/annex3e.pdf

d. Monitoring market activities.

The Investment Management Division; The Investment Management Division oversees investment companies including mutual funds and investment advisors. This division administers federal securities laws, in particular the Investment Company Act of 1940 and Investment Advisers Act of 1940. It also exercises oversight of registered or exempt utility holding companies under the Public Utilities Holding Company Act of 1935[186].

The Enforcement Division; The Enforcement Division works with the other three divisions, and other Commission offices, to investigate violations of the securities laws and regulations and to bring actions against alleged violators The SEC generally conducts investigations in private. While the SEC has civil enforcement authority only, the Division works closely with various criminal law enforcement agencies to develop and bring criminal charges when the misconduct warrants more severe action[187].

3.4.2 SROs - Self-regulators overseen by SEC

SRO is a member organization that creates and enforces rules for its members based on the federal securities laws. SROs are registered and overseen by the SEC and are the front line regulator of broker-dealers. The exchanges and the NASD are SROs. SROs must create rules that allow for disciplining members for improper conduct and for establishing measures to ensure market integrity and investor protection. SROs' proposed rules or changes to existing rules are published for public comment before final SEC review and approval.

The SEC may also amend the rules of SROs as it deems necessary or appropriate[188]. A rule so adopted should include a statement of the reason for or purpose in so amending the rule.

3.4.2.1 The New York Stock Exchange (NYSE):

NYSE is the largest exchange in U.S. It is responsible for the supervision of member firms to enforce compliance with financial and operation requirements, periodic checks on broker's sales practices and continuous monitoring of specialist operations. Every transaction made at the NYSE is under continuous surveillance during the trading day.

The NYSE has its origin in a founding agreement in 1792. It registered as a national securities exchange with the SEC in 1934. In 1971, it was incorporated as a not-for-profit corporation. In 1972, its board members voted to replace the Board of

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[186] Internet from 11/18/09
http://www.answers.com/topic/securities-and-exchange-commission
[187] West's Encyclopedia of American Law: SEC
http://www.answers.com/topic/securities-and-exchange-commission
[188] SRO;REGULATION OF THE SECURITIES MARKET IN THE UNITED STATES
http://www.info.gov.hk/info/expert/annex3e.pdf

Governors with a 25 member BODs, comprising a Chairman and CEO, 12 representatives of the public and 12 representatives from the securities industry.

Its mission is to add value to the capital-raising and asset management processes by providing the highest-quality and most cost effective self-regulated marketplace for the trading of financial instruments, promote confidence and understanding in the processes[189]. It also serves as a forum for discussion of relevant national and international policy issues.

3.4.2.2 NASD, Incorporated:

The NASD, Incorporated is a non-profit organization of which virtually all securities firms doing business with the public are members. Its membership includes 5,300 brokerage firms, with over 92,000 branch offices and more than 664,000 registered securities representatives. It provides education to industry professionals and investors. It operates the largest securities dispute resolution forum with arbitration and mediation programs in the world, and also monitors all trading on the NASDAQ Stock Market and other selected markets worldwide. Until recently, NASD was known as the owner of NASDAQ. In 2000, it decided to sell NASDAQ in order to concentrate solely on its core mission *Ensuring market integrity and investor confidence*[190].

3.4.3 The Executive Branch and the Legislature

The executive branch is not involved in the day to day regulation of the securities-market, or the establishment of rules governing the operation of the securities market and SROs, including the exchanges. The regulatory function is performed by the SEC which is an independent statutory body set up by statute.

Neither the executive branch nor the legislature has any power of direction over the SEC. The checks and balances under constitutional and administrative law doctrines are ensured through the power to appoint the Commissioners and to require the SEC to make reports and give evidence to the legislature. The SEC will consult the Secretary of the Treasury if the proposed changes to rules filed with the SEC by registered securities associations primarily concern conduct relating to transactions in Government securities. There is no statutory requirement for the SEC to consult the Secretary of the Treasury on other changes to the rules proposed by the SROs[191].

3.5 Listing and Delisting Requirements

Before securities may be admitted to trading on an exchange, they must be authorized for listing by the exchange and, in addition, must be registered under the SEA of 1934.

[189] Internet from 10/9/11
http://www.info.gov.hk/info/expert/annex3e.pdf
[190] ibid
[191] The Executive Branch and the Legislature; Regulation Of The Securities Market In The United States
http://www.info.gov.hk/info/expert/annex3e.pdf

3.5.1 Who Set the Listing Standards?

The exchanges set their own standards for listing and continuing to trade, such as rules governing corporate governance standards, board meetings, audit and other committees, concentration of voting power, voting rights, etc. The SEC does not set listing standards[192]. Listing, or delisting, is an arrangement between the exchanges and the applicants/listed companies. The initial listing requirements mandate that a company meets specified minimum thresholds for the number of publicly traded shares, total market value, stock price and the number of shareholders. Some exchanges such as the NYSE have broad discretion regarding the listing of a company. An exchange may deny listing or apply additional listing criteria even if the company meets all the stipulated listing standards[193]. After a company starts trading, it must continue to meet the various standards set by the exchanges. These continuing standards are usually less stringent than the initial listing requirements.

3.5.2 Listing Procedure

An issuer is required to file an application with the exchange and file with the SEC a duplicate original of a registration statement conforming to the rules of the SEC. Having received the application and sufficient supporting documents, the exchange will authorize the company's securities for listing and certify such authorization to the SEC. Registration becomes effective automatically 30 days after receipt by the SEC of the exchange's certification, but may become effective within a shorter period, by order of the SEC, upon request made by the company to the SEC. Once the registration process is completed, the company's securities can be traded[194]. The original listing date can be set for a day any time after the effectiveness of registration.

3.5.3 Failure to Meet Listing Criteria

When a company fails to meet any of the continued listing criteria, the exchange may suspend its securities from dealings or remove the securities from the list at any time. In the case of delisting, the exchange will suspend trading in the security and submit an application to the SEC to strike the security from listing and registration.

3.5.4 Role of SEC in Changing the Rules

Although the SEC does not set listing standards, it is involved in the process of changing the rules, including listing rules, set by the exchanges in the following ways;

[192] Listing and Delisting Requirements
http://www.sec.gov/answers/listing.htm
[193] NYSE; Listing Standards
http://www.nyse.com/regulation/nyse/1147474807344.html
[194] Internet from 10/9/11
http://www.info.gov.hk/info/expert/annex3e.pdf

a. All proposed new rules or changes to existing rules of the registered exchanges have to be reviewed and approved by the SEC[195];

b. The SEC may amend the rules of the registered exchanges [196] as it deems appropriate or necessary.

c. The SEC may also ask the registered exchanges to review their rules, including those relating to listing standards[197].

3.5.5 Enforcement of Listing Rules

The enforcement and setting of listing-rules are primarily the responsibilities of exchanges which also serve as *Self-Regulators* in operating the market and administering the listing regime. As stated above, the SEC does have some control over the setting of listing rules as the rules proposed by the exchanges are subject to its review, amendment and approval. Backed by statutory enforcement powers, the SEC can investigate any potential securities violation, as it deems necessary, and can impose a wide range of sanctions. The law also provides that willful and knowing violations of securities law are criminal offences subject to prosecution, and those investors who have suffered losses in the purchase or sale of securities in reliance on false or misleading statements and reports may initiate class action suits to seek damages[198].

3.6 Fundamental Rationales for U.S. Securities Regulation

Currently, the U.S. securities-regulation law is voluminous enough to fill a law library and is constantly changing, although basic principles remain fairly stable. The basic framework of securities regulation grew out of a desire to protect investors. Arguably it plays a more important role in terms of enhancing the efficiency of financial-

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[195] Ibid

[196] under the provisions of Section 19(b)(3) of the 1934 Act
The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in on such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as the listing or striking from listing of any security.

[197] For instance, in the aftermath of the *meltdown* of significant companies due to failures of diligence, ethics and controls, the former SEC Chairman, Mr. Harvey Pitt, asked the NYSE on 13 February 2002 to review its corporate governance listing standards. Pursuant to that request, the NYSE appointed a Corporate Accountability and Listing Standards Committee to review the NYSE's listing standards, along with recent proposals for reform, with the goal of enhancing the accountability, integrity and transparency of the companies listed on the exchange. Following the review, the NYSE has filed the Corporate Governance Proposals for new corporate governance listing standards with the SEC for review and approval.

[198] Ibid

markets, whereas it placed a very limited emphasis on the prevention of systemic risk[199]. Three fundamental rationales for U.S. securities regulations are;

1. Protecting Investors
2. Enhancing Efficiency
3. Systemic Risk

3.6.1 Protecting Investors

Securities regulations were initiated to protect the investors, mostly. The disclosure and registration requirements in state blue sky laws, in the Securities Act of 1933 and the SEA of 1934 are all primarily designed to protect investors, especially individual investors. Investors are often at an informational disadvantage with respect to issuers of securities. Although institutional investors have the leverage to compel an issuer to disclose relevant data and the expertise to evaluate such data, unsophisticated consumers lack both the leverage and the expertise. For this reason Governments have found it useful to standardize accounting practices, require the regular disclosure of data relevant to a firm's financial prospects and encourage the development of rating agencies which enable even small investors to take advantage of economies of scale in gathering and analyzing data.

The Congressional hearings that were held in the early 1930's on the operation of stock markets found considerable evidence of stock price manipulation[200]. Different schemes were used to manipulate the prices of the stocks so that the manipulator could make a profit at the expense of ordinary investors. The SEA 1934 made most types of manipulation illegal in order to prevent this kind of scheme.

U.S. has prohibited insider trading to ensure that corporate officials and owners with better information about the financial prospects of their companies cannot profit at the expense of non-insiders.

Takeover rules and regulations to protect minority shareholders are designed to make sure takeovers occur in an orderly way and minority shareholders are not frozen out and exploited by majority holders.

3.6.2 Enhancing Efficiency

Although historically securities regulations were primarily introduced to protect investors they also play an important role in enhancing the efficiency of securities markets. Disclosure standards and registration requirements ensure that information is released to the financial markets. This information will be reflected in market prices and allow prices to accurately reflect values. In other words these regulations help improve the informational efficiency of the market.

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[199] Internet from 6/22/10
http://www.ehow.com/about_5150414_stock-exchange-regulations.html
[200] Internet from 4/14/10
http://knowledge.wharton.upenn.edu/papers/1174.pdf

Prohibitions on manipulation are also important in ensuring that prices accurately reflect underlying values. If manipulation is prevalent there will potentially be a significant misallocation of resources. This takes the form of investment being distorted from the efficient allocation. Perhaps more importantly it will usually reduce the willingness of investors to participate in markets and this will reduce the total amount of investment that is undertaken.

There is large academic literature on desirability of allowing insider trading. One view is that insider trading is desirable because it leads to prices being more informative, which improves allocation of investment[201].Another view is that, insider-trading involves the informed benefiting at the expense of the uninformed and this reduces the willingness of uninformed investors to participate.

Takeover rules and regulations to protect minority shareholders can also be justified on the grounds of efficiency enhancement. Takeover rules are designed to allow takeovers to take place as smoothly as possible. They thus enhance operation of the market for corporate control and help ensure that the team that is best suited to do so manage assets. Regulations to protect minority shareholders ensure that they are willing to participate in the capital markets. If they ran a significant risk of being expropriated by majority holders they would simply withdraw and investment and liquidity would be reduced.

Finally, investment management rules play an important role in efficiency enhancement. By reducing the opportunities for abuse by investment managers they again increase the willingness of investors to participate in financial-markets[202]. The rules are designed to reduce agency problems and lower the incentives for managers to take risks. To the extend they are successful in achieving this they will also lead to greater investment and increased liquidity.

3.6.3 Systemic Risk

Securities-regulation has placed a very limited emphasizes on the prevention of systemic-risk. In the U.S., securities firms are not subjected to consolidated prudential supervision focused on the soundness of the institution as a whole. Instead, the emphasis is on protecting some of the functions that the securities firm performs.

Securities firms segregate customer funds from the firms' own funds. Thus bad news about the firms' own assets need not cause concern about the assets of the firms' clients. (Indeed, as noted earlier, in the U.S. the SIPC protects the assets of clients in case the separation of client funds from the firm's own funds has been compromised through incompetence or fraud).

Securities firms generally hold liquid, tradable assets that are marked to market daily. This relatively transparent balance sheet reduces the vulnerability of the typical securities firm to the asymmetric information problems that arise from the opacity of a typical bank balance sheet. Moreover, in the event that a securities firm is subject to

[201] Ibid
[202] Ibid

a loss in confidence and a consequent inability to borrow, it can reduce the size of its balance sheet relatively easily, without incurring fire sale losses on the liquidation of assets.

Securities firms do not have direct access to large value payment systems. Although securities firms generate very substantial payments in the course of conducting business for their clients and for their own, proprietary accounts, they rely on commercial banks to clear and settle such payments[203]. Thus, the collapse of a securities firm would affect the payments system only to the extent that it caused the collapse of the bank that clears and settles payments on its behalf. In the U.S., the most substantial test of these hypotheses to date is the collapse of the DBLG[204].

PART-(B);

U.K. SYSTEM OF SECURITIES REGULATION

3.7 Securities regulation in U.K.; an Introduction

In the U.K., the FSMA sets out the statutory framework for the regulation of the financial markets, and provides for the establishment of the FSA as the single statutory regulator directly responsible for the regulation of deposit-taking, insurance and investment businesses. It is an independent non-Governmental body (a company limited by guarantee and financed by levies on the industry) accountable to the Treasury and, through it, to the Parliament. In UK, the HM Treasury[205] is responsible for the overall institutional structure of regulation in the field of financial stability, and the legislation which governs it[206].

The FSA is not subject to the executive authority of the treasury, although the members of its board are all appointed by the Chancellor of the Exchequer. There is, however a variety of circumstances where the FSA will need to alert the Treasury about possible problems, such as serious problems which could cause wider economic disruption, diplomatic or foreign relations problems, or a problem that might suggest the need for a change in law, etc. The Government's power of oversight lies in the requirement for the FSA to produce an annual report on its work to the Treasury, which has to be laid before the Parliament. The Treasury's power to commission investigations into activities may give rise to public concern, and independent reviews of the FSA's resource management

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[203] Internet from 3/26/09
http://fic.wharton.upenn.edu/fic/papers/04/0411.pdf

[204] The DBLG had been the most profitable investment-bank on Wall-Street during the mid-eighties, it was mortally wounded in March 1989 when it pled guilty to six felony charges and agreed to pay the Government $650 million in fines.

[205] HM Treasury, in full Her Majesty's Treasury, informally The Treasury, is the U.K. government department responsible for developing and executing the British government's public finance policy and economic policy.

[206] Internet from 10/9/11
http://www.info.gov.hk/info/expert/annex3e.pdf

3.8 FSA

The FSA is an independent non-Governmental body, quasi-judicial body and a company limited by guarantee responsible for the financial regulation of the financial services industry in the U.K. Its board is appointed by the Treasury[207]. Its main office is based in Canary Wharf, London, with another office in Edinburgh.

Firms providing certain financial services are required to register with the FSA. The FSA can refuse to register firms, and can ban firms from providing certain services[208]. It frequently examines allegation of violations of its rules by registered firms.

3.8.1 Background for Setting up the FSA

Prior to the coming into effect of the FSMA, the responsibility for the regulation of the financial matters was shared by several organizations, namely the Bank of England, the Securities and Investments Board (which became the FSA), SROs, the Department of Trade and Industry Insurance Directorate, the Building Societies Commission, the Friendly Societies Commission and the Registry of Friendly Societies. Their powers had derived from different pieces of legislation, and each had approached its regulatory tasks in its own distinctive way.

The FSA is in corporate and legal terms the Securities and Investments Board[209] renamed[210]. The Securities and Investments Board changed its name to the FSA on 28 October 1997 and it now exercises statutory powers given to it by the FSMA 2000, which replaced the earlier legislation and came into force on 1 December 2001[211]. The purpose of creating a single regulator was to produce a more coherent and cost-effective approach to regulation, and to remove the scope for duplication, gaps and inconsistency that had affected the old system.

The FSA acquired its responsibility for supervising banks, listed money market institutions and related clearing houses from the Bank of England, and the regulatory and registration functions from the SROs (including the listing function of the LSX). The FSA's assuming all of the listing regulatory functions formerly performed by the LSX has removed the potential for conflict of roles on the part of LSX, particularly in light of pressures to relax listing standards, and has recognized that statutory regulators can better weigh public interest arguments than a profit seeking exchange[212].

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[207] http://nds.coi.gov.uk/Content/Detail.asp?ReleaseID=394966&NewsAreaID=2

[208] FSA; http://moneyterms.co.uk/fsa

[209] Former regulator of the UK investment market (in accordance with the Financial Services Act 1986) which was replaced by the FSA in October 1997
It was introduced in 1987 following the deregulation process of the so-called Big Bang, and acted as an umbrella organization to such self-regulating bodies as the Stock Exchange

[210] The legislative background, FSA: an outline. Page 6 of 49
http://www.fsa.gov.uk/pubs/policy/launch.pdf

[211] FSA; From Wikipedia, the free encyclopedia
http://en.wikipedia.org/wiki/Financial_Services_Authority

[212] Internet from 10/9/11

3.8.2 FSA's Four Statutory Objectives

The FSMA requires the FSA to pursue four objectives[213]

1. Market Confidence

   Maintaining confidence in the financial system[214]

2. Public Awareness

   Promoting public understanding of the financial system[215]

3. Consumer Protection

   Securing the appropriate degree of protection for consumers[216]; and

4. The Reduction of Financial Crime

   Reducing the extent to which it is possible for a business to be used for a purpose connected with financial crime[217].

3.8.3 FSA's Principles of Good Regulation

In pursuing the functions under FSMA, FSA required to have regard to additional matters that refer to as 'principles of good regulation'. These are:

3.8.3.1 Efficiency and Economy

(The need to use all resources of FSA in the most efficient and economic way)

3.8.3.2 Role of management

(This principle is designed to secure an adequate but proportionate level of regulatory intervention by holding senior management responsible for risk management and controls within firms)

3.8.3.3 Proportionality

(The restrictions we impose on the industry must be proportionate to the benefits that are expected to result from those restrictions)

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http://www.info.gov.hk/info/expert/annex3e.pdf

213 Statutory objectives
http://www.fsa.gov.uk/Pages/About/Aims/Statutory/index.shtml

214 Section-3 of FSMA 2000

215 Section-4 of FSMA 2000

216 Section-5 of FSMA 2000

217 Section-6 of FSMA 2000

3.8.3.4 Innovation

(The desirability of facilitating innovation in connection with regulated activities)[218]

3.8.3.5 International character

The international character of financial services and markets and the desirability of maintaining the competitive position of the UK, involves co-operating with overseas regulators, both to agree international standards and to monitor global firms and markets effectively

3.8.3.6 Competition

The need to minimize the adverse effects on competition that may arise from the activities of FSA and the desirability of facilitating competition between the firms regulated by FSA

These two principles cover avoiding unnecessary regulatory barriers to entry or business expansion. Competition and innovation considerations play a key role in cost-benefit analysis work. Under FSMA, the Treasury, the Office of Fair Trading and the Competition Commission all have a role to play in reviewing the impact of rules and practices on competition.

3.8.3.7 Public awareness

The desirability of enhancing the understanding and knowledge of members of the public of financial matters, including the UK financial system[219]

3.8.4 The Regulatory Approach of FSA

To attain the objective of upholding efficient, clean and orderly financial-markets, and help retail-consumers to achieve a fair deal, the FSA has embarked on a risk based approach to regulation, which recognizes both the proper responsibilities of consumers and of a firm's own management, and the impossibility and undesirability of removing all risks and failure from the financial system. It switches resources from reactive post-event actions towards front-end intervention, and creates incentives for firms to manage their own risks better thereby reducing the burden of regulation[220].

