



ISO 27001 Certified

National Clearing Company of Pakistan Limited

8th Floor, Pakistan Stock Exchange Building, Stock Exchange Road, Karachi

NCCPL/CM/JUNE-18/02

June 7, 2018

**Subject: Direct Payment System - Custody Model
Concept Paper**

Dear Broker Clearing Members,

This is with reference to the letter No. SMD/SE/2(206)/2009 received from the Securities and Exchange Commission of Pakistan (SECP) Dated June 06, 2018.

The SECP vide this letter, has directed NCCPL to implement "Direct Payment System - Custody Model ("DPS") in order to revamp custodial services. The SECP's directive and the Concept Paper of the DPS functionality are attached herewith for your review. Please note that comments/feedback (if any) on the Concept Paper should be communicated to NCCPL in writing **till Thursday, June 14, 2018.**

To understand the salient features of DPS, NCCPL has arranged awareness session for the market participants as per the following schedule:

S. No.	Venue	Date	Time
01	Pakistan Stock Exchange (PSX) Auditorium, Karachi	Monday, June 11, 2018	02:30 pm
02	ISE Towers REIT Management Company Limited Auditorium, Islamabad	Tuesday, June 12, 2018	02:30 pm
03	LSE Financial Services Limited Auditorium, Lahore	Thursday, June 14, 2018	02:30 pm

For any further queries or concerns, please feel free to contact the Customer Support Department at UAN No. 021-111-111-622.

Regards,

_____sd_____

Rehan Saif
Head of PD & CSS

CC:

1. Executive Director - Policy, Regulation and Development Department - SMD
Securities & Exchange Commission of Pakistan - Islamabad
2. Managing Director - Pakistan Stock Exchange Limited
3. Chief Executive Officer - Central Depository Company of Pakistan Limited
4. All Settling Banks



Securities and Exchange Commission of Pakistan
Securities Market Division
Policy, Regulation and Development Department

June 06, 2018

No. SMD/SE/2(206)/2009

Mr. Muhammad Lukman,
Chief Executive Officer,
National Clearing Company of Pakistan Limited,
Karachi.

Direction under Sections 31(1)(a), 31(1)(c), 31(2)(d) and 170(2)(g) of the Securities Act, 2015


The Securities and Exchange Commission of Pakistan (“the Commission”) with the view to revamp the existing custodial services, having an inherent risk of misuse of clients’ assets, considered the National Clearing Company of Pakistan Limited’s (“NCCPL”) proposal of ‘Direct Payment System – Custody Model’ (“DPS”) (*as enclosed*) and accordingly, has accorded its approval for implementation of the proposed plan.

In view of the forgoing, the Commission in exercise of its powers conferred under Sections 31(1)(a), 31(1)(c), 31(2)(d) and 170(2)(g) of the Securities Act, 2015, in the interest of the public, for ensuring integrity of the securities market and for the protection of customers, hereby directs the NCCPL to execute the implementation plan, as per the following schedule:

Sr.	Activity	Target Date
1	Approval of concept paper by the Commission	Second week of June, 2018
2	Circulation of concept paper to Market Participants followed by presentations to market participants to seek comments and incorporate necessary changes in the proposed model, subject to prior approval of the Commission	Third week of June, 2018
3	Regulatory changes in NCCPL and CDC Regulations (phase 1 & 2 development)	First week of July, 2018
4	Phase 1 development jointly by NCCPL and CDC	Last week of July, 2018
5	Phase 2 development jointly by NCCPL and CDC	First week of November, 2018

Furthermore, the NCCPL is also directed to:

- Evolve a mechanism wherein reasonable assurance shall be required from Broker Clearing Members (“BCMs”) in the form of auditor’s certificate and/or clients’ confirmations to ensure accuracy as BCMs shall be providing opening balances of their clients in phase 2 of this implementation plan; and


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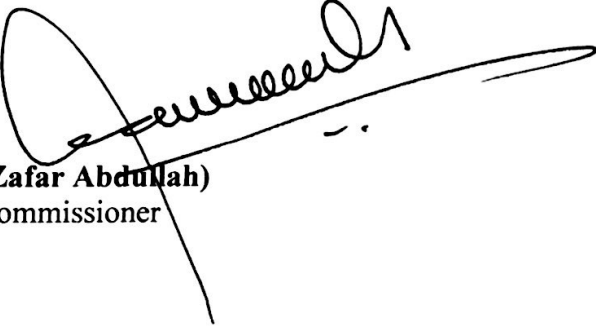
Securities and Exchange Commission of Pakistan

Securities Market Division

Policy, Regulation and Development Department

- b) Emphasize during circulation, presentations, awareness stage to market participants that the NCCPL shall be the facilitator in new custody model and it will be unconditional, irrevocable and absolute responsibility of BCMs to meet all obligations arising out of subject custody model.

