TABLE OF CONTENT

1. What is Equity Trading?

In finance, equity trading is the buying and selling of a company's shares. Shares in publicly listed companies are bought and sold through stock exchanges, such as the New York Stock Exchange, London Stock Exchange or Karachi Stock Exchange, which serve as managed auctions for stock trades. Stock shares in smaller unlisted companies are bought and sold in over-the-counter (OTC) markets.

Equity trading can be performed by the owner of the shares, or by an agent authorized to buy and sell on behalf of the share's owner. Proprietary trading is buying and selling for the trader's own profit or loss. In this case, the principal is the owner of the shares. Agency trading is buying and selling by an agent, usually a stockbroker, on behalf of a client. Agents are paid a commission for performing the trade.

2. What is Stock Exchange?

Stock Exchange (also called *Stock Market* or *Share Market*) is one important constituent of capital market. Stock Exchange is an organized market for the purchase and sale of industrial and financial security. It is convenient place where trading in securities is conducted in systematic manner i.e. as per certain rules and regulations.

It performs various functions and offers useful services to investors and borrowing companies. It is an investment intermediary and facilitates economic and industrial development of a country.

3. Role of Stock Exchanges In Capital Market

Stock Exchanges play a crucial role in the consolidation of a national economy in general and in the development of industrial sector in particular. It is the most dynamic and organized component of capital market. Especially, in developing countries like Pakistan, the stock exchanges play a cardinal role in promoting the level of capital formation through effective mobilization of savings and ensuring investment safety.

- Barometer of National Economy
- Liquidity of investment
- Effective Mobilization of savings
- Promoting Capital formation
- Wider Avenues of investment
- Investment priorities
- Financial resources for public and private sectors
- Indicator of Industrial Development
- Wide Marketability to Securities

Stock Exchanges in Pakistan:

There are three stock exchanges in Pakistan:
i) Karachi Stock Exchange Ltd.
ii) Lahore Stock Exchange Ltd.
iii) Islamabad Stock Exchange Ltd.

4. What is Equity Share

The capital of the company can be divided into different units with definite value called shares. Holders of these shares are called shareholders or members of the company. There are two types of shares which a company may issue (1) Preference Shares (2) Equity Shares.

4.1 Preferences Shares

Shares which enjoy the preferential rights as to dividend and repayment of capital in the event of winding up of the company over the equity shares are called preference shares. The holder of preference shares will get a fixed rate of dividend. Preference shares may be:

4.1.1 Cumulative Preference Share

If the company does no earn adequate profit in any year, dividends on preference shares may not be paid for that year. But if the preference shares are cumulative such unpaid dividends on these shares go on accumulating and become payable out of the profits of the company, in subsequent years. Only after such arrears have been paid off, any dividend can be paid to the holder of quality shares. Thus a cumulative preference shareholder is sure to receive dividend on his shares for all the years our of the earnings of the company.

4.1.2 Non-cumulative Preference Shares

The holders of non-cumulative preference shares no doubt will get a preferential right in getting a fixed dividend it is distributed to quality shareholders. The fixed dividend is to be paid only out of the divisible profits but if in a particular year there is no profit as to distribute it among the shareholders, the non-cumulative preference shareholders, will not get any dividend for that year and they cannot claim it in the next year during which period there might be profits. If it is not paid, it cannot be carried forward. These shares will be treated on the same footing as other preference shareholders as regards payment of capital in concerned.

4.1.3 Redeemable Preference Shares

Capital raised by issuing shares, is not to be repaid to the shareholders (except buy back of shares in certain conditions) but capital raised through the issue of redeemable preference shares is to be paid back by the raised thought the issue of redeemable preference shares is to be paid back to the company to such shareholders after the expiry of a stipulated period, whether the company is wound up or not. As per section (80) 5a, a company after the commencement of the Companies (Amendment) Act, 1988 cannot issue any preference shares which are irredeemable or redeemable after the expiry of a period of 10 years from the date of its issue. It means a company can issue redeemable preference share which are redeemable within 10 years from the date of their issue.

4.1.4 Participating or Non-participating Preference Shares

The preference shares which are entitled to a share in the surplus profit of the company in addition to the fixed rate of preference dividend are known as participating preference shares. After the payment of the dividend a part of surplus is distributed as dividend among the quality shareholders at a particulate rate. The balance may be shared both by equity shareholders at a particular rate. The balance may be shared both by equity and participating preference shares. Thus participating preference shareholders obtain return on their capital in two forms (i) fixed dividend (ii) share in excess of profits. Those preference shares which do not carry the right of share in excess profits are known as non-participating preference shares.

