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Regulatory Awareness Session

Futures Brokers (Licensing & Operations) Regulations

Pakistan Mercantile Exchange Limited

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Regulatory Framework

PRIMARY LEGISLATION

- SECP Act, 1997
- Companies Act, 2017
- Futures Market Act, 2016
- Anti-Money Laundering Act, 2020

SECONDARY LEGISLATION

- Futures Exchanges (Licensing and Operations) Regulations, 2017
- PMEX Rule Book
- Futures Brokers (Licensing and Operations) Regulations, 2018
- SECP (AML & CFT) Regulations, 2020
- Listed Companies (Code of Corporate Governance) Regulations, 2019
- Securities and Futures Advisers (Licensing and Operations) Regulations, 2017

Policies, procedures, directives, guidelines, circulars issued by SECP/PMEX

Learning Objective

- To take an overview of regulatory requirements of Futures Brokers (Licensing and Operations) Regulations, 2018 including recent amendments in Regulations

Introduction

- Previously regulatory framework for brokers was scattered under the Securities and Exchange Ordinance, 1969, Commodity Exchange & Futures Contracts Rules, 2005, PMEX Regulations and circulars issued by SECP from time to time.
- Futures Market Act, 2016 (the “**Act**”) was implemented on **June 15, 2016** which *inter alia* requires SECP to make comprehensive regulations for licensing and operations of futures brokers.
- SECP notified the Futures Brokers (Licensing and Operations) Regulations, 2018 on **September 25, 2018**.

Objectives of Brokers Regulations

- Covers requirements of the Futures Market Act, 2016 and consolidates and refines all the existing requirements applicable to the futures brokers in one master regulatory document.
- Prescribes some new requirements in line with the international best practices and IOSCO recommendations/requirements.
- Incorporates changes relating to code of conduct, capital adequacy regime and fit and proper criteria for brokers.
- Focuses on building governance standards, promoting transparency and ensuring greater investors protection with an ultimate aim to restore public confidence and enhance customer base in Pakistani capital market.

Structure of Brokers Regulations

- **Chapter I: Preliminary**
 - *Regulation 1-2*
- **Chapter II: Licensing requirements for Futures Broker**
 - *Regulation 3-11*
- **Chapter III: Conduct of Futures Broker**
 - *Regulation 12-27*
- **Chapter IV: Accounting and Audit**
 - *Regulation 28-34*
- **Forms, Schedules and Annexures**
 - *4 Forms*
 - *1 Schedule*
 - *4 Annexures*

Recent Regulatory Amendments

(S.R.O.1912 (I)/2022 dated Oct 14, 2022)

- Removal of **prior permission** from SECP for Securities Brokers.
- Removal of SECP's **prior approval** on reduction in sponsors.
- Removal of **restriction for CEO** to hold any office in other company.
- Removal of **Sponsors twice Net Worth** amount/wealth statement.
- Reduction in **Net Worth** from Rs. 20M to **Rs. 10M**.
- Extension in time from **15 days to 3 months** for office visit.
- Annual inspection of branches changed to **periodic basis**.
- Extension in time from **quarterly to bi-annual** for testing of contingency plan.
- Removal of **customer assets segregation & book keeping**.
- Removal of **additional opinion** in audit report.
- Removal of **examination of CIB report** by PMEX.
- Proviso for **relaxation in educational qualification**.
- Removal of **bi-annual board meeting**.
- SBP Panel A/B auditor changed to **QCR rated firms**.
- Quarterly financial statements requirement changed to **voluntary basis**.

Chapter I: Preliminary

- **PREAMBLE:**

- Enabling provisions of the Futures Market Act, 2016 includes sections 58,59,60,61,62,63,64,66,68,95 and 114 of the Act.

- **SHORT TITLE AND COMMENCEMENT:**

- Futures Brokers (Licensing and Operations) Regulations, 2018
- Effective date: September 25, 2018

- **DEFINITIONS:**

- Terms defined in the Futures Market Act, 2016 are used where required

Chapter II: Licensing Requirements

PROHIBITION (Reg. #3)

- No person shall act or perform the functions of a Futures Broker unless such person is licensed as a Futures Broker with the Commission in accordance with the Act and these Regulations.