Moreover, Mr. Hammad Javed, Joint Director and Mr. Muhammad Umair, Deputy Director will be in continuous coordination with NCCPL for ensuring smooth implementation of DPS.



(Zafar Abdullah)
Commissioner

Copy Forwarded to:

1. Board of Directors, NCCPL
2. Chief Executive Officer, Central Depository Company of Pakistan Limited

Direct Payment System “DPS”

Concept Paper – Second Draft

Ver: 02June 04, 2018

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A. Overview

Trading Rights Entitlement Certificate (“TREC”) Holders of the Pakistan Stock Exchange (PSX) execute trades in various markets for their proprietary accounts as well as on behalf of their individual, corporate and foreign investors. Such TREC Holders are admitted as Clearing Member (“CM”) by the National Clearing Company of Pakistan Limited (“NCCPL”) for Clearing and Settlement of all trades and transactions on its respective settlement date through National Clearing and Settlement System (“NCSS”).

The custodial services for both securities and cash are primarily dealt with by Broker Clearing Member (BCM) for their respective investors. Prior to December 20, 2010, in NCSS, Securities Settlement was dealt through respective BCM’s CDS Participant Main Account on Net Basis. To strengthen the securities transfer mechanism, “Automated Securities Settlement System” was implemented in December 20, 2010 jointly by NCCPL and CDC whereby, NCSS generates the Balance Orders based on settlement date-wise, security-wise and investor-wise for CDS Sub-Account Wise for respective BCMs, as a straight through processing of securities settlement into the investors’ directly. However, the Pay and Collect Settlement in NCSS is processed at BCM Level on “Net Payable” or “Net Receivable” basis on a particular settlement date. Afterwards, BCMs are responsible to debit and credit respective clients’ accounts as a part of their internal clearing.

In order to bring efficiency & transparency and to avoid incentive to unauthorized trading and/or misuse of client securities under their control, it has been envisaged that NCCPL will extend the scope of its services for the investors of capital market by way of providing them a facility to receive payments directly from NCCPL in their designated bank accounts maintained with any of the Settling Bank of NCCPL. For this purpose, every BCM should have to maintain two separate/distinct account in the settling bank namely “Proprietary” and “Clients”. Accordingly, NCCPL will generate separate payment instructions through its enhanced Pay & Collect functionality for BCM proprietary and its client so as to credit the net payment in respective BCM and Investor account in such settling bank. For that very purposes, the operations of such Settling Bank Account of clients of BCM will be managed and controlled by NCCPL.

Net Payable Obligation of the Investor at Broker-Level, as determined by NCCPL will be settled by NCCPL through respective BCM’s Client Designated Settling Bank Account as per existing Pay & Collect Module. BCM shall remain responsible for collection of amount from the Investors and ensure that amount of Investors should be deposited only in such Client Designated Settling Bank Account. However, BCM shall be required to upload investor-level collection details to NCCPL on daily basis. It shall be the responsibility of a BCM to maintain

proper record of amount received in the respective Investors account and provide accurate collection details to NCCPL

NCCPL will develop controls in the System to reconcile NetPayable Obligation and Credit Amount of each Investor at Broker-Level on a particular settlement date. NCCPL shall release funds against Net Payable Obligation from the Designated Settling Bank of a Broker subject to credit balance of relevant Investor only. Any instruction which is over and above the Net Payable Amount of the Investor shall not be released and BCM shall be responsible to arrange such amount to meet NCSS Settlement Obligation.

