INSTITUTE OF CAPITAL MARKETS

NEWSLETTER | JUNE 2016

Message From The CEO

Mr. Muhammad Ali Khan

The last few years have seen a rapid growth in size, quality and sophistication of capital markets, because of changes in the policy and regulatory environment, the entrepreneurial initiatives of individuals and institutions, and the availability of trained manpower. The continuing growth of capital markets is further adding to the demand for well-trained professionals.

Institute of Capital Markets is dedicated to the professional development of capital markets and research on capital markets as well as the well being of capital markets by educating the professionals about the norms and ethics being practiced in the markets. ICM has had a pioneering role in meeting the demand for educated manpower. It is Pakistan's first specialized institution devoted to the education and updating of knowledge of manpower for capital markets. It will provided high-quality educational standards for all types of capital market participants; investors, brokers, mutual funds, investment banks and policy makers.

The Institute's main activities are (1) Licensing the professionals working in the capital markets by certifications. The institute's key responsibility is to educate the professionals working in different capital markets of Pakistan through examining their knowledge in their relevant field of work; (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 the Institute seeks to communicate its ideas to the audience both at home and overseas. The Institute's research is intended, first and foremost, to be neutral, professional and practical. Rooted in practice, it aims to contribute to the healthy development of Pakistani capital markets as well as to related policies by conducting neutral and professional studies of how these markets and the financial system are regulated and organized and how they perform.

The economy is changing all the time. The Institute hopes that, by responding to these changes positively, it can contribute to the dynamic development of the country's capital markets as well as of the economy itself.

00 CONTENT

-NEWSLETTER SPECIAL-

BUDGET FY17

01

Introduction To The Organization

The **Institute of Capital Markets** (ICM), Pakistan's first securities market institute, has been established as a permanent platform to develop quality human capital, capable to meet the emerging professional knowledge needs of capital markets and create standards among market professionals. The Institute has been envisioned to conduct various licensing examinations leading to certifications for different segments of the capital markets. In addition, ICM will also provide a platform for research & development, exchange of ideas and consulting services on Capital Markets issues.

ICM PROGRAMMES

LICENSING CERTIFICATIONS

- Fundamentals of Capital Markets
- Pakistan's Market Regulations
- Stock Brokers Certification
- Mutual Funds Distributors
- Commodity Brokers Certification

