

CONCEPT PAPER ON EQUITY MARKET OPPORTUNITY FUND

Rationale / Background:

The credit crunches due to global inflation and rising interest rates, commodity prices have impacted Global Capital and Equity Markets.

Among global constraints, the Pakistan Equity Market also suffers due to imperfect and incomplete information flow, currency weakness and media speculations about chaotic political situation and deteriorating law and order which lead to negative sentiments among investors about the economic fundamentals.

However, the economics fundamental of Pakistan listed securities, with respect to current profitability and medium term growth remain bright. Many securities are trading at low P/E ratios due to “margin selling” as opposed to their intrinsic values. This dislocation of real and perceived values creates an opportunity for a long term institutional investor.

Pakistan is not the first developing nation to witness such circumstances; India, Taiwan, Honk Kong, Thailand, and Korea are amongst developing nations which have witnessed such a steep decline in the past (Refer Annexure 4 for international precedents). These jurisdictions have established state sponsored funds that benefited from value buying and served to stabilize their respective markets.

Concept:

Market Stabilization funds are launched in the markets in order to stabilize the market conditions and to provide favorable conditions for investors to put in stake. Mainly these funds are proposed by the respective exchanges, securities governing authority or the government it self. These types of funds are not only used for stock exchanges but have also been used for purpose of stabilizing prices in economy. As we all know Exchange Rate stabilizing funds have also been implemented in many countries.

It is proposed that an EQUITY MARKET OPPORTUNITY FUND (EMOF) be established which is considered to be the most institutionalized way for market intervention by regulators/governments in a formalized fund structure having approved preset rules of operation. The objective of fund is to reduce volatility by acting as shock absorber and not as means to prop up the market or any scrip price.

Objective:

Equity Market Opportunity Fund (EMOF) shall be established with the objective of:

- providing stability and liquidity to the market in times of stress
- providing exit opportunity to small investors
- reduce the systemic risk in the market

The EMOF will not be a fund, but a club of like-minded institutions, willing to step up to provide relief to the market by investing at attractive fundamental valuations.

Proposed Participants of EMOF:

Participants of EMOF will be Financial Institutions (Banks & DFI's), state-owned institutions and Semi Government companies having substantially large pension and gratuity funds such as SBP, SLIC, EOBI, PRC, NIC, PIC, CAA, CDA, KPT, PSMC, PSO, SNGP, WAPDA, Retirement funds of OGDC, PPL, SSGC, EOBI, PSO, PIA, NILC, Pak Railways, Banks and DFI's etc.

Management of EMOF:

- Institutions will be invited to join this fund, and firm commitments will be obtained.
- The initial size of the fund shall not be less than Rs 50 billion.
- EMOF shall be managed by NITL
- A separate UIN shall be allotted to EMOF
- NITL will be given responsibility to open a CDC account for each participant. Shares allocated to each participant will be deposited in this account.
- NITL will allocate shares purchased on any day to each participant on the basis of that participant's percentage financial commitment to the Fund.
- Fund will commence operations within 3 working days of financial closure.

Investment Strategy:

1. EMOF will invest in KSE-30 Index scrips that are eligible for CFS and CFS MK – II. Fund allocation will be according to the weight of each eligible scrip as a percentage of total CFS value as of July 08, 2008. Listed securities of Brokerage houses and their holding companies will not be eligible (Refer Annexure 1).
2. The EMOF shall provide support to the market for 5 trading days in Phase One.
3. The EMOF shall invest the funds during the 5 days in the following manner:
 - On day 1, the Fund will invest in eligible scrips at the closing values in the Ready Market provided that these values are below 20% of their 6-month weighted average prices. (Refer Annexure 2)
 - From day 2 onwards, the Fund will invest in scrips at the closing values of the Ready Market provided that:
 1. These values are below 20% of their 6-month weighted average prices; and
 2. The scrip closed at the lower circuit breaker on that day.
4. The EMOF shall be utilized in the following manner:
 - 30% of funds will be made available on Day 1
 - 30% of funds will be made available on Day 2
 - 30% of funds will be made available on Day 3
 - 10% of funds will be made available on Day 4
 - Any unutilized funds shall continue to be made available till the 5th trading day.

Note:

On each day, bids will be available for each eligible scrip, according to the weight of that scrip in the Fund. The weight-age will be determined by the weight of each scrip as a percentage of the CFS value as of July 08, 2008. (Refer to Annexure 1)

5. After Phase one, if funds are still available, the EMOF will review its investment strategy and may re-enter the market.

Divestment strategy

The fund shall divest its holdings when the share prices of any particular scrip exceed 20% of their weighted average of last six months (refer Annexure 3).

Process

- Offers from brokers on behalf of their eligible clients will be submitted to the Exchange in the prescribed format to be notified separately, after the end of the ready market session on each of the five days of Phase one.
- These offers will be matched on the basis of parameter stated below.
- The Fund shall first accommodate all offers of up to 20, 000 shares per scrip. In the event those offers exceed the total bid quantity, the settlement will be pro-rated. If surplus bid quantity is available, after accommodating all offers to the extent of 20,000 shares each, remaining offer will be settled on pro-rata basis if necessary.
- If total offer is less than bid quantity, then all offers will be accommodated subject to the overall limit of Rs. 100 million per UIN (for all eligible scrips).
- The resultant transactions executed through this process will be entered into the system on the following day.
- Future purchases will also be accommodated through this process; however settlement shall take place on the expiry of the respective contracts.
- No brokerage/ commission shall be levied on buy trades of EMOF
- No SECP levies or exchange laga shall be applicable on EMOF.
- Investor will be allowed to enter its bid only through any one broker. Offers entered through more than one broker shall be disregarded by the Exchange.

Conditions:

- Institutions (banks, insurance companies, NBFIs, state-owned enterprises and mutual funds) shall not be eligible to sell their holdings to EMOF.
- Brokerage houses (their proprietary accounts), their directors, employees and their immediate family members/related parties shall not be eligible to sell their holdings to EMOF.
- Those institutions participating in the Fund cannot sell the shares eligible for the Fund in the Futures or Ready Market till the Fund operations are complete.
- Existing purchases per UIN as of July 08, 2008 will be eligible for sale to EMOF

Risks:

The Fund is not guaranteed to earn positive returns. Market risks are present and a long term investment horizon needs to be maintained. However, historical performance of Pakistani Equity Markets suggests a potential for positive returns over the long term.