For this purposes, NCCPL will initiate necessary changes in:

- NCSS Pay & Collect Module to determine and generate Investor's net money obligation at BCM-Level; and
- Investor Registration Mechanism to obtain IBAN of all capital market investors.
- Bank Pay & Collect Module to create linkage of BCMs Designated Bank Account with respective Banks to process investor's money settlement instructions
- Up-load facility for BCMs for the transmission of credit details of Investors
- Up-load facility for BCMs for the transmission of Fee/Commission and Taxes details of Investors
- Reconciliation Mechanism for settlement obligation and available balances
- SMS/Email System for Investors to intimate fund movement
- Additional features in UIN Information System (UIS)
- Un-blocking of securities. Changes will also be required in CDS

Presently, the role of Settling Banks with regards to Regular NCSS Settlement is limited to the extent of Debiting/Crediting Settling Bank Account of BCMs. Considering, the extended role of NCCPL to make direct payment into the investor's account, the settling banks shall be required to extend their role to facilitate NCCPL to credit money obligation in designated bank accounts of investors.

The proposed mechanism will eliminate the handling of funds credited to the Securities Brokers on account of trades and transactions executed by them on behalf of Investors. This will bring control over mishandling of assets under custody of BCM. This will also reduce the

administrative work for BCM and enable them to focus their efforts on promoting the investment activity in the capital markets and discharge their role of trading in a more transparent and efficient manner.

This document has been prepared to propose the operational model of the payment mechanism and highlight certain other important requirements to be fulfilled for implementing the “Direct Payment System (DPS)” for the review and consideration of Securities and Exchange Commission of Pakistan (SECP).

It may please be noted that the proposal represents the initial assessment of the DPS envisaged by NCCPL in accordance with the work performed and scenarios analyzed by the management at a macro level. The in depth evaluation of the model, technical assessment of the software application and legal review of the corresponding impact on the regulatory framework of NCCPL by the legal counsel may lead to determination of further requirements/ conditions to implement the model. Therefore, the proposal should not be considered as all exhaustive. However, best efforts are being made to include major material modalities within this proposal.

B. NCCPL Proposed DPS Model

I. IBAN Requirement at Investor Registration Level

1. In order to directly transfer the amount in the Investor bank account of a Broker Clearing Member "BCM", new fields will be added in the NCSS UIN registration module whereby the BCM will be required to provide the IBAN number of the principle account holder with the name and branch of the respective bank.
2. It will be the responsibility of a BCM to obtain a valid IBAN from investor and enter the same into NCSS at the time of registration of investor client code.
3. From Go-Live Date, in case where IBAN is not provided by BCM in the NCSS for opening of new client code of any investor, such investor client code tagging process will remain incomplete and consequently such investor client code shall not be transmitted to PSX for trading.
4. For investors already registered in NCSS, BCM shall also be required to update IBAN of their investor in NCSS. Reasonable time will be given to BCMs to complete such registration.
5. For verification of IBAN, NCCPL will obtain data from CDC for existing CDS Account Holders as CDC performs its verification of IBAN through 1-Link System. For new investor registration, NCCPL will seek direct access of 1-Link System to perform verification of IBAN. Till direct access of 1-Link System is established by NCCPL for IBAN verification, NCCPL will transmit relevant information of investor to CDC for the verification of IBAN. CDC, accordingly perform IBAN verification as per existing mechanism and update status of investor IBAN through integrated system between CDC and NCCPL.
6. In case of multiple bank accounts, Investor(s) shall be required to maintain unique bank account for trading and registration with a BCM., Investors can maintain their Bank Account in the same Bank in which respective BCM is maintaining Designated Settling Bank Account for fast processing of credit in their respective Bank Account. Investors can also maintain their Bank Account in any other Bank however considering various operational matters linked with inter-bank on-line fund transfers, credit in their respective Bank accounts will be processed with some delays along with some additional bank transaction cost.

II. Net Pay & Collect Money Settlement at BCM Level

In the proposed functionality NCSS will generate separate net Pay & Collect obligation for the BCM's proprietary and each Client positions (for trades & transactions executed in all markets viz-a-viz; ready, DFC, CSF, SIFC, Index Options, MTS, MFS & SLB etc) in the respective settling bank branch account exclusively marked as "BCM Proprietary Account" and "BCM Client Account" as the case may be. Whereas, net Pay & Collect obligations for the BCM's proprietary and each client positions for NDM and Debt Market will be processed separately in the respective settling bank branch account exclusively marked as "BCM Proprietary Account" and "BCM Client Account" as the case may be as NDM and Debt Market Trades are settled exclusively on Trade-for-Trade Basis without applying any netting with other markets. For money settlement, "BCM Proprietary Account" and "BCM Client Account" should be maintained in the same Designated Settling Bank of NCCPL.