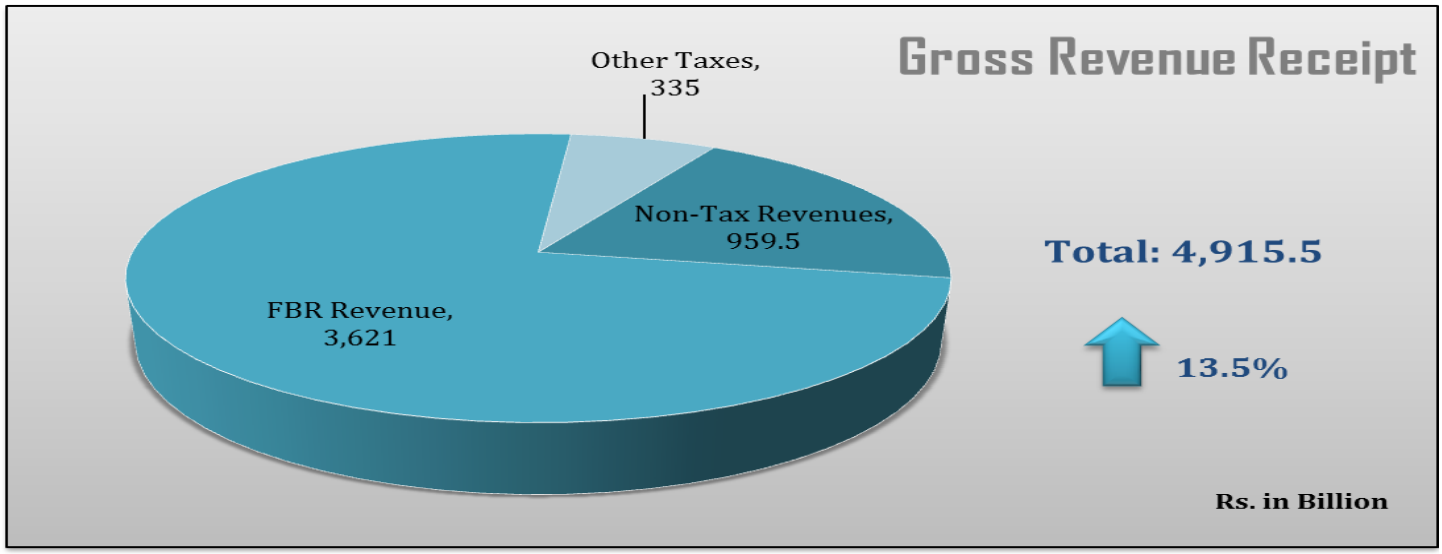
INSURANCE CERTIFICATIONS

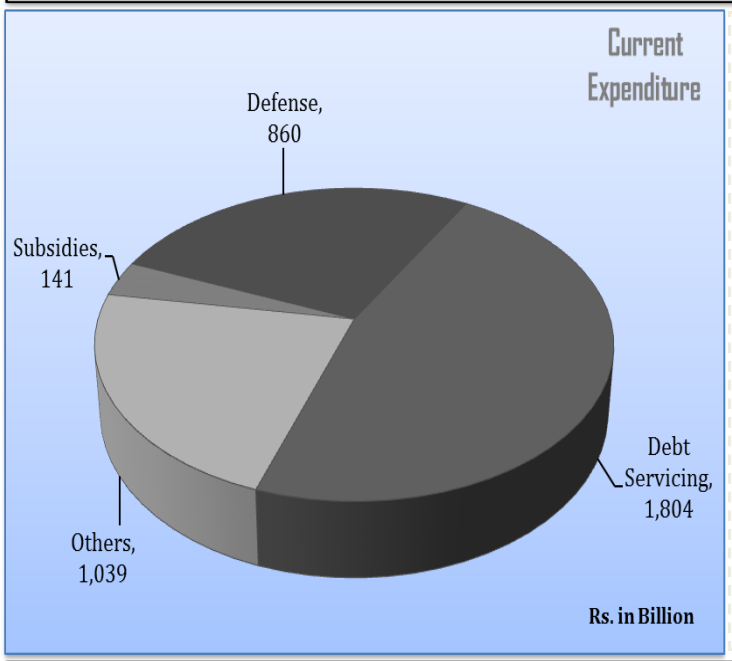
- General Takaful Training
- Family Takaful Training
- Life Insurance Agent
- Non-Life Insurance Agent

OTHER CERTIFICATIONS

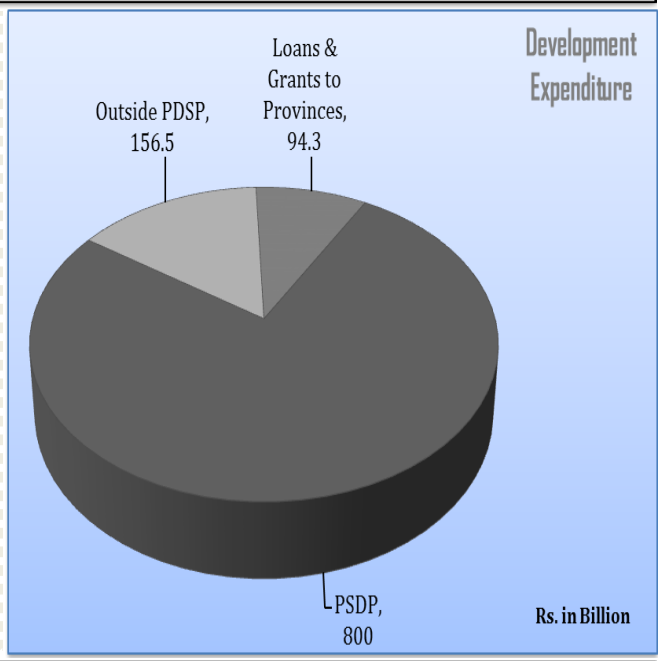
- Financial Advisors Certification
- Financial Derivative Traders Certification
- Compliance Officers Certification
- Clearing and Settlement Operations Certification
- Risk Management Certification
- Capital Budgeting and Corporate Finance Certification
- Investment Banking and Analysis Certification
- Islamic Finance Certification

