Chapter 6

Capital Markets

Introduction

The primary role of the capital market is to raise long-term funds for governments, banks, and corporations while providing a platform for the trading of securities. This fundraising is regulated by the performance of the stock and bond markets within the capital market. The member organizations of the capital market may issue stocks and bonds in order to raise funds. Investors can then invest in the capital market by purchasing those stocks and bonds. The capital market, therefore, functions as a link between savers and investors. It plays an important role in mobilizing the savings and diverting them in productive investment. In this way, capital market plays a vital role in transferring the financial resources from surplus and wasteful areas to deficit and productive areas, thus increasing the productivity and prosperity of the country and promotes the process of economic growth in the country.

The capital market includes the stock market (equity securities) and the bond market (debt). Capital markets may be classified as primary markets and secondary markets. In primary markets, new stock or bond issues are sold to investors via a mechanism known as underwriting. In the secondary markets, existing securities are sold and bought among investors or traders, usually on a securities exchange, over-the-counter, or elsewhere. The capital market facilitates lending to the businessmen and the government and thus encourages investment. It provides facilities through banks and nonbank financial institutions. Various financial assets, *e.g.,* shares, securities, bonds, etc., induce savers to lend to the government or invest in industry. With the development of financial institutions, capital becomes more mobile, interest rate falls and investment increases.

The capital market not only reflects the general condition of the economy, but also smoothens and accelerates the process of economic growth. Various institutions of the capital market like nonbank financial intermediaries allocate the resources rationally in accordance with the development needs of the country. The proper allocation of resources results in the expansion of trade and industry in both public and private sectors, thus promoting balanced economic growth in the country.

As discussed in preceding paras, the capital market is that segment of the financial market that deals with the *effective* channeling of medium to long-term funds from the surplus to the deficit unit. The process of transfer of funds is done through instruments, which are documents (or certificates), showing evidence of investments. The trading instruments in the capital market consist of (i) Debt Instruments which is used by either companies or governments to generate funds for capital-intensive projects. When the instrument is issued by the federal government, it is called a *Sovereign Bond (ii)* Equities issued by companies only and can also be obtained either in the primary market or the secondary market. (iii) Preference Shares issued by corporate bodies and the investors rank second (after bond holders) on the scale of preference. The instrument possesses the characteristics of equity in the sense that when the authorized share capital and paid up capital are being calculated, they are added to equity capital to arrive at the total (iv) derivatives are those instruments that derive from other securities, which are referred to as underlying assets (as the derivative is derived from them). The price, riskiness and function of the derivative depend on the underlying assets since whatever affects the underlying asset must affect the derivative. The derivative might be an asset, index or even situation. Derivatives are mostly common in developed economies. Some examples of derivatives are Mortgage-Backed Securities (MBS), Asset-Backed Securities (ABS), Futures, Options, Swaps, Rights, Exchange Traded Funds or commodities,

Every capital market in the world is monitored by financial regulators and their respective governance organization. The purpose of such regulation is to protect investors from fraud and deception. Financial regulatory bodies are also charged with minimizing financial losses, issuing licenses to financial service providers, and enforcing applicable laws. In Pakistan the Securities Exchange Commission of Pakistan (SECP) serve as a regulatory body for smooth functioning of Capital Market.

Capital Market Reforms and Developmental Activities undertaken during 2012-13

In line with its objectives to develop a robust, efficient and competitive capital market in Pakistan, the Securities and Exchange Commission of Pakistan (SECP) during the period under review introduced various structural, legal and fiscal reforms aimed at strengthening risk management, increasing transparency, improving governance of the capital market infrastructure institutions, enhancing investor protection and launching new product/market development initiatives. The highlights of these reform measures are as follows:

- **Demutualization of Stock Exchanges:** The stock exchanges in Pakistan were successfully corporatized and demutualized on August 27, 2012 consequent to promulgation of the Stock Exchanges (Corporatization, Demutualization and Integration) Act, 2012. The Act was approved in a joint session of the Parliament and subsequently promulgated after presidential consent on May 7, 2012. Demutualization is a ground-breaking reform for the Pakistan capital market as it would address the conflicts prevalent in the earlier mutualized set-up of the stock exchanges by segregation of commercial and regulatory functions and separation of ownership and trading rights. This development has brought the Pakistan stock exchanges on par with their global counterparts. While bringing enhanced governance and transparency at the stock exchanges, demutualization will also project a positive image of the Pakistan stock market on the international platform and will facilitate the exchanges in attracting global strategic investors of good stature and increase the depth of primary and secondary market.

- **Default Management in the Post Demutualized Environment**
  Post demutualization, each member/initial shareholder of the stock exchanges has been allotted shares and a Trading Right Entitlement Certificate (TREC) in lieu of the membership card. In the event of default of any TREC holder, the proceeds of such card are no longer available for utilization to satisfy the members and investor's claims. In order to cater this, a concept of Base Minimum Capital (BMC) was introduced which is required to be deposited and maintained at all times by each TREC holder with the respective stock exchanges. The BMC will be available for utilization as collateral in the event of default by the relevant TREC holder in the demutualized regime.

- **Revamping of Capital Gains Tax (CGT):** With the aim to facilitate the government in its objective of documentation of the economy and to bring the income of securities market investors within the tax ambit, CGT regime was revamped to address the practical issues and encourage activity in the security market. Accordingly, the Finance (Amendment) Ordinance, 2012 was promulgated on April 24, 2012 and the Income Tax Rules were promulgated subsequently to give effect to the revised CGT regime. Under the revised CGT regime, the National Clearing Company of Pakistan Limited is acting as an intermediary to deduct and deposit CGT from investors' transactions while providing an automated and efficient mechanism for the calculation, deduction and deposit of tax.

- **Code of Corporate Governance 2012**: With the objective of fostering good governance principles and practices in the corporate sector, a new Code of Corporate Governance, 2012 was introduced for the listed companies as a part of the stock exchanges' regulations. The Code incorporates international best practices and standards and introduces more stringent requirements to ensure transparency and good governance in companies with public stake.

