



**REGULATIONS GOVERNING  
DEFAULT MANAGEMENT**

**OF**

**KARACHI STOCK EXCHANGE LIMITED**

**(As amended on March 18, 2013 and sent for Gazette Notification)**

## **REGULATIONS GOVERNING DEFAULT MANAGEMENT**

### **Preamble**

Whereas a detailed review of Regulations Governing Members' Default and Procedure for Recovery of Losses at the Karachi Stock Exchange has been undertaken by the Karachi Stock Exchange.

And whereas in the process of review of various aspects of default under the existing Rules and Regulations, it is deemed necessary that the existing Regulations Governing Members' Default and Procedure for Recovery of Losses be repealed and replaced by these new regulations, in order to protect the interest of all concerned.

Now, therefore, the Board of Directors of the Karachi Stock Exchange Limited with the prior approval of the Securities & Exchange Commission of Pakistan hereby make these Regulations which shall come into effect on publication in the official gazette of Pakistan.

### **1. Short Title**

These Regulations may be called "Regulations Governing Default Management" of the Karachi Stock Exchange Limited.

### **2. Definitions**

In these Regulations, the following expressions shall, unless the context requires otherwise, have the meanings herein specified below:

- (a) "Default Management Committee" means a committee of such name established under the NCCPL Regulations;
- (b) "All Markets" means collectively Ready Market, Margin Trading Market, Securities Lending and Borrowing Market, Deliverable Futures Contract Market, Cash-Settled Futures Market, Stock Index Futures Contract Market and Futures Trading in Provisionally Listed Companies Market and individually referred to as a "Market";
- (c) "Blocked Account" means the same as defined in the Stock Exchanges (Corporatization, Demutualization and Integration) Act, 2012;
- (d) "Board" means Board of Directors of the Exchange;
- (e) "CDC" means the Central Depository Company of Pakistan Limited;
- (f) "Default Committee" means a committee constituted by the Chief Regulatory Officer in consultation with the Regulatory Affairs Committee from time to time;
- (g) "Defaulter" means a TRE Certificate Holder declared as defaulter by the Board in accordance with these Regulations;
- (h) "Exchange" means the Karachi Stock Exchange Limited and includes its successors;
- (i) "KATS" means the automated trading system for securities introduced by the Exchange and known as Karachi Automated Trading System;
- (j) "NCCPL" means the National Clearing Company of Pakistan Limited;
- (k) "NCCPL Final Notice" shall mean a notice issued to a suspended TRE Certificate Holder by NCCPL pursuant to NCCPL Regulations requiring the suspended Clearing Member to pay his final liabilities as determined by the Default Management Committee;
- (l) "NCCPL Regulations" means the Regulations framed by NCCPL from time to time with regard to its

functions and operations;

- (m) "NCSS" means National Clearing and Settlement System of NCCPL established pursuant to its regulations;
- (n) "TRE Certificate" means a Trading Right Entitlement (TRE) Certificate issued by the Exchange evidencing right of a TRE Certificate Holder to apply for registration as a Broker in accordance with the Brokers and Agents Registration Rules, 2001 as amended from time to time;
- (o) "TRE Certificate Holder" means a person who is issued a TRE Certificate by the Exchange under section 5 of the Stock Exchanges (Corporatization, Demutualization and Integration) Act, 2012, or purchases or acquires such TRE Certificate under section 16 of the said Act or is issued a fresh TRE Certificate in accordance with the provisions of the said Act;
- (p) "Regulatory Affairs Committee (RAC)" means a committee constituted by the Board with prior approval of SECP.