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[218] Principles of good regulation
http://www.fsa.gov.uk/pages/About/Aims/Principles/index.shtml

[219] Financial Services and Markets Act (FSMA); BCRM (BUSINESS COMPLIANCE AND RECOVERY MANAGEMENT)
http://www.bcrm.co.uk/reg_financial_services_act.php

[220] Regulatory Approach; annex-3; Regulation Of The Securities Market In The United States
http://www.info.gov.hk/info/expert/annex3e.pdf

3.8.5 The Responsibilities of FSA

3.8.5.1 Authorization

The FSA authorizes or approves all firms or individuals before they can carry on a regulated activity unless the firm is exempt from regulation under the FSMA. It aims to allow only those firms and individuals satisfying the *threshold conditions*(which include honesty, competence and financial soundness) to engage in regulated activities.

3.8.5.2 Supervision

It supervises deposit-takers and insurance firms, major financial groups, pension review, investment markets and exchanges, listing matters, and regulates investment firms.

3.8.5.3 Enforcement

The FSMA provides the FSA with statutory investigation and enforcement powers. The FSA investigates and where appropriate, disciplines and/or prosecutes firms/individuals for breaches of the FSA's rules and FSMA requirements. Enforcement actions may take the form of withdrawal of a firm's authorization, financial penalties, seeking injunctions, prosecution actions and requiring the firms to compensate consumers, etc[221].

3.8.5.4 Reducing Financial Crime

FSA focuses on money laundering, fraud and dishonesty, and criminal market misconduct such as insider dealing. Under the FSMA, the FSA can make rules on firms' systems and controls relating to money laundering; supervise firms' compliance with those requirements; and prosecute firms for systems and controls failures in this area.

3.8.5.5 International Activity

The FSA maintains bilateral contacts with other regulators in Europe and around the globe, as well as supporting groups where regulators can share information with one another.

3.8.5.6 Service to Consumers

It promotes public understanding of the financial system and secures an appropriate degree of protection for consumers by providing information and generic advice to consumers, operating a consumer help line and providing schools with resources on personal finance education[222].

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[221] Internet from 10/9/11
http://www.info.gov.hk/info/expert/annex3e.pdf

[222] Introduction to the FSA;
http://www.fsa.gov.uk/pubs/other/fsa_intro.pdf

3.8.5.7 Responsibilities for Investment Markets

As far as the investment markets are concerned, the FSA is responsible for –

a. Supervising Exchanges, Clearing and Settlement Houses and Other Market Users and Practitioners

The FSA recognizes and supervises eight Recognized Investment Exchanges (RIEs). These are organized markets on which member firms can trade investments such as equities and derivatives. Examples are the LSX and the London Metal Exchange. The FSA is also responsible for recognizing and supervising Recognized ClearingHouses which organize the settlement of transactions on RIEs. It also has the responsibility for applications from, and supervision of, recognized overseas investment exchanges (such as the Sydney Futures Exchange and NASDAQ) and recognized overseas clearing houses regarding cross-border trading.

b. Conducting Market Surveillance and Transaction Monitoring

The FSA analyses transactions collected from authorized firms, RIEs and settlement systems to look for unusual trading activities. It has issued the Code of Market Conduct which sets out the standards required of all market participants[223] and monitors compliance with powers to impose financial penalties.

3.9 Listing of Securities

Unlike the U.S., where the stock-exchange is responsible for assessing the eligibility of an issuer to be listed whilst the regulator is responsible for information disclosed to the market by the issuer, all responsibilities for primary market regulation in the UK lie with the UKLA, a division of the FSA which is the competent authority responsible for admission of securities to the official list. There is a distinction between *admission to listing* and *admission to trading*. The former process is to ensure that minimum standards for the protection of investors are met and to provide for mutual recognition of the listing status across the EU. The latter process is for a stock exchange to decide whether trading of a security should be permitted on its trading board[224].

3.10 United Kingdom Listing Authority -UKLA

The FSA, when it acts as the competent authority for listing of shares on a stock exchange, under Part VI of FSMA[225], is referred to as the UKLA. In this role, the FSA is a securities regulator, focused on the companies which issue the securities traded in financial markets[226].

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[223] Regulatory Approach; annex-3; Regulation Of The Securities Market In The United States http://www.info.gov.hk/info/expert/annex3e.pdf

[224] ibid

[225] Financial Services and Markets Act 2000, Part VI http://www.legislation.gov.uk/ukpga/2000/8/part/VI

[226] UKLA;

UKLA is the body authorized by the FSA that decides on the rules for the listing of public companies, reviews and approves the prospectuses of companies that want to list and which in consultation with various departments of the LSX, enforces those rules[227].

UKLA's main role is to maintain the Official-List[228]. This is simply a list of all securities it has approved for trading on exchanges in the UK. It also maintains a list of the issuers of those securities.

The UKLA also sets the requirements for listing and the rules for procedures and documents related to listing[229], such as Initial Public Offer[230]& prospectuses[231].

3.10.1 Regulatory Objectives of the UKLA

The UKLA establishes and updates listing rules which govern the listing of securities with the regulatory objectives to –

a. Provide an appropriate level of protection for investors in securities,

b. Facilitate access to capital markets for a broad range of enterprises, and

c. Seek to maintain the integrity and competitiveness of UK markets for listed securities.

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http://www.fsa.gov.uk/Pages/Doing/UKLA/index.shtml

[227] FINANCE GLOSSARY; UK Listing Authority
http://www.finance-glossary.com/define/UK-Listing-Authority/2170/0/U

[228]The Official List is the list of all securities that have been approved by the UKLA for trading on financial exchanges in the UK. The Official List is published by the UKLA. It can be browsed online at the Official List section of the FSA website. Securities can not trade on a stock exchange in the UK unless they appear on the Official List. Most other countries have similar regulations.

[229] Internet from 3/8/11
http://moneyterms.co.uk/ukla/

[230]An Initial Public Offer (IPO) is the sale of shares to the public as a precursor to the shares trading on an exchange for the first time. An Initial Public Offer is not the only way in which a company can start trading in its securities, but it is the most common for shares. The shares offered in an Initial Public Offer are usually a new issue, but they may also be shares held by major shareholders, or a mixture of both

[231]A prospectus is a document that is published by a company prior to raising capital. The most important type of prospectus is that issued prior to an Initial Public Offer as:

i. The company is usually trying to raise a substantial amount of capital.
ii. The company has no track record and has previously published less information than companies that are already listed.

A prospectus is in some ways similar to an annual report: it contains a full set of financial statements together with various non-financial information
Initial Public Offer prospectuses usually contain more useful information than an annual report. It is usually much easier for an investor with no prior knowledge of a company to analyze it at Initial Public Offer (relying primarily on the prospectus) than later when there are more, but individually less complete, sources of information. The level of detail required in a prospectus can make it a very expensive document to produce

Under the FSMA, the FSA has a duty to publicly consult on any proposed changes to the rules or the issuing of guidance[232], and to conduct and publish cost benefit analysis.

3.10.2 Responsibilities of UKLA

More specifically regarding the listing and the delisting of securities, UKLA's responsibilities include the following,

3.10.2.1 Admitting Securities to the Official List for Listing

The UKLA considers applications for listing by examining and approving prospectuses, listing particulars and equivalent offering documents to ensure that the issuer has met all the relevant conditions as set out in the listing rules before it is admitted to the official list. The power to make no disciplinary decisions (e.g. listing approval) rests with the relevant FSA executives, with appeal to the Listing Authority Review Committee. The UKLA seeks to ensure that listed companies comply with their on-going obligations under the listing rules (including the provision of a regular flow of relevant information into the market), and has the power to impose a financial penalty on a listed company or its directors for breaches of the listing rules[233]. The FSMA requires the FSA to publish a policy statement setting out the factors to be taken into account in its decisions to impose financial penalties.

3.10.2.2 Regulation of Sponsors and Advisers

Advisors and sponsors cannot provide services to issuers unless they are approved by the FSA, as *fit and proper*.

3.10.2.3 Imposing and enforcing ongoing obligations on issuers

Imposing and enforcing ongoing obligations on issuers to promote full, accurate and timely disclosure to the market of all relevant information through the continuing obligations set out in the listing rules. As with the vetting of prospectuses for listing, the UKLA does not investigate or verify the accuracy or completeness of the information given, but it reserves the right to require additional information.

3.10.2.4 Suspending and cancelling listing

Suspending and cancelling listing to protect investors from trading without access to full and complete information. The UKLA will suspend securities from the official list if there is not enough information available to ensure an orderly market. It will cancel a company's securities if there are special circumstances which prevent normal

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[232] Regulatory Approach; annex-3; Regulation Of The Securities Market In The United States http://www.info.gov.hk/info/expert/annex3e.pdf

[233] ibid

dealings in them[234]. The power to make disciplinary decisions rests with a Regulatory Decisions Committee.

Firms which are aggrieved by the regulatory decisions of the Listing Authority Review Committee or Regulatory Decisions Committee may appeal to the Financial Services and Markets Tribunal. Review is on the full merits of the case. Parties may introduce new evidence and the Tribunal can affirm, reverse, or otherwise alter any determinations of the Listing Authority Review Committee or Regulatory Decisions Committee[235].

3.11 London Stock Exchange (LSX)

The LSX is one of the world's leading equity exchanges and the most international of all stock exchanges, with about 470 companies from over 60 countries admitted to trading on its various trading boards. It is a publicly listed company and, in the context of the FSMA, one of the RIEs recognized and supervised by the FSA[236].

3.11.1 Historical Background

LSX is founded in 1773 and reincorporated as a private limited company in 1986; the LSX is also the world leader in international share trading.

Prior to the setting up of the FSA, the LSX was a private limited company, and was the Competent Authority for Listing in the UK. In July 1999, the LSX announced its intention to move from its mutual ownership to a new basis of transferable share ownership, ending the traditional link between usage and ownership of the Exchange[237]. The purpose was to move the Exchange towards a more commercial basis of operation that would allow greater speed and flexibility in its decision making process, which had become essential because of the increasing competition and demand for more efficient delivery of services and more innovative products. After announcing its intention to demutualise, the Exchange had discussed with the Treasury about its statutory role as the Competent Authority for Listing. In the light of the new ownership structure that the Exchange intended to create, and its intended

[234] FSA board set up the Regulatory Decisions Committee because the Financial Services and Markets Act (FSMA) require the investigation and recommendation functions to be carried out separately from the taking of decisions and issuing of statutory notices. The RDC decides whether the FSA should give the statutory and other notices described as within its scope by the Handbook, any regulatory guide or legislation.
http://www.fsa.gov.uk/pages/About/Who/board/committees/RDC/index.shtml

[235] Where disagreements arise between the FSA and firms or individuals about the FSA's regulatory decisions, the matter can be referred to the Financial Services and Markets Tribunal. The Financial Services and Markets Tribunal is an independent judicial body established under Section 132 of the Financial Services and Markets Act 2000
http://www.fsa.gov.uk/pages/About/Who/Accountability/FSAMT/index.shtml

[236] LSX delivers world's fastest real-time price information system using Cisco
http://www.cisco.com/en/US/prod/collateral/switches/ps5718/ps708/prod_case_study0900aecd8053494c.pdf

[237] History of the LSX
http://www.money-zine.com/Investing/Stocks/London-Stock-Exchange

move to a more commercial basis of operation, the Treasury agreed with the LSX to transfer the role of Listing Authority to the FSA.

In 2000, the LSX transferred its role as the UKLA to the FSA and became a public limited company. It was listed in July 2001. Notwithstanding the transfer of the listing functions, the Exchange has continued to set its own requirements for companies quoted on its trading boards, including the right to decide whether or not to admit a listed security to trading and to make and enforce its own rules[238].

3.12 Relationship between the FSA and LSX in the Regulation of Listing/Trading

The FSMA provides the framework for the regulation of the securities market. It is a criminal offence to carry on a regulated activity without authorization or exemption. Most of the statutory powers are held by the FSA, to which the LSX is answerable as an RIE. To become and remain an RIE, an exchange must satisfy the FSA that it meets the various prerequisites set out in the FSMA, including effective arrangements for monitoring and enforcing compliance with its rules.

3.12.1 Admission to trading

Admission to trading on the main market is a two-stage process. A company which wants to have its securities admitted to trading on the LSE has to apply to the FSA for the admission of its securities to the Official List by the UKLA of the FSA. Having obtained admission to the Official List, the company would need to seek admission to trading on the Exchange[239].

3.12.2 Continuing Obligations

After admission to trading, the companies must comply with continuing obligations which include timely publication of price sensitive information in accordance with the UKLA's listing rules, and disclosure of information as set out in the Admission and Disclosure Standards (Standards) devised and enforced by the Exchange which are applicable to companies admitted to trading on the main market. The purpose of requiring companies to comply with continuing obligations is to give their investors proper information for determining the current value of the securities.

3.12.3 Enforcement

The Exchange monitors compliance with the Standards. It can censure a company for breaching the Standards by suspending trading in the company's securities and, in extreme cases, cancel the right of a company's securities to be traded.

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[238] LSX
http://www.answers.com/topic/london-stock-exchange
[239] Internet from 10/9/11
http://www.info.gov.hk/info/expert/annex3e.pdf

The FSA has issued in July 2002 a discussion paper entitled *Review of Listing Regime* for public comments[240]. It was noted in the paper that, *there remains a degree of uncertainty in the corporate sector about the role of the competent authority*. It appears that many market participants were unclear, following the transfer of the UKLA from the LSX to the FSA, about the boundaries between those functions carried out by the LSX and those performed by the FSA as the competent authority for listing. The FSA has expressed its intention to explain clearly the role and responsibility of the competent authority in the context of the changing UK and EU regulatory environment[241].

3.13 Financial Services Act - 1986

Financial Services Act 1986 was an Act of the Parliament of the U.K. passed by *Margaret Thatcher's*[242]Government, which deregulated the financial services sector. The Act is now replaced by the FSMA 2000, which modified the content of the Act and imposed some tighter controls[243].

3.14 The Financial Services and Markets Act (FSMA), 2000

FSMA-2000 came into full force and effect on 1 December 2001. However, the term *full force and effect* is somewhat tempered by the fact that there had been six previous commencement orders bringing substantial sections of FSMA 2000 into effect[244], the most significant of those being Commencement Order No 3 (SI 2001 No 1820) [245] which gave the FSA its rule making powers.

Whereas under the Financial Services Act 1986 (the 1986 Act) the Securities and Investments Board had been established as, in effect, a regulator of regulators, the

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[240] The FSA's Discussion paper DP14 is entitled 'Review of the listing regime'. It was published in July 2002 and the period for discussion responses closes on 15 October 2002. http://www.fsa.gov.uk/pubs/discussion/dp14.pdf

[241] Internet from 10/9/11 http://www.info.gov.hk/info/expert/annex3e.pdf

[242] Margaret Hilda Thatcher, (born 13 October 1925) was Prime Minister of the U.K. from 1979 until 1990.

[243] Financial Services Act 1986; From Wikipedia, the free encyclopedia http://en.wikipedia.org/wiki/Financial_Services_Act_1986

[244] Insider Dealing and Market Abuse: The FSMA 2000, Author; K. Alexander http://ideas.repec.org/p/cbr/cbrwps/wp222.html

[245] This Order brings into force, on 18th June 2001, the provisions of the FSMA 2000 (the Act) listed in the Schedule. They include provisions

i. Relating to the constitution of the FSA (the Authority)
ii. Providing for the establishment of the scheme manager of the Financial Services Compensation Scheme under Part XV of the Act
iii. Providing for the establishment of the ombudsman scheme operator under Part XVI of the Act (to be known as the Financial Ombudsman Service)
iv. Conferring rule-making powers on the Authority and on the ombudsman scheme operator, and related procedural provisions.
v. Imposing restrictions on the disclosure of confidential information
vi. Relating generally to criminal offences, and to criminal and civil proceedings, under the Act

FSA is now the single regulator. Not only has it taken over the regulatory responsibilities of the;

a. SRO's

b. Personal Investment Authority

c. Investment Management Regulatory Organization, and

d. Securities and Futures Authority (SFA)

But it has also been given the power to regulate the banking and insurance industries.

This replaces the regulatory framework for the latter two industries previously contained in the Banking Act 1987 and Insurance Companies Act 1982[246].

3.14.1 Repeals

Consequential Amendments and Repeals Order 2001 (SI 2001 No 3649)[247] sets out important repeals in addition to those contained in Section 22 to FSMA 2000, the following have been repealed[248]:

a. Policyholders Protection Acts 1975[249] and 1997[250];

b. Insurance Companies Act 1982[251];

c. Financial Services Act 1986[252];

d. Banking Act 1987[253];

e. Insurance Companies (Reserves) Act 1995[254].

Further repeals include those of the Banking Co-ordination (Second Council Directive) Regulations 1992[255], the insurance Companies (Third Insurance Directive) Regulations 1994[256]and the Investment Services Regulations 1995[257]. The Order then

[246]Briefing Note; FSMA 2000 Financial Services
This article originally appears in the February 2002 issue of Tolley's Company Law and Insolvency Newsletter and is reproduced here with the kind permission of Butterworths Tolley
http://www.druces.com/news/docs/FSMA.pdf

[247] http://www.legislation.gov.uk/uksi/2001/3649/contents/made

[248] Section-3; The principal repeals and revocations; Consequential Amendments and Repeals Order 2001 (SI 2001 No 3649)
http://www.legislation.gov.uk/uksi/2001/3649/article/3/made

[249] http://www.legislation.gov.uk/ukpga/1975/75/contents

[250] http://www.legislation.gov.uk/ukpga/1997/18/contents

[251] http://www.legislation.gov.uk/ukpga/1982/50/contents

[252] http://www.legislation.gov.uk/ukpga/1986/60/contents

[253] http://www.legislation.gov.uk/ukpga/1987/22/contents

[254] http://www.legislation.gov.uk/ukpga/1995/29/contents

[255] http://www.legislation.gov.uk/uksi/1992/3218/contents/made

[256] http://www.legislation.gov.uk/uksi/1994/1696/contents/made

proceeds to detail amendments that are required to various Acts including those to the Companies Act 1985.

3.15 Comparison; U.K and U.S. Models of Securities Regulation

Item	U.K.	U.S.
Regulatory model	Government regulation	Central government regulation with private sector involvement (SROs)[258]
Responsible authority	FSA	a) SEC, b) State Authorities
Cross-sector supervision	Yes	No
Self-regulatory Organizations	No	Yes, substantial involvement of a) exchanges, b) associations
Regulatory philosophy	To ensure market transparency and integrity	To ensure market transparency and integrity
Accountability	Treasury	Congress
Listing	UKLA	Exchanges

PART-(C);

INDIAN SYSTEM OF SECURITIES REGULATION

3.16 Securities regulation in INDIA; an Introduction

The Indian securities market, considered one of the most promising emerging markets, is among the top eight markets of the world. The Stock Exchange, Mumbai, which was established in 1875 as *The Native Share and Stockbrokers Association* (a voluntary non-profit making association), has evolved over the years into its present status as the premier Stock Exchange in the country. At present 24 stock exchanges operate all over India. These stock exchanges provide facilities for trading securities; Securities markets provide a common platform for transfer of funds from the person who has excess funds to those who need them[259]. Securities market is regulated by the SEBI.

[257] http://www.legislation.gov.uk/uksi/1995/3275/contents/made

[258] Securities Market Regulation, Monthly Report DEUTSCHE BUNDESBANK, January 2006, page 25

[259] http://www.scribd.com/doc/48566235/Learning-20Session-205th

3.16 Components of Securities Market of India

The major components of the securities market are listed below:

- *Securities*-Shares, Bonds, Debentures, Futures,Options, Mutual Fund Units
- *Intermediaries*- Brokers, Sub brokers, Custodians, Share transfer agents, Merchant Bankers
- *Issuers of securities*- Companies, Bodies corporate, Government, Financial Institutions, Mutual funds, Banks
- *Investors*-Individuals, Companies, Mutual funds, Financial Institutions, Foreign Institutional Investors
- *Market Regulators*- SEBI, Stock Exchanges as SRO's, Reserve Bank of India[260] (to some extent), Department of Company Affairs

3.17 Market Regulators

Securities market is regulated by following governing bodies[261]:

1. SEBI
2. Department of Economic Affairs
3. Department of Company Affairs
4. Reserve Bank of India
5. Stock exchanges

3.17.1 Securities and Exchange Board of India

The SEBI is the regulator for the securities market in India. The SEBI is similar to the U.S. SEC. The SEBI is relatively new (1992) but is a vital component in improving the quality of the financial markets in India, both by attracting foreign investors and protecting Indian investors[262].