- **Pakistan Mercantile Exchange Limited (PMEX):** To fulfill the hedging requirements of various classes/groups of investors in the commodity market and in pursuit of enhancing the product suite at the PMEX, futures contract in silver (10 ounces) was approved. From the regulatory standpoint, Regulations governing System Audit of Brokers at PMEX were approved to introduce regular inspections/audits of the members to check and ensure their compliance with the relevant regulatory framework.

- **Introduction of Odd-Lot Market**
  To facilitate investors in trading of thinly traded securities and fractional shares due to corporate entitlements, a separate odd lot market has been reintroduced at the stock exchanges which will operate parallel to the cash market under the risk management system of the exchanges.

- **Introduction of Index-based Option Contracts:** To add depth to the market and to allow investors to leverage positions for large diversified portfolios, Index-based Option Contracts were launched at the Karachi Stock Exchange in line with international best practices. Options are globally popular derivative products which provide various benefits such as help to create orderly, efficient, and liquid markets, and giving flexibility, leverage and risk minimization to the investors.

Pakistan Equity Capital Market

Stock market performance is one of the key determinants of economic and political conditions of a country. The Karachi Stock Exchange (KSE) is Pakistan's first and one of the oldest stock exchanges in emerging markets of South Asia. KSE was established on 18th September, 1947, just two months after Pakistan became an independent state. KSE is the Pakistan's largest stock exchange. The other exchanges in Pakistan, the Lahore Stock Exchange (LSE) and the Islamabad Stock Exchange (ISE), were established in 1974 and 1989, respectively.

The Pakistan Stock Market depicted an outstanding performance during July 2012 – March 2013 which has witnessed an exponential growth consequent to various favourable events taking place at political and economic front. There have been numerous factors which played vital role in fueling the index pace; these included implementation of long awaited Capital Gain Tax Rules, Demutualization of the stock exchanges, considerable decline in the discount rate by SBP which was brought down to single digit figure of 9.5% in December 2012, substantial foreign interest in stocks, declining inflation rates etc. Further, a politically stable environment also helped to achieve a flourishing capital market.

Highlight of 2012 Global Markets

The performance of global equities substantially improved in 2012 when compared to 2011. The World Index was up 13.2 per cent as compared to 7.6 percent in 2011. Turkey led the world with more than 65 percent gain. Emerging markets generally performed well during the year as investor sentiment continued to improve. This was partly due to some continued stabilization of the euro zone debt crisis, where yields on peripheral government bonds continued to fall. Emerging markets like Philippines, Egypt, Poland and Thailand, showed more than 40% of total return for 2012. Developed markets also witnessed improved equity performance in 2012. Belgium, Singapore, German, New Zealand, and Austria led the developed countries, with more than 30% gain each for 2012. US S&P index lagged most of the world markets in 2012 but still delivered 16% total return in 2012. After a good return in 2011, dividend stocks underperformed in 2012 as US dividend investors headed for the exit door due to the fear of potential 2013 dividend tax rate hike.

Pakistan Stock Markets has outperformed during first nine months of current fiscal year among Global Stock Markets including India, China, Hong Kong, Tokyo, USA and UK. Participation of foreign investment was the main reason behind the better performance of Karachi Stock Exchange (KSE). In addition, the better return on Pakistan Stocks has also attracted the foreigners which they did not find in the other Global Markets, Beside this, the local investors has found the best avenue in the capital market because of consecutive decline in the discount rate. KSE-100 Index has witnessed an increase of 30.7 per cent from 13801.41 to 18043.31 during first nine months. In the same way, the US S&P 500 has registered an increase of 15.2 per cent while the UK FTSE 100 was up by 15.1 per cent during the period under review. The Index of Tokyo NIKKEI 225 , however, stood at 12,397.91 with an impressive increase of 37.7 per cent The Hong Kong market went upward by 14.7 per cent but China Shanghai Composite could not perform and increased only by 0.5 percent. Beside this, Bombay Sensex Index stood at 18,835.77. It may be noted that as compared with the other world indices, Pakistan Stock market performed well during current fiscal year.

Table 6.1: Global Stock Indices during June 30, 2012 to March 2013

	Index	Date		Change June 2012-Mar 2013	
		30-Jun-12	March 31 2013	Points	%
KSE	100 Index	13,801.48	18,043.38	4,241.97	30.7
Philippines	PSE Composite	5,246.41	6,847.47	1,601.06	30.5
Jakarta	Composite	3,955.58	4,940.99	985.41	24.9

Table 6.1: Global Stock Indices during June 30, 2012 to March 2013

	Index	Date		Change June 2012-Mar 2013	
		30-Jun-12	March 31 2013	Points	%
Kuala Lumpur	KLSE Composite	1,599.15	1,671.63	72.48	4.5
US	S&P 500	1,362.16	1,569.19	207.03	15.2
New Zealand	NZX 50	3448.35	3,509.55	61.20	1.77
UK	FTSE100	5,571.10	6,411.70	840.60	15.1
Australia	AORD	4659.80	4,420.00	-239.80	-5.15
Seoul	Composite	2100.69	2,014.04	-86.65	-4.12
Tokyo	Nikkei225	9,006.78	12,397.91	3,391.13	37.7
Singapore	Strait times	2,878.45	3,308.10	429.65	14.9
Hong Kong	Hang Seng	19,441.46	22,299.63	2,858.17	14.7
India	Senses	1,7429.83	18,835.77	1,405.94	8.1
Taiwan	T.weighted	8652.59	7,933	-719.59	-8.32
Thailand	Set (Bangkok)	1,172.11	1,561.06	388.95	33.2
China	Shanghai Comp	2,225.43	2,236.62	11.19	0.5

Source: Karachi Stock Exchange

Performance of Karachi Stock Exchange

Karachi Stock Market remained in record high trajectory during 2012-13, with the KSE-100 Index is setting new records by each passing day and trading at above 20,300 level in mid May 2013 for the first time in its history. On the economic front, the picture remains mixed with the external sector just managing to stay afloat due to improvement in inward remittances by overseas Pakistanis. Yet, foreign debt repayments, especially to the IMF have put downward pressure on the Rupee to some extent. However, improved economic stability and expected new political set up in the country as a result of Election, 2013 keep the investors local, as well as foreign, in bullish frame of mind and no body wanted to miss the opportunity. During July 2012-March 2013 foreign investors were the net buyer showing a net inflow of US $227.67 million as per National clearing and Settlement of Pakistan (NCCPL).

