HABIB PUBLIC SCHOOL ALUMNI ASSOCIATION

Small brokers charge headlong at SECP

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Few regulations have been opposed by stockbrokers as vociferously as the proposed New Broker Regime.

The two dozen "big brothers" of the fraternity are maintaining a safe distance from the controversy: the proposed regulations do not appear to touch their pockets and, in fact, promises to secure them bigger business. Despite all the wailing and gnashing of teeth by the rest of the market players represented by the PSX Stockbrokers Association, the protest has scarcely dented the regulators' determination. But whatever is the New Broker Regime?

Officials at the Securities and Exchange Commission of Pakistan (SECP) contend that it "primarily aims to strengthen the capital market and restore investor confidence".

The model suggests three categories of brokers be created: Trading Only (TO) brokers who would be allowed to execute proprietary trades/trades by clients but would not keep custody of proprietary or client assets and would not settle trades.

The second class is of Trading and Self-Clearing (TSC) brokers who would execute and settle trades of their clients and also keep custody of client assets.

It is the third category of brokers — Trading and Clearing (TC) brokers, widely perceived as big brokers — that appears to be a major beneficiary of the law. They would be empowered to execute and settle proprietary client trades, keep custody of client assets and also offer custodial and clearing services to TO brokers and their clients.

The SECP says that currently all brokers are allowed to keep custody of client shares and money irrespective of their financial standing, which is to be remodelled along international practices to let brokers with capacity to meet the requisite level of compliance, particularly related to anti–money laundering (AML) and combating the financing of terrorism (CFT) in light of Financial Action Task Force (FATF) requirements.

According to the regulator, the "well-capitalised brokers" currently have a market share exceeding 90 per cent in terms of both client asset custody and trading quantum while the "small brokers" have merely 10pc of the aggregate customer base and contribute nominally to the trading quantum. The new regime aims at segregating the market to reduce systemic risk.

According to an SECP insider, 27 brokers have defaulted in the last 10 years, resulting in investor claims of around Rs5.8 billion. Thus, the average is two to three broker defaults per year with claims of more than Rs200 million. He points out that thousands of investors have lost their investments.

A broker — who has merely 220 square feet of a room for his office — scoffed at the insinuation that small brokers were perpetrators of major frauds, noting that "super brokers" committed such crimes.

The SECP official, who asked not to be named, said: “Presently, top 60 brokers have more than 80pc customers. Further, top 50 brokers generate more than 80pc of the trading volume. The smallest 170 brokers have just 10pc of the total clientele.”

The thinking in Islamabad is that allowing small brokers to bite only as much as they can chew will reduce the chance of mishandling of client assets. On the other side, the PSX Stockbrokers Association says the idea of creating super brokers should be dropped. The association laments that the New Broker Regime concept note issued in November 2019 aimed at altering the business model of stockbrokers for the third time in as many years.

To comply with the post-demutualisation requirements, the brokers’ body had agreed to the proposed segregation of brokers by virtue of minimum paid-up capital, minimum net worth, minimum net capital balance and minimum liquid capital for the three categories. But the rules were abruptly changed.

Apparently TO brokers are under more pressure. As their powers are being curtailed in the New Broker Regime and shifted to the TC brokers, “the TO broker is likely to become irrelevant/redundant”.

On the implementation of the regulations, the TC brokers would turn into super brokers of the exchange. The association says: “Although the number of TC brokers is not likely to be more than 15-20, yet almost 90pc of the securities and money, including those belonging to the TO brokers and their clients, would come under the control of the TC brokers,” resulting in the concentration of wealth in fewer hands with a potential threat to the market.

A small broker who has run his securities firm as a privately owned company for 70 years with family members on the board has been asked to comply with the Code of Corporate Governance regulations, employ a chartered accountant as chief financial officer, appoint a chartered account as internal auditor, set up an audit committee and get accounts audited by an A-class audit firm, secure a rating by various rating agencies and, above all, comply with the minimum net worth requirement for the TSC category, which has gone up to Rs125m from Rs35m.

The brokers contend that all the existing regulations with the surveillance system of the SECP and the fully automated systems of the PSX, National Clearing Company and Central Depository Company were good enough to keep their business in check.

The regulator does not agree with the view that its regulations are pushing the small brokers out of business. “Presently, only around 45pc of all brokers fall below the minimum threshold of Rs100m required for the TSC brokers. In addition, those brokers have less than 10pc of the market share in terms of custody and trading. On the other hand, 55pc of the brokers have more than 90pc market share and that would not be affected,” the SECP official asserts.

“The minimum net worth requirement for the TSC category is Rs100m and presently more than 100 brokers fall between the Rs100m and Rs500m range. Around 18 brokers have net worth of more than Rs500m, which is the threshold for the TC brokers. These combined have a market share of more than 90pc.”

So does the entire controversy revolve around the wide gulf that is envisaged to be created in respect of power and privileges between the 18 big brokers with net worth of over Rs500m and the 170 small brokers who cater to just 10pc of the total clientele?