BUDGET 2016-2017

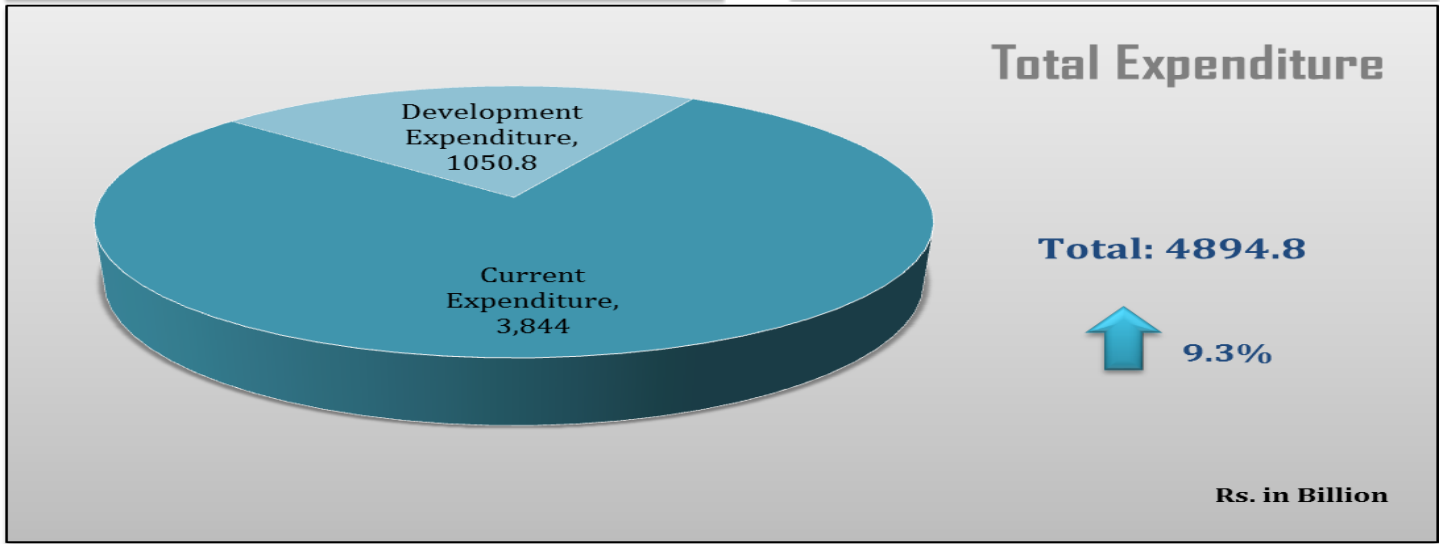




AT A GLANCE



Source: MoF, Foundation Research, June 2016



02

BUDGET 2016-2017

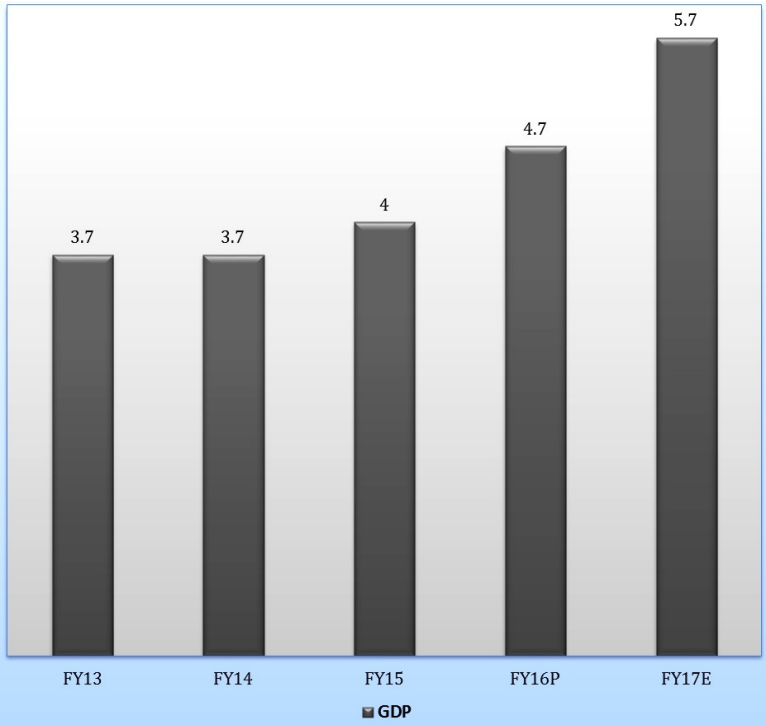
The budget 2016-17 shows that the government has focused on ensuring a sustainable economic growth where fiscal incentives have been granted to both industrial and agriculture sectors.

The gross revenue receipts have been estimated at Rs.4915.5 billion, showing an increase of 13.5% over the budget estimates of 2015-16. The total expenditure for 2016-2017 has been estimated at Rs.4,894.8 billion, out of which current expenditure is Rs.3,844.0 billion and development expenditure is Rs.1,050.8 billion, indicating an increase of 9.3%.

The government intends to increase tax collections and bring down non-essential expenditures, mainly subsidies, to make resources available for developmental expenditures in order to attain GDP target of 5.7% in FY17. The major theme of the budget is to enhance available resources by encouraging documentation and imposing higher taxes for revival of investment boost exports. For equity market, increased levy for non-filers, extension of super tax and doubling of Withholding Tax on broker commissions would be bitter medicine to chew.

The government aspires to push GDP growth to 5.7% in FY17 versus 4.7% in FY16, shown in Figure 1. The prediction of GDP is based on 3.5% growth in agriculture along with 5.7% and 6.7% growth in services and industrial, respectively. Growth target for services can be achieved easily due to robust domestic demand but the attainment of industrial and agriculture targets depend on exogenous factors. Moreover, growth targets would remain vulnerable to international oil prices as unfavorable movements would weaken fiscal and external account stability.

Figure 1: GDP Targets



Source: MoF, Foundation Research, June 2016

Policy Measures

- The government has extended the definition of 'holding period' for Capital Gain Tax while introducing new slabs for non-filers (See the Figure 2). Purchases before July 2012 are still exempted. The change in capital gain tax would be suppressive for market depth, but lower returns on alternative investments and up gradation to MSCI Emerging markets would keep the fund flow intact.

BUDGET 2016-2017

- Withholding Tax on dividend income has been increased for non-filers from 17.5% to 20%. Dividend from Mutual funds excluding stock fund has also been increased from 10% to 15%. This would have a negative impact on the stock market.
- Super tax has been extended for another year which is 4% for Banks and 3% for Non-Banking Companies.
- Corporate tax has been reduced from 32% to 31%. It will have a positive impact in long run.
- 20% tax credit has been extended for new listings which will bode well for upcoming IPOs.
- The equity requirement for companies that are currently undergoing expansion cycle has been reduced from 100% to 70%.
- Withholding tax on brokerage commission has been increased from 0.1% to 0.2%. It would adversely affect the liquidity position of the stock members.
- Deduction of tax at source withdrawal of cash and certain banking transactions by non-filers is applicable only if the withdrawal or total sum of transactions in a day be more than Rs.50,000.
- The scope of minimum turnover tax has been extended. It is applicable on the companies making gross loss. This would not affect the major sectors but would increase tax liability for smaller sectors.
- Property income for all cases is currently subject to tax on net-income basis. It is now proposed that tax shall be payable on the basis of gross rent instead of net income in case of individuals and association of persons. Property income in the hands of individuals and AOPs of an amount less than Rs.200,000 in a tax year will not be taxable only if such person does not derive income from any other head.
- Exemption from WHT on profit on debt paid to an organization in respect of a Term Finance Certificate issued on or after July 1, 1999 is proposed to be withdrawn.
- Tax credit for a company opting for enlistment in any stock exchange in Pakistan is now proposed to be allowed at 20% of the tax payable in the year of enlistment and the following year as against the present restriction to the year of enlistment.