[260]The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934. The Central Office of the Reserve Bank was initially established in Calcutta but was permanently moved to Mumbai in 1937. The Central Office is where the Governor sits and where policies are formulated. Though originally privately owned, since nationalization in 1949, the Reserve Bank is fully owned by the Government of India
http://www.rbi.org.in/scripts/AboutusDisplay.aspx

[261] http://www.scribd.com/doc/30928913/Overview-of-the-Indian-Securities-Market

[262] Investopedia explains Securities And Exchange Board Of India-SEBI
http://www.investopedia.com/terms/s/sebi.asp#ixzz1WSBo6s00

The SEBI established in 1988[263]through an executive resolution and became a fully autonomous body by the year 1992 by the Government of India in 1992 with SEBI Act 1992[264] being passed by the Indian Parliament, with defined responsibilities to cover both development & regulation of the market. SEBI is headquartered in the business district of Bandra-Kurla complex in Mumbai, and has Northern, Eastern, Southern and Western regional offices in New Delhi, Kolkata, Chennai and Ahmedabad.

Controller of Capital Issues was the regulatory authority before SEBI came into existence. It derived authority from the Capital Issues (Control) Act, 1947.

The SEBI, initially, was a non statutory body without any statutory power. However in 1995, the SEBI was given additional statutory power by the Government of India through an amendment to the SEBI Act 1992[265]. The SEBI, in April 1998, was constituted as the regulator of capital market in India under a resolution of the Government of India.

The SEBI, since its inception, has been working targeting the securities and is attending to the fulfillment of its objectives with commendable zeal and dexterity. The improvements in the securities markets like capitalization requirements, margining, establishment of clearing corporations etc. reduced the risk of credit and also reduced the market.

The SEBI has introduced the comprehensive regulatory measures, prescribed registration norms, the eligibility criteria, the code of obligations and the code of conduct for different intermediaries like, bankers to issue, merchant bankers, brokers and sub-brokers, registrars, portfolio managers, credit rating agencies, underwriters and others. It has framed bye-laws, risk identification and risk management systems for Clearing houses of stock exchanges, surveillance system etc. which has made dealing in securities both safe and transparent to the end investor[266].

3.17.1.1 Functions and responsibilities of SEBI

The SEBI has to be responsive to the needs of three groups, which constitute the market:

a. The issuers of securities

b. The investors

c. The market intermediaries.

The SEBI has three functions rolled into one body: quasi-executive, quasi-judicial and quasi-legislative. It drafts regulations in its legislative capacity, it conducts the investigation and enforcement action in its executive function and it passes rulings

[263] http://finance.indiamart.com/india_business_information/sebi.html

[264] http://en.wikipedia.org/wiki/Securities_and_Exchange_Board_of_India#cite_note-1

[265]http://www.sharemarketbasics.com/Terms/Controller-of-Capital-Issues-CCI.php

[266] http://finance.indiamart.com/india_business_information/sebi_introduction.html

and orders in its judicial capacity. Though this makes it very powerful, there is an appeals process to create accountability.

The SEBI has enjoyed success as a regulator by pushing systemic reforms aggressively and successively (e.g. the quick movement towards making the markets electronic and paperless rolling settlement on T+2 bases). SEBI has been active in setting up the regulations as required under law.

The SEBI has also been instrumental in taking quick and effective steps in light of the global meltdown and the Satyam fiasco. It had increased the extent and quantity of disclosures to be made by Indian corporate promoters. More recently, in light of the global meltdown, it liberalized the takeover code to facilitate investments by removing regulatory structures[267]

3.17.1.2 Powers of SEBI

For the discharge of its functions efficiently, the SEBI has been invested with the necessary powers which are:

a. To approve by–laws of stock exchanges

b. To require the stock exchange to amend their by–laws

c. Inspect the books of accounts and call for periodical returns from recognized stock exchanges

d. Inspect the books of accounts of financial intermediaries

e. Compel certain companies to list their shares in one or more stock exchanges

f. Levy fees and other charges on the intermediaries for performing its functions

g. Grant license to any person for the purpose of dealing in certain areas

h. Delegate powers exercisable by it

i. Prosecute and judge directly the violation of certain provisions of the companies Act[268]

3.18 Present Governing Securities Laws in India

Theses Acts are governing the securities transactions in India, at present

a. The Securities Contracts (Regulation) Act, 1956,

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[267] SEBI doubles retail limit, tightens IPO norms
October 26, 2010 02:38 IST
http://business.rediff.com/report/2010/oct/26/sebi-tightens-ipo-norms.htm

[268] http://en.wikipedia.org/wiki/Securities_and_Exchange_Board_of_India#cite_note-1

b. The Securities & Exchange Board of India Act, 1992[269], and

c. The Depositories Act, 1996

d. The other relevant laws which affect the capital market are[270]:-

e. The Foreign Exchange Regulations Act, 1973

f. Arbitration and Conciliation Act, 1996

g. Companies Act, 1956

h. Debt Recovery Act (Bank and Financial Institutions Recovery of Dues Act, 1993)

i. Banking Regulation Act

j. Benami Prohibition Act

k. Indian Penal Code

l. Indian Evidence Act, 1872[271].

3.18.1 The Securities Contracts (Regulation) Act, 1956

The Securities Contracts (Regulation) Act, 1956, containing a mere 31 sections, keeps a tight vigil over all the Stock Exchanges of India since 20th February, 1957. The Securities Contract (Regulation) Act, 1956, provides for regulations of transaction insecurities through control over stock exchanges, Most of the powers under this act are exercised by Department of Economic Affairs (DEA), some are concurrently exercised by DEA and SEBI and a few powers by SEBI[272].

The provisions of the Act were formally administered by the Central Government. However, since the enactment of The SEBI Act, 1992 the Board (Securities and Exchange Board of India) established under it is concurrently having powers to administer almost all the provisions of the Act. By virtue of the provisions of the Act, carrying on the business of dealing in securities without a license from SEBI is prohibited. Any Stock Exchange which is desirous of being recognized has to make an application under Section 3 of the Act to SEBI who is empowered to grant recognition and prescribe conditions including that of having SEBI'S representation (maximum three persons) on the Stock Exchange and prohibiting the Stock Exchange from amending its rules without the SEBI's prior approval.

A public limited company in India has no obligation to have its shares listed on a recognized Stock Exchange[273]. But if a company intends to offer its shares or debentures

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[269] Available at
http://www.sebi.gov.in/acts/act15ac.html

[270] http://www.sudhirlaw.com/chapter11.htm

[271] http://www.sebi.gov.in/sebiweb/home/list/1/1/0/0/Acts

[272] http://www.scribd.com/doc/30928913/Overview-of-the-Indian-Securities-Market

[273] Internet from 11/5/08

to the public for subscription by issue of a prospectus, it must, before issuing such prospectus apply to one or more of the recognized stock exchanges for permission to have the shares or debentures intended to be so offered to the public to be dealt with in each of such stock exchange in terms of Section 73 of the Companies Act, 1956. However, under the provisions of Section 21[274] of the Securities Contracts (Regulation) Act, 1956, the SEBI compel the listing of securities by public companies if it is of an opinion that it is necessary or expedient in the interest of trade or public. In the event of the Stock Exchange refusing to list the securities of any public company an appeal to SEBI is provided under the Act.

The Act, 1956 required amendment to include derivatives in the definition of securities to enable SEBI to introduce trading in derivatives. The necessary amendment was then carried out by the Government in 1999. The Securities Laws (Amendment) Bill, 1999 was introduced. In December 1999 the new framework was approved. Derivatives have been accorded the status of Securities. The ban imposed on trading in derivatives in 1969 under a notification issued by the Central Government was revoked. Thereafter SEBI formulated the necessary regulations/bye-laws and intimated the Stock Exchanges in the year 2000[275]. The derivative trading started in India at National Stock Exchange of India[276]in 2000 and Bombay Stock Exchange started trading in the year 2001.

3.18.2 The Securities and Exchange Board of India Act, 1992

The SEBI Act, 1992 is deemed to have come into force on January 30, 1992. Relatively a brief act containing only 35 sections, the SEBI Act governs all the Stock Exchanges and the Securities Transactions in India. The Act was enacted to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto. Section 11[277] of the SEBI Act provides that it shall the duty of the Board to protect the interest of investors in securities and to promote the development of and to regulate the securities market by such measures as it thinks fit[278]. It empowers the

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http://www.sudhirlaw.com/chapter11.htm

[274]Conditions for listing; **Section 21.** Where securities are listed on the application of any person in any recognized stock exchange, such person shall comply with the conditions of the listing agreement with that stock exchange.

Substituted by the Securities Laws (Amendment) Act, 1995 w.e.f. 25.01.1995

Prior to its substitution section 21 read as under;

"Power to compel listing of securities by public companies.- Notwithstanding anything contained in any other law for the time being in force, if the SEBI is of opinion, having regard to the nature of the securities issued by any public company regard to the nature of the securities issued by any public company as defined in the Companies Act, 1956 (1 of 1956), or to the dealings in them, that it is necessary or expedient in the interest of the trade or in the public interest so to do, it may require the company, after giving it an opportunity of being heard in the matter, to comply with such requirements as may be prescribed with respect to the listing of its securities on any recognized stock exchange"

http://www.sebi.gov.in/cms/sebi_data/attachdocs/1287136670083.pdf

[275] http://finance.indiamart.com/india_business_information/sebi_introduction.html

[276] The National Stock Exchange (NSE) is a stock exchange located at Mumbai, Maharashtra, India. It is the 9th largest stock exchange in the world by market capitalization and largest in India by daily turnover and number of trades, for both equities and derivative trading. NSE has a market capitalization of around US$1.59 trillion and over 1,552 listings as of December 2010.

http://en.wikipedia.org/wiki/National_Stock_Exchange_of_India

[277] Section 11; Functions of Board, http://www.sebi.gov.in/acts/act15ac.html

[278] Preamble at; http://www.sebi.gov.in/acts/act15ac.html

Board to regulate the business in Stock Exchanges, to register and regulate the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers, etc., to register and regulate the working of collective investment schemes including mutual funds, to prohibit fraudulent and unfair trade practices and insider trading, to regulate take-overs, to conduct enquiries and audits of the stock exchanges[279], etc.

As all Stock Exchanges are required to be registered with SEBI under the provisions of the Act, under Section 12[280] of the SEBI Act all the stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deed, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediary who may be associated with the Securities Markets are obliged to register with the Board and the Board has the power to suspend or cancel such registration. The Board is bound by the directions given by the Central Government from time to time on questions of policy and the Central Government has the right to supersede the Board. The Board is also obliged to submit a report to the Central Government every year, giving true and full account of its activities and policies. Any one aggrieved by the Board's decision is entitled to appeal to the Central Government.

3.18.3 The Depositories[281]Act, 1996

An Act, to provide regulation of Depositories in securities and for matters connected therewith and/or incidental thereto has been enacted in India, w.e.f. 20th September 1995 which is titled as *The Depositories Act, 1996.* The Depository Act, 1996, which provides for electronic maintenance and transfer of ownership of dematerialized securities, SEBI administers the rules and regulation under this Act[282] and it extends to the whole of India. The paper based ownership and transfer of securities has been a major drawback of the Indian Securities Markets since it often resulted in delay in settlement and transfers of securities and also leads to bad delivery, theft, forgery etc. The Depositories Act, 1996 was therefore enacted to pave the way for smooth and free transfer of securities[283].

3.18.4 The Companies Act, 1956

The Companies Act, 1956 set out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, disclosures to be made in public issues and non-payment of dividend[284]. Powers under this Act are exercised by SEBI in case of listed public companies and public companies proposing to get their securities listed[285]

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[279] Internet from 11/5/08: http://www.sudhirlaw.com/chapter11.htm

[280] Section 12; Registration of stock brokers, sub-brokers, share transfer agents, etc http://www.sebi.gov.in/cms/sebi_data/attachdocs/1305184278487.pdf

[281] As per the definition provided in Section 2(e) of the said Act, a *Depository* means a company formed & registered under the Companies Act, 1956 and which has been granted certificate of registration under sub-Section (1A) of Section 12 of the SEBI Act, 1992

[282] http://www.scribd.com/doc/30928913/Overview-of-the-Indian-Securities-Market

[283] http://www.sudhirlaw.com/chapter11.htm

[284] Internet from 10/24/10 http://www.scribd.com/doc/24308929/Innovative-Derivative-Products

[285] Internet from 12/30/05

CHAPTER # 4;

LEGAL FRAMEWORKS OF SECURITIES MARKET REGULATIONS IN PAKISTAN

4.1 Pakistani Standards for Securities Markets Regulation

The Pakistani model for securities markets regulation are adopted from U.S. model i.e the regulation of stock exchanges is divided between the SECP and the stock exchanges as SRO's. It is the responsibility of the SECP to provide the framework for the stock market, whereas it is the stock exchanges, which are primarily responsible for ensuring regulatory compliance on the part of the financial intermediaries, in their capacity as (SROs). The SECP is an autonomous statutory body that entrusted with the integrated administration and regulation of, inter-alias, corporate sector, the Capital markets, and the financial (non-banking) sectors of Pakistan. Its regulatory ambit extends to the Insurance sector, Non-Banking Financial Institutions and to the significant components of capital markets such as Stock Exchanges, Commodity exchange, CDC, NCCP Limited, beside the vast and growing corporate sector. The Policy making for each of these areas also falls under our purview that entails not only the revision of existing laws and regulations to bring them in line with best practices but also the promulgation of new laws etc

4.2 The Main institutions & Constituents of the Capital Market in Pakistan

The following are the main capital market institutions in Pakistan:-

a. The Stock Exchanges,

b. Commercial banks,

c. Specialized banks[286],

d. Securities and bonds market[287],

e. Insurance companies

f. And non-bank financial institutions[288]

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http://nseindia.com/content/us/ismr2001ch1.pdf

[286] Industrial Development Bank of Pakistan, SME Bank Limited, the Punjab Provincial Cooperative Bank Ltd,Zarai Taraqiati Bank Limited

[287] *Efficiency in Stock Market*, A Case Study of KSE by Khalid Mustafa .Thesis submitted to International Institute of Islamic Economics. International Islamic University (2002)

[288] The role of stock exchange in the development of capital markets in Pakistan. Economic Review | December 1, 1995 | Ali, Muhammad Imtiaz
http://www.encyclopedia.com/doc/1G1-18065352.html

The capital market in Pakistan is mainly made up of the following constituents.

a. KSE

b. National Investment Trust

c. Investment Corporation of Pakistan

d. National Development Finance Corporation

e. Agriculture Development Bank of Pakistan

f. Industrial Development Bank of Pakistan

g. Pakistan industrial Credit and Investment Corporation

h. Federal Bank for Cooperatives

i. Equity Participation Fund

j. House Building Finance Corporation

k. Small Business Finance Corporation

The above-mentioned institutions have played a very important role in the growth of Capital markets in Pakistan[289] and accelerated assistance available to the private sector of the economy.

4.3 SECP

4.3.1 Predecessors of SECP

4.3.1.1 Investment Wing of Ministry of Finance

At the outset, the Investment Wing of Ministry of Finance was administering the regulation of securities.

4.3.1.2 Securities and Exchange Authority of Pakistan

Then, the Securities and Exchange Authority of Pakistan established in 1971, as an attached department of Finance Ministry, to regulate the securities.

4.3.1.3 Corporate Law Authority (CLA)

Subsequently, CLA formed as an attached department of Ministry of Finance. The F.G was empowered to constitute a CLA[290].

[289]Chapter 3, CAPITAL MARKET IN PAKISTAN: Efficiency in Stock Market. A Case Study of KSE by Khalid Mustafa. Page-36, Thesis Submitted to International Institute of Islamic Economics. International Islamic University (2002)

The following corporate laws assigned to it:

a. The Companies Act, 1913

b. The SEO, 1969

c. The Monopolies and Restrictive Trade Practices (Control & Prevention) Ordinance, 1970

d. The Companies (Appointment of Investment Advisers) Act, 1971

e. The Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980

While in the process of restructuring into the new SECP, the CLA was overseeing and regulating the securities market, as well as registering companies. The policy board of SECP, with both public and private sector representation, appointed in May 1998, provided policy guidelines, through its monthly meetings, to the SECP[291].

4.3.2 Establishment of the SECP

SECP was created as statutory body under the SECP Act of 1997. It is an independent and autonomous regulatory body, began operation on 1 of January 1999, as scheduled in the Asian Development Bank's Capital Market Development Program, as a successor to the CLA with the mandate to regulate the corporate sector and the capital markets in Pakistan[292]. It functions as *Apex regulator* of the capital markets, corporate sector, NBFC's, CISs, Insurance and Private Pensions/Occupational Savings Schemes

SECP is an active and energetic securities regulator and has achieved a high degree of compliance with the principles of IOSCO. It also remains committed to achieve and maintain high regulatory standards as evidenced by the major reforms in the Pakistani financial sector and its regulation. As a regulator it is aware of the changes taking place in the regulatory, economic and financial environment globally.

Over the years, the mandate of the SECP has considerably broadened to include sectors as diverse as the non banking financial institutions, insurance and pensions[293]. The SECP's wider role has brought with it increased challenges. However, in all its regulatory actions, irrespective of the sector to which these pertain, the SECP has been guided by a single principle: investor protection.

In terms of the present legal regime, the regulation of the capital markets is therefore divided between the SECP and the stock exchanges. Whereas it is the responsibility of

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[290] Section 11 of the Companies Ordinance, 1984

[291] A Study of Financial Markets; Reforming Pakistan's Capital Markets, by Catherine Chou, p-76
http://www.adb.org/Documents/Books/Rising_to_the_Challenge/Pakistan/3-pak-cap.pdf

[292] Preamble of Act No. XLII of1997 (SECP Act, 1997)
http://www.secp.gov.pk/corporatelaws/pdf/secpact1997

[293] Establishment of SECP
http://www.secp.gov.pk/aboutus.asp

the SECP to provide the framework for the market, it is the stock exchanges, in their capacity as (SROs), which are primarily responsible for ensuring regulatory compliance on the part of the financial intermediaries[294].

4.3.3 Mission of SECP

The mission of SECP is to promote and maintain fair, efficient, secure and transparent market and to facilitate the orderly development of the stock exchange[295].

Fair;

The stock exchange assures that no investor will have an undue advantage over other market participants.

Efficient Market;

Orders executed and transacted are settled in the fastest possible way.

Transparency;

Investor makes informed and intelligent decision about the particular stock based on information. Listed companies must disclose information in timely, complete and accurate manner to the exchange and the public on a regular basis. Required information include stock price, corporate conditions and developments dividend, mergers and joint ventures, and management changes[296], etc.

All the companies registered with the SECP are required to fulfill certain post-incorporation statutory and legal requirements to stay compliant with their corporate obligations. Fulfilling of these post incorporation requirements not only bring transparency in the corporate affairs of a company, but also enhance the SECP's regulatory capabilities. Besides, necessary information is readily available to shareholders, investors, creditors and the public[297].