Chapter II: Licensing Requirements

ELIGIBILITY CRITERIA FOR OBTAINING LICENSE (Reg. #4)

- SECP **prior permission** before obtaining TRE Certificate of PMEX;
- Memorandum of Association allow to apply for license as Futures Broker;
- Applicant is **not a single member company** and holds a valid TREC;
- Identification of Sponsors required to hold at least **51%/25%** shares in case of **unlisted/listed** company;
- SECP **prior written approval** required for change in Sponsors;
- Applicant and Sponsors barred from **holding more than one license or controlling interest** in any other company holding license as a Futures Broker;
- Applicant, Sponsors, Directors & Senior Management Officers (SMOs) to comply with **Fit & Proper Criteria**;
- CEO is barred from holding such office in any other company;
- Director/Employee cannot hold the position of Director or any other position in any other company licensed as a Futures Broker;
- Sponsors to have at least **20%** representation on its Board of Directors;

Chapter II: Licensing Requirements

ELIGIBILITY CRITERIA FOR OBTAINING LICENSE (Reg. #4)

- Names of Sponsors, Directors & CEO appearing on FBR **list of Active Tax Payers**;
- Meets minimum **Rs. 10 Million Net Worth** requirement;
- Have requisite number of personnel/employees having **mandatory certification**;
- Ultimate beneficial owners not convicted in any predicate offences provided under AML Act, 2010, Anti-Terrorist Act 1997 or any other criminal offence.

Chapter II: Licensing Requirements

SECP PRIOR PERMISSION FOR FUTURES BROKER ACTIVITY (Reg. #5)

- An Application as per **Form A** along with documents specified in **Annexure A** and receipt evidencing payment of processing fee as specified in **Schedule I** shall be filed with the SECP before obtaining TRE Certificate of PMEX;
- SECP may permit by an order in writing to establish a Futures Broker company;
- SECP permission shall be valid for **six months** unless extended for a maximum period of further three months under special circumstances, on the application of the sponsors made before the expiry of initial six months;
- Sponsors shall obtain TRE Certificate from PMEX, get the Futures Broker company incorporated and submit an application to SECP for grant of license.

Chapter II: Licensing Requirements

APPLICATION THROUGH PMEX (Reg. #6)

- A Futures Broker shall submit an application **Form A-1** along with information/documents as per **Annexure A-1** and receipt evidencing payment of fee as specified in **Schedule I** for grant of license to SECP through PMEX.
- PMEX shall scrutinize the application and information/documents and submit the same to the SECP along with letter of recommendation.
- Any subsequent change in the information shall be communicated to SECP **within five working days** from the date of such change.

Chapter II: Licensing Requirements

FINANCIAL RESOURCES REQUIREMENT (Reg. #7)

- Comply with minimum Net Worth of **Rs. 10 Million**.
- In case of failure to meet the above requirement, PMEX shall give **30 calendar days** to the Futures Broker for compliance, failing which PMEX shall restrict the trading facility and its license shall be suspended by SECP.
- **Net Worth** = Total Assets – Total Liabilities – Surplus on revaluation of fixed assets.

Chapter II: Licensing Requirements

GRANT OF LICENSE (Reg. #8)

- SECP may grant license of Futures Broker for a period of **one year**.
- SECP may obtain **CIB reports** from SBP and may conduct a **visit of the premises** to verify the genuineness of information submitted.
- Within **three months** of the grant of license, prior to allowing commencement of business, PMEX shall conduct **on-site visit** of Broker's premises to confirm that the Futures Broker has deployed professional management and has put in place necessary technological systems and internal procedures, adequate office space and infrastructure, an organizational structure, appropriate arrangements for risk management, clearing and settlement, internal control measures, KYC and CDD measures.

Chapter II: Licensing Requirements

RENEWAL OF LICENSE (Reg. #9)

- A Futures Broker shall **30 days prior to expiry** of its license apply to SECP through PMEX in **Form C** along with an undertaking and receipt evidencing payment of renewal fee as specified in **Schedule I**, for renewal of its license.
- License renewal shall be valid for a period of **one year**.
- PMEX shall scrutinize the application/documents and submit to SECP along with letter of recommendation **one month prior to expiry date of license**.

Chapter II: Licensing Requirements

PROCEDURE FOR REFUSAL TO GRANT/RENEW THE LICENSE (Reg. #10)

- SECP may refuse to grant or renew a license, after giving a reasonable opportunity of hearing to the applicant.
- The applicant, may **within a period of 30 days** from the date of receipt of refusal, prefer an appeal to the appellate bench of the Commission under Section 33 of the SECP Act, 1997.
- A Futures Broker whose application for renewal of license is refused shall immediately inform all its existing customers, settle all dues of the customers **within 15 days** and shall remain responsible for clearing and settlement of all its obligations up to the date it has been working as Futures Broker, in the manner specified by PMEX with the approval of SECP.