Taxation Measure

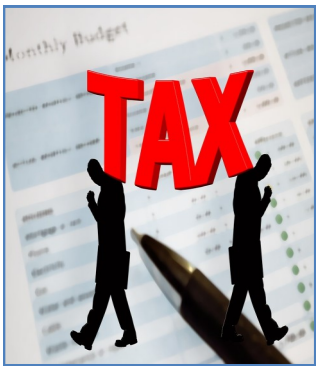
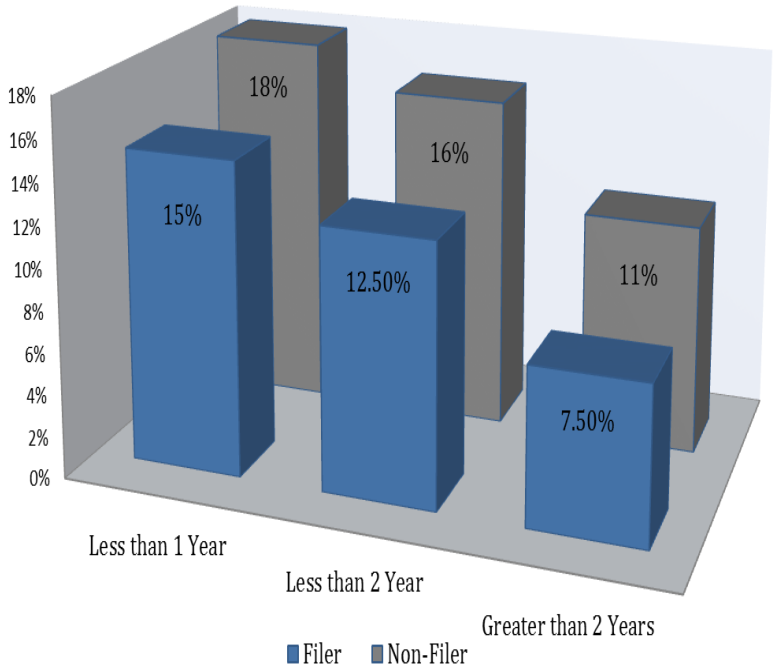


Figure 2 below shows capital gain tax for filers and non-filers. The government has extended the holding period definition by removing cap of 4 years. Now 7.5% tax would be charged where holding period of a security is more than two years. Where

Figure 2: Capital Gain Tax for Filers and Non-filers



Source: MoF, Foundation Research, June 2016

the rates have remained unchanged for filers, the government has increased the capital gain tax to 18% for holding less than 1 year, 16% for holding less than 2 years and 11% for holding more than 2 years for non-filers. The development would be negative for the market depth at least in the short run. Furthermore, the government has also included future commodity contracts at Pakistan Mercantile Exchange (PMEX) in the definition of derivative products and thus, effectively brought future commodity contracts under the ambit of Income tax ordinance Section 37A (that relates to capital gain tax on securities). Both filers and non-filers are to be taxed at single rate of 5%. It is believed that the development would be neutral to positive for the equity markets.

A unique non-income based fixed tax has been introduced by the Government for Builders and Developers under which tax liabilities for the builders and developers shall be determined on area basis, instead of the value of property or actual transaction value. This will be applicable for projects approved by the relevant authorities after July 01, 2016. As a consequence of the introduction of the above tax, the minimum tax regime for builders and developers introduced in the last budget would be withdrawn.

The government has extended the holding period for taxation of capital gain on sale of immovable property from two years to five years to be charged at uniform tax rate of 10%.

Exemption from Minimum Tax under section 113 allowed to companies operating Trading Houses for a period of ten years is proposed to be withdrawn and replaced by reduced (minimum tax) rate of 0.5% up to tax year 2019 and 1% thereafter.

Financing

It is envisaged that the banks will finance the deficit of Rs.453 billion. 20% of the deficit is projected to be financed via external sources and privatization proceeds. The government has also planned to issue Eurobond/Sukuk of US$1.7 billion and projected to raise Rs.50 billion from privatization proceeds.

03

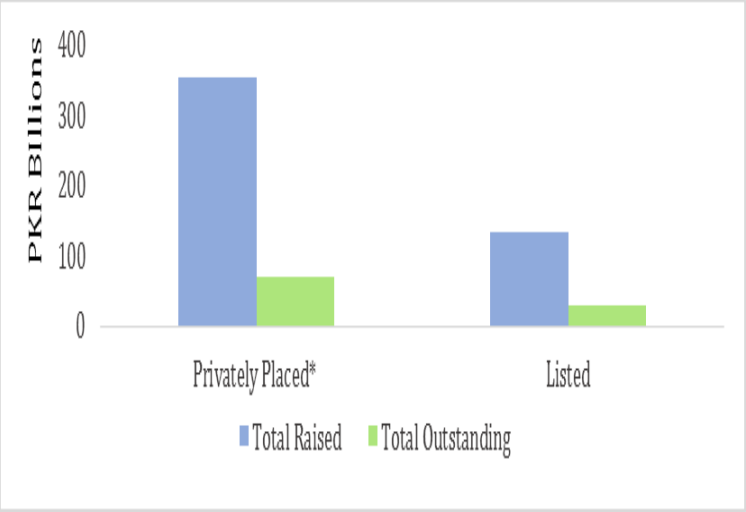
Corporate Fixed Income Securities in Pakistan

An efficient corporate Fixed Income Securities Market (FISM) plays an important role in the development of any economy. A well-functioning and efficient corporate debt market lowers the cost of capital, decreases cost of raising long-term capital, reduces reliance on banks for provision of long-term debt, and increases return on equity by employing optimal capital structure.