4.3.4 Laws Administered by SECP

a. Listed Companies (Substantial Acquisition of Voting Shares & Takeovers) Ordinance, 2002

b. Insurance Ordinance, 2000

c. SECP Act, 1997

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[294]Report of the Task Force to Review the Market Situation March 2005, Para # 7, By Dr. Tariq Hassan (Chairman, SECP) 20, September 2005

[295] Mission;
http://www.secp.gov.pk

[296] The Role and Function of a Stock Exchange By Enid E Bissember
http://www.gasci.com/eeb%20presentation%20to%20gASCI.ppt

[297] Securities & Exchange Commission of Pakistan; Actively Monitor The Stock Market
http://www.cmda.gov.mv/docs/Anx-IV%20Pakistan%20-%20presentaiton%20SEC.pdf

d. Central Depositories Act, 1997

e. Companies Ordinance, 1984

f. Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980

g. Companies (Appointment of Legal Advisors) Act 1974

h. SEO, 1969[298]

i. 29 sets of Rules framed under the statutes administered by SECP

j. SECP was given regulation-making powers by Government of Pakistan through Finance Act 2007. Subsequently, 09 Regulations have been developed under various statutes.

k. Guidelines issued for internet trading, issue of Commercial Paper/TFCs[299]/Prospectus, Code of Corporate Governance, compliance of Anti-Money Laundering requirements for market intermediaries etc.

4.4 Governing Laws/Rules for Regulating the Business of Stock Exchange

Majority Statutory Law /Rules to Regulate the Stock Exchanges are:

a. SEO, 1969[300]

b. Securities & Exchange Rules 1971

c. SECP Act 1997

d. Specific Purpose Legislations For Conduct Of Trade

4.3.5 SEO, 1969

The objectives of the SEO, 1969 are:

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[298] Internet from 10/17/08
http://www.secp.gov.pk/laws.asp

[299] What is a TFC

i. A corporate debt instrument issued by companies to generate short and medium-term funds.
ii. Corporate TFCs offer institutional investors, in particular retirement funds and insurance companies, with a viable high yield alternative to the National Saving Schemes (NSS) and bank deposits
iii. TFCs are also an essential complement to risk free, lower yielding government bonds such as PIB
iv. TFCs can be issued both as a fixed or floating rate instrument and may have a call or put option

[300] Preamble of SEO, 1969

a. The protection of investors,

b. Regulation of Markets,

c. Dealings in securities, and for matters ancillary thereto[301].

4.3.6 SECP Act, 1997

The SECP Act 1997 is an Act to provide for the establishment of the SECP and to provide for matters connected therewith and incidental thereto. Whereas it is expedient to provide for the establishment of the SECP for the beneficial Regulation of the capital markets, superintendence and control of corporate entities and for matters connected therewith and incidental thereto[302].

The SECP Act 1997established the SECP as the apex regulator of the capital markets. Under this law, the SECP is to be assisted in achieving its regulatory objectives by the stock exchanges, which are the front line regulators and which continue to exercise their wide-ranging powers under the SEO, 1969 under the general regulatory umbrella of the SECP.

In terms of the present legal regime, the regulation of the stock market divides between SECP and Stock exchanges. Whereas it is the responsibility of the SECP to provide the framework for the market, it is the stock exchanges, in their capacity as SROs, which are primarily responsible for ensuring regulatory compliance on the part of the financial intermediaries[303].

4.3.6.1 Summary of Main Provisions of SECP Act, 1997

1. The Commission (SECP) would be a body corporate and a legal person.

2. The Commission (SECP) would comprise of such number of commissioners including a Chairman as may be fixed by the F.G but minimum and maximum number of commissioners shall be five and seven respectively. The tenure of the chairman will be three years while that of the commissioners shall be two or three years to be determined through random ballot to facilitate continuity of the Commission. The incumbents would be eligible for a second term[304].

3. The Commission (SECP) would administer the following laws:

   a. The SEO, 1969;

   b. The Companies Ordinance, 1984;

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[301] Internet from 4/16/09
http://unpan1.un.org/intradoc/groups/public/documents/APCITY/UNPAN015862.pdf
[302] Preamble of SECP Act, 1997
[303] Internet from 4/15/09
http://www.secp.gov.pk/ChairmanSpeeches/PDF/sep_20_SSC.pdf
[304] Internet from 11/25/08
http://www.secp.gov.pk/annualreport/2000/organization.pdf

c. The Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980

d. The Insurance Act, 1938 (since replaced by the Insurance Ordinance, 2000);

e. The Companies Legal Advisers Act, 1974; and

f. The SECP Act, 1997.

All the powers of the Authority and the F.G (except power for rules making) under the above laws are exercised by the Commission.

4. The Government can assign administration of any other law to the Commission[305] (SECP).

5. Commission (SECP), with the approval of the SEPB[306], shall determine the Terms and conditions of the employees.

6. The main functions of the Commission in respect of securities market are:

   a. Regulation of securities market

   b. Regulation and supervision of the activities of capital market institutions like central depository and stock exchanges clearing houses

   c. Registering and regulating work of stock brokers, sub-brokers, trustees, bankers to the issue, registrars to the issue, under-writers, portfolio managers and investment advisers

   d. Regulation of collective investment schemes, Unit Trusts and Mutual Funds

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[305] Internet from 5/16/10
http://secp.gov.pk/annualreport/pdf/AR1999-2000.PDF

[306] While ensuring full autonomy of the Commission, the Act provides for establishment of a SEPB (the Policy Board). The main objective of the Policy Board is to provide guidance to the Commission in all matters relating to its functions and to formulate policies in consultation with the Commission. The Policy Board is also responsible for advising the Government on any matter falling within the purview of the Act and other Corporate Laws; and to express its opinion on policy matters referred to by the Government or the Commission. The Act provides that the F.G shall appoint a Policy Board consisting of seven members out of whom four would be ex-officio while three would represent the private sector. The ex-officio members are:

i. Secretary, Finance Division
ii. Secretary, Law and Justice Division
iii. Chairman of the Commission, and
iv. Deputy Governor of the SBP

Following a recent amendment in the Act, the size of the SEPB increased to nine members, including the Secretary, Commerce Division, as another ex-officio member. The term of an ex-officio member is the period of incumbency of his/her official position whereas the term of a private sector member is for a fixed period of four years.

e. Regulating substantial acquisition of share, mergers and takeover of companies[307]

7. A SEPB shall be constituted, which shall consist of seven members out of whom three would be from private sector while four would be ex-officio namely; Secretary, Finance Division, Secretary, Law and Justice Division, Chairman of the Commission and a Deputy Governor of the SBP. The tenure of the private sector members of the Policy Board shall be four years.

The main functions of the Board are, to:

a. Advise the F.G on all matters relating to securities market, regulation of companies and corporate sector and protection of interest of investors, measures to encourage self regulation by the stock exchanges and non bank financial institutions and measures to promote securities market

b. Approve the budget of the Commission, and

c. Oversee the performance of the Commission to the extent that purposes of the Act are achieved[308]

8. The Commission shall administer and control a Fund consisting of all sums received from F.G, grants and sums raised by Commission and fees, penalties and other charges levied by the Commission.

9. The Fund shall be expended for the purposes of meeting lawful expenditure of the Commission.

10. Commission is required to prepare an Annual Report on the activities of the Commission and release for the general public and to be submitted to the F.G and the Parliament.

11. Accounts of the Commission are to be audited by two auditors; one to be appointed by the Federal Government and the other by the Commission.

12. Commission has been vested with sufficient powers to carry out investigation and inspection and call for any information relevant to its scope of work.

13. Appellate Bench is to be constituted by the Commission to hear appeals in respect of an order passed by Commissioner[309]

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[307] Internet from 5/16/10
http://secp.gov.pk/annualreport/pdf/AR1999-2000.PDF
[308] Internet from 11/25/08
http://www.secp.gov.pk/annualreport/2000/organization.pdf
[309] Ibid

4.5 Demualization of stock Markets

Demutualization and integration of three stock exchanges is to enhance transparency and governance at the exchanges and to eliminate the conflict of interest inherent in the mutualized structure.

Demutualization means separation of ownership from the right to trade in stock exchange. In order to make the stock markets more efficient and transparent, the Demutualization Act is drafted to establish a framework for the demutualization process of the stock exchanges. After demutualization, the ownership, the management and the trading rights at the exchange will be segregated from one another.

The most important and debating step taken by the SECP was the 'Demutualization' of the three stock exchanges. It's important that more than 85 percent of world's leading stock exchanges have already been demutualized.

In Pakistan, the Act: ***The Stock Exchanges (Corporatization, Demutalization, Integration) Act 2012***, has been very recently passed by the National Assembly, signed by the President and published in the official gazette of Pakistan on May, 09th, 2012. Under this system, the stock-exchanges will convert into profit making organizations and the members of stock-exchanges will be receiving dividend from the stock exchange income. In this case, the members will have to lose their rights of brokerage business. The brokers will be different from the members of the stock exchange. By implementation of this system, the transparency and independency will be ensured.

4.6 Regulatory Structure

Regulatory structure of Pakistan's Financial and Corporate sector, is as below

MINISTRY OF FINANCE

SBP	**SECP**	FBR
(Banks & Financial Institutions)	**(Three Stock Exchanges)**	
	NCCP **National Depository Company**	

The commercial banks and DFIs are working under the supervision of the SBP; while the NBFCs are functioning under the supervision of the SECP. This distribution based on one of standardized functions of the central bank – guardian of money market. The state bank (Being the guardian of money market) is responsible to supervise the operation of those institutions, which can directly affect the money market operation and performance. While, the SECP is responsible for all those companies, which offer their securities to public. The NBFCs allowed to business in the areas of leasing, investment advisory services, assets management services (open ended and closed ended mutual funds) and the financing (including housing finance)[310].

4.7 Stock Exchanges in Pakistan and their Regulation (as SROs)

In Pakistan, there are three stock exchanges, namely;

1. KSE
2. LSE
3. ISE

In Pakistan, all stock exchanges are mutualized. That is, they are owned by market participants. They operate as SROs. The KSE is the country's oldest and largest exchange with market capitalization and is by far the most active and almost all companies listed on LSE and ISE is also listed on KSE[311]. As per information in the annual report, the SECP is actively pursuing the process of demutualization of the exchanges to keep up with the global trend. All exchanges have now agreed to the establishment of demutualized stock exchanges and to their corporatization and integration.

The KSE has introduced a state-of-the-art computerized trading system known as KATS to provide a fair, transparent, efficient and cost effective market for the investors. Each and every order/ trade is duly logged & recorded, with pre-trade client-wise margins verification system effective at order level[312].

The gilt-edged market is mainly confined to the SBP, the commercial Banks and the insurance companies. There is no market for corporate bonds while institutions like the State Bank, the commercial banks insurance companies; local bodies, Public corporations and provident funds hold almost all the Government securities. Commercial banks are required to maintain liquidity at 18% of their assets in cash and unencumbered approved securities whereas insurance companies are required to maintain 40% of their assets in government and government approved agencies. The major markets for gilt-edged securities exist only at Karachi and normally business firm all over the country is referred to Karachi for execution. The banking sector is

[310] Internet from 3/27/09
http://www.pakistan.gov.pk/ministries/planninganddevelopment-ministry/mtdf/36-Capital%20Market%20development/36-Capital%20Market%20Dev.pdf

[311] IMF Country Report No. 04/215; Pakistan: Financial System Stability Assessment, including Reports on the Observance of Standards and Codes on the following topics: Monetary and Financial Policy Transparency, Banking Supervision, and Securities Regulation p 15

[312] Free and Well-Developed Equity Market: Securities & Exchange Commission of Pakistan
http://www.cmda.gov.mv/docs/Anx-IV%20Pakistan%20-%20presentaiton%20SEC.pdf

the major holder of Government securities. Banks are required by law to keep a certain percentage of their assets in liquid form, including unencumbered Government securities i.e., securities, which are not pledged for loans.

4.7.1 KSE

The KSE is the country's oldest and largest exchange with market capitalization and is by the most active, almost all companies listed on LSE and ISE are listed on KSE[313]. It is also, the second oldest stock exchange in South Asia.

The KSE is the biggest and liquid stock exchange in Pakistan. It was announced the *Best Performing Stock Market of the World for the year 2002*. As of Dec 8, 2009, 654 companies were listed with a market capitalization of Rs. 2.561 trillion (US$ 30.5 billion) having listed capital of Rs. 705.873 billion (US$ 10.615 billion).

The KSE has introduced a state-of-the-art computerized trading system known as KATS to provide a fair, transparent, efficient and cost effective market for the investors. Every order/ trade is duly logged & recorded, with pre-trade client-wise margins verification system effective at order level[314].

4.7.1.1 KSE-100 Index

KSE-100 Index[315] is a stock index acting as a benchmark to compare prices on the KSE over a period of time. In determining representative companies to compute the index on, companies with the highest market capitalization are selected. However, to ensure full market representation, the company with the highest market capitalization from each sector is also included.

4.7.1.2 KSE-30 Index

The KSE has launched the KSE-30 Index with base value of 10,000 points, formally implemented from Friday, September I, 2006. The main feature of this index that makes it different from other indices is:

a. KSE-30 index is based only on the free-float of shares, rather than on the basis of paid-up capital.

[313]IMF Country Report No. 04/215; Pakistan: Financial System Stability Assessment, including Reports on the Observance of Standards and Codes on the following topics: Monetary and Financial Policy Transparency, Banking Supervision, and Securities Regulation p 15

[314]Free and Well-Developed Equity Market: Securities & Exchange Commission of Pakistan http://www.cmda.gov.mv/docs/Anx-IV%20Pakistan%20-%20presentaiton%20SEC.pdf

[315]*History of KSE-100 Index*

The index was launched in late 1991 with a base of 1,000 points. By 2001, it had grown to 1,770 points. By 2005, it had skyrocketed to 9,989 points. It then reached a peak of 12,285 in February 2007. KSE-100 index touched the highest ever benchmark of 14,814 points on December 26, 2007, a day before the assassination of former Prime Minister Benazir Bhutto, when the index nosedived. The index recovered quickly in 2008, reaching new highs near 15,500 (citation needed) in April.

b. The other indices in KSE represent total return of the market. That is, when a company announces a dividend, the other indices at KSE are not reduced/adjusted for that amount of dividend (whether cash or bonus).Whereas, KSE-30 Index is adjusted for dividends and right shares.

4.7.2 Trading Instruments of KSE

The vast number of instruments trading on our markets provides Pakistani investors with fantastic opportunities but also with its own unique challenges. Equities, corporate and Government bonds and Exchange Traded Funds are just some of the asset classes traded on the KSE.

4.7.2.1 Equities

Company shares ('equities') are among world's most popular investments. Equities give investors the opportunity to share in the success of companies by benefiting from the potential for both income and capital appreciation[316].

4.7.2.2 Bonds

A debt investment in which an investor loans money to an entity (corporate or Governmental) that borrows the funds for a defined period of time at a fixed interest rate. Bonds are commonly referred to as fixed-income securities and are one of the three main asset classes, along with stocks and cash equivalents.

4.7.2.3 Exchange Traded Funds

Exchange Traded Funds can be traded like a stock. Investors can do just about anything with an Exchange Traded Funds that they can do with a normal stock, such as short selling. Because Exchange Traded Funds are traded on stock exchanges, they can be bought and sold at any time during the day[317] (unlike most mutual funds[318]). Their price will fluctuate from moment to moment, just like any other stock's price, and an investor will need a broker in order to purchase them, which means that s/he will have to pay a commission. On the plus side, Exchange Traded Funds are more tax-efficient[319]and have a very low operating and transaction costs.

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[316] Investing in Shares:
http://www.kse.com.pk/investors-corner/shares.php?id=5&sid=5.11

[317]What Does Bond Mean?
http://www.investopedia.com/terms/b/bond.asp

[318]Fund operated by an investment company that raises money from shareholders and invests it in stocks, bonds, options, commodities, or money market securities. These funds offer investors the advantages of diversification and professional management. For these services they charge a management fee, typically 1% or less of assets per year. Mutual funds may invest aggressively or conservatively. Investors should assess their own tolerance for risk before they decide which fund would be appropriate for them. In addition, the timing of buying or selling depends on the outlook for the economy, the state of the stock and bond markets, interest, and other factors.

[319] Exchange Traded Fund:
http://www.investorwords.com/1810/Exchange_Traded_Fund.html

4.7.3 Rules and Regulations of KSE

Following is the list of Rules and Regulations of KSE

a. General Regulations

b. Listing Regulations

c. Over the Counter

d. Cash-Settled Futures Contract

e. Provisionally Listed Companies

f. Short Selling, 2002

g. Proprietary Trading

h. Margin[320] Trading, 2004[321]

i. KATS Regulations

j. Regulations Governing System Audit of the Brokers of the Exchanges, 2004

k. Risk Management

l. Regulations for Branch Offices

m. Regulations Governing Stock Index Futures Contract (SIFC)

n. Deliverable Futures Contract

o. Members' Default Management Regulations

p. BATS (BATS) Regulations

q. Investors Protection Fund Regulations[322]

4.7.3.1 General Regulations

General regulations of KSE, may be called as *General Regulations of the KSE (Guarantee) Limited*[323]

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[320] 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

[321] S.R.O 541 (I)/2004
http://www.secp.gov.pk/corporatelaws/pdf/MarginTradigRules_2004.pdf

[322] http://www.kse.com.pk/kseregulations

[323] http://www.kse.com.pk/kseregulations/otherdocs/genrules.zip
(As amended on January 18, 2010 and sent for Gazette Notification)

4.7.3.2 Listing Regulations

Listing Regulations may be called as *The Listing Regulations of the KSE (Guarantee) limited*[324]. Moreover, it shall apply to the following companies:

a. Listed companies[325]

b. Listed securities[326]

c. All companies and securities applying for listing[327].

4.7.3.3 Over the Counter

To introduce the concept of OTC market was, to provide investors transparent and an efficient source of investment, besides encouraging enterprising promoters to set up new industries and their existing enterprises by raising finance in a cost-effective way through listing mechanism on OTC market. In this regard, in order to provide necessary regulatory framework for the OTC Market[328], the KSE (Guarantee) Limited, in exercise of the powers conferred by section 34(1) of the SEO, 1969 (XVII of 1969) with prior approval of SECP, make Regulations, which may be called as *The Regulations Governing Over The Counter (OTC) Market Of The KSE (Guarantee) Limited*[329].

4.7.3.4 Cash-Settled Futures Contract

In order to introduce Cash-Settled Futures Contract of 90 days duration at the KSE, necessary regulations were framed by KSE[330]. These Regulations are called as *Regulations Governing Cash-Settled Futures Contract of the KSE (Guarantee) Limited*[331].

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[324] http://www.kse.com.pk/kseregulations/otherdocs/listedrules.zip

[325] Listed company means a company, a body corporate, or other body which has been listed in accordance with the regulations and whose securities are listed and include a provisionally listed company under these regulations for trading in provisionally listed companies of the Exchange

[326] Listed security shall include any share, scrip, debenture, participation term certificate, modaraba certificate, mushariqa certificate, Sukuk Certificates, TFC, bond, pre-organization certificate or such other instruments as the F.G may by notification in the Official Gazette specify for the purpose and which is accepted for listing on the Exchange in accordance with the Regulations

[327] Sec-1, PRELIMINARY, of the Listing Regulations of the KSE (Guarantee) Limited.
(As amended on March 16, 2010 and sent for Gazette Notification)

[328] PREAMBLE; The Regulations Governing OTC Market of the KSE (Guarantee) Limited
(As amended on March 18, 2010 and sent for Gazette Notification)

[329] SHORT TITLE & COMMENCEMENT; The Regulations Governing OTC Market of the KSE (Guarantee) Limited
http://www.kse.com.pk/kseregulations/otherdocs/otc-rules.zip

[330] PREAMBLE; The Regulations Governing Cash-Settled Futures Contract of the KSE (Guarantee) Limited
(As amended on September 17, 2009 and sent for Gazette Notification)

[331] http://www.kse.com.pk/kseregulations/otherdocs/futurecashsett.zip

4.7.3.5 Provisionally Listed Companies

It was expedient to make new regulations for provisionally listed securities to regulate future trading in securities in the process of Provisional Listing[332]. Listing should be done simultaneously with the publication of the prospectus, which required regulations to regulate such trading, in order to protect the interest of investors and to avoid kerb trading. Therefore, with the prior approval of the SECP, the KSE (Guarantee) Limited makes the Regulations, namely, *Regulations for Futures Trading in Provisionally Listed Companies, 2002 of the KSE (Guarantee) Limited*[333]

4.7.3.6 Short Selling, 2002

In order to regulate short selling[334] under Ready Market subject to its proper regulation in line with the international practice, it was desirable that necessary Regulations be framed in this regard[335]; therefore KSE makes the Regulations, namely: *Regulations for Short Selling Under Ready Market, 2002 Of The KSE (Guarantee) Limited*[336].