### **3. Suspension on Account of Settlement Failure**

- 3.1 (a) In case a TRE Certificate Holder fails to pay any amount payable by him or fails to deliver securities to the Exchange or to other TRE Certificate Holder(s) as directed by the Exchange in accordance with the Regulations of the Exchange, the Exchange shall issue a notice requiring such TRE Certificate Holder to rectify the default within 30 minutes. On failure to comply with the notice by the TRE Certificate Holder within the time allowed, the trading rights of such TRE Certificate Holder shall be restricted or suspended by the Exchange by issuing a notice in writing, a copy of which shall also be delivered to NCCPL and CDC.
- (b) Upon receiving of a notice from the Exchange under regulation 3.1(a) above, NCCPL shall also restrict or suspend such TRE Certificate Holder's access to the services offered by NCCPL under its relevant regulations.
- 3.2 In case a TRE Certificate Holder is suspended by NCCPL as its Clearing Member and (i) if the suspension notice from NCCPL is received after the trading hours of the Exchange, the Exchange shall immediately suspend such TRE Certificate Holder and (ii) if such suspension notice is received during the trading hours of the Exchange, the Exchange shall immediately restrict such TRE Certificate Holder's access to all KATS terminals in a manner that such TRE Certificate Holder is not able to take any further Exposure in any of the Markets during the remaining trading hours on that day, provided that one or more KATS terminals of such TRE Certificate Holder may be operated under the supervision of the Exchange for the purpose of reducing his Exposure. The Exchange shall suspend such TRE Certificate Holder after the end of the trading hours on that day.
- 3.3 In addition to suspension of such TRE Certificate Holder, the Exchange shall also transfer on the same day upon demand of NCCPL the following collaterals provided by suspended TRE Certificate Holder in the relevant Market to meet his settlement obligations towards NCCPL:
  - (i) Cash Margins, if any, deposited by such TRE Certificate Holder with the Exchange;
  - (ii) Securities, if any, pledged/deposited by such TRE Certificate Holder to meet failure of delivery obligations in the priority given in clause 4.3 of these regulations; and
  - (iii) Proceeds of Bank Guarantee(s), if any, provided by such TRE Certificate Holder against respective market.
- 3.4 Upon suspension of a TRE Certificate Holder, who is Clearing Member of the NCCPL, due to his failure to meet settlement obligations on the settlement day, NCCPL may en-cash Bank Guarantee provided by the Trustees of Clearing House Protection Fund Trust (CHPFT) up to the amount earmarked as margins against his Exposure in accordance with the CHPFT Trust Deed and the Regulations Governing Risk Management of the Exchange.

#### **4. Closing out of Unsettled and Open Positions**

4.1 Upon suspension of a TRE Certificate Holder, the matter shall be referred to the Default Management Committee. The Exchange shall provide all data and information relating to the unsettled and open positions of the suspended TRE Certificate Holder in All Markets, trades, contracts, and transactions, which are not available with NCCPL, to the Default Management Committee along with the market-wise details of Margin Eligible Securities deposited by the suspended TRE Certificate Holder in accordance with the Risk Management Regulations of the Exchange.

Provided that all types of margins held by the Exchange and NCCPL with respect to each of the markets shall be applied exclusively to settle the claims against that market only by the Exchange and NCCPL respectively. Any surplus may be shared equally amongst the markets other than such market in proportion to the losses.

4.2 The suspended TRE Certificate Holder's unsettled and open positions in All Markets (together with his unsettled and open positions reported by NCCPL) shall be closed-out and squared up in the manner specified by the Default Management Committee and final liability of the suspended TRE Certificate Holder shall be determined by the Default Management Committee.

4.3 (a) The Default Management Committee may square-up or sell out Margin Eligible Securities in the manner specified below for determining final loss, if any, of the suspended TRE Certificate Holder.

(b) Upon suspension of a TRE Certificate Holder due to his failure to meet obligations either on his proprietary account or on account of his clients, the collaterals held by the Exchange shall be dealt with in the following manner:

i) The collaterals in the form of Margin Eligible Securities and/or Cash/Bank Guarantee deposited by the TRE Certificate Holder and/or any individual who holds at least 10% shares of the Corporate Brokerage House in case acting as Corporate Brokerage House, in accordance with the Regulations Governing Risk Management of the Exchange shall be retained by the Exchange against all trades executed through him and held by the Exchange with respect to each of the markets and shall be subjected to and applied exclusively in accordance with these Regulations of the Exchange and relevant NCCPL regulations. These margins shall remain available to the Exchange till the satisfaction of all money and/or delivery obligation and/or any other obligation ascertained after squaring-up and/or closing out of his positions (including his proprietary and/or client's position) as provided in these Regulations of the Exchange and relevant NCCPL regulations. In such case of liquidation of collaterals as margins on UIN basis, such TRE Certificate Holder or the individual who holds at least 10% shares of the Corporate Brokerage House in case acting as Corporate Brokerage House, as the case may be, shall have no claims whatsoever against the Exchange and/or NCCPL.