The history of corporate FISM in Pakistan is not very long. The debt management reforms in the early 90's along with monetary management measures resulted in the establishment and development of primary & secondary markets for short-term and long-term government securities. Companies started issuing long-term fixed income securities (FIS), referred to as Term Finance Certificates (TFCs), in 1995. While some companies opted to raise debt capital by issuing TFCs, the majority continued to rely on bank financing due to high discount rates, the crowding-out effect, and high costs of raising funds publically.

According to SECP (2015 a,b,c), 122 listed TFCs were issued between 1995 and 2014. Approximately 84% of the listed TFCs have been redeemed as of February 2015. Private placement of TFCs started in 2003 and 88 TFCs were issued until February 2015, out of which 55 have already been redeemed. It is observed that from 2003 onwards companies opted for private placements of TFCs (88) more than listed TFCs (73). This discrepancy can be attributed to higher costs of Initial Public Offerings (IPOs) and stringent regulatory requirements associated with listing TFCs. The total raised and outstanding debt capital through TFCs is presented in Figure 1. The amount raised from privately placed TFCs far exceeds the amount raised from listed TFCs.

Figure 1: *Total Capital Raised and Total Outstanding*



Source: SECP (2015 a)
*Notes: *Includes privately placed TFCs listed on OTC*

Given the small size of the Pakistan corporate debt market (between $0.01 and $2 billion), it is termed as a micro market (IOSCO, 2015). Marginal growth has been witnessed in recent years in corporate debt securities; however, corporate FISM in Pakistan is still underdeveloped as compared to its regional counterparts, which is evident from Table 1 below. While the domestic corporate debt markets are a fraction of those in the region, international corporate debt mar-

kets are non-existent in Pakistan. Table 2 presents the details of long-term corporate debt securities outstanding in Pakistan as of May 2015.

Table 1: *Size, Growth and Depth of Selected Regional Corporate Bond Markets*

Selected Regional Markets	Domestic Corporate Bond Markets (2014)			International Corporate Bond Markets (2014)		
	Size (US$ billions)	Growth (CAGR 2005-2014)	Depth (% of GDP)	Size (US$ billions)	Growth (CAGR 2005-2014)	Depth (% of GDP)
Pakistan	0.27	5.99%	0.15%	N/A	N/A	N/A
India	156.39	26.18%	9.15%	28.75	12.28%	1.68%
Sri Lanka	N/A	N/A	N/A	2.2	30.00%	4.59%
Saudi Arabia	20.81	60.22%	3.95%	9.81	20.77%	1.86%
United Arab Emirates	43.56	N/A	15.16%	75.08	22.38%	26.12%

Source: IOSCO (2015)

Table 2: *Outstanding Long-term Corporate Debt Securities in Pakistan*

Type of FIS	Issues Outstanding	Amount Outstanding PKR in Billions
Term Finance Certificates - Listed	20	30.360
Term Finance Certificates - Privately placed	33*	68.860
Sukuk	52	415.127
Participation Term Certificates	1	1.080
Total	106	515.427
****4 privately placed TFCs trade on over-the-counter (OTC) market***		

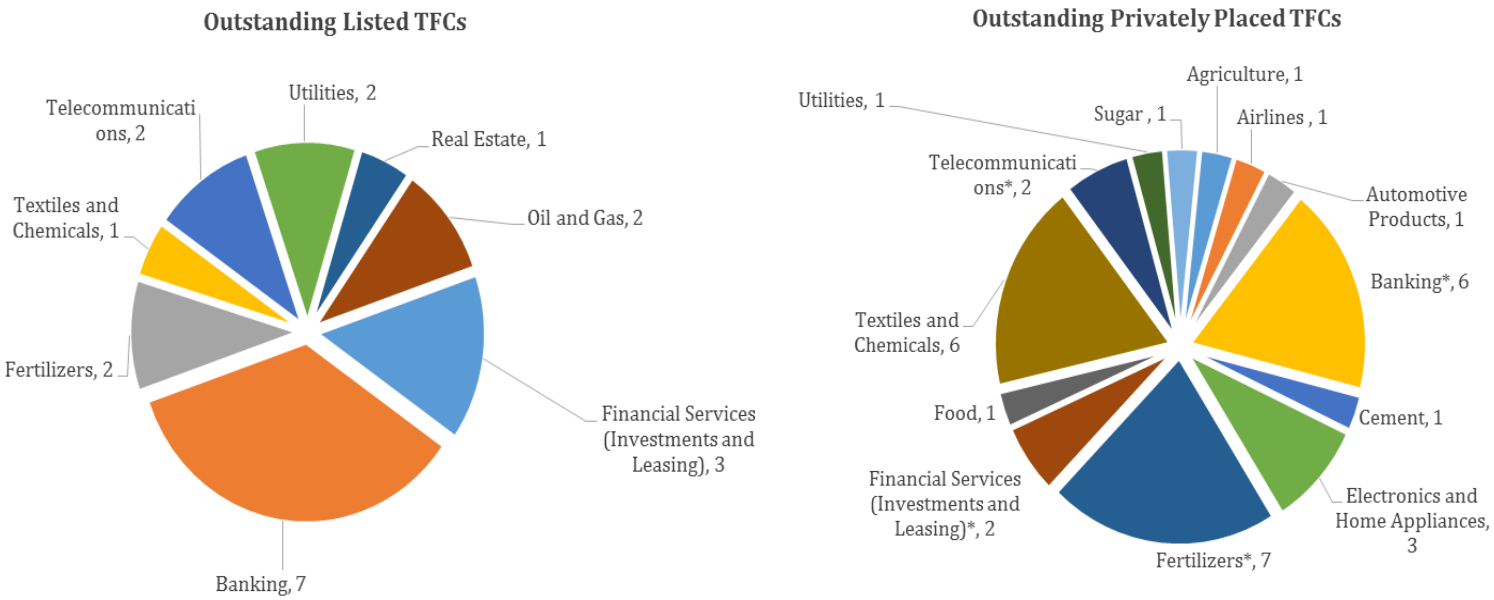
Source: Pakistan Economic Survey (2014-2015)