During current fiscal year inflation went down to single digit, averaging 7.8 percent (Jul-April) and this gave room to the State Bank of Pakistan for cutting discount rate by 250 bps (Aug 2012:150 bps, Oct 2012: 50bps and Dec 2012: 50bps), bringing down policy rate to 9.5%. Despite continued energy shortages and substantial fiscal borrowings from the banking system, credit extended to private business has shown some nascent recovery. These factors also contributed to bullish trend in KSE.

A total of 571 companies were listed at the Karachi Stock Exchange (KSE) as of March 31, 2013 with total Listed Capital of Rs. 1,106.514 billion. The aggregate market capitalization at end of March 2013 stood at Rs. 4,446.90 billion. KSE 100 index opened at 13,801.41 points on July 01, 2012 and closed at 18,043.31 during the mentioned period showing a gain of 30.73 %. The benchmark index touched historical high of 18,311.66 points on March 01, 2013. The average daily traded volume in the Ready Market for the Jul-March FY13 period also showed improvement and remained 165.08 million shares against 108.21 million shares during same period last year.

Table 6.2: Profile of Karachi Stock Exchange

Description	2008-2009	2009-2010	2010-2011	2011-2012	2012-13 (upto March)
Total listed companies	651	652	639	591	571
New companies listed	8	8	1	3	
Fund mobilized(Rs. in billion)	44.95	111.83	31.04	115.1	21.1
Total Listed Capital (Rs. in millions)	781,793.81	909,893.67	943,732.85	1,069,840.00	1,106,510.00
Total Market Capitalization (Rs. in millions)	2,120,650.87	2,732,373.61	3,288,657.32	3,518,140.00	4,609,928.61
Total Shares Volume (Million)	28,332.78	42,959.12	28,018.14	38,100.00	34,650.00
Average Daily Share volume (million)	115.64	172.53	111.63	150.00	190.00

Source: Karachi Stock Exchange

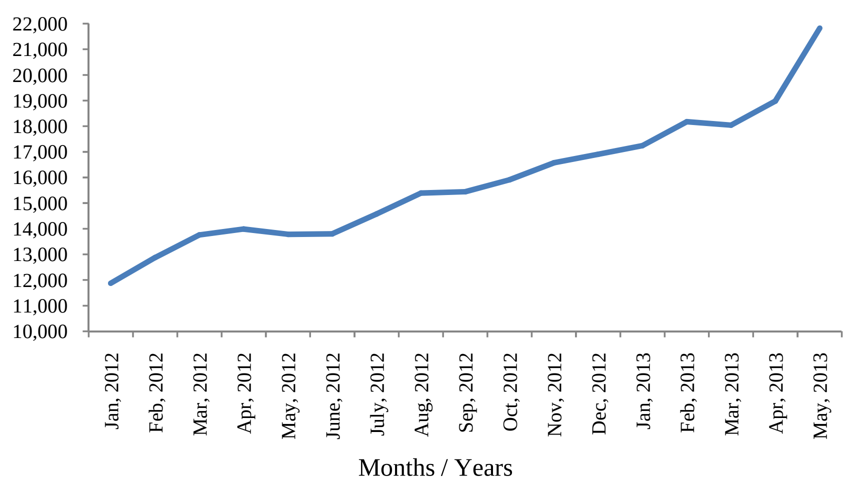
The closing level of KSE 100-index as on end May, 2013 stood at 21,823.05 (the highest level of eleven months) registering a growth of 58.1 percent as compared to July 01, 2012 where index stood at 13,801.41 points.

Table 6.3: Leading Stock Market Indicators on KSE (KSE-100 Index: November (1991=1000)

Months	2011-12			2012-13		
	KSE Index (end month)	Market Capitalization (Rs. Billion)	Turnover of shares (billion)	KSE Index (end month)	Market Capitalization (Rs. Billion)	Turnover of shares (billion)
July	12,190.37	3,247.4	1.2	14,577.00	3,797.3	2.0
August	11,070.58	2,938.0	1.0	15,391.58	4,051.1	2.8
September	11,761.97	3,125.8	1.4	15,444.82	4,037.7	2.8
October,	11,868.88	3,119.1	1.8	15,910.11	4,090.7	2.6
November	11,532.83	3,022.6	0.9	16,573.86	4,307.8	4.5
December	11,347.66	2,960.1	0.8	16,905.33	4,375.9	3.3
January	11,874.89	3,064.0	1.6	17,242.74	4,468.1	3.5
February	12,877.88	3,317.7	3.9	18,173.67	4,647.3	5.4
March	13,761.76	3,501.8	7.0	18,043.31	4,609.9	5.1
April,	13,990.38	3,548.9	6.6	18,982.42	4,819.6	3.9
May	13,786.62	3,502.0	4.3	21,823.05	5,502.2	-
June	13,801.41	3,493.3	1.7			

Source: Karachi Stock Exchange

Fig-8.1: KSE 100 index



The process of new listing at the KSE, however, remained slow during Jul-Mar, FY13 and only one company was granted approval by the SECP under Section 62(1) of the Companies Ordinance, 1984 i.e. Offer for sale of 14.581 million preference shares of Javedan Corporation Limited to the general public, institutional investors and high-net-worth individuals. However, SECP continued their efforts to encourage new listings which include the following:

- The management of unlisted public companies is being approached through stock exchanges to motivate them for listing at the stock exchanges.
- An IPO Summit has also been organized in July 2012 to identify potential IPOs and to attract them to list their companies on the stock exchanges.
- The recommendations of Technical Committee, comprising members from all the three stock exchanges and the Commission for encouragement of new listing are being implemented. Such steps include revision of the existing regulatory framework for new listing; introduction of SME Exchange Board for listing of small capital based companies and venture

companies; amendments in the Listing Regulations for reviewing the minimum allocation of capital to the general public; devising a procedure for allocation of capital to various categories of applications during IPOs; and bringing uniformity in the listing regulations of all the three stock exchanges of Pakistan.