ii) The collaterals derived by the Exchange from the respective sub-accounts of clients of a TRE Certificate Holder and/or from the TRE Certificate Holder of another Stock Exchange as client of such TRE Certificate Holder (deposited by the TRE Certificate Holder in accordance with the Regulations Governing Risk Management of the Exchange) shall be retained and utilized by the Exchange to the extent of margin requirement against their trades/transactions and relevant Mark-to-Market losses on UIN basis, whereby such collaterals will remain available to the Exchange till the satisfaction of all money and/or charges related to the trading of such client, ascertained after squaring-up and/or closing out of the concerned TRE Certificate Holder's position. In such case of liquidation of collaterals as margin on UIN basis, such clients shall have no claims whatsoever against the Exchange and/or NCCPL. No collateral shall be so utilized in excess of the margin requirements against the trades/ transactions of that client and the respective Mark-to-Market losses.

(c) For the purpose of delivering Margin Eligible Securities squared-up or sold out by the Default Management Committee, the Exchange will be authorized to execute pledge call on Margin Eligible Securities pledged by the suspended TRE Certificate Holder in accordance with CDC Regulations dealing with pledge transactions.

(d) While disposing of the collaterals, in the form of Margin Eligible Securities, cash and/or bank guarantee, of clients of a TRE Certificate Holder kept as margin, the Exchange shall have the absolute discretion to liquidate such collaterals in preference to others to meet the obligations of Exchange/ NCCPL.

4.4 Upon receipt of copy of NCCPL Final Notice, the Exchange shall serve a final notice to the suspended TRE Certificate Holder calling upon the suspended TRE Certificate Holder to pay the liabilities stated in the NCCPL notice within the time allowed in said notice.

## **5. Declaration as Defaulter**

5.1 Upon receipt of a notice from NCCPL declaring the suspended TRE Certificate Holder a defaulter under NCCPL Regulations, such TRE Certificate Holder shall be declared a Defaulter by the Board under relevant regulations of the Exchange.

5.2 ATRE Certificate Holder who has been adjudicated as insolvent, or in case of Corporate TRE Certificate Holder against whom a winding-up order has been passed by the Court for failure to discharge its obligations towards creditors or a resolution for voluntary winding-up has been passed without obtaining prior consent of the Exchange, shall *ipso facto* be declared as defaulter.

## **6. Consequences of Default**

A TRE Certificate Holder who has been declared a Defaulter shall at once cease to be a TRE Certificate Holder of the Exchange and his TRE Certificate and other assets in the control of the Exchange shall vest in the Exchange for utilization in accordance with these Regulations.

## **7. Function of the Default Committee**

The Default Committee shall manage and supervise all proceedings relating to the collection and realization of the assets of a Defaulter in accordance with these Regulations.

## **8. Default Management Procedure**

### **8.1 Defaulters' Assets:**

The Default Committee; shall recover all moneys, securities and other assets due or deliverable to the Defaulter by any other TRE Certificate Holder in respect of any transactions or dealing made subject to any Regulations of the Exchange or NCCPL and such assets shall, if not contrary to the provisions of any law for the time being in force, vest with the Exchange. Without prejudice to the generality of the foregoing the Defaulter's assets shall include:

(i) securities, if any, held in the custody of the Exchange after their squaring-up or selling out under regulation 4.2 above or recovered by the Default Committee as stated in above paragraph;

(ii) cash/bank guarantee, if any, remaining unutilized by NCCPL after squaring-up initiated before determination of NCCPL Final notice and any other assets under the control and custody of Exchange as may be determined by the Default Committee; and

(iii) Base Minimum Capital maintained with the Exchange in accordance with the Regulations Governing Risk Management of the Karachi Stock Exchange Limited; and office(s) within the Exchange premises, if any, in the control of the Exchange;

### **8.2 Claims against Defaulter:**

(i) The Default Committee shall invite claims relating to Defaulter's obligations other than

those which are already included in the closing out process pursuant to Regulation 4 above from all TRE Certificate Holders of the Exchange and the investors against the Defaulter within a timeframe as may be determined by the Default Committee for this purpose.