Although there are several types of long-term corporate FIS offered in Pakistan, this article primarily focuses on *outstanding publicly listed and privately placed TFCs*. A follow-up article on Sukuks will be published in next month's newsletter.

Figures 2-5 below provide a comparison between outstanding publicly listed and privately placed TFCs with respect to sectoral distribution, years of issue, tenor, and coupon rates. The tenor of outstanding privately placed TFCs ranges between 3.5 years and 10 years with an average tenor of 6.5 years. On the other hand, listed TFCs have tenors between 2 years and 10 years, with an average tenor of 5.8 years. However, a large

number of TFCs, listed or privately placed, have a tenor of 5 years. The highest number of TFCs were issued in 2008. It is evident that privately placed TFCs offer a variety of coupon rates as compared to listed TFCs. The 6-month KIBOR appears to be most commonly used base rate. The premium over the base rate varies depending on the credit rating and other characteristics of the TFCs.

***Figure 2**: Sectoral Distribution of Outstanding TFCs*



Source: SECP (2015 b,c)

*Notes: * Includes TFCs listed on OTC*

***Figure 3:** Years of Issue of Outstanding TFCs*

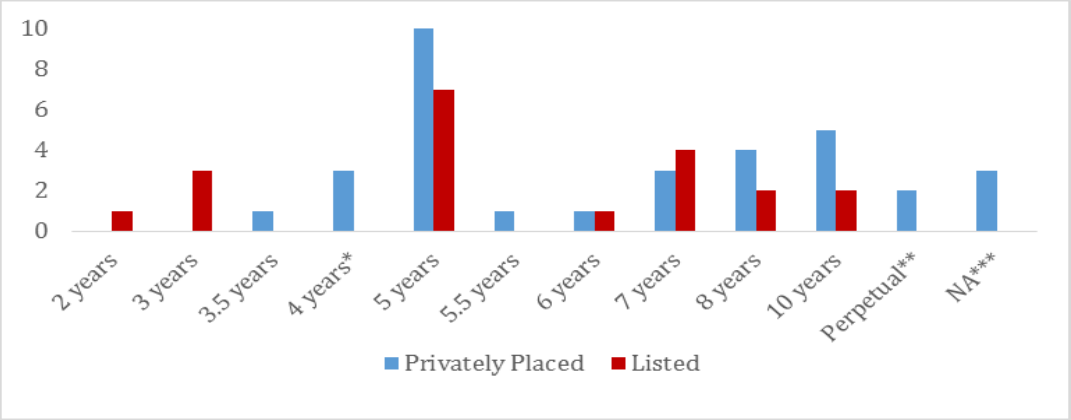
Source: SECP (2015 b,c)

*Notes: * Includes Privately Placed TFCs listed on OTC*

03

Corporate Fixed Income Securities in Pakistan

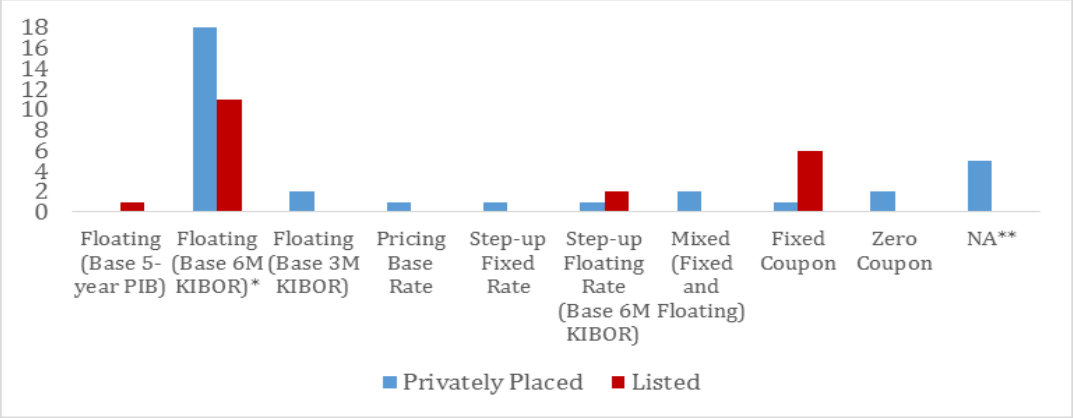
Figure 4: *Tenor of Outstanding TFCs*



Source: SECP (2015 b,c)