Chapter II: Licensing Requirements

CANCELLATION OF LICENSE (Reg. #11)

- A Futures Broker may apply to SECP for cancellation of its license along with a confirmation from PMEX that such Futures Broker has informed all its existing customers, settled all dues and pending claims of the customers and has completed all formalities for closure of business.
- SECP may, after being satisfied, cancel the license of Futures Broker.
- The license of Futures Broker shall cease to be valid if:
 - TRE Certificate is cancelled by PMEX;
 - Futures Broker surrenders its license;
 - Futures Broker declared defaulter by PMEX or TRE Certificate suspended by PMEX and the reason for such default and/or suspension is not removed within a period of six months from declaration of such default and/or suspension;
 - Futures Broker surrenders TRE Certificate and PMEX cancels such TRE Certificate;
 - Futures Broker is declared insolvent by a Court;
 - Futures Broker fails to apply for renewal of license before its expiry;
 - License is suspended by the SECP and such suspension has not been revoked till expiry of license.

Chapter II: Licensing Requirements

CANCELLATION OF LICENSE (Reg. #11)

- A Futures Broker whose license is ceased shall inform all its existing customers, settle all dues of the customers **within 15 days** and shall remain responsible for clearing and settlement of all its obligations up to the date on which it has been working as Futures Broker.

Chapter III: Conduct of Futures Broker

■ **ADVERTISEMENTS (Reg. # 12)**

- Restriction on false, misleading or deceptive advertisement.
- Restriction on advertisement promising or guaranteeing any return.
- Restriction on advertisement during suspension of Broker.

■ **DISCLOSURE OF FINANCIAL RISK (Reg. # 13)**

- Restriction to commence business unless RDD is provided and obtain a written acknowledgement from customer.
- PMEX to prescribe standardized risk disclosure document.

■ **CONFLICT OF INTEREST AND CONFIDENTIALITY (Reg. # 14 & 15)**

- Formulate policies, procedures and controls to maintain confidentiality and to minimize conflict of interest b/w Futures Broker & its customers.
- Inform immediately to the customer in case any conflict of interest arises.
- Have mechanism to resolve all conflicts of interests in an equitable manner.

Chapter III: Conduct of Futures Broker

DUTIES AND OBLIGATIONS OF FUTURES BROKER (Reg. # 16)

- Abide corporate governance code prescribed in **Annexure C** to the Regulations;
- Establish **internal code of practice** to ensure protection of customers' interests and compliance with the applicable laws;
- KYC and CDD of customers;
- Ensure compliance with all legal and regulatory requirements;
- Inculcate a culture of compliance through **ongoing education and training**;
- Maintain a functional & accessible **website** and submit **quarterly compliance report** to PMEX;
- Not to indulge in manipulative practices;
- Not encourage trading solely to generate commission or other monetary gain;
- Not have incentive structure that encourages trading which is not suitable with risk profile of customer;
- Do not maintain anonymous or fictitious persons accounts;
- Do not operate any branch without registration with PMEX;

Chapter III: Conduct of Futures Broker

DUTIES AND OBLIGATIONS OF FUTURES BROKER (Reg. # 16) – Contd....

- Not accept money against a **promised or guaranteed return**;
- Prescribe policies for **employees trading**;
- Have **internal control policies** and framework duly approved by Board;
- Establish and implement **contingency plan** to ensure continuity of its operations in the event of a disaster or crisis.

Chapter III: Conduct of Futures Broker

- **ESTABLISHMENT OF RELATIONSHIP (Reg. # 17)**
 - Enter into agreement on SAOF and obtain acknowledgment of RDD.
 - Identity, address and contact details of customers are known and verified.
 - Information in SAOF is updated, complete and correct at all times.
 - Do not change any detail without prior approval of the customer.
 - Develop KYC & CDD policies and procedures in compliance with AML laws.
- **CUSTOMERS' RIGHTS (Reg. # 18)**
 - Do not exclude any duty/liability to customer has under any law.
- **EXECUTION OF CUSTOMER ORDERS (Reg. # 19)**
 - Restriction to deal on account of customer without prior instruction of customer.
 - Restriction to execute discretionary trades on behalf of customers.
 - Restriction to take or use the password on behalf of customers.
- **ORDER RECORDING (Reg. # 20)**
 - Telephonic orders and orders received in person shall be recorded.