- For facilitating IPO investors, the system of e-IPO is being developed and for this a committee has been formed by SECP.

Sector wise Performance

Oil and Gas sector, Food Producers, Chemicals, Construction, Electricity and materials were the outperformers sector. In 2012 a growth of around 12% was noted in profitability of the sectors listed at Karachi Stock Exchange. The market performance of some of the major sectors is mentioned below:

Oil & Gas:

In this sector 12 companies are listed at Karachi Stock Exchange. In addition to Oil and Gas exploration companies, Oil marketing companies and Refineries are also listed in this sector. Due to increase in consumption and change in well head prices, Pakistan Oil and Gas sector has also shown good profits, this sector continued to be the major market player. In 2012 the total profit after tax was Rs. 162,622.84 million whereas in 2011 it was Rs. 134,496.29 million. As on April 30, 2013 the total market capitalization of this sector was Rs.1,440,505 million as against total paid up capital of Rs.74,708.34 million.

Chemicals

In this sector 32 companies are listed, having total paid up capital of Rs.94,349.03 million and the market capitalization was Rs. 411,244.40 million. The profit after tax of this sector was Rs.38,048.86 million. Six fertilizer manufacturing companies also quoted in this sector.

Construction and Materials

This sector comprises of 36 companies, with total listed capital of Rs.76,873.18 million and the market capitalization of Rs.204,947 million.. On the back of higher consumption and good exports, the sector also showed growth which translated into good financial results compared to last year. In 2012 sector showed profit of Rs 20,782.84 million as against the loss of Rs. 404.28 million in year 2011.

Automobile and Parts

The sector comprises of 16 companies with the total paid up capital of Rs. 6,797.96 million and the total market capitalization was Rs.72,039 million. The sector posted a total profit of Rs. 426.94 million in 2012. Automobile sales has also picked up in spite of increase in prices of locally manufactured cars and import of reconditioned cars.

Personal Goods

Largest sector with 178 companies (mostly related to textile sector) listed in this sector with the listed capital of Rs. 49,995.58 million and market capitalization of Rs.257,457 million. The total loss after tax of this sector was Rs.(5,605.55) million. The results of spinning sector were encouraging.

Fixed Line Communication

The sector comprises of 5 companies which includes PTCL with capital of Rs.51,000 million. The total paid up capital of this sector was Rs. 68,878.47 million and the market capitalization of Rs. 75,485.86 million. The total profit after tax was Rs. 6,679.86 million in 2012.

Food Producers

This sector comprises of 51 companies with the dominance of sugar related companies. The total paid up capital was Rs.19,767.46 million and market capitalization was Rs.742,219.7 million. The profit after tax of this sector was Rs.20,620.92 million in year 2012 as against Rs. 16,462 million in 2011.

Commercial Banks

The sector comprises of 23 listed banks with listed capital of Rs. 375,738 million and market capitalization of Rs. 817,779 million. The total profit after tax of this sector increased to Rs. 114,936 million from Rs. 104,213 million in 2012.

Pharma and Bio Tech.

The sector comprises of 9 listed pharmaceutical companies with the paid up capital of Rs.4,955.77 million, whereas the market capitalization was Rs. 63,969 million. The total profit after tax of this sector was Rs. 5,149.74 million in 2012 as compared to Rs.4,041.26 million in 2011.

Electricity

The sector comprises of 16 companies with the listed capital of Rs. 133,040 million and the market capitalization was Rs.159,912 million. The profit after tax of this sector has shown growth of 674 percent and the after tax profit of this sector was Rs.20,736 million in 2012 as against Rs.2644 million in 2011.

Performance of Blue chips

During July-March 2012-13, the total paid up capital of fifteen big companies like OGDCL, Unilever Pakistan Limited, PPL, Nestle Pakistan Limited, MCB Bank Limited, Pakistan Telecommunication Limited, National Bank of Pakistan , etc. was Rs. 207.2 billion. These fifteen companies earned a profit after taxation of Rs.282.9 billion in the fiscal year up to March 2013. Out of the total profit after tax, the share of OGDCL and PPL was Rs.137.83 billion representing 48.7 percent of the fifteen big companies. For the period ending March 31, 2013, earnings per share for the top rated companies ranged from a 1.41 in the case of PTCL to 413.05 in respect of Unilever Pakistan. This indicates that the business environment in the current fiscal year has improved considerably for the blue chip companies.

Table 6.4: Price to Earning Ratio of Top Fifteen Companies

Name of Company	Profit After Tax in (Rs. Billion)	Paid up Capital (Rs. Billion)	EPS	Market Price (Rs.) March 31, 2013	PE ratio	Market Capitalization (Rs. Billion)
Oil & Gas Development Company Limited	96.91	43.01	22.53	203.94	9.05	8771.31
Unilever Pakistan Limited	5.49	0.66	413.05	12,250.00	29.66	8142.50
Pakistan Petroleum Limited	40.92	16.43	24.91	175.21	7.03	2878.87
Nestle Pakistan Limited	5.86	0.45	129.32	5773.95	44.65	2618.46
MCB Bank Limited	20.94	10.12	20.70	189.29	9.15	1915.32
Fauji fertilizer Company Limited	20.84	12.72	16.38	109.90	6.71	1398.19
Habib Bank Limited	21.56	13.34	16.17	96.51	5.97	1286.96
Pakistan Oilfields Limited	11.85	2.37	50.11	453.63	9.05	1073.04
Pakistan Telecommunication Limited	7.21	51.00	1.41	20.30	14.36	1035.30
United Bank Limited	18.01	12.24	14.71	82.16	5.59	1005.79
Engro Foods Limited	2.60	7.61	3.41	127.13	37.29	967.69
National Bank of Pakistan	16.16	21.26	7.60	39.02	5.14	830.155
Colgate Palmolive (Pak) Limited	1.62	0.44	37.15	1,828.16	49.21	796.99
Engro Corporation Limited	1.25	5.11	2.44	129.00	52.87	659.54
Allied Bank Limited	11.68	10.41	11.22	58.95	5.26	613.66

Source: Karachi Stock Exchange

Performance of Lahore Stock Exchange

The turn over shares of the Lahore Stock Exchange (LSE) during July-March 2012-13 was 0.6 billion compared to almost the same figure in the same period last year. Total paid up capital with the LSE increased from Rs. 989.4 billion in June 2012 to Rs. 1,045.8 billion in March 2013. The LSE index, which was 3,707.6 points in June 2012, increased to 4,100.4 points in March 2013. The market capitalization of the LSE has increased from Rs.3,279.1 billion in June 2012 to Rs, 4,249.3 billion in March, 2013. Three new companies were listed with the LSE during Jul-March, 2012-13, as compared to two listings in the same period last year. The amount of funds mobilized at the LSE by way of subscription was Rs.0.3 billion in the first nine months of the outgoing fiscal year. A profile of LSE is given in Table-6.5.