4.7.3.7 Proprietary Trading

In exercise of the powers conferred under Section 34(l) of the SEO, 1969 (XVII of 1969), the Stock Exchanges, with the prior approval of the SECP, make the Regulations for Proprietary Trading, These regulations may be called as *Regulations For Proprietary Trading, 2004*[337]. Moreover, it is applicable to a broker, agent[338] and an associated person[339].

4.7.3.8 Margin Trading, 2004

It was mandatory under the Margin Trading Rules, 2004, notified by the SECP, to make detailed regulations for the Members (Brokers) with respect to grant of Margin

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[332] PREAMBLE; Regulations For Futures Trading In Provisionally Listed Companies (FTPLC), 2002 Of The KSE (Guarantee) Limited
(As amended on September 17, 2009 and sent for Gazette Notification)

[333] http://www.kse.com.pk/kseregulations/otherdocs/futureTradingProvScriprs.zip

[334]Short Selling is defined in this regulation as A sale by a Member, on his Proprietary Account or on Client's Account, not owning securities at the time of sale or the sale without constituting a Pre-Existing Interest but is a sale on Proprietary Account or Client's Account entered into on the basis of Prior Contractual Borrowing Arrangement to meet delivery requirements on the settlement date

[335] PREAMBLE; THE REGULATIONS FOR SHORT SELLING UNDER READY MARKET, 2002 of the KSE (Guarantee) Limited
(As amended on September 17, 2009 and sent for Gazette Notification)

[336] http://www.kse.com.pk/kseregulations/otherdocs/shortselling.zip

[337] http://www.kse.com.pk/kseregulations/otherdocs/ProprietaryTrading.zip

[338] Agent means a person appointed by a broker to act on his behalf for the purposes recognized by a stock exchange

[339] Associated person means any partner, employee, officer or director of a broker. Whereas *Broker* means any member of the Exchange engaged in the business of executing transactions in securities for the account of others and for his own account and is registered with the Commission under the Brokers and Agents Registration Rules, 2001

Financing and Margin Trading facilities to clients and to regulate such trading[340]. Therefore, the KSE (Guarantee) Limited, in exercise of the powers conferred by sub-section 1 of section 34 of the SEO, 1969 (XVII of 1969) makes, with the prior approval of the SECP, the Regulations namely; *The Margin Trading Regulations Of The KSE (Guarantee) Limited, 2004*[341]

4.7.3.9 KATS[342] Regulations

The KSE (Guarantee) Limited decided to introduce automated trading through (KATS) and it is necessary and expedient to frame regulations for operation, regulation and control of the KATS[343]. Therefore, the BODs of The KSE (Guarantee) Limited, with the prior approval of the F.G hereby makes the regulations, namely *KATS Regulations of the KSE Guarantee) Limited*[344]

4.7.3.10 Regulations Governing System Audit of The Brokers Of The Exchanges, 2004

It is considered an expedient to have regulations for conducting the system Audit of brokers in order to ensure compliance with the requirements of;

a. The SEO, 1969,

b. Securities and Exchange Rules, 1971,

c. Code of Conduct for Brokers as enshrined in the Third Schedule of the Brokers and Agents Registration Rules, 2001

d. The Articles,

e. The Rules and Regulations of the Exchange, and

f. The directives issued by the Commission from time to time

And thereby promote investor confidence in fair dealings at the Exchange which is one of the key ingredients in the development of the securities-markets[345]. Therefore, SECP in exercise of powers conferred under section 34 (1) of the SEO, 1969, approved the following Regulations with certain amendments. This may be called as

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[340] PREAMBLE; The Margin Trading Regulations of the KSE Ltd October 26, 2004

[341] http://www.kse.com.pk/kseregulations/otherdocs/marginTrading.zip

[342] KATS means the securities automated trading system introduced by the KSE (Guarantee) Limited

[343] PREAMBLE; KATS Regulations of the KSE (Guarantee) Limited
(As amended on January 04, 2010 and sent for Gazette Notification)

[344] http://www.kse.com.pk/kseregulations/otherdocs/kats.zip

[345] PREMBLE; Regulations Governing System Audit of the Brokers of the Exchanges, 2004 of the KSE (Guarantee) Limited
(As amended on September 17, 2009 and sent for Gazette Notification)

Regulations Governing System Audit of the Brokers of the Exchanges, 2004 Of the KSE (Guarantee) Limited[346]

4.7.3.11 Risk Management

In order to implement a transparent and effective risk management system in respect of all market[347] segments, it was deemed expedient to frame Regulations in this regard[348]. Therefore, the KSE makes the Regulations, which may be called as *Regulations Governing Risk Management of KSE*[349]

4.7.3.12 Regulations for Branch Offices

The Members of the KSE opened their Office(s)/Branch Office(s)[350], within or outside the KSE premises, in order to promote equity investment. And whereas in order to;

a. Maintain a smooth process for opening of the Office(s)/Branch Office(s) and ensure full compliance of the Rules and Regulations of the Exchange

b. The protection of investors dealing through such Office(s)/Branch Office(s)

c. Matter arising out of or connected therewith

It was necessary to frame necessary Regulations to meet the underlined objectives[351]. Therefore, the BODs of the KSE makes Regulations, which are *Regulations Governing KSE Members' Office(S)/Branch Office(S) For Conducting The Business*

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[346] SHORT TITLE & COMMENCEMENT; Regulations Governing System Audit of the Brokers of the Exchanges, 2004 of the KSE (Guarantee) Limited
http://www.kse.com.pk/kseregulations/otherdocs/BrokersSystemaudit.zip

[347] All Markets means collectively Ready Market, Deliverable Futures Contract Market, Cash-Settled Futures Market, Stock Index Futures Contract and Futures Trading in Provisionally Listed Companies Market and individually referred to as a Market

[348] PREMBLE; Regulations Governing Risk Management of KSE
(As amended on March 08, 2010 and sent for Gazette Notification)

[349] *Short Title;* Regulations Governing Risk Management of KSE http://www.kse.com.pk/kseregulations/otherdocs/RiskMgmt.zips

[350] Office(s) or Branch Office(s) means an Office/Branch/Shop opened and maintained by a member within or outside the premises of the Exchange for conducting the business and trading of shares and securities and includes Member's Main Office but excludes the Member's Telephone Booth. Provided that the operation of KATS Terminal within or outside KSE Building shall also be treated as Office(s)/Branch Office(s) for the purpose of these Regulations. Provided further that in case where a Member has only one location of operation and does not have Office/Branch Office at an alternate/second location, shall mandatorily be required to install one Remote Disaster Recovery (DR) Terminal in accordance with the KATS Regulations of the Exchange, and may be installed at any place which shall not deemed to be Office/Branch Office under these Regulations

[351] PREAMBLE; Regulations Governing KSE Members' Office(s)/Branch Office(s) for conducting the business and trading of shares and securities within and outside the Exchange of the KSE (Guarantee) Limited
(As amended on January 04, 2010 and sent for Gazette Notification)

And Trading Of Shares And Securities Within And Outside The Exchange Of The KSE (Guarantee) Limited[352]

4.7.3.13 Regulations Governing Stock Index Futures Contract

In order to introduce Stock Index Futures Contract at the KSE, necessary Regulations were framed by KSE to regulate Stock Index Futures Contract[353].Which may be called as *Regulations Governing Stock Index Futures Contract of the KSE (Guarantee) Limited*[354]

4.7.3.14 Deliverable Futures Contract

In order to introduce derivative market to bring the KSE comparable with the other leading securities markets of the world, KSE introduced the trading in Deliverable Futures Contracts. And in order to regulate trading in and settlement of Deliverable Futures Contracts[355], KSE make new regulations for trading in and settlement of Deliverable Futures Contracts, namely, *Regulations Governing Deliverable Futures Contract of the KSE (Guarantee) Limited*[356]

4.7.3.15 Members' Default Management Regulations

A detailed review of Regulations Governing Members' Default and Procedure for Recovery of Losses at the KSE has been undertaken by the KSE, so in the process of review of various aspects of default, KSE repealed and replaced the Regulations Governing Members' Default and Procedure for Recovery of Losses by these new regulations, in order to protect the interest of all concerned[357].New regulations are called as *Members' Default Management Regulations of the KSE (Guarantee) Limited*[358]

4.7.3.16 BATS Regulations

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[352] Sec-1, SHORT TITLE: Regulations Governing KSE Members' Office(s)/Branch Office(s) for conducting the business and trading of shares and securities within and outside the Exchange of the KSE (Guarantee) Limited
http://www.kse.com.pk/kseregulations/otherdocs/Reg_BranchOff.zip

[353] PREAMBLE; The Regulations Governing Stock Index Futures Contract of the KSE Limited (As amended on September 17, 2009 and sent for Gazette Notification)

[354] Sec-2; SHORT TITLE AND COMMENCEMENT, of The Regulations Governing Stock Index Futures Contract of the KSE (Guarantee) Limited
http://www.kse.com.pk/kseregulations/otherdocs/RegGovern_SIFC.zip

[355] PREAMBLE; REGULATIONS GOVERNING DELIVERABLE FUTURES CONTRACT of the KSE (Guarantee) Limited.
(As amended on March 08, 2010 and sent for Gazette Notification)

[356] Sec-2; SHORT TITLE AND COMMENCEMENT, of Regulations Governing Deliverable Futures contract of KSE of the KSE (Guarantee) Limited
http://www.kse.com.pk/kseregulations/otherdocs/RegGovDelFutCont.zip

[357] Preamble; Members' Default Management Regulations of the KSE (Guarantee) Limited (As amended on March 08, 2010 and sent for Gazette Notification)

[358] Sec-1, Short Title; Members' Default Management Regulations of the KSE (Guarantee) Limited.
http://www.kse.com.pk/kseregulations/otherdocs/membersDefault.zips

The KSE (Guarantee) Limited decided to introduce trading in the debt instruments through its BATS. The new debt market platform BATS allows electronic order entry and matching facility, which provides a more efficient and transparent way to trade debt market securities[359]. Therefore, KSE framed regulations for operation and control of trading activities in the debt market securities at the Exchange. Which is called as *Bond Automated Trading System (BATS) Regulations of the KSE (Guarantee) Limited*[360]

4.7.3.17 Investors Protection Fund Regulations

To ensure effective risk management in secondary market trading and to protect investors' interest in the case of a default by a member of the Exchange, KSE prepared necessary rules and regulations[361].Because the Management of KSE considers that the investors' confidence in the fair dealings at the Exchange is the key to rapid development of the market. So, the KSE (Guarantee) Limited in exercise of the powers conferred by sub-section (1) of section 34 of the SEO, 1969 makes, the regulations, namely: *KSE Investors Protection Fund Regulations of the KSE (Guarantee) Limited*[362]

4.7.4 LSE

LSE is the second largest and first automated stock exchange of Pakistan, and is dynamic and emerging market with large number of listed companies and state of the art technology. It provides a transparent, geographical independent trading environment to attract retail investors[363].

4.7.4.1 History of LSE

The LSE (Guarantee) Limited was established in October 1970, under the SEO of 1969 by the Government of Pakistan in response to the needs of the provincial metropolis of the province of Punjab. It initially had 83 members and was housed in a rented building in the crowded Bank Square area of Lahore. The number of listed companies has increased to 519 since its inception[364].

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[359] Preamble; Bond Automated Trading System (BATS) Regulations of the KSE (Guarantee) Limited.
(Sent for Gazette Notification on September 28, 2009)

[360] Sec-1, SHORT TITLE AND EXTENT; Bond Automated Trading System (BATS) Regulations of the KSE (Guarantee) Limited.
http://www.kse.com.pk/kseregulations/otherdocs/bats.zip

[361] Preamble; The KSE Investors Protection Fund Regulations of the KSE (Guarantee) Limited
(As amended on September 30, 2009 and sent for Gazette Notification)

[362]Sec-1, SHORT TITLE AND COMMENCEMENT: The KSE Investors Protection Fund Regulations of the KSE (Guarantee) Limited
http://www.kse.com.pk/kseregulations/otherdocs/invstProtectionFund.zip

[363] LSE; http://www.lahorestock.com/

[364] Internet from 9/22/11
http://en.wikipedia.org/wiki/Economy_of_Lahore

The LSE was the first stock exchange in Pakistan to use the internet and currently 50% of its transactions are via the internet[365].

4.7.4.2 Branches of LSE

The LSE has opened branches in the industrial cities of Faisalabad and Sialkot for trading. The Sialkot branch is referred to as the *Sialkot Trading Floor.*

Activities of LSE have increased significantly in all operational areas since its inception. Over the years, LSE has successfully met various challenges and has now emerged, fully geared and positioned to aggressively compete with its fellow Exchanges, contributing towards the growth of Capital Markets in Pakistan[366].

4.7.4.3 Important Developments over the Past Years

A number of significant initiatives have been taken to improve the regulatory regime and the trading environment for the benefit of Institutional Investors as well as listed companies. Although the list of such initiatives is exhaustive, below some of these incentives are touched upon;

1. LSE was the first Exchange in the country to undertake automation of trading at the exchanges in 1994. LSE has made large investments in technology & automation to keep pace with globalization of securities trading. The Exchange is fully committed to providing a transparent, efficient, fair and investor friendly environment for the benefit of Investors and Issuers. The goal is to bring LSE up to international standards in operational, technical, regulatory and quality management areas and to ensure that not only domestic but also foreign investors are attracted[367].

2. LSE has made direct investment in Pakistan Credit Rating Agency (Pvt.) Ltd., CDC Ltd, NCCP Ltd., and National Commodity Exchange Ltd., all of which play a central role in developing the infrastructure around the financial markets of Pakistan. In addition, LSE is an active member of the Federation of Euro-Asian Stock Exchanges and the South Asian Federation of Exchanges, helping to expand its outreach, presence and profile beyond the boundaries of Pakistan.

3. LSE was the first Exchange in Pakistan to offer Internet based trading to its members in the year 2001. It enables the brokers to reach out to the untapped retail markets. Currently, more than 50% of the total trading volume at the

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[365] Internet from 3/4/10
http://www.freebase.com/view/en/lahore_stock_exchange
[366] Internet from 8/28/11
http://en.wikipedia.org/wiki/Lahore_Stock_Exchange
[367] Internet from 9/13/11
http://commerceplus.blogspot.com/2010/07/project-on-stock-exchange.html

LSE originates from Internet trading terminals. The aim of this measure is to transform the LSE from a regional to a national player over a period[368].

4. LSE has increased its geographical outreach by establishing its branches in other cities of the Province. Two such branch offices have become operational in Faisalabad and Sialkot. Similar Offices in other cities are also being contemplated.

5. LSE has improved the quality of operations and upgraded them to modern international standards. This has included upgrading LSE's IT infrastructure, updating regulations and procedures to incorporate existing and expected technological changes.

6. LSE has successfully launched UIN System with an objective to bring more efficiency and transparency to the stock business and to improve the surveillance and monitoring capacity of the Exchange.

7. LSE has implemented a regular timetable for the Broker System Audit, in order to build investors' confidence[369].

8. A visible trend at the LSE has been the increasing number of corporate members. It is heartening to note that part of this increase has been due to the entry of investment banks/financial institutions (or their subsidiaries) as members of the Exchange.

9. LSE Training Institute specifically dedicated to the Capital Markets, is the first of its kind in Pakistan and was established in 2006. Formal courses have been introduced to provide trained human resources for the capital markets. It has also launched a series of Education Programs with a view to educate the brokers, agents and general public about the securities market and its laws.[370].

10. In another trend-setting example, LSE and ISE have joined hands to establish a Unified Trading Platform which will help to bring increased liquidity in the market, improve price discovery, maximize transparency, increase turnover, broaden investor base, curtail risks and distortions in trade, provide cost effective service to the investing public and enhance the image of both the Exchanges.

As part of second generation capital market reforms being pursued by the SECP, demutualization is being seriously considered by the members of the exchanges. Demutualization is in line with international standards, which will ensure that the exchange truly and fairly represents the interests of all stakeholders[371].

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[368] ibid

[369] ibid

[370] Internet from 8/28/11
http://en.wikipedia.org/wiki/Lahore_Stock_Exchange

[371] Internet from 9/13/11
http://commerceplus.blogspot.com/2010/07/project-on-stock-exchange.html

4.7.5 Rules & Regulations of LSE

The LSE, being a self regulatory organization has its own sets of rules and regulations to regulate its various activities including listing of companies/ securities on its ready board quotation, supervision of member firms to enforce compliance with financial and operational requirements, periodic checks on broker's sales practices, and the continuous monitoring and surveillance of their trade operations. Therefore, the LSE in exercise of the powers conferred by sub-section (1) of section 34 of the SEO, 1969 (XVII of 1969) makes, with the prior approval of the F.G (SECP), some rules and regulations[372].

List of the rules and regulations of the LSE are as under;

1. General Rules & Regulations
2. Automated Trading Regulations For LOTS.
3. BATS Regulations.
4. Branch Office Members Regulations.
5. Carry Over Transaction Regulations.
6. Investor Protection Fund Regulations.
7. LSE Listing Regulations.
8. Procedures for Handling of Unpaid Right into Central Depository System
9. Regulations for Futures Trading in Provisionally Listed Companies.
10. Regulations for Proprietary Trading.
11. Regulations for Securities Lending & Borrowing.
12. Regulations for Trade and Settlement of Deemed Listed Securities.
13. Regulations Governing Cash Settled Futures Contract.
14. Regulations Governing Deliverable Futures Contracts.
15. Regulations Governing Future Contracts of LSE.
16. Regulations Governing Members Default Management.
17. Regulations Governing Risk Management.