Chapter III: Conduct of Futures Broker

- **CONTRACT NOTES (Reg. # 21 & 22)**
 - Issue & deliver contract note of every transaction executed for customers.
 - Retain proof of sending contract notes to customers.
- **RECEIPT OF CUSTOMER MONEY (Reg. # 23)**
 - Restriction to receive customer money or hold customer assets in own name.
- **PERIODIC REPORTING TO CUSTOMER (Reg. # 25)**
 - Furnish reports to customers on daily/periodic basis as specified by PMEX/SECP.
 - Provide any account report/information as and when requested by customer.
- **CUSTOMER COMPLAINTS (Reg. # 26)**
 - Have **procedures** for proper handling of customer complaints.
 - Redress grievance **within 30 days** of receipt or as specified by PMEX/SECP.
 - Submit **quarterly customer grievance report** to PMEX.

Chapter III: Conduct of Futures Broker

APPOINTMENT & FUNCTIONS OF COMPLIANCE OFFICER (Reg. # 27)

- Designate/appoint a Compliance Officer (CO) fulfilling fit and proper criteria.
- CO is responsible for **monitoring compliance** of the Futures Broker.
- CO to **report non-compliance** to the Futures Broker.
- In case no or inadequate action by the Futures Broker, CO to immediately inform PMEX and SECP of such non-compliance.
- CO to prepare **quarterly compliance reports** and submit to BOD of Futures Broker.
- Any instance of non-compliance to be reported to BOD on immediate basis.

Chapter IV: Accounts and Audit

GENERAL (Reg. # 28)

- Futures Broker may prepare Financial Statements (FS) on **trade date** or **settlement date** basis and shall:
 - not change the basis during a financial year; and
 - disclose the basis in FS

MAINTENANCE OF BOOKS OF ACCOUNTS (Reg. # 29)

- Keep accounting and other records for a minimum period of **10 financial years**
- Intimate to PMEX and SECP the place where books of accounts/records are maintained

PREPARATION AND SUBMISSION OF FINANCIAL STATEMENTS (Reg. # 30)

- FS to be prepared **quarterly, half-yearly** and **annually**
- Disclosures in FS relating to:
 - Pattern of shareholding (name of persons holding above 5%)
 - All changes in shareholding above 5%
- Submission of annual FS along with audit report to SECP **within 4 months** of close of financial year.

Chapter IV: Accounts and Audit

APPOINTMENT OF AUDITORS (Reg. # 31)

- Notify SECP in writing **within 14 days** of appointment, removal or resignation of an auditor.
- Audit scope is extended to include further areas in respect of auditor's opinion on:
 - Adequate internal controls and compliance function
 - Performance of the Compliance Officer
- Notify SECP on resignation/removal of auditor. Where auditor is removed during their tenure, the Futures Broker shall appoint the auditor **with prior approval of SECP**.

SUBMISSION OF INFORMATION & RETURNS (Reg. # 32)

- SECP may require to submit information or periodical or exceptional returns as it may require at any time.

MANAGEMENT RATING (Reg. # 33)

- Futures Broker may obtain management rating on annual basis from a Credit Rating Company licensed by SECP and disclose such rating at all times on their websites and all advertisements.

Forms, Schedules and Annexures

Sr. No.	Attachments	Contents
1	Annexure - A	Information & Documents to be provided along with Application for Prior Permission to Undertake Futures Broker Activity
2	Annexure - A-I	Information & Documents to be provided along with Application for license as a Futures Broker
3	Annexure - B	Fit & Proper Criteria for Applicant, Sponsors, Directors and Senior Management Officers of Futures Broker
4	Annexure – C	Corporate Governance Code for Futures Broker
5	Schedule I	Schedule of Fees
6	Form A	Form of Application for Prior Permission to Undertake Futures Broker Activity
7	Form A-I	Form of Application for license as a Futures Broker
8	Form B	SECP License as Futures Broker
9	Form C	Form of application for Renewal of License as Futures Broker