*Notes: * Includes Privately Placed TFCs listed on OTC; ** Privately Placed TFCs listed on OTC; *** Information not available*

Figure 5: *Coupon Rates of Outstanding TFCs*



Source: SECP (2015 b,c)

*Notes: * Includes Privately Placed TFCs listed on OTC; ** Information not available*

All TFCs that are intended to be listed are required to fulfill the regulatory requirements set out by the SECP. The issuer and the issue are required to have a minimum credit rating of Triple B Minus (BBB-) by a licensed credit rating agency. The issuers are required to conduct a detailed feasibility study of the capital investment for which the TFCs are being issued. The issuer is also required to disclose any pre-IPO and underwriting arrangements, appoint a trustee, get clearance from the stock exchange, and finally obtain an auditor's certificate. The issuers are required to produce a prospectus providing details about the company, updated financial statements, the purpose of raising debt capital, tenor of the issue, rate of return, embedded options, expenses of the

issue, bankers and trustees, details of all potential risks associated with the issue, and other material information that may facilitate decision-making.

The regulatory requirements for private placement of TFCs are still at the draft stage (SECP, 2016). Just like the private placement of equities, the privately placed TFCs do not require the issuers to publish a prospectus. An information memorandum is sufficient for the purpose, which significantly reduces the cost of raising long-term debt for companies. Unlike listed TFCs, the privately placed TFCs do not have a requirement of minimum credit rating. This may suggest that institutions and high net worth investors are willing to assume greater risk in exchange of greater return. Moreover, the characteristics of privately placed TFCs are customized depending on the mutual suitability for the parties engaged in the transaction.

The market for TFCs in Pakistan is illiquid, which is a common phenomenon for long-term debt securities globally. All listed TFCs are traded through the Pakistan Stock Exchange platform as there is no separate corporate FISM in Pakistan. The SECP encourages the issuers to appoint market makers, either a brokerage house or an investment bank, in order to provide bid/offer prices and thereby improve the liquidity of TFCs in the secondary market.

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04

Investors' Terms Of The Month

Clearing House

A clearing house by whatever name or designation established or arranged to be established by a Stock Exchange for the registration of dealing in securities or settlement of trading in futures contracts.

Dealing in Securities

Making or offering to make, whether as principal or agent, with any person or inducing or attempting to induce any person to enter into or to offer to enter into-

i. Any agreement for or with a view to acquiring, disposing of, subscribing for or underwriting securities, or

ii. Any agreement the apparent or ostensible purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities.

Government Securities

Monetary obligations of the Federal Government or a Provincial Government or of a corporation wholly owned or controlled, directly or indirectly, by the Federal Government or a Provincial Government and guaranteed by the Federal Government and any other security as the Federal Government may, by notification in the Official Gazette, declare, to the extent determined from time to time, to be a Government Securities.

Liquid Net Worth

The book value or net worth of a Non-Banking and Finance Companies reduced by its fixed assets and direct investment of more than twenty percent in the paid up capital of client enterprises or a lease or leases in respect of its assets aggregating more than twenty per cent of the total assets of the enterprise.

Redeemable Capital

Finance obtained on the basis of participation terms certificate (PTC), musharika certificate, terms finance certificate (TFC), or any other security or obligation not based on interest, other than an ordinary share of a company, representing an instrument or a certificate of specified denomination, called the face value or nominal value, evidencing investment of the holder in the capital of the company on terms and conditions of the agreement for the issue of such instrument or certificate or such other certificate or instrument as the Federal Government may, by notification in the official Gazette, specify for the purpose.

Domestic Newsfeed

Pakistan upgraded to Emerging Markets Status

Pakistani bourse has been upgraded from the frontier markets status to Emerging Markets Index by MSCI. Pakistan was part of the MSCI EM for over 14 years from 1994 to 2008, when in the great global financial market crisis regulators lost their nerve and imposed the infamous `floor` that virtually blocked the investors' exit.

MSCI decided to upgrade the status after extensive consultation with international fund managers. Pakistan's stock market will gain access to a larger pool of foreign funds. The MSCI committee has shortlisted nine companies for inclusion in the MSCI Emerging Markets Index which include OGDC, UBL, MCB, HBL, ENGRO, PSO, LUCK, FFC and HUBC.

During the last few years, Pakistan showed significant improvement which is one of the reasons for reclassification to emerging markets. Pakistan met the criteria for the upgrade to MSCI EM Index. It is expected that the market upgrade would bring in massive net flows. According to the calculation by major market players, there would be an inflow of 0.2% of the $1.5 trillion Emerging Markets funds, which could amount to $250 million.

Agreement signed for partial introduction of High-Grade Petrol

The oil-marketing companies (OMCs) and refineries have reached an agreement with the government for partial launch of high-grade expensive petrol in Pakistan.

Under the agreement, the 87 RON petrol which is a low-quality petrol would be replaced with 92 RON while High Octane Blending Component of 95 RON at present would be replaced with 97 RON HOBC. The government had asked the oil industry to replace 87 RON with a better grade '92 RON' which provides better engine efficiency and slightly lower carbon footprint, but due to higher prices, the local refineries had been resisting.

The new product will be launched in the market in July and would be evaluated in October 2016.

Amendments introduced to Finance Act

38 new amendments have been introduced to the Finance Act 2016. 21 amendments out of 38 are related to income tax measures, 15 to sales tax and 2 to federal excise duty (FED).