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[372] Internet from 11/1/10
http://www.brokernet.com.pk/Regulations/

18. Regulations Governing Short Selling.
19. Regulations Governing Stock Index Futures.
20. Regulations Governing OTC.
21. Rules for Allotment of Rooms to Members.
22. Systems Audit Regulations.
23. The Margin Trading Regulations of LSE.
24. UTS Regulations[373]

4.7.5.1 General Rules & Regulations are:

LSE (Guarantee) Limited General Regulations[374]

4.7.5.2 Automated Trading Regulations for LOTS[375] are:

Automated Trading Regulations for LSE (LOTS)[376]

4.7.5.3 Regulations for BATS are:

Bond Automated Trading System Regulations of the LSE (Guarantee) Limited[377]

4.7.5.4 Branch Office Members Regulations are

Regulations Governing LSE Members' Office(S)/Branch Office(S) For Conducting The Business And Trading Of Shares And Securities Within/Outside The Exchange[378]

4.7.5.5 Carry Over Transaction Regulations are

Carry-Over Transaction Regulations of the LSE (Guarantee) Limited[379]

4.7.5.6 Regulations for Investor Protection Fund are

LSE Investor Protection Funds Regulations[380]

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[373]http://www.lahorestock.com/Regulations

[374] www.lahorestock.com/Regulations/General%20Regulations.pdf

[375] Abb. of (Lahore Online Trading System)

[376] http://www.lahorestock.com/Regulations/Automated%20Trading%20Regulations %20For%20LOTS.pdf

[377] http://www.lahorestock.com/Regulations/Bond%20Automated%20Trading%20 System%20Regulations.pdf
Approved as per approval of SECP dated 25-11-09,& sent for gazette notification on 1-12-09

[378] www.lahorestock.com/Regulations/BranchOfficeMembersRegulations.pdf

[379] www.lahorestock.com/Regulations/Carry%20Over%20Transaction%20Regulations.pdf

4.7.5.7 LSE Listing Regulations are

The Listing Regulations of LSE (Guarantee) Limited[381]

4.7.5.8 Unpaid Right into Central Depository System are

There are also some Procedures for Handling of Unpaid Right into Central Depository System[382]

4.7.5.9 Regulations for Futures Trading in Provisionally Listed Companies are

Regulation for Futures Trading In Provisionally Listed Companies (FTPLC), 2002[383]

4.7.5.10 Regulations for Proprietary Trading are

Regulations for Proprietary Trading Of the LSE (Guarantee) Limited[384]

4.7.5.11 Regulations for Securities Lending & Borrowing are

Regulations for Securities Lending and Borrowing, 2004[385]

4.7.5.12 Regulations for Trade and Settlement of Deemed Listed Securities are

Regulation for Trade and Settlement of Deemed Listed Securities[386]

4.7.5.13 Regulations Governing Cash Settled Futures Contract are

Regulations Governing Cash Settled Futures Contract of the LSE (Guarantee) Limited[387]

4.7.5.14 Regulations Governing Deliverable Futures Contracts are

Regulations Governing Deliverable Futures Contracts of LSE (Guarantee) Limited[388]

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[380] www.lahorestock.com/Regulations/Investor%20Protection%20FundRegulations.pdf

[381] http://www.lahorestock.com/Regulations/LSE%20Listing%20Regulations.pdf

[382] http://www.lahorestock.com/Regulations/ProcedureHandling.aspx

[383]http://www.lahorestock.com/Regulations/Regulations%20For%20Futures%20 Trading%20in%20Provisionally%20Listed%20Companies.pdf
Entire Regulations reproduced as per approval of SECP dated 25-11-09 and sent for gazette notification on 1-12-09

[384]www.lahorestock.com/Regulations/Regulations%20For%20Proprietary%20Trading.pdf

[385]http://www.lahorestock.com/Regulations/Regulations%20For%20Securities %20Lending%20&%20Borrowing.pdf

[386]http://www.lahorestock.com/Regulations/Regulations%20For%20Trade%20and %20Settlement%20Of%20Deemed%20Listed%20Securities.pdf

[387]http://www.lahorestock.com/Regulations/Regulations%20Governing%20Cash %20Settled%20Futures%20Contract.pdf

[388]http://www.lahorestock.com/Regulations/Regulations%20Governing%20Deliverable

4.7.5.15 Regulations Governing Future Contracts of LSE are

Regulations Governing Futures Contracts of LSE[389]

4.7.5.16 Regulations Governing Members Default Management are

Members' Default Management Regulations of the LSE (Guarantee) Limited[390]

4.7.5.17 Regulations Governing Risk Management are

Regulations Governing Risk Management of LSE[391]

4.7.5.18 Regulations Governing Short Selling are

The Regulations for Short Selling Under Ready Market[392]

4.7.5.19 Regulations Governing Stock Index Futures are

Regulations Governing Stock Index Futures Contract (SIFC)[393]

4.7.5.20 Regulations Governing OTC are

The Regulations Governing Over the Counter (OTC) Market of LSE (Guarantee) Limited[394]

4.7.5.21 Rules for Allotment of Rooms to Members are

Rules for Allotment Of Rooms To Members Of The LSE (Guarantee) Limited[395]

4.7.5.22 Systems Audit Regulations are

Regulations Governing System Audit of the Brokers of the Exchanges, 2004[396]

4.7.5.23 The Margin Trading Regulations of LSE(SIDRA)are

The Margin Trading Regulations of LSE (Guarantee) Limited[397]

%20Futures%20Contracts.pdf

[389]http://www.lahorestock.com/Regulations/Regulations%20Governing%20Future%20Contracts%20of%20LSE.pdf

[390]http://www.lahorestock.com/Regulations/Regulations%20Governing%20Members%20Default%20Management.pdf

[391]http://www.lahorestock.com/Regulations/Regulations%20Governing%20Risk%20Management.pdf

[392]http://www.lahorestock.com/Regulations/Regulations%20Governing%20Short%20Selling.pdf

[393]http://www.lahorestock.com/Regulations/Regulations%20Governing%20Stock%20Index%20Futures.pdf

[394] http://www.lahorestock.com/Regulations/Regultaions%20Governing%20OTC.pdf

[395]http://www.lahorestock.com/Regulations/Rules%20For%20Allotment%20Of%20Rooms%20To%20Members.pdf

[396] http://www.lahorestock.com/Regulations/Systems%20Audit%20Regulations.pdf

4.7.5.24 UTS Regulations are

Unified Trading System Regulations[398]

4.7.6 ISE

The ISE is one of the three stock exchanges of Pakistan and is located in the capital of Islamabad. It was incorporated on October 25, 1989 with the main object of setting up of a trading and settlement infrastructure, information system, skilled resources, accessibility and a fair and orderly market place that ranks with the best in the world. The purpose for establishment of the stock exchange in Islamabad was to cater to the needs of less developed areas of the northern part of Pakistan[399], and it became fully operational on August 10, 1992.

4.7.6.1 Mission Statement

The mission statement if ISE is;

"To create value for our investors and listed companies through dynamic market operations, fair, transparent business practices and effective management"

4.7.6.2 Vision Statement

The vision statement of ISE is;

"To be the pre-eminent stock market in Pakistan and achieve market recognition both in terms of quality and delivery of our services"

4.7.6.3 At Present

There are 119 members out of which 93 are corporate bodies including commercial and investment banks, DFIs and brokerage houses. The other 26 Members are individual persons who are well educated, enterprising and progressive minded. The BODs governs the affairs of the Exchange. The BODs consists of ten directors, of which five are elected member directors and four are non-member directors nominated by the SECP while the managing director by virtue of his office is the tenth director of the Board. In order to protect the interest of the investing public, the Exchange has established an Investors Protection fund.

Since the inception of automated trading system (ISECTS), the trade volume has been multiplying day by day and the average daily turnover has now crossed the figure of 1 million shares. Now all the listed securities are traded through the ISECTS[400]. The

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[397] http://www.lahorestock.com/Regulations/The%20Margin%20Trading%20 Regulations%20Of%20Lahore%20Stock%20Exchage%20SIDRA.pdf

[398] http://www.lahorestock.com/Regulations/Unified%20Trading%20 System%20Regulations.pdf

[399] ISE: http://www.ise.com.pk/index.asp

[400] Internet from 3/4/10

physical handling system of securities and shares has been phased out and majority of the scrip are settled through CDC of Pakistan Limited.

4.7.7 Rules and Regulations of ISE

ISE, being a SRO has its own sets of rules and regulations to regulate its various activities including listing of companies/ securities on its ready board quotation, supervision of member firms to enforce compliance with financial and operational requirements, periodic checks on broker's sales practices, and the continuous monitoring and surveillance of their trade operations[401].

The list of Rules and Regulations of ISE, is as following

4.7.7.1 General Rules & Regulation

General Regulations of the ISE[402]

4.7.7.2 Registration Rules for Brokers & Agent

Brokers and Agents Registration Rules, 2001[403]

4.7.7.3 Guidelines for Internet Trading

These Guidelines are called as *Internet Trading Guidelines, 2005*. The scope of the Guidelines extends to all internet trading service providers. The Guidelines shall not apply to proprietary trade networks or private trading networks operated between a Stock or Commodity Exchange and its members[404].

4.7.7.4 Regulations for BATS

ISE decided to introduce trading in the debt instruments through its ISEBATS. Regulations in this regard are called as *ISE Bond Automated Trading System (ISEBATS) Regulations Of ISE (G) Ltd.* The new debt market platform (ISE Bond Automated Trading System) allows electronic order entry and matching facility, which provides a more efficient and transparent way to trade debt market securities[405].

4.7.7.5 Trading Regulations for ISE Computerized Trading System (ISECTS)[406]

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http://en.wikipedia.org/wiki/Islamabad_Stock_Exchange
[401]Internet from 11/1/10
http://www.brokernet.com.pk/Regulations/
[402] http://www.ise.com.pk/Regulation/PDF/General_Regulations_of_ISE_&_Annexure.pdf
[403] S. R. O. 299 (1) /2001: Short title and commencement
http://www.ise.com.pk/Regulation/PDF/Brokers%20&%20Agent20Registration20Rules.pdf
[404] www.ise.com.pk/Regulation/PDF/Internet%20Trading%20Guidelines202005.pdf
[405] http://www.ise.com.pk/Regulation/PDF/ISE_Bond_Automated_Trading_System_Regulations.pdf
[406]*ISECTS or ISE Computerized Trading System* means the computerized system for automated trading introduced by the Exchange

ISE introduced computerized trading through ISE-Computerized Trading System. To frame regulations for operation, regulation and control of the computerized trading, following Regulations in this regard is - *ISE Computerized Trading Regulations*[407].

4.7.7.6 ISE Investors Protection Fund Regulations

Investors' confidence in the fair dealings at the Exchange is the key to rapid development of the market. To ensure effective risk management in secondary market trading and to protect investors' interest in the case of a default by a member of the Exchange there is following regulations; *ISE Investors Protection Fund Regulations*[408]

4.7.7.7 Listing Regulations of ISE

These Regulations may be called *Listing Regulations of the ISE Limited.* It applies to all companies, and securities applying for listing and those listed on the Exchange[409].

4.7.7.8 National Savings Bonds Rules

These Regulations are called as -*National Savings Bonds Rules, 2009*[410]

4.7.7.9 Regulations for Margin Trading

It was mandatory under the Margin Trading Rules, 2004, notified by the SECP, to make detailed regulations for the Members (Brokers) with respect to grant of Margin Financing and Margin Trading facilities to clients and to regulate such trading. For the purpose, the regulations are *The Margin Trading Regulations of the ISE Limited*[411]

4.7.7.10 Regulations for Proprietary Trading

These regulations are called as - *Regulations for Proprietary Trading of ISE, 2004* and they are applicable to a broker, agent and an associated person[412].

4.7.7.11 Regulations for Short Selling under Ready Market

Regulations for Short Selling under Ready Market, 2002 - were framed in order to regulate short selling under Ready Market subject to its proper regulations in line with the International Practice[413].

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[407] http://www.ise.com.pk/Regulation/PDF/ISE%20Computerized%20Trading%20 Regulations.pdf

[408] http://www.ise.com.pk/Regulation/PDF/ISE%20Investors%20Protection%20Fund%20 Regulations.pdf

[409] http://www.ise.com.pk/Regulation/PDF/Listing_Regulations_compatible.pdf

[410] S.R.O. (1)/2009
In exercise of the powers conferred by section 28 of the Public Debt Act, 1944 (XVIII of 1944), the F.G is pleased to make the following Rules, the same having been previously published vide Notification No. S.R.O. 1026(1)/2009, dated the 8th December, 2009
http://www.ise.com.pk/Regulation/PDF/National_Savings_Bonds_Rules_2009.pdf

[411] www.ise.com.pk/Regulation/PDF/Regulations%20for%20Margin%20Trading.pdf

[412] www.ise.com.pk/Regulation/PDF/Regulations_governing_Proprietary_Trading.pdf

[413] http://www.ise.com.pk/Regulation/PDF/Regulations_governing_Short_Selling.pdf

4.7.7.12 Regulations for Trading in Provisionally Listed Companies

In order to avoid KERB trading and to protect the interest of investors, listing is done simultaneously with the publication of the prospectus. Regulations to regulate such trading are *Regulations For Futures Trading In Provisionally Listed Companies (FTPLC), 2002*[414]

4.7.7.13 Regulations Governing Cash-Settled Futures Contracts

Necessary Regulations at ISE were framed to regulate Cash-Settled Futures Contract, in order to introduce Cash-Settled Futures Contract of 90 days duration. These are *The Regulations Governing Cash-Settled Futures Contract*[415]

4.7.7.14 Regulations Governing - Deliverable Futures Contract [416]

ISE, to introduce derivative market, and to bring the comparable with the other leading securities markets of the world, it introduced trading in deliverable futures contracts. In order to regulate trading in and settlement of deliverable futures contracts, new regulations for trading in and settlement of deliverable futures contracts are *Regulations Governing Deliverable Futures Contract of ISE*[417].

4.7.7.15 Rules and Regulations for Future Contracts of ISE

Futures Contract in shares on the Future Contract Market of the Exchange, conducts under the following Rules & Regulations of the Exchange with such modifications, alternations and additions as may be made from time to time by the BODs of ISE with prior approval of SECP.

Regulations Governing Futures Contracts of the ISE (Guarantee) Limited[418]

4.7.7.16 Regulations Governing ISE Members Offices/ Branch Offices

The ISE, in order to promote equity investment, the members of the ISE (Guarantee) Limited (ISE) are opening their Office(s)/Branch Office(s) within or outside the ISE premises. and whereas in order to maintain a smooth process for opening of the Office(s)/Branch Office(s) and ensure full compliance of the Rules and Regulations of the Exchange as well as the protection of investors dealing through such Office(s)/Branch Office(s) as well as matter arising out of or connected therewith, ISE framed necessary Regulations to meet the underlined objectives. These Regulations are *Regulations*

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[414] http://www.ise.com.pk/Regulation/PDF/Regulations%20for%20 Trading%20in%20Provisionally%20Listed%20Companies.pdf

[415] http://www.ise.com.pk/Regulation/PDF/Regulations_Governing_Cash-Settled_Futures_Contracts.pdf

[416]Deliverable Futures Contract means, Standardized Stock Futures contract which shall be trading under Deliverable Futures Contract Market and settled/delivered in accordance with these regulations as amended from time to time.

[417] http://www.ise.com.pk/Regulation/PDF/REGULATIONS_ GOVERNING_DELIVERABLE_FUTURES_CONTRACT.pdf

[418] http://www.ise.com.pk/Regulation/PDF/Regulations %20Governing%20Future%20Contracts%20of%20ISE.pdf

Governing ISE Members' Office(S)/Branch Office(S) For Conducting the Business and Trading of Shares and Securities within and outside the Exchange[419]

4.7.7.17 Regulations Governing Market Makers[420] of ISE

ISE, in order to provide liquidity in the securities market by obligating the Market Makers to submit both bids and offers for a Designated Product during the Designated Market Making Period, framed necessary Regulations in this regard, are *Regulations Governing Market Makers of ISE*[421]

4.7.7.18 Regulations Governing Member's Default Management of ISE

A review of various aspects of default under the existing Rules and Regulations of Members' Default and Procedure for Recovery of Losses at the ISE, it was deemed necessary that the existing Regulations Governing Members' Default and Procedure for Recovery of Losses be repealed and replaced by these new regulations, in order to protect the interest of all concerned. Therefore, ISE regulated regulations, which are *Members' Default Management Regulations of the ISE (Guarantee) Limited*[422].

4.7.7.19 Regulations Governing OTC Market of ISE

In order to introduce the concept of OTC market in order to provide investors an efficient and transparent source of investment besides encouraging enterprising promoters to set up new industries or expand their existing enterprises by raising finance in a cost-effective way through listing mechanism on OTC market, ISE framed necessary regulations for the OTC Market, these Regulations are the *Regulations Governing OTC Market*[423]

4.7.7.20 ISE Governing Risk Management Regulations

Regulations Governing Risk Management of ISE was regulated in order to implement a transparent and effective risk management system in respect of all market segments[424].

4.7.7.21 Regulations Governing System Audit of Members

Regulations for conducting the System Audit of brokers in order to ensure compliance with the requirements of the SEO, 1969, Securities and Exchange Rules, 1971, Code of Conduct for Brokers as enshrined in the Schedule-III of the Brokers and Agents Registration Rules, 2001 the Articles, Rules and Regulations of the Exchange and the

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[419] http://www.ise.com.pk/Regulation/PDF/Regulations_Governing_Members_Branch_Office_&_Annexure.pdf

[420] *Market Maker* means a Corporate Broker of the Exchange permitted under these Regulations or a financial institution which satisfies the eligibility criteria devised by the Exchange with prior approval of the Commission to function as a Market Maker in terms of Market Making Agreement.

[421] http://www.ise.com.pk/Regulation/PDF/Regulations%20Governing%20Market%20Makers%20of%20ISE.pdf

[422] http://www.ise.com.pk/Regulation/PDF/Regulations_governing_Memebr%27s_Default_management.pdf

[423] http://www.ise.com.pk/Regulation/PDF/Regulations_governing_OTC.pdf

[424] http://www.ise.com.pk/Regulation/PDF/Regulations_Governing_Risk_Management.pdf

directives issued by the Commission from time to time and thereby promote investor confidence in fair dealings at the Exchange which is one of the key ingredients in the development of the securities markets. ISE farmed necessary regulations, which are called as *Regulations Governing System Audit of the Brokers of the ISE Ltd 2004*[425].

4.7.7.22 Regulations for UTS

To protect the investors' interest and improve the operational efficiency of stock market it is essential to

(i) Improve transparency in trades executed by the member of one stock exchange on behalf of the member of the other stock exchange and

(ii) Strengthen the control over the custody of investors' securities and funds.

Therefore, ISE and LSE agreed to establish UTS, pursuant to their agreement dated August 26, 2006, for the execution of Orders by their Members, and regulated (new, consolidated and uniform regulations) trading on the UTS, which applies to all such Members who are eligible to trade on UTS. These regulations are called as *Unified Trading System Regulations, 2007*[426].

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[425] http://www.ise.com.pk/Regulation/PDF/System%20Audit%20Regulations-2004.pdf
[426] http://www.ise.com.pk/Regulation/PDF/Unified%20Trading%20System%Regulations

CHAPTER # 5;

REFORMS AND RECOMENDATIONS

SECP carried out and employed a multitude of Stock market reforms aimed at improved risk management, accommodation of new products, increased transparency, good governance and greater investor protection.

5.1 Reforms

To bring reforms in the stock market of Pakistan, a loan agreement was signed by the Government with the Asian Development Bank in January 1998, under which SECP was set up on 1st January 1999. The SECP has in recent years, launched a surfeit of reforms, to facilitate market development and regulation in the backdrop of its mission to;

> *Develop a fair, efficient and transparent regulatory framework, aimed at fostering growth of a robust corporate sector and broad based stock market in Pakistan*[427].

Since SECP's origin, it has carried out Practical and wide-ranging reforms relating to

1. Risk management
    a. VAR based Margining Regime
    b. Client level Margining system
    c. Pre-trade Margin verification system
2. Governance
    a. The 2002 Code of Corporate Governance
3. Transparency
4. Market development
5. Investor protection
6. Investor education
7. Corporate Sector
8. Demutalization

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[427] Developing Bond Markets In Pakistan By Muhammad Arif Joint Director Financial Markets Strategy and Conduct Department SBP

9. Non-Banking Financial Sector
10. Insurance
11. Proposals for Finance Act
12. Formation of the CDC
13. Netting
14. Valuation of Securities suitable to be held as security
15. Mark-to-Market Loss Assortment and profit Dispersal
16. Position Limits
17. Special Margins
18. Price-discovery and Trade-Settlement
    a. UIN
    b. Free Float Index
    c. Changes in Existing Continuous Funding System
19. Regulations propagated to enable Formation of group companies
20. The rationalization of trading practices
21. Streamlining of rules and regulations
22. Improving confidence of the investors
23. Justification of the carry-over trade (COT) system
24. Regulations by the SECP and the SBP
25. Conventions for financing to brokers by banks / DFIs[428]
26. The Margin Trading Rules[429]

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[428] 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
http://www.sbp.org.pk/bpd/2004/annx_c22.pdf

[429] S.R.O 541 (I)/2004
http://www.secp.gov.pk/corporatelaws/pdf/MarginTradigRules_2004.pdf

27. Initiation of the self-regulating professional management system at the stock exchanges
28. Implementation of the automatic national clearing and settlement scheme
29. Induction of the T+2 systems
30. Launching a code of conduct under the brokers Registration Rules
31. Reinforcing the Margin Requirements
32. Implementation of the capital competence limits on broker exposure
33. Redefining the minimum net capital desires for the brokers
34. Replacement of the *Blank Selling* by generally putative and carefully regulated *Short Selling*, and
35. Implementation of the Un-disclosed trading System

All of above stated reforms have been executed in the last few years by the SECP or its pattern institution (CLA). These provided due incentive to development of existing resilient and broad-based stock market in the country[430].