Table 6.5: Profile of Lahore Stock Exchange

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13 (Jul-Mar)
Total Number of Listed Companies	520	514	511	510	496	459	441
New Companies Listed	10	2	9	25	9	2	3
Fund Mobilized (Rs billion)	38.8	29.7	32.8	67.5	18.1	13.3	0.3
Listed Capital (Rs billion)	594.6	664.5	728.3	842.6	888.2	989.4	1045.8
Turnover of Shares (billion)	8.2	6.5	2.7	3.4	1.1	0.9	0.6
LSE 25 Index	4,849.9	3,868.8	2,132.3	3092.7	3,051.1	3,707.6	4100.4
Aggregate Market Capitalization (Rs billion)	3,859.8	3,514.2	2,018.2	2622.9	3,166.0	3,279.1	4249.3

Source: Lahore Stock Exchange

Performance of Islamabad Stock Exchange

The turnover of share of the Islamabad Stock Exchange (ISE) was 0.02 billion during July-March 2012-13 as compared to 0.01 billion during the same period last year. The ISE 10 index has increased from 2,774.14 points in June 2012 to 3,413.29 points in March 2013, recording a growth of 23 percent percent. No new company was listed and Rs.0.1 billion was mobilized on the ISE during the first nine months of the current fiscal year. The ISE started functioning in 1992 and has now developed in to a vibrant, efficient and stable market. Today the ISE is one of the premier stock exchanges of the country known for the highest standard of transparency in its operations, excellent risk management, dynamic market technology and lowest overall costs of listing. A profile of the ISE is given in Table 6.6

Table 6.6: Profile of Islamabad Stock Exchange

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13 Jul-Mar
Number of Listed Companies	246	248	261	244	236	218	212
New Companies Listed	12	7	15	2	-	-	-
Fund Mobilized (Rs. billion)	30.7	24.6	24.8	76.7	17.8	12.8	0.1
Listed Capital (Rs. billion)	488.6	551	608.6	715.7	727.0	830.5	-
Turnover of Shares (billion)	0.2	0.6	0.3	0.2	0.04	0.03	0.02
ISE 10 Index	2,716	2,749.6	1,713.0	2,441.2	2,722.8	2,871.14	3,413.29
Aggregate Market Capitalization (Rs billion)	3,060.6	2,872.4	1,705.1	2,261.7	2,621.1	2,824.4	-

Source: Islamabad Stock Exchange
-: Not available

Debt Capital Markets

A well-developed corporate bond market is essential for the growth of economy as it provides an additional avenue to corporate sector for raising funds to meet their financial requirements.

During the period under review July 2012 to March 2013 three (3) Issues of listed debt instruments were offered to the general public, i.e., offering Term Finance Certificates (TFC) of Rs. 500 million (TameerSarmaya Certificate TFC-1), Rs. 500 million (TameerSarmaya Certificate TFC-2) and Rs. 5,000 million (Bank Alfalah Limited TFC-5) by Tameer Microfinance Bank Limited and Bank Alfalah Limited.

Sr. No	Name of the Company	Subscription period	Formal Listing Date	Listed at	Issue Size: (Rs. Million)
i.	Tameer Microfinance Bank Ltd. (TameerSarmaya Certificate, TFC-1)	21-Nov-12 to 21-Feb-13	14 Jan, 2013	KSE	500
ii.	Tameer Microfinance Bank Ltd (TameerSarmaya Certificate, TFC-2)	21-Nov-12 to 21-Feb-13	14 Jan, 2013	KSE	500
iii.	Bank Alfalah Limited (TFC-5)	19-20 Feb-2013	28 Mar, 2013	KSE	5000
				TOTAL	6,000

Further, in addition to the above, during the period July 2012 to March 2013 a total of six (06) debt securities issued through private placement were reported. The break-up of the privately placed corporate debt issues is as follows:

Sr. No.	Name of Security	No. of Issues	Amount (Rs. Billion)
i.	Privately Placed Term Finance Certificates	3	1.5
ii.	Sukuk*	3	50.8
	Total	6	52.3

* Includes Sukuk Issue of Rs47, 018 million by Pakistan Domestic Sukuk Company Limited

As on March 31, 2013 a total of 131 corporate debt securities were outstanding with an amount of Rs.613.37 billion as follows:

Sr. No.	Name of Security	No. of Issues	Amount outstanding (Rs. Billion)
i.	Listed Term Finance Certificates (L-TFCs)	38	62.6
ii.	Privately placed Term Finance Certificates (PP-TFCs) *	42	70.5
iii.	Sukuk *	51	480.2
	Total	131	613.4

*: Data is updated on semi-annual basis

Measures for the development of debt markets:

Following measures have been taken for the development of corporate debt market:

- For encouragement of Islamic debt Market, the draft Issue of Sukuk Regulations, 2012 were notified for seeking public comments. These regulations are being finalized in light of comments received from the stake holders.
- The Securities and Exchange Commission of Pakistan has prescribed the Debt Securities Trustee Regulations, 2012 (DST Regulations) and under these regulations so far 15 Debt Securities Trustees were granted registration. List of these registered DSTs is available on the Commission's official website.
- In order to encourage listing of debt securities on the exchanges, separate set of regulations for debt securities are being framed.
- Regulatory framework for the credit rating agencies (CRAs) are being revamped so that CRAs play an effective role in the development of debt market. In this regard a committee, comprising of the representatives of SECP, CRAs and SBP constituted by the Commission has submitted its report and given the recommendations in respect of strengthening the existing Regulatory Framework for CRAs viz. the Credit Rating Companies Rules, 1995 and the Code of Conduct for CRAs dated February 17, 2005; to review the proposals of CRAs regarding enhancement of the rating universe; Diversification of capital structure of CRAs and their listing on the stock exchanges; and Regulatory framework for establishment of a Bond Pricing Agency (BPA).
- In order to rationalize the cost of issue of corporate bonds, steps are being taken to reduce the rate of stamp duty applicable on issue and transfer of Term Finance Certificates (TFCs) and Commercial Papers.
- For the development of the debt capital market, the settlement of trading in debt securities listed at OTC (Over-The-Counter) segment of the stock exchanges has been made mandatory through the National Clearing and Settlement System (NCSS) of National Clearing Company of Pakistan Limited (NCCPL) against the earlier practice of settlement of these trades on counter party basis outside the NCSS. This initiative will facilitate auto settlement of these trades.

Mutual Funds

The total size of mutual funds industry stood at Rs. 468.40 billion as on February 28, 2013 as compared to Rs. 410 billion as on June 2012 showing an increase of Rs. 58.4 million or 14.24% over the period. The total number of funds stood at 146 on February 2012 as compared to 144 as on June 2012.

Money market Funds (both Conventional and Shariah Compliant) continued to dominate the AUMs of the industry with the largest share of the mutual fund industry i.e. 36.22%. Equity funds (both Conventional and Shariah Compliant) held the second largest market share i.e. 33.15%, followed by Income funds (both Conventional and Shariah Compliant) with market share of 23.08%.

Among other initiatives for the growth of mutual funds industry and better protection of investors the following steps were also taken:

- Considering the issue faced by Asset Management Companies (AMCs) and Mutual Funds in valuation methodology and provisioning criteria of debt securities, and in line with the proposal of independent consultant on debt securities certain amendments were made in the criteria for classification and provisioning of debt securities. These amendments include, change in time frame for provisioning in debt securities and definition of traded and thinly traded securities.

- SECP allowed launching of a new type of CIS known as commodity scheme. Commodity schemes are allowed to invest 70% of net assets in commodity and commodity futures contracts. The first commodity fund namely 'UBL Gold Fund', under the management of UBL Fund Managers was offered to general public from February 13, 2013.
- With an objective to facilitate the industry by achieving reduced turnaround time for the approval of constitutive documents, simplify the contents for understanding of a layman and ensure a level playing field for all market participants, the commission standardized the offering documents and trust deeds to be used by asset management companies for new funds.
- SECP has made amendments in Regulation 65 of the Non-Banking Finance Companies and Notified Entities Regulations (NBFC &NE Regulations) 2008 aimed at safeguarding interest of the share/certificate holders of closed end funds (CEF). These amendments empowered the share/certificate holders to decide whether to convert the CEF into open end scheme or revoke. In pursuance to the amendment Extra Ordinary General Meetings of the share/certificate holders of CEF were held in which the share/certificate holder of the 8 CEF decided to convert into open end scheme and for one CEF they opted in favour of revocation.

The position as of February 28, 2013 is as follows.

Total Assets Size of Industry	Rs. 468.40 billion
Total Number of Funds	146
Total Number of AMCs/IAs	28
Assets Size of AMCs/IAs	Rs. 41.70 billion
Discretionary /Non-discretionary portfolio	Rs. 51.40 billion

Modaraba

The modaraba sector has an established legal framework that allows it flexibility to provide wide range of financial products and services under the tenets of Islamic shariah which reflect the innovative and dynamic nature of the industry. Modarabas have played a vital role in the development and growth of Islamic modes of financing in the country and the capital markets since their inception in 1980. Most of the modarabas in Pakistan are doing business in the financial sector while a few are engaged in the industrial, trading or other services sectors. Like any other industry, modarabas' create a distinctive value proposition that meets the needs of its customers.

Currently, 40 registered modaraba companies are in existence and total number of operational modarabas are 26. As per the audited financial statements of modarabas, the aggregate paid-up fund of modarabas was Rs.9.312 billion. The total assets of the modaraba sector stood at Rs.29.549 billion against Rs.26.343 billion in the corresponding year. Similarly, total equity of the modaraba sector was Rs.13.445 billion which shows an increase of Rs.1.421 billion as compared to Rs.12.421 billion during the previous year. Despite recession in the market, as of June 30, 2012, out of 26 modarabas, 18 modarabas declared cash dividend to their certificate holders ranging from 1.2% to 65%. Additionally two modarabas issued 30% and 20% right certificates, respectively, whereas, one modaraba issued 10 percent stock dividend to the certificate holders.

In order to improve the financial standing and image of modarabas in the financial sector of the country, the SECP, after detailed consultation with stakeholders and industry experts introduced "Shariah Compliance and Shariah Audit Mechanism" for modarabas in February 2012. The modaraba companies were advised to immediately bring inline the business transactions of the modaraba with Shariah mechanism, however, with regard to equity investments of the modaraba, one year grace time was provided i.e. February 2013 for compliance. As of December, 2012, the majority of modarabas have fully complied with the Shariah mechanism and disseminated the report of Shariah advisors in this regard with the 2nd quarter accounts of Modarabas for the period ended December 31, 2012.

Investment Banks and Leasing Companies

Leasing and investment finance companies are an important constituent of the Non-Bank Financial (NBF) Sector. Leasing companies focus on providing lease facilities to its customers and are an important source of funding for the SME sector. Investment finance companies can undertake a broad range of business services which includes money and capital market activities, project financing, corporate financial services and non-fund based services.

Presently, there are 7 investment finance companies and 8 leasing companies in Pakistan. The size of leasing and investment finance companies is miniscule and their contribution to our financial system is well below the requisite level. Leasing and investment finance companies are facing a variety of challenges such as absence of level playing field, limited resource mobilization, inability to tap debt and equity markets, high cost of borrowings, liquidity problems, dearth of skilled human resource, limited branch network etc.

