Newsletter December 2015

Institute of Capital Markets

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Topic of the Month "RISK MANAGEMENT"

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Message from Chief Executive

Mr. Muhammad Ali Khan

The last few years have seen a progressive change in size, quality and sophistication of capital markets. The rapid growth has taken place because of modifications in policy and regulatory environment, the entrepreneurial initiatives of individuals and institutions, and availability of trained manpower. The continual growth of capital markets demands for qualified and well-trained professionals.

Institute of Capital Markets (ICM) is Pakistan's first specialized institution dedicated to the professional development, research and well-being of capital markets by educating the professionals about the norms and ethics being practiced. The institute's main activities are (1) Licensing the professionals working in the capital markets by certifications in order to educate and examine knowledge of professionals working in relevant fields; (2) studying the latest developments in the capital markets in order to discover whether there is such a thing as an ideal market economy; and (3) contributing to the development of capital markets in Pakistan. By means of these three activities, ICM seeks to communicate its ideas to the audience at both, home and overseas.

ICM plays a pioneering role in meeting the demand of the educated manpower required for specialized capital markets. It is devoted to educate and update knowledge of capital markets participants such as investors, brokers, mutual funders, investment bankers and policy makers by following high-quality educational standards.

The institute's research is intended, first and foremost, to be neutral, professional and practical. Rooted in practice, research aims to contribute to the healthy development of Pakistan's capital markets as well as to related policies by conducting professional studies of how these markets and the financial system are regulated, organized and how they perform.

Risk Management

The process of identifying, assessing and prioritizing uncertainty in investment decision-making is known as Risk Management. Risk management takes place every time a manager or an individual attempts to quantify the potential of profitability or losses in an investment. Appropriate action is taken according to the assessment that how much shall be invested with respect to venture objectives and risk tolerance. Inadequate risk management can result in severe consequences for companies as well as individuals. For example, the recession that began in 2008 was largely caused by the loose credit risk management of financial firms.

Risk management can be divided into a two-step process simply - determining what risks exist in an investment and then handling those risks in a way best-suited to your investment objectives. Risk management occurs everywhere in the financial and capital world. It occurs when an investor buys low-risk government bonds over more risky corporate debt, when a fund manager hedges their currency exposure with currency derivatives and when a bank performs a credit check on an individual before issuing them a personal line of credit.

The capital market risk usually defines the risk involved in the investments. The stark potential of experiencing losses following a fluctuation in security prices is the reason behind the capital market risk. The capital market risk could not be diversified in the past.

Nowadays risk in capital markets has minimized drastically because of development in information technology hence management has become more convenient. By compiling all the historical data at one place, people are able to make wiser investment decisions by studying the previous ups and downs in the market of stocks and trade. Predictions of coming 20 years can be made using the previous and prevailing trends. Technology does not only help making risk management easier for markets but also increases the clientele by showing an attractive side of industry to the world.

With diversified range of products and commodities, risk management has been made relaxed for public. Now people have the confidence and trust to invest in various products at the same time.

Investors' Terms Of The Month

Negligence
Failure to use that degree of care which an ordinary person of reasonable prudence would use under the given or similar circumstances. A person may be negligent by acts of omission or commission or both.

Strategic Management
The downside risks by reducing the likelihood, magnitude, and unpredictability of losses and financing recovery from these losses. Strategic risk might arise from making poor business decisions, from the substandard execution of decisions, from inadequate resource allocation, or from a failure to respond well to changes in the business environment.

Registrar
An institution or organization that is responsible for keeping records of bondholders and shareholders. If you are the owner of a bond or a share in a company you will be registered as an owner by one of these institutions.

Panic Selling
Wide-scale selling of an investment, causing a sharp decline in price. In most instances of panic selling, investors just want to get out of the investment, with little regard for the price at which they sell.

Extraordinary Redemption
A provision that gives a bond issuer the right to call its bonds due to an unusual one-time occurrence, as specified in the offering statement. Extraordinary redemptions, also called "extraordinary calls," occur when bond proceeds aren't spent according to schedule, when bond proceeds are used in a way that makes nontaxable bond interest taxable, or when a catastrophe destroys the project being financed, among other reasons.

Haggle
When two parties involved in the purchase of a good and service negotiate the price until both parties can mutual agree on a price, the bargain is called haggle. The process of haggling involves two parties making offers and counteroffers to each other. The individual trying to buy the good and service is trying to pay the least amount possible, while the seller's primary objective is to maximize gains.