5.1.1 Risk management Reforms

The SECP reconnoitered the application of a new risk management structure, based on international best practices, to improve the prevalent risk management framework at the exchanges. A new Risk Management Structure was introduced in December 2006, after a comprehensive review of the existing framework. SECP's reforms particularly concentrate to reinforce risk management in the stock market[431]. It includes:

a. A new netting regime

b. Conversion of transactions (COT) into Continuous Funding System

c. Redefining of Net capital balance in line with international values

d. Introducing Capital adequacy standards for brokers

e. Strengthening of Margin deposits with pre-trade margin confirmation at the exchanges

[430] Speech delivered on Capital Markets Developments in Pakistan and Role of Regulatory Authority to the officers of the 85thNational Management Course at the Pakistan Administrative Staff College. Lahore on November 8, 2006

[431] CAPITAL MARKETS CHAPTER 7, Economic Survey 2006-07

f. Defining of Position limit for brokers in the ready, stocks and Continuous Funding System market

g. A VAR based margining system

5.1.1.1 *Netting*

To recognize the true contact of the market, the netting regime has been renovated. Netting of exposure margin has been banned across markets, across clients and across settlement periods. The predominant practice of netting amplified the exchange risk and would hide actual degree of exposures. Client level netting has been applied in the ready market and futures market with effect from 2007[432]

5.1.1.2 *Value at Risk (VAR) based Margining regime:*

In order to lessen systematic risk in the stock market and in line with international best applies, a reread risk management regime was introduced recently, at the stock exchanges which includes VAR based margining system, netting regime, position limits, market to market loss assemblage, special margins, and valuation of securities (haircuts regime). To reduce universal risk at the stock exchanges the new marketing system has been introduced based at VAR - Principle i.e. the maximum amount of money that can be lost on given scrip over a given period with a given level of confidence. VAR provides a precise statistical estimate of the maximum feasible loss on a portfolio when markets are behaving normally. VAR is a state of the art risk management system practiced internationally and takes into account risk related with each share based on historical data[433].

Numerous regulatory amendments were accepted to improve the standards for selection of eligible securities to implement scrip-wise circuit breakers and to introduce concentrations margins exchanging special margins in the deliverable and cash settled future market along with presenting liquidity margins in the ready market.

5.1.1.3 *Client level margining system:*

A client level margining system was introduced, whereby all margin requirements of each UIN are encountered from respective UIN-wise securities/ cash deposit, thus preventing misuse of client's margins and fundamentally shifting the system from broker-level to client-level.

5.1.1.4 *Pre trade margin verification system:*

A pre-trade margin verification system was introduced which ensures that brokers don't exceed their capital adequacy limits and deposit supplies. The system checks at the time of placing an order weather the concerned member is within his capital

[432] http://www.finance.gov.pk/admin/images/survey/chapters/07-Captial%20Market.pdf
[433] http://www.millat.com/economy/economic%20suervey%202007/07-Captial%20Market.pdf

adequacy limit and has sufficient margin deposits for implementation of trades in the market[434].

5.1.2 Corporate Governance Reforms

Independent management has been selected at the stock exchanges to run the daily operations. The structure of boards of directors has been changed through nomination of non-member directors, one of whom must also be the chairman of the board.

Pursuant to the introduction of the Code of Corporate Governance in March 2002, the SECP has taken several steps to increase the level of transparency in corporate reporting.

Several amendments were made to the Companies Ordinance, 1984 to make key provisions of the Code applicable to all companies including public sector listed companies[435].

5.1.2.1 The 2002 Code of Corporate Governance

a. The Code of Corporate Governance – 2002, was the first ever institutional effort to suggest improved disclosure and corporate governance standards. The Code is applicable to all listed companies and is a collection of best international practices. It is made to order to local conditions and provides a framework for proficient control and supervision of listed companies.

b. The SECP, being the apex regulator of the capital markets, oversees the enforcement and implementation of the Code while the stock exchanges are primarily responsible for its enforcement[436].

c. The SECP is endowed to approve any amendments to the Code and to allow any relaxation from the provisions of the code subject to fulfillment of necessary conditions.

d. The SECP initiated review of the Code taking into account the lessons learned from practical issues and concerns relevant to listed companies.

e. The SECP released the revised draft of the Code for public in 2010, proposing modifications to evolve the governance requirements according to the changing business concerns and to adopt international governance standards. Some of the important amendments include representation of independent executive directors, roles of chairman and CEO, number of total directorships in listed companies, self-evaluation of the boards; directors' education, training and recompense and additional committees of the board.

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[434] http://www.finance.gov.pk/admin/images/publications/YearBook2005_06.pdf

[435] http://www.secp.gov.pk/CS/ChairmanSpeeches/PDF/2006/Nov_08_SeminarProgram.pdf

[436] Senate Body learns about SECP's Reform: The financial daily international, dated Thursday 14th April
http://thefinancialdaily.com/uncategorized/senate-body-learns-about-secp-reforms-45522.aspx

f. The SECP has launched a consultation process among stakeholders to reform the Code and substantive feedback[437]. The SECP will undertake another round of consultations with major stakeholders on the final revised Code.

5.1.2.2 Re-composition of the board of Directors (BOD) of Stock exchanges;

In order to reinforce governance, enhance transparency, and lessen conflict of interest on the board of the stock exchanges, the size of the BOD of the exchanges was reduced and reconstituted to include 50% independent directors; while appointment of chairman of BOD from amongst the non-member/ non-broker directors was made compulsory.

5.1.2.3 Fit and proper Criteria for directors on the boards of the stock exchanges, the CDC, and NCCPL;

Fit and proper Criteria for directors on the boards of the stock exchanges, the CDC, and NCCPL was introduced to ensure that the BODs of these important Capital Market entities comprise of Professionals that satisfy the highest standards of honesty and integrity, promote business ethics and program practices of good governance[438]

5.1.3 Transparency Reforms

To improve Transparency in the capital market, SECP have implemented the following:

a. Banned In-House Badla

b. Introduced System of undisclosed trading to check front running[439]

5.1.3.1 Blank selling

Blank selling has been banned in a ready market and is replaced by regulated short selling[440].

5.1.4 Market Development Reforms

In the area of Market Development, SECP;

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[437] Pakistan Today » Business » SECP pushing for corporate governance reforms, dated Thursday, April 14, 2011
http://www.pakistantoday.com.pk/pakistan-news/Business/06-Jan-2011/SECP-pushing-for-corporate-governance-reforms

[438] Internet from 12/18/09
http://www.thefinancialdaily.com/NewsDetail/107106.aspx

[439] Speech delivered on Capital Markets Developments in Pakistan and Role of Regulatory Authority to the officers of the 85thNational Management Course at the Pakistan Administrative Staff College. Lahore on November 8, 2006.

[440] Developing Bond Markets In Pakistan By Muhammad Arif Joint Director Financial Markets Strategy and Conduct Department SBP

a. Introduced trading in futures contracts to provide a basic prevarication instruments and investment alternatives to the investors

b. Developed OTC market and incentives have been provided to promote listings on the OTC market.

c. CDC has been set up to automatically record and transfer securities[441]

5.1.4.1 *Debt Market Development Reforms;*

To provide transparent and efficient price discovery for debt market securities at the stock exchanges through an automated trading platform, a Bond Automated Trading System (BATS) was introduced. Subsequently, a committee of stakeholders was constituted to suggest long term maintainable solutions to encourage trading activity on the BATS. On the committee's recommendations, BATS has been reinstated with numerous system enhancements in line with global standards to facilitate the participants of the market.

5.1.4.2 *Automation of transfer of securities into central depository system against trade/transactions settled through NCSS.*

For preventing chances of misuse in procedures governing the moments of book-entry securities in the central depository system and for establishing adequate level of authentication, an automated clearing and settlement process has been recently introduced, whereby securities would move directly from sellers sub-account or house account to the buyers sub-account or house account at the CDC. Such straight processing in the settlement procedure would not involve any manual intervention[442].

5.1.4.3 *Introduction of T+2;*

A shorter T+2 settlement cycle was introduced at the stock-exchanges in accordance with global best practices.

5.1.4.4 *Over-The-Counter (OTC) Markets;*

Regulations governing OTC market at the stock exchanges were approved and efforts are being made to promote listings on the OTC market. Further, a regulatory framework has been devised allowing companies to list their debt securities issued through private placements on the stock exchanges under these regulations. Such securities will be traded on BATS by the qualified institutional buyers.

5.1.4.5 *Book building Mechanism;*

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[441] Speech delivered on *Capital Markets Developments in Pakistan and Role of Regulatory Authority* to the officers of the 85thNational Management Course at the Pakistan Administrative Staff College. Lahore on November 8, 2006

[442] http://www.finance.gov.pk/publications/YearBook200809.pdf

In line with international best practices, a new mechanism for issuing/offering shares to High-Net Worth clients and international investors known as book building was launched.

5.1.5 Demutualization

In order to make the stock markets more efficient and transparent, SECP was pursuing the process of demutualization and integration and was keeping a close liaison with the stock exchanges and other stakeholders to drive the process[443]. After demutualization, the ownership, the management and the trading rights at the exchange will be segregated from one another and will bring greater balance among interests of different stakeholders in the corporate and governance structure of the exchanges.

In this regard, on January 28, 2006, SECP and the KSE signed a MOU on critical issues, which inter-alias covers matters relating to the issuance and transfer of trading rights, the moratorium period, Code of Governance, issuance of shares, transfer of assets, shareholding structure and composition of BODs.

SECP engaged the services of legal expert to draft special legislation (Act and accompanying Rules and Regulations) to enable demutualization and integration of exchanges.

Moreover, in order to facilitate the process of corporatization and demutualization, a new section 32-E was inserted in the SEO, 1969 through the Finance-Act, which provided that all the Stock Exchanges shall stand corporatized and demutualized up to December 31, 2007[444].

The SECP, in consultation with the stakeholders, has drafted an Act, namely; *Stock-Exchanges (Corporatization, Demutualization and Integration) Act*, to establish a framework for the demutualization process of stock exchanges. The Act has been passed by the national assembly and signed by the president of Pakistan, recently. And is published in the Gazette of Pakistan on 09th of may 2012.

5.1.6 Investor Protection & Education Reforms

For the investor protection and education Reforms in the capital market, SECP have implemented the following:

a. Arbitration procedures has been streamlined,

b. Investors' complaints are actively addressed,

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[443] Internet from 5/6/10
http://www.finance.gov.pk/admin/images/survey/chapters/07-Captial%20Market.pdf

[444] Official newsletter of SECP, Feb-April 2009, spring edition, page 4
http://www.secp.gov.pk/newsletter/pdf/nl_sprng_09.pdf

c. Investor Protection Funds are in the process of being fully funded[445]

5.1.7 Segregation of Client's Assets from Broker's Assets and Standardization of CDC Sub-account Opening Form;

To ensure satisfactory protection of the obligations and rights of the sub account holders as well as the brokers, a standardized CDC sub account opening form was introduced which restricts any general purpose authority to be given by client to brokers. Further, in order to that clients assets are not misused, it has been mandatory for brokers to maintain separate bank accounts for clients cash assets and to ensure that margin deposited in form of securities is maintained in a separate account at the CDC.

5.1.8 Corporate Sector Reforms

The significant reforms that have been carried out by regulators, in the corporate sector, some of these are:

a. Introduction of an expeditious corporatization process at the front end of Company Registration Offices, a company can now be incorporated within three days, far less time compared to any other contemporary jurisdiction

b. Provision of name search facility on the SECP's website to facilitate promoters, and online registration and filing of documents is being introduced[446]

5.1.9 Non-Banking Financial Sector Reforms

In the Non-Banking-Financial-Sector, the SECP has successfully accomplished Consolidation through introduction of the concept of NBFCs that envisages a whole variety and range of financial products tailored to the needs of customers through one window operation. These financial products include Investment Finance Services, Leasing, Housing Finance Services, Venture Capital Investment, Discounting Services, Investment Advisory Services and Asset Management Services[447].

5.1.10 Reforms in Insurance Sector

A number of reforms have been introduced n insurance sector, including[448];

a. Stringent solvency standards have been introduced.

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[445] Internet from 11/4/11
http://www.secp.gov.pk/CS/ChairmanSpeeches/PDF/2006/Nov_08_SeminarProgram.pdf

[446] Ibid

[447] Speech delivered on Capital Markets Developments in Pakistan and Role of Regulatory Authority to the officers of the 85thNational Management Course at the Pakistan Administrative Staff College. Lahore on November 8, 2006

[448] Developing Bond Markets In Pakistan By Muhammad Arif Joint Director Financial Markets Strategy and Conduct Department SBP

b. Minimum paid up capital requirements for insurance companies have been enhanced[449].

c. Insurance companies have been directed to obtain reinsurance treaties from the international A class re-insurers[450].

5.1.11 Securities (Leveraged Markets and Pledging) Rules, 2011

In order to introduce the leverage products (Margin Financing and margin trading), the securities lending/borrowing mechanism and to meet the increasing liquidity and financing need of Stock Exchanges, the Securities (Leveraged Markets and Pledging) Rules, 2011 were drafted by the SECP with input from all relevant stockholders and were promulgated by the F.G in 2011.

These rules provide the broad regulatory cover to the products of

a. Margin Financing,

b. Margin Trading

c. Securities Lending and Borrowing, and

d. Pledging of Clients Securities[451]

5.1.11.1 Margin Financing

One of the distinct features of Margin Financing under these rules is the identification of the counter party which will enable financiers to assess the credit worthiness of finances. In addition to offering investment flexibility whereby financiers will be able to choose scrip for financing based on their analysis of fundamentals and liquidity positions, the requirement of maintaining minimum equity participation ratio by the financee will ensure better sharing of risk between the parties[452].

5.1.11.2 Margin Trading

To provide for alternate source of leverage financing, the Concept of Margin Trading System has been introduced. This financing option is based on the concept of Reverso-Repo and will be available through normal undisclosed trading mechanism. As in the case of margin financing, financees in the Margin Trading System Market will be required to pay minimum equity participation in cash and to maintain that ratio, mark-to-mark losses will also be required to be paid in cash. In Margin Trading

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[449] Rs. 500 million for life insurance companies from existing Rs. 150 million and Rs. 250 million for non-life from existing Rs. 80 million;

[450] Speech delivered on Capital Markets Developments in Pakistan and Role of Regulatory Authority to the officers of the 85thNational Management Course at the Pakistan Administrative Staff College. Lahore on November 8, 2006

[451] publications
Capital market posts steady growth Business Recorder, June 3 2011.

[452] publication
Law Division vets draft Securities Rules., Business Recorder, June 4 2010

System banks, Development finance institutions, Investment finance companies, equity funds, special purpose equity funds and brokers would be eligible financiers using trading terminal provided by the authorized intermediary.

5.1.11.3 Securities Lending and Borrowing

The Securities Lending and Borrowing Model envisage the authorized intermediary to act as a facilitation agent between borrowers and lenders of securities and provide an automated platform, whereby Securities Lending and Borrowing contracts will be executed between the parties[453].

5.1.11.4 Pledging of Clients Securities.

Further, as per the existing practice, Clients Securities are pledged for a variety of reasons by brokers including pledges in favor of exchanges and the clearing company in respect of margin requirements and pledges in favor of financial institutions for financing arrangements. The said rules seek to provide conditions and requirements that will govern the pledging mechanism and also restrict/ prohibit pledges which are executed in contravention thereof[454]. The rules provide for the brokers to carry out appropriate due diligence of their clients, enter into a written agreement with the clients; disclose risks involved in the relevant transaction and the financing options available in the market. Further, brokers will be required to conduct credit risk assessment of their clients and assign credit limits accordingly.

5.1.12 Proposals for Finance Act

The SECP furnished proposals to the F.G. for its consideration in the Finance Act, in order to remove irritants to smooth functioning of companies and financial institutions as well as to encourage their progressive development. These proposals were based on the suggestions received from different quarters and, largely, on the recommendations of the Task Force on Corporate Tax Policy, jointly formed by the SECP and FBR. Most of the recommendations of the SECP were accepted by the F.G [455] and included in the Finance Act. Several other recommendations have been sent to F.G. for approval.

5.1.13 Formation of the CDC

CDC of Pakistan Limited was formed under Central Depositories Act 1997 which was passed on June 10, 1997. Subsequently, CDC of Pakistan Limited Regulations were developed and approved by the SECP.

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[453] publication
COM: Comments sought on the Draft Rules approved by Govt, PPI - Pakistan Press International, June 4 2010

[454] publication
Law Division vets draft Securities Rules., Business Recorder, June 4 2010

[455] http://www.secp.gov.pk/services.asp

CDC was primarily established to operate the CDS for equity, debt and other financial instruments that are traded in the Capital Market of Pakistan[456]. Though, with the passage of time and development of Pakistan's Capital Market, it now also provides services that are beyond the traditional depository services. CDS is an electronic book entry system used to record and maintain securities and their transfer's registration. The system changes the ownership of securities without any physical movement or endorsement of certificates and execution of transfer instruments.CDC provides depository services to a wide range of Capital Market participants which includes Brokers, Asset Management Companies, Banks (including Custodian Banks) and general retail investors[457]. It also serves to link up the Issuers and Registrars of securities and the market for the purpose of executing corporate actions like disbursement of corporate benefits and carrying out mergers and splits.

Taking another step towards capital market development, CDC has diversified its operations in the following services[458].

5.1.13.1 Investor Account Services

Investor Account Services[459] has been launched in 1999 and allows retail investors to open and maintain securities' accounts directly with CDC.

5.1.13.2 Trustee and Custodial Services

In 2002, Trustee and Custodial Services[460] were commenced and enlists Open-end and Closed-end-Mutual-Funds and Voluntary-Pension-Schemes.

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[456] http://www.cdcpakistan.com/userpanel/AboutUs/ViewContent.aspx?m=au&type=0008

[457] CDC - CDC of Pakistan Limited
http://www.facebook.com/pages/CDC-Central-Depository-Company-of-Pakistan-Limited/167362749982585?sk=wall#!/pages/CDC-Central-Depository-Company-of-Pakistan-Limited/167362749982585?sk=info

[458] http://www.cdcpakistan.com/userpanel/AboutUs/ViewContent.aspx?m=au&type=0001

[459] Investor Account Services offered by CDC allows retail investors to directly open and maintain accounts with CDC in Central Depository System for electronic settlement of securities. Earlier, to settle the securities through Central Depository System, investors had to open client accounts (sub accounts) with the CDS Participants (brokers & financial institutions). With Investor Account Services, investors can now have direct access to their account.

i. Investors now have direct access to their securities, which are maintained by CDC and accounts operated on the instructions of investors.
ii. CDC is regulated by the Securities & Exchange Commission of Pakistan. The relevant legislations are Companies Ordinance 1984, Central Depositories Act 1997 and CDC of Pakistan Limited Regulations

For detail info:
http://www.cdcpakistan.com/UserPanel/AboutUs/ViewContent.aspx?m=cb&type=0038

[460] In 2002, the mutual fund industry started flourishing in the Pakistani Capital Market and provided a new concept and investment arena to retail and individual investors who possess inadequate knowledge of the capital market but are interested in utilizing its benefits. CDC, realizing the importance and service demands of this sector started Trustee & Custodial Services in 2002, initially with two open-ended mutual funds with net assets value of Rs. 500 million. The prime responsibility of CDC as the trustee/custodian is to take into its custody all the assets of the Collective Investment Scheme and hold them in trust on behalf of the unit or certificate holders. Additionally, CDC carries out the instructions of the asset management

5.1.13.3 Share Registrar Services

Launched in 2008, Share Registrar Services provides issuing companies state-of-the-art facilities of registrar and transfer agent services, including registration and verification of shares and records and customer dealing on behalf of issuer companies[461]

5.1.14 Valuation of Securities eligible to be held as security

In order to effectively categorize the collateral, all securities are now classified on the basis of liquidity and volatility. Further, to ensure minimization of trading risk, haircut can now be applied accompanied with impact cost analysis. Eligible securities, acceptable by the exchanges against deposit as exposure, are presently being evaluated on the basis of the new Haircut Regime. Previously, only the turnover and Earnings per Share of the scrip were considered for ranking of eligible securities against deposit.