SECP in the past had taken a number of steps for development of these important players of the NBF Sector. In order to ensure development of these entities, a detailed in-depth review of the whole business model and prevalent regime was carried out with a fresh perspective. Based on the thorough review and considering the global best practices as well as the interests of all the stakeholders, the following comprehensive way forward is being suggested for sustainable growth of leasing and investment finance companies:

- In line with international best practices, the concept of activity based regulatory regime will be implemented for these companies.
- Investment finance services (IFS) is being re-defined with more focus on non-fund services and product innovation.
- Framing comprehensive regulatory regimes for unregulated activities such as investment advisory services, corporate advisory services etc.
- Creating a more conducive regulatory regime to promote the concept of mid-sized non deposit taking NBFCs.
- Introducing various risk management measures such as Capital Adequacy Ratio, rationalizing leveraging capacity etc. to protect the interest of the various stakeholders.

The revised investment finance services model is expected to encourage the participants to focus more on non-fund based services and product innovation to meet the unique requirements of their clients.

The above measures are aimed not only at addressing the issues currently faced by the entities undertaking investment finance services and leasing business but would also benefit the overall financial system in terms of better resource mobilization, level playing field, more focus on product innovation, development of priority sector and reduction in systemic risk. However, the suggested measures require extensive consultation with all stakeholders of the financial market and based on their feedback any reforms would be considered for implementation.

Financials of investment banking sector:

		(Rs. Millions)
Particulars	Dec 31, 2012	Feb 28, 2013
Total Assets	13,855	13,897
Total Liabilities	9,990	10,246
Total Equity	2,773	3,669
Total Deposits	5,221	4,575

Financials of leasing sector:

		(Rs. Millions)
Particulars	Dec 31, 2012	Feb 28, 2013
Total Assets	33,364	33,660
Total Liabilities	28,854	29,038
Total Equity	4,432	4,549
Total Deposits	7,991	7,946

Voluntary Pension System

The last two decades witnessed pension reforms globally. In high-income countries, the driving force has been the threat that the current pension systems will become unaffordable as demographic developments presented a major risk. The countries that were in the process of transition from command economy to market economy confronted the challenge of introducing a public pension system in place of social security available to their populace under socialist system. However, again, the demographic change and affordability have been the driving force in these countries for reforms. It is anticipated that Pakistan shall also face similar challenges in the near future. Lately, the government is considering to reform the current pension system. Luckily, the dependency ratio at this point of time is extremely favourable for Pakistan to shift from defined benefit system to defined contribution system. While reforms at the national level will take some time, the SECP has introduced Voluntary Pension System (VPS), with the approval of the government. VPS envisages contributions by Pakistan nationals in a pension fund approved by the SECP. The pension fund promises a stream of income to its members after retirement. The government has given tax incentives to individuals under the current tax regime.

The penetration of VPS is low at the moment, being new to Pakistan and non-binding upon employers and individuals. It is hoped that with the passage of time and complementary reforms in defined benefit retirement schemes, the system would gain foothold and substance. So far, 11 pension funds have been launched under the VPS.

The size of pension funds has grown as under since 2007:

Date	No. of pension funds	Net assets in Rs. Million
30-JUN- 07	4	420
30-JUN-08	7	766
30-JUN-09	7	870
30-JUN-10	9	1,301
30-JUN-11	9	1,557
30-JUN-12	11	2,742
28-Feb- 13	11	3,734

The government has also been endeavoring to bring parity among retirement schemes. As a result a number of improvements have been brought in the tax regime governing VPS and other retirement schemes in consultation with FBR. However, certain aspects are yet to be reformed. In the current year, tax-free withdrawal from the contributions made in the VPS out of provident fund has been permitted, thereby bringing parity in the tax treatment between provident fund and VPS. To encourage funding of retirement schemes VPS need to be made interchangeable with other retirement schemes such as gratuity and superannuation funds. This will encourage funded schemes leading to accumulation of assets and efficient deployment of retirement savings.

Furthermore, VPS Rules which were notified in 2005 were reviewed for improvement and updating on a number of fronts. A number of changes have taken place in the market and the fund management practices. Draft prepared in this regard was shared with the stakeholders and after considering feedback the amendments in the VPS Rules were notified in November, 2012.

REITs

Real Estate Investment Trusts (REITs) provide property owners an opportunity to securitize their properties. It also provides the investors with small capital base to invest in the real estate assets. Currently there are three REIT management companies operating in Pakistan. Keeping in view the macroeconomic indicators, the SECP has taken necessary measures to attract entrepreneurs to venture into the regulated real estate business, Amongst these, amending the REIT Regulations in 2010 was one initiative taken in this direction. Significant amendments included reduction of fund size, introduction of hybrid REITs and reduction in share capital for the REIT management companies (RMCs). As a result, the SECP received two new applications for launch of REIT schemes during the year in addition to the ones already under consideration. But these measures still proved inadequate to attract high yield properties into REITs. To improve the regulatory framework a committee was formed which included leading market players. This committee after reviewing the REIT models in different jurisdictions have come up with a draft report which was shared with public for their comments. The report highlights the major impediments for the growth of REITs in Pakistan and suggests the measures to foster growth. Some of the key measures suggested in the report are :

- Reduction in Equity requirement of RMC and bring it down to PKR 50 million
- Reduction in fund size of REIT scheme after aligning it with listing Regulations
- Reducing RMC mandatory holding in REIT Scheme to 10%
- Increasing the use of customer advances up to 70% of sale value
- Allowing unsecured borrowings to REIT Scheme
- Increasing the eligible cities where REITs can be launched
- Allowing Asset Management Companies to manage REITs
- Introducing performance fee for RMCs
- Simplifying the regulatory processes for REIT approvals

Future Roadmap

The SECP's future roadmap, as outlined below, envisages introduction of key structural and regulatory reforms, development of equity, derivative, debt, commodities and currencies markets, and measures for improving governance, risk management, efficiency and transparency in capital market operations:

- **Post-demutualization reforms*:*** The SECP in collaboration with the stock exchanges is in the process of introducing consequential reforms which are essential for taking the exchanges forward in the demutualized setup. The stock exchanges are in the process of bringing in strategic investors which will enable the exchanges to benefit from their extensive expertise and technological assistance, apart from bringing foreign investment and broadening the investor base. Simultaneously, efforts will be made for listing of the stock exchanges so their shares are offered to the general public in terms of the demutualization law. The possibility of integration of the three stock exchanges is also being explored to benefit from operational synergies in line with international best practices.