Sweetener
A special feature or benefit added to a debt instrument (such as bonds) or a preferred stock offering to increase its value in the markets. Two popular forms of sweeteners are warrants and rights, which allow the holder to either convert securities into stock at a later date or purchase shares at below-market prices.

False Market
A market where prices are manipulated and impacted by erroneous information, preventing the efficient negotiation of prices. These types of markets will often be marred by volatile swings because the true value of the market is clouded by the misinformation.

Game Theory
A model of optimality taking into consideration not only benefits less costs, but also the interaction between participants.

TAPI project to revolutionize energy sector in S. Asia

The launch of Turkmenistan-Afghanistan-Pakistan-India (TAPI) gas pipeline project has been termed as a revolution in the energy sector by Lahore Chamber of Commerce and Industry (LCCI)

If the project is completed in time, the main benefits having annual capacity of 33 billion cubic meter of gas would help energy starved Pakistan to overcome ongoing crisis in the industrial sector. Due to which large-scale manufacturing sector would be able to manage their export orders easily and earn much needed foreign exchange for the country.

The chamber urged the government to remove all obstacles coming in the way of the project as it holds vital importance for the national economy and exports. In a joint statement, LCCI President Sheikh Muhammad Arshad, Senior Vice-President Almas Hyder and VicePresident Nasir Saeed said that the leaders of Turkmenistan, Afghanistan, Pakistan and India had laid foundation of a new era of progress and prosperity in South Asia.

The LCCI president said the TAPI project would not only help Pakistan to overcome ongoing energy crisis, it would also promote political and economic interaction between Pakistan and Afghanistan, the main stakeholders of this project.

Pakistani businesses invited to invest in Russia

Russian Ambassador to Pakistan Alexey Yurivich Dedov on Saturday invited Pakistani businessmen to explore huge untapped Russian market where their merchandise could get a good place for having good quality.

During his visit to the Lahore Chamber of Commerce and Industry (LCCI), he said both countries should take sector-specific measures to enhance mutual trade that did not reflect its potential.

The diplomat expressed the optimism that both Pakistani and Russian businessmen could enter into joint ventures to benefit each other.

He said the Russia had a lot to offer to Pakistani business community while Pakistani businessmen could learn a lot from the country for the technological upgrade of their industrial units.

On the occasion, LCCI senior vice president Almas Hyder said after the establishment of a mega steel mill at Karachi in 1970s, no major initiative had been taken by Russian Federation.

He said Pakistan’s share in total foreign trade of Russia was insignificant while trade balance was also in favour of Moscow.

Mr Hyder said Pakistan could export textile, garments, rice, leather, sports goods, surgical equipment and pharmaceuticals to the Russian market while Russia could enhance export of power equipment, steel, urea, chemicals etc to Pakistan.

He said oil and gas sector in Pakistan offered great opportunities to Russia, adding mining of marble and granite was also an attraction for the Russians.

‘Tax rules worsen business climate’

The World Bank says tax regulations in Pakistan are frequently altered, and unpredictable tax rules worsen the business climate and may deter potential investment.

The report “Towards a more friendly tax regime: Key challenges in South Asia,” points out that South Asia’s tax regulations are complex and difficult to administer and comply with. Complexity stems from availability of special schemes, reduced rates and exemptions for different sectors, locations, types of firms or products.

Furthermore, tax laws are often written in vague language, which makes it difficult for a typical small and medium enterprise (SME) to understand its tax liabilities and provide room for multiple interpretations by both firms and tax administrators, creating opportunities for leakages and corruption, according to the report.

The report cites Pakistan and Bangladesh among the South Asian governments who make changes in tax regulations much more frequently. The changes were even more frequent in Pakistan.

Regulatory News

Futures Market Act introduced in Senate

With the introduction of Futures Market Act 2015 in the Senate, a major step has been achieved towards modernizing the commodity and stock exchanges in Pakistan. The Act will eventually abolish the Securities and Exchange Ordinance, 1969 which will affect Pakistan Mercantile Exchange (PMEX) and the stock exchanges, being governed under this law.

It is a serious issue that majority of the amendments and changes introduced over futures trade have been enacted through the Finance Bill, said an official of the Ministry of Finance. After getting through the Senate, the draft will be forwarded to the National Assembly. After it is approved by both the houses, Pakistan will have a new law for futures trade. However, after the future market law is passed, all brokers who intend to trade in futures market will need to get a new license.