- (ii) The Default Committee shall not entertain any claim against the Defaulter which is not forwarded within the prescribed time limit. This time limit shall not be less than 30 days.
  - (iii) The Default Committee shall also not entertain any claim against the Defaulter which does not arise out of any contract made between a TRE Certificate Holder and such Defaulter subject to the Regulations of the Exchange or NCCPL.
  - (iv) The Default Committee shall verify each claim to ascertain the genuineness of each claim and for such purpose may seek advice or employ the services of an independent expert.
- 8.3 False or fictitious claims: The Board on the recommendation of Default Committee, may impose fine, suspend, cancel or forfeit the TRE Certificate of a TRE Certificate Holder when it is proved that any claim filed by such TRE Certificate Holder against the Defaulter was false or fictitious.
- 8.4 Accounts of the Defaulter: The Default Committee shall keep a separate account in respect of all money, securities or other assets payable or deliverable to a Defaulter by other TRE Certificate Holders or NCCPL and which are received by them and shall defray there from all costs, charges and expenses incurred in or about the collection of such assets or in or about any proceedings taken by them in connection with the default.
- 8.5 Disposal of the Defaulter's assets: All assets of the Defaulter recovered or received by the Default Committee shall be disposed off by the Default Committee.
- 8.6 Application of the proceeds: Proceeds of the Defaulter's assets realized by the Default Committee other than those mentioned in regulation 8.1 (iii) above shall be utilized towards payment of the amount specified in the NCCPL Final Notice. Any surplus together with the funds recovered from the sale of assets mentioned in regulation 8.1 (iii) above shall be utilized to settle claims admitted by the Default Committee as provided in Regulation 10 below.

In case where Proceeds of the Defaulter's assets realized by the Default Committee other than those mentioned in regulation 8.1 (iii) above are not sufficient for payment of amount specified in NCCPL Final notice then the contribution mentioned in Regulation 9 (a) below shall be utilized. Any surplus remaining out of contribution from CHPFT shall be deposited in the CHPFT and the funds recovered from the sale of assets mentioned in 8.1(iii) above shall be utilized in accordance with regulation 10 below.

In case where the funds recovered from the sale of assets mentioned above and the contribution from the CHPFT are not sufficient to satisfy the NCCPL Final notice then the funds mentioned in regulation 8.1(iii) above shall be utilized. Any surplus shall be utilized in accordance with the Regulation 10 below.

Provided that the proceeds of the shares of the Exchange constituting the Base Minimum Capital shall only be utilized towards payment of the amount specified in the NCCPL Final Notice, satisfying investor claims in accordance with these Regulations and any surplus shall be deposited in the CHPFT and Investors Protection Fund in proportion to utilization of these funds.

## **9. Contribution from Clearing House Protection Fund and Investors' Protection Fund**

In the event the funds recovered through the sale of assets of the Defaulter and remaining after application in the manner mentioned in Regulation 8.6 above are not sufficient to satisfy NCCPL Final notice and all claims admitted by the Default Committee then the following contributions shall be made available:

- (a) From CHPFT for satisfaction of NCCPL Final notice and claims of TRE Certificate Holders in accordance with the provisions prescribed in the relevant Trust Deed of the CHPFT on recommendation by the Board subject to adjustment of amount en-cashed by NCCPL against the Bank Guarantee provided by CHPFT under clause 3.4 above; and
- (b) From Investors' Protection Fund for satisfaction of claims of investors in accordance with the provisions prescribed under the relevant trust deed of the fund and Investors' Protection Fund Regulations

**10. Settlement of Claims**

10.1 Any surplus fund left after application in accordance with Regulation 8.6 above, including any unutilized amount of funds recovered from the sale of assets mentioned in regulation 8.1(iii) above, shall be distributed in the following priority:

(i) TRE Certificate Holders' other claims as per Regulations of the Exchange and verified by the Committee pursuant to Regulation 8.2

(ii) Investors claims as per Regulations of the Exchange.