III. Proposed Net Payment Settlement at Client Level for Receivable Position

1. BCMs shall be required to make sure that correct IBAN of their existing investors should be provided through NCSS UIN Registration.
2. NCSS will generate Net Receivable Position at investor-level and transfer the investor wise required amount in the Designated Settling Bank Account of BCM directly by issuing a concurrent credit instruction to the "main contact branch" of Designated Settling Bank for onward credit of amount in respective bank account of the investors of BCM maintained with the same or any other bank branch of settling bank on the basis of provided IBAN.
3. BCM will have an option to mark the specific client to hold amount (as per the authorization of its client) in the BCMs' clients settling bank account.
4. Before such credit instruction, NCSS shall ensure that all securities delivery obligation as determined through Balance Orders are fulfilled from the investor's respective CDS sub-account.
5. On each Settlement Date, following information of an investor will be provided by NCCPL to Main Contact Branch of Designated Settling Bank through NCSS Pay and Collect Module:
 - BCM Designated Bank Account Number
 - Investors Name;
 - UIN;
 - IBAN;
 - Bank Name;
 - Bank Branch; and

- Amount
- Reference “NCC Settlement”

6. In case where amount is not processed on-line by main contact branch due to any restriction in investor’s account, inappropriate investor information provided by BCM and or any reason whatsoever, NCCPL shall hold such credit in the marked “Client Account” of Designated Settling Bank Account of BCM till the removal of discrepancy by investor/BCM as the case may be.
7. NCCPL will act as a facilitation agent to pass such credit to investor’s bank account without incurring any liability to investor and/or its BCM. Necessary legal coverage will be made accordingly in NCCPL Regulations.
8. In case where BCM fails to provide IBAN of their existing investors, such investors shall continue to trade at PSX, however, their receivable amount will not be credited from the Designated Settling Bank Account until IBAN and other related information is provided to NCCPL.
9. It shall be the responsibility of BCM to utilize hold amount as specified in point 3, 6 and 8 above only on account of respective investor. NCCPL shall generate exception Report on daily basis in NCSS to track money settlement details of such investors and also make available such report to respective BCM as well. In case of any inappropriate handling of amount identified by NCCPL and/or relevant investor as the case may be, NCCPL shall impose penalty on such BCM to be specified in NCCPL Regulations.
10. NCCPL also compute, determine and collect CGT on capital market trades/transactions and collect/refund CGT through BCMs. In the proposed DPS, CGT collection will be made by NCCPL through Clients Designated Settling Bank Account of a BCM monthly. BCM shall remain responsible for collection of CGT Amount from its Clients and deposit the same in the Designated Settling Bank Account. For CGT refund, NCCPL will process credit directly to the investors Bank Account.
11. Direct Credit in the account of Investors will bring transparency in the capital market operations however following are the challenges that need to be addressed considering business practices:

A. Re-purchase of Securities (Phase-II)

NCCPL will give credit to Investor on the Settlement Date. Where an Investor wishes to buy Security, such Investor will again need to deposit funds with the Broker which leads to operational hassle to the Investor and BCM as well.

To handle this situation, as explained above, NCCPL will develop a functionality whereby, at the time of Registration of Investor by BCM in NCSS, option will be made available to BCM to select Credit Instruction Type "Direct Credit" or "Credit on Instruction". Once BCM selects Direct Credit option, respective investor will receive direct credit in respective Bank Account on the Settlement Date. In case where BCM selects Credit on Instruction option, respective investor's credit or part of the credit amount will be hold in the separate Client's account maintained in the Designated Settling Bank Account of BCM by NCCPL and shall only be released in the respective Bank account of such Investor on a request submitted to NCCPL through respective BCM. Option to change credit instruction for Investor will also be available with BCM.

B. Collection of Fee/Commission and Taxes

Presently, BCM deducts Fee/Commission and Taxes (including CGT) before discharge credit to the Investors.