- **Establishment of a Central Country Party:** In line with international best practices, efforts are being made for enabling NCCPL to function as a Central Counter Party for providing protection to the investors and resolving the pending settlements in case of defaults. In addition to the above, possibility of structural reforms such as merger of the depository and clearing companies will be assessed.

- **Commodities Market developments:** For developing the commodities market, the possibility of setting up new commodity futures and spot exchanges will be explored. The said measure will also facilitate healthy competition and business generation while contributing towards greater market outreach to the investors resulting in growth in the size of the commodities market. Efforts are also being made to introduce regulations governing branch offices for Pakistan Mercantile Exchange (PMEX) so that branch offices of brokers are adequately regulated and only authorized persons of brokers have access to trading accounts and other sensitive information.

- **SME Exchange**

  In order to provide alternate source of financing for the Small and Medium Enterprises (SME) of the country, the SECP is working in coordination with stakeholders to implement a framework for establishment of an SME Exchange for allowing fund raising through IPOs and secondary trading of the securities of SME sector.

- **Development of Islamic Capital Market:** In an effort to introduce Shariah-compliance products in line with global best practices, the SECP has established a Shariah Board comprising of eminent Islamic scholars and market professionals to ensure that all products/services offered under this umbrella are in conformity with the Shariah principles. Additionally, introduction of Shariah-compliant investment alternatives is in the pipeline.

- **Strengthening of the Debt Market:** To accelerate growth in the debt market, efforts will be made for listing of Government Debt instruments at the stock exchanges and integration of National Savings Scheme instruments into the mainstream capital market in coordination with the federal government and the SBP. Also, to promote transparency and price discovery of debt securities and to minimize pricing issues of debt securities, establishment of an independent Bond Pricing Agency (BPA) conforming to international standards is in the pipeline. The BPA is expected to contribute towards stimulating activity in the primary and secondary debt markets, increasing market depth, reducing information asymmetry, increasing credibility of financial statements through accurate asset-liability valuation and product development etc.

- **Development of new Products and Systems:** Regarding new product/system development, the future SECP agenda includes listing and trading of call warrants on stock exchanges, stock options, and cross listings of foreign and domestic indices at Pakistan and foreign stock exchanges to boost activity in index futures market. Further avenues are being explored for introducing the latest risk management techniques including introduction of the Standardized Portfolio Analysis of Risk (SPAN) margining regime in the derivative market segments. For investors in the commodities segment, the SECP is actively pursuing with PMEX and the Karachi Cotton Association in an endeavor to launch cash-settled cotton futures contract at PMEX. The SECP is also engaged in dialogue with SBP to expedite launch of currency futures contracts at PMEX. Further, work is underway for establishment of a Collateral Management Company (CMC) that would have a national network of approved warehouses with storage, grading/certification capabilities for the commodities market. The CMC will issue electronic warehouse receipts and the same will be made available for trading on PMEX.

- **Establishment of a Brokers' Association:** Considering the important role of market intermediaries, the possibility of establishing a brokers' association is being assessed which will provide an effective platform for the stock broking community to voice their concerns to the government and regulatory bodies and ensure professional training and exposure to the intermediaries while creating awareness among them about capital market issues.

- **Centralized Know Your Client Organization:** To facilitate the securities market investors, NCCPL will act as a Centralized KYC Organization whose objective will be to register and maintain investors' KYC records in line with the international best practices pertaining to KYC and CDD policies. The said KYC records will be available for access by all market intermediaries and this measure will assist in removing the duplication presently faced in the KYC process by bringing uniformity to the same.

National savings Schemes

The Central Directorate of National Savings is a key player in domestic debt management arena which is manifested by its portfolio of over Rs. 2.30 trillion with an extensive outreach to over 6 million valued investors who park their life long savings in the schemes offered by NSS.

Central Directorate of National Savings (CDNS) is engaged in making innovative efforts to promote saving culture in the country. The CDNS offers attractive saving products to various categories of people to suit their specific needs. CDNS are currently engaged in restructuring of the CDNS to better cater for the needs of the investors and introduce more profitable products. Focus is on introducing short term saving certificates and expansion of CDNS network not only across the country but also to overseas Pakistanis. Detail of the investment made in the saving schemes is given in Table: 6.7

Table: 6.7: National Savings Schemes (Net Investment) (Rs. Billion)

S.#.	Name of Scheme	2008-09	2009-10	2010-11	2011-12	2012-13 (Jul-Mar
1	Defence Savings certificates	(27,411.28)	(32,493.15)	9,748.10	7,295.52	2,8173.02
2	National Deposit Scheme	(2.71)	(0.13)	(1.01)	(0.94)	(0.21)
3	Khaas Deposit Scheme	(1.64)	(3.84)	(2.62)	(0.55)	(0.08)
4	Premium Saving Certificate	--	--	--	--	-
5	Special Savings Certificates(R)	128,469.03	61,856.60	43,960.21	(52,834.15)	39,077.83
6	Special Savings Certificates(B)	(8.53)	(0.30)	(0.74)	(0.85)	(0.16)
7	Regular Income Certificates	40,094.28	44,538.27	46,946.79	43,971.60	26,982.65
8	Bahbood Savings Certificates	78,537.96	59,267.18	61,731.56	52,254.51	36,897.61
9	Pensioners ’Benefit Account	22,215.74	18,166.85	17,940.32	16,359.53	14,033.27
10	Savings Accounts	(10,899.15)	1,021.30	(625.30)	3,978.46	(706.88)
11	Special Savings Accounts	21,627.05	31,375.53	14,240.79	61,098.77	119,445.72
12	Mahana Amdani Accounts	(50.03)	(195.73)	(77.94)	(90.52)	(61.53)
13	Prize Bonds	14,649.97	38,556.68	41,083.40	56,324.21	41,173.81
14	National savings Bonds	--	3,625.16	--	--	(3,425.58)
15	Short Term savings Certificates	-	-	-	-	2,490.80
	Total	267,220.71	225,714.46	234,943.98	188,355.59	304,080.26