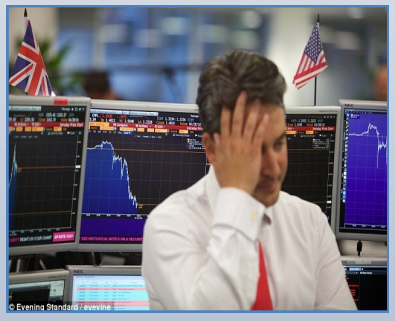
An amendment was made to allow benefit of tax credit of 100% for establishing a new industry in case of reduced equity-investment ratio of 70%. The government has given the authority to the commissioners to

issue notices if a taxpayer has not filed returns for the past 10 years.

The exemption limit of income from an approved gratuity scheme is further extended to Rs.300,000 from Rs.200,000. 2% point reduction in tax rate has been introduced by the government for Shariah-compliant companies, 30% for tax year 2016, 29% for tax year 2017 and 28% for tax year 2018 and onwards. The reduced rate will be available if the company is Shariah-compliant as per criteria of the SBP, SECP and FBR.

International Newsfeed

Brexit vote hammered Global Markets



Britain`s vote to leave the European Union (EU) sent shockwaves across global markets. Sterling crashed to a 31-year low at one point and the Euro also plunged against the Dollar.

London`s benchmark FTSE 100 index slumped 7.5% at the open, but it began to recover when British Prime Minister said he would step down and pledge to provide liquidity to volatile markets. In the Eurozone, the losses were of a magnitude unseen since the dark days of the global economic crisis.

The Frankfurt stock exchange suffered a blow of 6.2%, while Paris dropped down by 8%. The liquidity support promised by the Bank of England appears to have been the main catalyst for the turnaround.

UK government bonds rose, taking their 10-year yield to a historic low, Gold hit a two-year high and oil prices tumbled more than $2 per barrel due to the shock referendum.

Cap on Oil Price

Global demand for oil is rising due to solid economic growth, and supply has been restrained by unexpected production cuts due to wildfires in Canada and rebel attacks in Nigeria, as well as falling US shale production.

The above-mentioned factors have pushed the oil price above the key level of $50. But there are still large oil inventories waiting to feed into the market, causing a supply glut that is likely to keep a lid on gains for some time.

On the supply side, these involve a surprisingly strong return of Iran to the oil market while on the demand side, relatively weak oil prices will bring more buyers into the market. Countries outside the OECD club of highly-developed nations will provide the bulk of fresh demand. Worldwide oil demand is likely to continue to grow by 1.3m bpd into next year.

Regulatory Newsflash

Investment Finance License issued by SECP

In order to carry out micro financing as a non-bank micro-finance company, the SECP has issued the first investment finance services license to Punjab Rural Support Programme. According to the new regulatory regime, all the entities undertaking microfinance activities except micro-finance banks are required to obtain a license from the SECP.

The aim of the SECP is to onboard the microfinance institutions as non-bank microfinance companies. The SECP has approved certain draft changes in the current regulatory framework to provide flexibility for smooth transition of microfinance institutions into non-bank microfinance companies.

Notices issued by Insurance Companies

29 show cause proceedings against insurance companies have been initiated by the Securities and Exchange Commission of Pakistan for non-compliance with the Insurance Ordinance, 2000.

The reasons for issuance of notice include failing to meet the fit and proper criteria, failure to meet the minimum solvency requirements, non-filing of returns, annual audited financial statements, failure to maintain proper books and records and late payments of claims.

17 proceedings were concluded by the Insurance Division of SECP against the companies, CEOs and directors of the insurance companies for violating the standards.

Regulations for Brokers Licensing

The SECP has approved Securities Brokers (Licensing and Operations) Regulations 2016. A primary objective of the new regulations is categorization of brokers into two categories: trading and clearing, to allow custodial functions with financially sound brokerage houses only. To achieve the key aspect, the concept of professional or general clearing member is also in the pipeline to facilitate clearing and settlement of trading by only brokers. Various new requirements are introduced to help achieve the goals of risk management.

GLOSSARY

Compliance	تعمیل
Gross Income	کل آمدنی، گروس انکم
Limited Liability	محدود ذمہ داری/واجبہ
Policy Board	پالیسی بورڈ
Quoted Price	نرخیہ قیمت
Reporting Regime	رپورٹنگ کا نظام
Securities Market	تمسکاتی بازار
Underwriter	ذمہ نویس
Working Days	ایام کار

Markets In Review

Monthly Review

	Crude Oil (WTI)
Beginning	49.51
Ending	48.99
Change	-0.52

	KIBOR (6 Months)	
	Bid %	Offer %
Beginning	5.90	6.15
Ending	5.83	6.08
Change	-0.07	-0.07

	Pakistan Stock Exchange 100 Index
Beginning	36,061.56
Ending	37,783.54
Change	+1721.98

	Gold 10 Grams
Beginning	Rs.41,485
Ending	Rs.42,685
Change	+1200

	Silver 10 Grams
Beginning	Rs.557.14
Ending	Rs.557.14
Change	0

Foreign Exchange Rates						
	GBP (£)		EURO (€)		USD ($)	
	Buying	Selling	Buying	Selling	Buying	Selling
Beginning	Rs.152.73	Rs.153.02	Rs.115.93	Rs.116.15	Rs.104.40	Rs.104.60
Ending	Rs.138.88	Rs.139.14	Rs.115.41	Rs.115.63	Rs.104.30	Rs.104.50
Change	-13.85	-13.88	-0.52	-0.52	-0.1	-0.1