To handle this situation, NCCPL will develop up-load functionality in NCSS whereby BCM, on each Trade Date, will provide client level information of Fee/Commission and Taxes including CGT, need to be hold by NCCPL from the credit due to respective Investors on the Settlement Date. Accordingly, Fee/Commission of Brokerage will be credited to respective BCM Proprietary settling bank account by NCCPL and CGT amount will hold in the Clients settling bank account by NCCPL. It is suggested to implement a maximum limit to be specified by NCCPL that can be hold by BCMs on credits of Investors.

It will be the responsibility of a BCM to provide accurate information to NCCPL to hold credit amount of Investor. In case of any error in input of hold credit amount NCCPL shall not be held responsible for any claim from BCM and/or Investor as the case may be.

IV. Proposed Settlement in DPS- (NetPayable Obligation)-Phase II

1. NetPayable Obligation of the Investor at Broker-Level, as determined by NCCPL will also be settled by NCCPL through respective BCM's Client Designated Settling Bank Account as per existing Pay & Collect Module.
2. BCMs' proprietary payment obligation will remain same and to be settled directly with its Settling Bank marked as "Proprietary Account"
3. Responsibility for the collection of amount from Investors shall remain with the BCM. BCM shall be required to collect payment from Investors only in the Designated Settling Bank Account for Clients.
4. BCM shall also be required to upload investor-level collection details to NCCPL on daily basis through NCSS up-load functionality. It shall be the responsibility of a BCM to provide accurate detail to NCCPL and maintain proper record in their Back Office System.
5. Compliance with the said requirements as mention in point 3 and 4 above will continuously be monitored in System Audit/ Joint Inspection. In case of any discrepancy is found during audit, action in terms of penalty and suspension should be initiated against such BCM.
6. NCCPL, on the basis of such information, will generate alerts to relevant investor through SMS and/or Email. In addition to this, deposit detail of Investor will also be made available by NCCPL on UIN Information System (UIS) whereby Investor can view credit detail uploaded by BCM in their account. For the education of Investors, stakeholders will arrange awareness through effective marketing plan for Investors focusing to make payment to BCMs only in the Designated Settling Bank Account for Clients.
7. NCCPL will develop controls in the System to reconcile NetPayable Obligation and Credit Amount of each Investor at Broker-Level on a particular settlement date.
8. On the basis of daily reconciliation, NCCPL shall release funds form Designated Settling Bank Account of a BCM against Net Payable Obligation subject to availability of credit balance of relevant Investor only.
9. In case of any shortfall in Net Payable Amount of the Investor BCM shall be held responsible to arrange such amount to meet NCSS Settlement Obligation.For that

purposes BCM will ensure sufficient fund is collected from the Investors and should avoid unauthorized funding to its clients to meet the settlement obligation of Investor.

10. NCCPL, on random basis, will also send Balance Confirmation Letters to the Investors of BCM on their registered addresses, intimating credit Balances held in the respective account of BCM.
11. NCCPL will act as a facilitation agent to operate Designated Settling Bank Account of BCM without incurring any liability to investor and/or BCM. Necessary legal coverage will be made accordingly in NCCPL Regulations.
12. Necessary corresponding changes will also be required in CDS where blocking and unblocking of shares will be performed on UIN level instead of CM/Participant level.
13. For the implementation of Direct Collection from the respective client accounts, detailed discussion and deliberation are required with the banks for finalization of the proposed collection functionality.

V. Phase-wise Implementation

Considering proposed mechanism will require major development in business, operational and legal part, it is suggested to implement in Phase-manner:

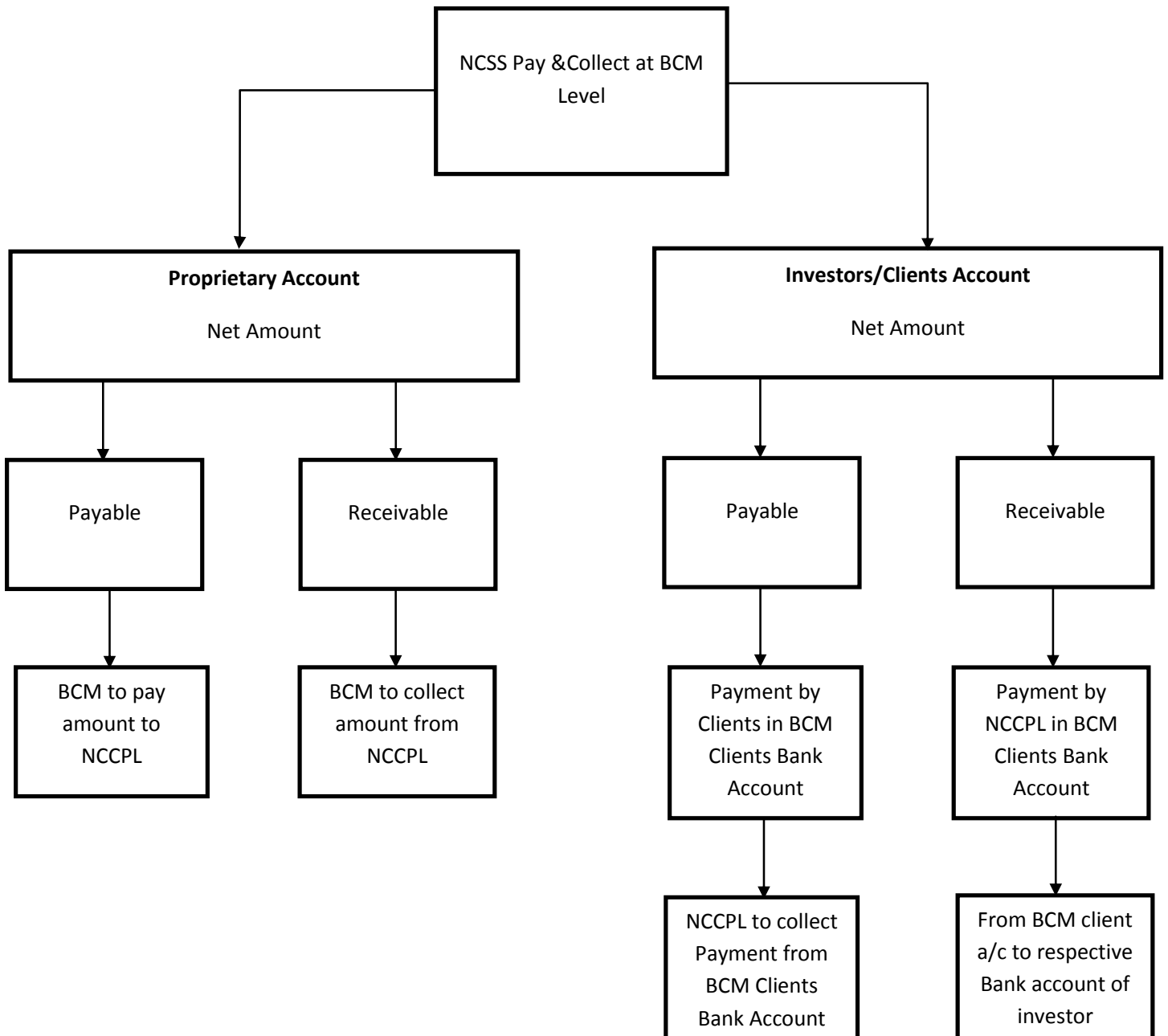
Phase 1: Proposed Settlement in DPS- (Net Receivable Position)

Phase 2: Proposed Settlement in DPS- (Net Payable Obligation/Amount hold for future purchases as explained in III 10 A).

VI. Proposed Implementation Plan

<u>Sr. #</u>	<u>Activity</u>	<u>Target Date</u>
01	Approval of concept paper by the Commission	Second week of June, 2018 (June 4-10)
02	Circulation of concept paper to Market Participants followed by presentations to market participants to seek comments and incorporate necessary changes in the proposed model, subject to prior approval of the Commission	Third week of June, 2018 (June 11-17)
03	Regulatory changes in NCCPL and CDC Regulations (phase 1 & 2 development)	First week of July, 2018 (July 2-8) * *As 1st July is falling on Sunday
04	Phase 1 development jointly by NCCPL and CDC	Last week of July, 2018 (July 30-31)
05	Phase 2 development jointly by NCCPL and CDC	First week of November, 2018 (November 1-4)

VII. Process Flow- Overall



Note: NCCPL shall use BCM client’s Bank account as a “Designated Settling Bank Account” with NCCPL for the settlement of Clients Account. Whereas, NCCPL shall use BCM Proprietary Bank account as a “Designated Settling Bank Account” with NCCPL for the settlement of Proprietary Account.