COMPLIANCE CALENDAR FOR FUTURES BROKERS			
Periodic / Timebound Requirements			
(Updated as of December 28, 2022)			
S. No.	Regulation Reference	Regulatory Requirements	Time Frame
FUTURES BROKERS (LICENSING AND OPERATIONS) REGULATIONS, 2018			
1	5	SECP Prior Permission for Futures Broker Activity	
	5(4)	The permission granted under sub-regulation (3) shall be valid for a period of six months unless extended for a maximum period of further three months under special circumstances, on the application of the sponsors made before the expiry of initial six months. During the validity of this permission, the sponsors shall obtain the TRE Certificate from PMEX, get the futures broker company incorporated and submit an application to the Commission for grant of license, after fulfilling all the conditions specified in these regulations.	Within six(6) months.
2	6	Application and Procedure for Granting a License	
	6(6)	Any subsequent change in the information provided to the Commission at the time of filing of application under sub-regulation (1) shall be communicated to the Commission within five working days from the date of such change.	Within five(5) working days.
3	7	Financial Resources Requirement	
	7(2)	In case a futures broker fails to meet the minimum net-worth requirement as specified in sub-regulation (1), the futures exchange shall allow a period of 30 calendar days to the futures broker to comply with the minimum capital requirement, failing which the futures exchange shall restrict the trading facility of such futures broker and its license shall be suspended by the Commission without prejudice to any other disciplinary action under the Act and these regulations.	Within thirty(30) calendar days.
4	9	Renewal of License	
	9(1)	(1) Subject to the provisions of the Act and these regulations, a futures broker having a valid license shall, thirty (30) days prior to the date of expiry of its license, apply to the Commission through futures exchange in Form C along with an undertaking stating that it is in compliance with all regulatory requirements and receipt evidencing payment of renewal fee of such amount as specified in Schedule I, for renewal of its license.	Thirty(30) days prior to expiry.
5	10	Procedure where License is not Granted/Renewed	
	10(2)	The applicant, if aggrieved by the decision of the Commission under sub-regulation (1) may, within a period of thirty days from the date of receipt of such refusal, prefer an appeal to the appellate bench of the Commission under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997.	Within thirty(30) days of receipt.
	10(3)	A futures broker whose application for renewal of license is refused shall immediately inform all its existing customers, settle all dues of the customers within fifteen days and shall remain responsible for clearing and settlement of all its obligations up to the date on which it has been working as a futures broker, in the manner specified by the futures exchange with the approval of the Commission.	Within fifteen(15) days.
6	11	Cancellation of License	
	11(4)	A futures broker whose license is ceased under sub-regulation (3) shall inform all its existing customers, settle all dues of the customers within fifteen days and shall remain responsible for clearing and settlement of all its obligations up to the date on which it has been working as a futures broker.	Within fifteen(15) days.

Periodic / Timebound Requirements (Updated as of December 28, 2022)			
S. No.	Regulation Reference	Regulatory Requirements	Time Frame
FUTURES BROKERS (LICENSING AND OPERATIONS) REGULATIONS, 2018			
7	16	Duties and Obligations of a Futures Broker	
	1(p)	Maintain a functional and accessible website as per requirements prescribed by the Commission and submit quarterly compliance report to the futures exchange.	On quarterly basis.
8	26	Customer Complaints	
	26(2)	A futures broker shall take all reasonable measures to redress customers' grievances promptly but not later than thirty days of receipt thereof and when called upon by the Commission or the futures exchange or any other regulatory body to do so it shall redress the grievances of customers within the time specified.	Within thirty (30) days of receipt.
	26(4)	A futures broker shall at the end of each quarter submit information about the number of customer grievances received, redressed and those remaining unresolved beyond three months of the receipt to the futures exchange along with the reasons thereof for delay	Within fifteen (15) days from the end of each quarter.
9	27	Appointment and Functions of Compliance Officer	
	27(5)	The compliance officer shall prepare quarterly compliance reports which shall be submitted to the board of directors of the futures broker.	On quarterly basis.
10	29	Maintenance of Books of Accounts	
	29(1)	A futures broker shall keep accounting and other records for a period of not less than ten financial years immediately preceding a financial year which shall sufficiently explain its business and transactions entered into (whether effected on its own behalf or on behalf of customers) and the financial position of the futures broker, and shall be such as to- (a) disclose with accuracy the financial position at that time; (b) enable the futures broker to prepare financial statements at any time and which comply with the requirements of law; and (c) demonstrate whether the futures broker is maintaining in its regulated activity with adequate financial resources to meet its business commitments.	At least ten(10) financial years.
11	30	Preparation and submission of Financial Statements	
	30(1)	A futures broker shall prepare financial statements for each quarter, half year and for each financial year. The financial statements of the futures broker shall be prepared in compliance with the requirements of the Companies Act including conformity with the accounting standards as directed by the Commission.	On quarterly, half yearly & annual basis.
	30(3)	A futures broker shall submit, within four months after the end of each financial year, its annual financial statements to the Commission along with its audit report.	Within four(4) months.
12	31	Appointment of Auditors	
	31(2)	A futures broker shall, within fourteen days, give written notice to the Commission of the appointment, removal or resignation of an auditor.	Within fourteen(14) days.



Thank You

Q & A