5.1.15 Mark-to-Market Loss Collection and profit Distribution

A new mark-to-market regime has been introduced at the stock exchanges. Mark to market loss in any scrip is the amount payable by a member, on account of his clients and his proprietary unsettled net position for a given day, to the clearing house due to difference between volumes weighted average price of the unsettled position and the *closing price* of the scrip at day end[462]

5.1.16 Position Limits

Market-wide, member-wide and client-wide, position limits have been introduced in the market to avoid concentration of positions and to restrain investors from being over leveraged. These limits have been linked with the free float of the scrip and are expected to minimize the possibility of any market abuse.

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company/investment adviser/pension fund managers in respect of the investment portfolio and the units/certificates held by the investors, while ensuring that, in all material respects, the scheme is being managed in accordance with the provisions of the constitutive documents, the NBFC Rules, the Regulations and VPS Rules
For detail info:
http://www.cdcpakistan.com/UserPanel/AboutUs/ViewContent.aspx?m=cb&type=0048

[461] CDC offers Share Registrar Services (SRS) (also known as Transfer Agent or R/TA services) to facilitate Issuers and their shareholders. This initiative was taken in early 2008 to cater to the growing need of more comprehensive and efficient SRS in the Pakistani Capital Market. SRS is one of the most important services required by a capital market in any country or region. Considering the current market scenario where none of the other SRS offerings are composite enough to offer a one-stop solution, CDC has developed a high-tech Share Accounting System with an exclusive Authority & Security Management System and workflow components to guarantee efficient SRS. CDC - SRS offers a composite portfolio of maintenance, registration, verification and direct customer dealing & interaction.
http://www.cdcpakistan.com/UserPanel/AboutUs/ViewContent.aspx?m=cb&type=0054

[462] Internet from 6/14/07
http://www.millat.com/economy/economic%20suervey%202007/07-Captial%20Market.pdf

5.1.17 Special Margins

In order to curb volatility and to mitigate systemic risk in the market, special margins have been introduced that shall be payable on daily basis only if the weighted average transaction cost of scrip in the Continuous Funding System or Future Deliverable Markets with respect to a member, is different from 26 weeks moving average price of that scrip in the Ready Market.

5.1.18 Price-discovery and Trade-Settlement

The following measures have been successfully introduced at the stock exchanges to strengthen integrity and transparency in terms of *Price-discovery and Trade-Settlement*[463]

5.1.18.1 Unique (Client) Identification Number (UIN)

In pursuance of the Commission's objective to increase market transparency and improve its surveillance capacity, UIN System was launched at pre trade level on 1 August 2006 at all three stock exchanges after implementing the requisite software and hardware changes by the stock exchanges and NCCPL. It establishes a traceable link between the executed trade and the investors at the stock exchange. UIN system has significantly enhanced the risk management at client levels and improved the surveillance and monitoring capacity of the SECP and the stock exchanges.

5.1.18.2 Free Float Index

In order to introduce a free float index that is representative of the market, the KSE-30 Sensitive Index was implemented w.e.f. September 1, 2006. The need for a market representative free float index was long felt as the capitalization weighted KSE 100 Index strongly tilted to a few scrips. Free float is based on the proportion of shares readily available for trading to the total shares issued and excludes the locked in shares[464]. The criterion for the selection of scrip son KSE-30 index was revised in 2007 in line with international best practices to include the impact cost as a measure to gauge the liquidity of scrip.

5.1.18.3 Changes in Existing Continuous Funding System

SECP enhanced the Continuous Funding System Limit for the Stock Exchanges, considering the demand in the market and ban on in-house badla. Further, a revised eligibility criterion for Continuous Funding System scrip has been introduced which inter-alias takes into account impact cost and free float of the scrip[465].

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[463] Ibid

[464] Internet from 5/6/10 http://www.finance.gov.pk/admin/images/survey/chapters/07-Captial%20Market.pdf

[465] Ibid

5.1.19 Regulations Framed for the Formation of Group Companies

SECP has promulgated the Group Companies Registration Regulations, 2008 to provide a regulatory framework for the formation of group companies, comprising a holding company and its subsidiaries. The Regulations will also empower the Commission to designate the group companies contemplating to avail group relief and group taxation benefits from the FBR.

The Regulations enabled a holding company desirous of forming a group with its subsidiary companies to apply to the Commission along with specified documents for registration as a Group for the purpose of designation to claim underlying tax benefits from FBR, as envisaged under the relevant provisions of the Income Tax Ordinance, 2001.

The Regulations also facilitates streamlining of the group ownership structures and consolidation of the complicated cross-company ownership to make the corporate sector internationally competitive[466].

5.1.20 Strategy for Companies in Violation/ Non- compliance of Listing Regulations of the Stock Exchanges;

For the purpose of safeguarding the investor's interest and for increased transparency, a policy was formulated to rectify the effect of the companies listed at the stock exchanges which are in continuous non-compliance of the securities market Laws. Subsequently, suspension of trading in the shares of forty such companies was ordered and restrictions were imposed on the transfer of their shares in both physical and book entry form along with restrictions on their off-market transactions at the stock exchange on which they were suspended

5.2 Ongoing Reforms

The following reforms are currently under process:

5.2.1 New Derivatives Product Development

The SECP is working towards the introduction of new derivatives products such as Cash-settled Futures, Index Futures and Options; in line with international west practices in order to provide much-needed avenues of leverage financing to the market.

5.2.2 New Futures Trading Act

A draft, Futures Trading Act has been prepared which provides a comprehensive and independent legal framework for the regulation of futures contracts. All the stakeholders were consulted before finalization of the proposed law, which has been submitted to the government for further process.

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[466] Official newsletter of SECP, Feb-March 2009, spring edition, page 8
http://www.secp.gov.pk/newsletter/pdf/nl_sprng_09.pdf

5.2.3 New Securities Act

The Commission, in order to remove various deficiencies in the existing SEO, 1969 had initiated work to formulate a Draft of Securities Act, which will ensure that the standards and practices followed in Pakistani markets conform to the best in the world.

5.2.4 Voluntary Pension System (VPS) Rules, 2005

The F.G took the initiative of development of the private pensions in Pakistan by allowing rebates for investments in approved pension schemes in year 2001 and vested the responsibility of development of necessary framework and regulation of private pensions in the SECP.

The SECP has proposed the draft legislation for the *Private Pension Schemes*, by issue of the *Voluntary Pension System Rules, 2005*[467]. Under new Voluntary pension System, professional fund managers would manage the money contributed by the participants. An important two-tier structure has been designed under which fund management and the custody of the funds has been separated. A trustee would be appointed for each pension fund to keep in its custody all the property of the pension fund. The new pension system is based on individual pension accounts. Employees as well as employers can make tax-free contributions into the pension funds and such contributions would be invested as per the investment and asset allocation Guidelines issued by SECP. Investment Income of the pension fund would also be tax-free. Only final benefits or premature withdrawals are taxable. So far, four Assets Management Companies have been registered with the SECP as Pension-Fund-Managers, which are engaged in designing their pension fund schemes. Their applications or seeking authorization to launch the proposed schemes are under consideration of the Commission[468].

5.2.5 Futures Market and Hedging (National Commodity Exchange Limited)

In the economy of Pakistan, the history of hedge trading has long roots. In the cotton market, hedging was a legitimate business; however, in 1970's its requirement was abolished because of the nationalization of cotton trading activities. In 1980s' Islamic Ideology Council did not permit the restoration of hedging. Now, the government has decided to restore the hedging in the commodity market. For this purpose, a company - National Commodity Exchange Limited has been formed. The company has been inaugurated. This commodity exchange will be responsible to introduce and develop the derivatives products in the financial markets of Pakistan.

However, the legislative measures are required to protect the interest of producers and consumers of those commodities where prices' fluctuations are common. Cotton and gold are included in those commodities, which are included in the priority list of the

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[467] Internet from 5/6/10
http://www.finance.gov.pk/admin/images/survey/chapters/07-Captial%20Market.pdf
[468] Ibid

National Commodity Exchange Limited[469]. Coordination is requisite between the SECP, Agriculture and Livestock (MINFAL), Ministry of Food, and Ministry of Commerce, for the legislation and harmonization in the interest of related parties.

5.2.6 Regulatory Framework for private Equity Funds

Private Equity is the equity investment in an asset in which the equity is not freely tradable in the stock market. Private equity funds raise contributions from smaller investors to create a capital pool. Private equity can play a vital role by providing growth capital to the corporate sector particularly the SMEs. Draft of the Private Equity Rules has been prepared by the Commission and is being finalized in the light of the recommendations received from the market participants[470].

5.3 Recommended Reforms

In Addition to the Ongoing Reforms, which should be executed as soon as possible, the SECP should launch the following Recommended Reforms as well:

5.3.1 Cooperation with developed and developing markets' regulators

Adequate Regulations should be drafted so that foreign investors are allowed to operate freely in our capital-market. There are no restrictions on the extent of foreign ownership stake, no limit on holding shares for trading purposes and nonresidents are exempted from tax on income from Government Securities and instruments of redeemable capital, further, there is no control on the sale of securities purchase in Pakistan by non-residents.

The SECP should also enter into MOU's with its counterpart in various jurisdictions, to provide comfort to foreign portfolio investors and regulators.

The SECP already have executed a MOU with the SEC of Sri Lanka and should continue its process of entering into similar MOUs with India, U.S. the U.K., Japan and other developed and developing markets over the globe.

5.3.2 Adequate Regulations to Prevent and/or Remedy Market Abuses

The SECP should direct each stock-exchange to set up an enhanced monitoring and surveillance wing to check market abuse; and to bolster its capacity in this regard.

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[469] Internet from 3/27/09
http://www.pakistan.gov.pk/ministries/planninganddevelopment-ministry/mtdf/36-Capital%20Market%20development/36-Capital%20Market%20Dev.pdf

[470] Internet from 5/6/10
http://www.finance.gov.pk/admin/images/survey/chapters/07-Captial%20Market.pdf

5.3.3 Socially Responsible Investing/Corporate Social Responsibility

Companies can contribute to sustainable economic development by running their businesses to achieve economic growth, but at the same time, protect consumer and other stakeholder interests.

Adequate regulations should be like this that the companies in Pakistan will adopt a strong culture of Corporate Social Responsibility by behaving in ethical ways, over and above legal requirements and by integrating economic, social and environmental impact in their operations.

5.3.4 Re-Regulation of the Corporate Sector In Order To Achieve Policy Objective of Efficient and Cost Effective Regulation

The SECP should set up any Commission to review the corporate laws, to harmonize the legal and regulatory framework in order to make it more efficient and cost effective.

5.3.5 Corporate Tax Rationalization for Listed Companies

The SECP should work in close conjunction with the FBR to incentivize corporatization, ensure the progressive development and graduation of corporate and to provide the necessary incentives for the development of the market in Pakistan.

5.3.6 Regulation for the Establishment of a Financial Crimes Unit

Full confidence of the investors can only be attained if the regulator is able to prevent market abuses such as market manipulation, fraud, and insider trading. New SECP initiatives should also include the establishment of a financial crimes unit to tackle white-collar crime, in addition to the existing anti-money laundering unit.

5.4 Other Measures Recommended For Reforms

Other Measures recommended for reforms include:

a. Regulatory framework for; Government securities issuing activities at sub national level and for public sector entities

b. Regulation for; the Promotion of Margin system based on VAR and Creation of a licensing regime for market intermediaries, which will ensure that they are appropriately qualified, adequately capitalized and adhere to applicable rules and regulations

c. Codes of Conduct for financial intermediaries and brokers

d. Regulations for; the Restriction on Netting across markets, across clients and across settlement periods

e. Regulations for; Adequate measures for the Implementation of Mark-to-Market Loss Collection and Profit Distribution system

f. Adequate measures for the Implementation of VAR based mechanism for valuation of eligible securities to be held as security

g. Rules/ principles to define and adhere the broad market access and transparency in Government funding operations

h. Regulatory-Objectives, to define debt management strategy that involves market finance and introduction of risk management objectives

i. Regulations for the Implementation of Stock Lending and Borrowing Mechanism

j. Finalization of a new Securities Act and Futures Trading Act and supplementing rules to strengthen the legal and regulatory framework to meet the changing demands of the capital market and to keep pace with international developments

k. Rules and Regulations for promotion of exchange-traded derivatives market in Pakistan.

l. Necessary Regulations for Strengthening of the NCCP

m. Introduction of a Code of Conduct for investment advisers

n. Re-writing of Proprietary Trading Rules

o. Rule for; effective monitoring and surveillance system at the exchanges to monitor and effectively regulate the Stock exchanges

p. Clear-Regulation for; Insider Trading, price manipulation, front running and other mal practices such as rumor mongering which destroys markets and cause investors confidence to evaporate, will not be tolerated, with strict enforcement.

q. Regulations for; Development of a single, well capitalized clearinghouse, capable of risk management, based on IOSCO standards.

CHAPTER # 6; CONCLUSION

Our Stock market is fragile, it lacks depth. The SECP should work hard to bring fresh regulations of the market to increase depth. Lack of depth enables unscrupulous persons to corner the market and thus manipulate. Review the listing regulations to facilitate unlisted companies to obtain listing. Government alone cannot ensure healthy competition and growth. It can provide an enabling environment for business, but ultimately it is the business community that has to take the lead. SECP should play a positive role as an intermediary and a feedback channel for exchange of views to bring government and business community close so that they can work in harmony and in close proximity for creating and implementing economic friendly policies and regulations. SECP should also be committed to engendering investor confidence and undertaking necessary measures for effective regulation and development of capital market in Pakistan.

I think there is need to give jolt to the system and enhance, broaden and deepen the reforms through regulations. All over the world, the regulatory bodies work to achieve the maximum efficiency in the financial markets. Only in the presence of efficiency, a stock market can reflect the real picture of the economy.

Effective securities regulation relies on the existence of a sound framework, including good contract and corporate law, a fair and timely judicial process, effective protection of property rights, good accounting and audit standards and sound taxation rules. SECP have observed that the lack of this basic framework has significantly affected the countries efforts to develop their markets and our observations are shared by others engaged in capital markets development work.

While Pakistan has definitely improved quite a bit, when we compare ourselves to the region, we are still lagging far behind and for me this is where we should strive to make more inroads. Despite the fact that our Equity Market capitalization as a percentage of Gross domestic product has increased, but it is still substantially low relative to other developing economies. In my view, the challenging capital market environment today also requires regulators to play a proactive role in the market beyond reactively adapting or amending existing laws and removing regulatory impediments.

A sound and resolute regulatory framework is indispensable to a resilient and efficient capital and financial markets. Without continuous and effective market reforms carried out keeping in view the local environment as well as the international best practices, markets structures will collapse upon themselves. The recent global financial turmoil has brought this fact into sharp focus. Unfortunately in Pakistan, the capital and financial markets as well as the corporate sector is currently being regulated through laws most of which are decades old, e.g. the SEO, 1969 (Securities Ordinance) the Companies Ordinance, 1984 (Companies Ordinance), the Modaraba Ordinance, 1980 etc. Then there are important areas where no separate substantive laws exist at all, for instance the Futures market, the Non-Banking Finance sector, Insolvency and Rehabilitation of companies. This fact has necessitated continuous upgrading and amendments of the existing laws for the last decade or so, which the Commission has been so efficiently following. However, one can upgrade and maintain old vehicles only for so long. Keeping this in view, the Law Division in collaboration with the operational department and international consultants has deliberated upon changing the façade of the corporate and capital market regulatory framework of Pakistan. In the first instance, as an umbrella law, the draft Financial Services Commission of Pakistan Act is being proposed, which will replace the existing SECP Act, 1997.

The Commission was meant to be a corporate and capital market regulator, however it has transformed into sort of a unified regulator with non-banking financial sector, the Insurance sector and recently the pension sector being added to its list of responsibilities. Hence the SECP Act, 1997 has had to be amended on numerous occasions. It is therefore imperative to streamline the fundamental structure to cater to this increased responsibility. In addition to increasing the powers of the Commission and removing the weaknesses of the current law, many new concepts are proposed to be introduced through the draft Financial Services Commission law. These include the establishment of an independent tribunal exercising original jurisdiction on the civil as well as criminal side and also appellate jurisdiction, Liability of shadow directors, Alternative dispute resolution mechanisms (including the office of an Ombudsman to hear investor complaints), Voluntary return and plea bargaining, and Provisions related to whistleblowers.

In order to streamline the existing provisions relating to securities regulation, it is being proposed that the Securities Ordinance, Takeovers Ordinance 2002, the CDC Act, CDC Rules and Clearing House Rules, 2005 will be replaced by a single enactment, the new Securities Act. The draft Act should have detailed provisions dealing with Stock exchanges, Market intermediaries, Central depositories, clearing houses, Takeovers, Market offences, Inspections, and Investigations. The proposed Act will not only streamline the existing provisions of law but will also provide for a consolidated system governing the securities market and its players. It will remove the weaknesses currently hampering successful investigation and prosecutions of offences like market manipulation and insider trading.

The regulation of the futures market and ancillary matters at present is being undertaken through secondary legislation i.e. Commodity Exchange and Futures Contracts Rules, 2005 as the Securities Ordinance does not address detailed provisions in this regard. In light of the needs and development of futures market in Pakistan, it was imperative to have a primary law to provide for all the substantive and procedural aspects involved therein. Therefore as a part of second generation of capital market reforms, the Futures Trading Act has been drafted in consultation with the international and local market participants to keep pace with the international best practices and to allow fair, transparent and efficient futures markets. The proposed law is comprehensive in nature and all regulatory requirements with regard to the futures market have been addressed. The proposed Act will repeal the relevant provisions of the Securities Ordinance and the Commodity Exchange and Futures Contracts Rules, 2005.

Securities markets make an important contribution to the integration process and the momentum of economic growth. There is a general consensus that securities markets need to be regulated as well as extensive agreement about the aims and principles of such regulation. The regulatory framework must be adapted to both the market structure and market developments, and must be continually refined. Flexible regulation enhances competitiveness and thus contributes to financial stability. In view of financial market globalization, it has for a long time already been impossible to regulate from a purely national perspective. After all, the competition between financial centers runs parallel to the competition between regulatory systems In order for locations to survive in this competitive environment, the level of regulation and its degree of restrictiveness in the various economic areas will tend to converge.

In this process, one element that will need to be checked is whether regulatory goals can be achieved more efficiently through self regulation or statutory regulation. Another major issue is the extent to which the international coordination of regulatory measures and bodies is better suited to meeting challenges which are similar the world over than if nations either act alone or restructure their supervisory regimes.

Suitable regulations should be done for enhancing the development prospects of Stock Exchanges of Pakistan. SECP, on the pattern of Securities Commissions of other countries of the world should be relieved of the administration of office of Registrar of Companies and Regulation of Insurance Sector to enable it to concentrate on its core function of regulating stock market and listed companies.

Measures should be planned to amend existing and frame new legislations for introduction of new products, strengthening of capital base market of intermediaries and encourage new listings. To successfully cope with its responsibilities SECP has to be fully manned with experts possessing not only the requisite knowledge and skills but also the vision to anticipate market stress and the technology to manage it.

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93. 2002 - Sarbanes-Oxley Act
94. 2007 - Regulation NMS