Provided in case the investors' claims admitted by the Exchange against a TRE Certificate Holder are more than the amount of surplus as mentioned in this Regulation, all the claims will be satisfied on pro-rata basis. The claims still remaining unsatisfied after pro-rata sharing will then be paid from the Investors Protection Fund in accordance with the KSE Investors Protection Fund Regulations.

10.2 Any surplus funds/assets available after satisfying claims in the above manner shall be refunded back to the CHPFT and Investors Protection Fund in proportion to utilization of these funds.

Provided where the amount of the Base Minimum Capital is not immediately available and contribution from CHPFT and Investors Protection Fund is utilized first, prior to the availability of Base Minimum Capital for satisfaction of claims admitted by the Exchange, any amount remaining unutilized out of the sale proceeds of the defaulter's assets, shall be deposited in the manner specified above after settlement of all claims as stated in sub-clauses 8.6 and 10.1 above.

**11. Allocation of losses**

11.1 In case the amount specified in NCCPL Final Notice remains unsettled after utilizing the proceeds of Defaulter's assets and the contribution made in accordance with Regulation 9, the remaining amount shall be allocated and recovered by NCCPL to the TRE Certificate Holders and non-broker clearing members admitted into NCSS by NCCPL in accordance with NCCPL Regulations.

11.2 The payments by the TRE Certificate Holders and non-broker clearing members admitted into NCSS under Regulation 11.1 above will be treated as claims of such TRE Certificate Holders and non-broker clearing members against the Defaulter and, if the default was caused on account of a default by any client(s) of such Defaulter, against such client(s).

**12. Business with Defaulter Forbidden**

Except with the prior permission of the Board, no TRE Certificate Holder shall carry on business for or with a person who has been declared a Defaulter by the Exchange and notice regarding such prohibition has been issued by the Exchange.

**13. Re-admission of a Defaulter**

13.1 If a Defaulter has paid his entire unpaid obligations to Exchange, NCCPL, TRE Certificate Holders, non-broker clearing members admitted into NCSS by NCCPL and investors and has reimbursed the amount utilized from any of the funds established or maintained by the Exchange or NCCPL, the Board may subject to such conditions as they think fit readmit a

Defaulter, if in opinion of the Board such Defaulter:

- i) had defaulted owing to the default of his clients whom he might reasonably have expected to be good for their commitments.
- ii) had not been guilty of bad faith or breach of any Regulations of the Exchange.
- iii) had kept his operation within a reasonable proportion of his means or resources.

13.2 A Defaulter shall not be re-admitted if his default had been contributed to by reckless dealings on his own account or his conduct had been marked by indiscretion and by the absence of reasonable caution and/or not in accordance with the Regulations of the Exchange and or NCCPL.

13.3 A TRE Certificate Holder who as an insolvent has been declared a Defaulter shall not be eligible for re-admission until he has paid in full all claims and dues against him and has been discharged as an insolvent by a court of competent jurisdiction.

13.4 A notice of every application by a Defaulter for readmission shall be posted on the notice board of the Exchange for at least fifteen days previous to his readmission decision.

13.5 Any TRE Certificate Holder or any other creditor intending to object to the re-admission of the Defaulter shall communicate the grounds of his objection to the Board by a letter within fifteen days of the date of posting of the notice of the application for readmission. All such objections shall be deemed privileged and confidential.

**14. Repeal**

The existing Regulations titled 'Members' Default and Procedure for Recovery of Losses' are hereby repealed and henceforth all references to the repealed regulations in the Regulations of the Exchange or any other documents shall be read as reference to these Regulations.

**15. Conflict Resolution**

In case of any conflict in the matters prescribed in these regulations of the Exchange and NCCPL Regulations dealing with default management of defaulter broker clearing member who is admitted into NCSS as Clearing Member by NCCPL, it shall be resolved by SECP in consultation with the Chief Executive Officer of the Exchange and the Chief Executive Officer of NCCPL.

**16. Overriding effect**

In case of any conflict or inconsistency between these Regulations and any other existing regulations of Karachi Stock Exchange, these regulations shall prevail to the extent of such conflict or inconsistency.