There are around 150 active brokers of PMEX while there will be a total of 380 brokers in the mutualized Pakistan Stock Exchange (PSX) that is scheduled to be inaugurated in January. The PSX will replace the three different stock exchanges of the country.

There are currently 60 brokers who have licenses of the Karachi Stock Exchange and the PMEX. However officials feel the scenario would change after the new regime of futures trade is introduced. There might be many brokers who would decide to work in futures market only and get away from the ready market because futures trade requires a higher financial capacity to withstand markets jerks, said a broker at the Islamabad Stock Exchange.

The major changes in the new law are strict monitoring mechanism and higher penalties for violators. Currently, the maximum penalty for a violation in futures trade is Rs50 million and that too has been approved through the Finance Bill.

International News

Global growth will be disappointing in 2016, warns IMF chief

Global economic growth will be disappointing next year and the outlook for the medium-term has also deteriorated, the head of the IMF said in a guest article for German newspaper Handelsblatt. IMF Managing Director Christine Lagarde said that the prospect of rising interest rates in the United States and an economic slowdown in China were contributing to uncertainty and a higher risk of economic vulnerability worldwide.

Added to that, Lagarde said that growth in global trade has slowed considerably and a decline in raw material prices is posing problems for economies based on these, while the financial sector in many countries still has weaknesses and financial risks are rising in emerging markets. All of that means global growth will be disappointing and uneven in 2016, noting that mid-term prospects had also weakened as low productivity, ageing populations and the effects of the global financial crisis dampened growth.

Normalization of US monetary policy and China's shift towards consumption-led growth were "necessary and healthy" changes but needed to be carried out as efficiently and smoothly as possible. The US Federal Reserve hiked interest rates for the first time in nearly a decade this last month and made clear that was a tentative beginning to a `gradual tightening cycle.

There are "potential spillover effects", with the prospect of increasing interest rates there already having contributed to higher financing costs for some borrowers, including in emerging and developing markets. While countries other than highly developed economies were generally better prepared for higher interest rates than previously, IMF was concerned about their ability to absorb shocks.

Emerging market companies with debt in dollars and revenue in sinking local currencies could struggle as the Fed begins what is expected to be a series of interest rate increases. She also warned that rising US interest rates and a stronger dollar could lead to companies defaulting on their payments and that this could "infect" banks and states.

US Fed slaps partial ban; HBL says its NY branch operational

Reacting to a Reuters report on Friday that the US Federal Reserve had barred the Habib Bank Limited from conducting any dollar-clearing transactions or accepting any new accounts for US dollar clearing as of Dec 11, the bank clarified that it maintains its US licence and would continue to provide services as usual.

The HBL said in a press release, "The orders limit the branch's growth of its US dollar-clearing business, but the branch is allowed to continue to conduct its current dollar-clearing business."

The US authority moved, the Reuters report said, because the bank "has not complied with US anti-money laundering laws".

Reuters cited the Fed's recent assessment: "HBL's risk management had broken down, as well as its compliance with laws such as the Bank Secrecy Act and regulations issued by the US Treasury Department".

The HBL press release said that during a recent examination, the US regulators found deficiencies in the risk management and BSA/AML compliance programme at HBL's New York branch and, subsequently, escalated the enforcement actions from the "written agreement" to a "consent order" in the case of New York State Department of Financial Services and a "cease and desist order" in the case of Federal Reserve Bank of New York.

"These orders impose certain additional requirements to remediate on the branch and provide mechanisms for enforcement if the remediation is not met," the HBL said.

"HBL cannot accept new foreign correspondent accounts or new customer accounts in New York for US dollar clearing without prior approval of the regulator. It cannot increase its US dollar-clearing business both in terms of number of transactions or the aggregate amount without prior permission of the US regulators," the press release said.

"HBL takes its regulatory responsibilities very seriously and has been taking actions in advance of even entering these orders to enhance its compliance programme, including engaging outside compliance consultants to review its current programme. We believe that these measures will put us in a position to move quickly on the requirements in the orders," asserted HBL.

When contacted, the State Bank of Pakistan (SBP) said it was aware and closely monitoring developments. Chief spokesman for the SBP said the central bank was willing to cooperate with US regulators. He said that even in normal situation, the regulators remained in contact.

Banking circle took the situation seriously and called it as a bad omen for the country as well as the banking industry.