VIII. Default Handling

1. The BCM shall be responsible for the settlement of Securities and Funds with the NCCPL for all trades/transactions executed on proprietary account and/or investors account.
2. In case where BCM fails to fulfill settlement obligation on account of proprietary trades, default proceedings will be initiated by NCCPL against such defaulting BCM however:
 - NCCPL will release fund to the respective investor who has settled their delivery obligations with NCCPL
 - NCCPL will deliver shares to the respective CDS accounts of investor who has settled their money obligation with NCCPL.
3. In the event of non-delivery of Security from selling investors CDS accountDPS, the NCCPL shall:
 - Hold credit of respective investor upto the extent of delivery default amount required for squaring-up/close-out process.
 - In case where credit amount of investor is short of required squaring-up/close-out amount (*amount can be short due to net money obligation at investor level*), in such case, respective BCM shall be responsible for the settlement of required amount with NCCPL.
 - In the event of non-payment of squaring-up/close-out amount by BCM, the settlement and default proceeding will be applied against such BCM in accordance with the NCCPL Regulations.
4. In the event of shortfall in the investor account, the NCCPL shall:
 - Transfer the payment obligation of investor to its respective BCM. In such case, respective BCM shall be responsible for the payment of required amount to NCCPL.
 - In case where BCM fulfill such payment obligation with NCCPL, respective shares of investors will be un-blocked in the respective CDS account of investor however such BCM will recourse on such shares as per applicable laws.
 - In the event of non-payment by BCM, the default proceeding will be applied against such BCM in accordance with the NCCPL Regulations.

C. SWOT Analysis

The below matrix shows the Strengths, Weaknesses, Opportunities and the potential Threats with regard to the proposed mechanism:

STRENGTH	WEAKNESS
<ul style="list-style-type: none"> ▪ Centralized Investor Registration mechanism is already in place. ▪ Established settlement processes with Commercial Banks to deal with investor level payment mechanism. ▪ Strong system development capability at NCCPL. ▪ Investor-level Risk Management Regime already implemented by NCCPL and also refunding CGT directly to investors of BCM ▪ Credit made in the investor account in case where BCM executes unauthorized trade. 	<ul style="list-style-type: none"> ▪ IBAN verification tools are not in place with NCCPL. ▪ NCCPL may be required to enhance SGF ▪ Termination of a settling bank shall require investors to provide new IBAN and CMs would be required to modify UIN registration details ▪ DPS will not be consistent with foreign Investors as they will continue to settle trades through Custodian Clearing Members
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> ▪ Enhance transparency in pay and collect settlement mechanism. ▪ Significantly Improved level of investors protection. 	<ul style="list-style-type: none"> ▪ Banks are required to update respective systems to perform bulk transactions. ▪ CNIC is not available in 1-Link system to verify complete detail of respective investor.

D. Legal Framework

1. NCCPL will seek legal advice with respect to various important modalities of the DPS and its impact on the overall regulatory framework of NCCPL to ensure that there is no bar/legal complexity involved in implementing the proposed DPS model. However, it is envisaged that material changes will be required in the NCCPL Regulations, 2015 and Procedures.
2. It is considered that there can be a requirement to amend the agreements executed by the BCM and settling banks with the NCCPL on account of introduction of DPS. This matter will also be discussed with the legal counsel.

Requirement to signing various new agreements DPS shall also be discussed and finalized with legal counsel.

3. We do not expect any material change in the regulations of CDC and PSX on account of implementation of DPS, however, both entities should review proposed model for any necessary amendments

E. Risk Management

Investor Level margining regime has already been applied by NCCPL on capital market trades and we do not expect any change in the prevailing risk management regime. However, NCCPL needs to determine and re-evaluate the size of Settlement Guarantee Fund (SGF) keeping in view the Gross Level Settlement Obligation of BCM.

F. System Development

NCCPL will incorporate necessary changes in NCSS and CGT System with respect to DPS once its operational model is reviewed and approved by the SECP and the Board.

G. Fee Structure

NCCPL will charge its fee on DPS at trade level as per the rate proposed and approved under NCCPL Regulations, 2015