4.2 Equity Shares

Equity shares will get dividend and repayment of capital after meeting the claims of preference shareholders. There will be no fixed rate of dividend to be paid to the equity shareholders and this rate may vary form year to year. This rate of dividend is determined by directors and in case of larger profits; it may even be more than the rate attached to preference shares. Such shareholders may go without any dividend if no profit is made.

5. The Karachi Stock Exchange and its Trading System

The Karachi Stock Exchange has introduced computerized trading system to provide a fair, transparent, efficient and cost effective market mechanism to facilitate the market participants, including the investors. The system being operated at Karachi Stock Exchange is called Karachi Automated Trading System (KATS).
The trading system comprises of various distinct segments, which are:

5.1 T+2 Settlement Systems:

In the T+2 settlement systems, purchase and sale of securities is netted and the balance is settled on the second day following the day of trade.

Benefits of T+2 Settlement Systems:
• It reduces the time between execution and settlement of trades, which in turn reduces the market risk.
• It reduces settlement risk, as the settlement cycle is shorter.

5.2 Provisionally Listed Counter:

The shares of companies, which are not already listed and which make a minimum public offering of a specified amount, which is presently Rs.150 million, are traded on this counter from the date of publication of prospectus/offering document. When the company completes the process of dispatch/credit of allotted shares to subscribers through CDC, it is officially listed and placed on the T+3 counter. Trading on the provisionally listed counter then comes to an end and all the outstanding transactions are transferred to the T+3 counter with effect from the date of official listing.

5.3 Spot/T+1 Transaction:

Spot transactions imply delivery upon payment. Normally in spot transactions the trade is settled within 24 hours.

5.4 Futures Contract:

A Futures contract involves purchase and sale of securities at some future date (normally within one calendar month), at a price fixed today. The number and names of companies to be traded on the Futures counter are determined every six months based on the eligibility criteria approved by the SECP in this regard and which are notified to the market participants in advance.

5.5 Odd Lots Market:

This market has been created to provide an automated platform through KATS enabling the investors to trade securities in lots which are less than the normal trading units (lots) of the securities approved for Ready Market. The minimum volume of a buy/sell order may be one share.

6. Order Execution Cycle

Order placed by the investor through desktop, mobile or web based interfaces are first evaluated at broker's end. Broker records the order and verifies the margin and cash requirements. If order is within the defined limits it is forwarded to Exchange, otherwise, order is rejected and a rejection message is sent back to client. If order is pushed to stock exchange, it queues the order in respective security book and send a confirmation of receiving the order. The order confirmation is recorded in the broker's database and forwarded to the investor's terminal (in case of web terminal, investor may need to refresh his page to view the order confirmation). Only when confirmation from exchange is received, it appears in Outstanding order view as a pending orders.

If order is traded in stock exchange, an execution confirmation is sent to broker. Broker record the execution and forwards it to investor's terminal as well. On receiving the execution confirmation, a trade record appears in the transaction list and outstanding volume of the pending order is reduced by the trade volume.

If order is completely executed it is removed from the outstanding orders window. If the link between investor machine and broker servers or the link between broker's server and stock exchange is broken, the order or execution confirmation may not be received at the terminal. In most of such cases reconnecting the terminal and refreshing the order book and trade book updates the client position, otherwise, the investor should call to brokers call center for verification.
In case of system failure, orders may be cancelled by calling the help desk.

7. Delivery and Settlement

A subsidiary account for each investor is opened in CDC at the time of account opening. Shares traded over the internet follows the standard delivery and settlement process. Shares purchased are deposited to CDC sub account on settlement date and client is expected to make the payments. In case of debit cash balance, a penalty may be imposed as communicated by the broker or broker can sell the client shares to cover the debit cash balance.

8. Risk Associated with Electronic/ Online Trading

All risks connected and involved with Electronic/Online Trading will be assumed fully by the client. Electronic/Online Trading may from time to time be adversely affected (inter alia) by network congestion, equipment failure, software failure, system breakdown, loss of connectivity, power failure, adverse market conditions, partial execution of order and/or technical glitches/failures (including but not limited to connectivity failures). Neither the Broker no any of its Directors or officers, its management, its branch offices, office of supervisory jurisdiction, and their respective registered representatives and employees, would be responsible or liable in any manner for any losses or damages that may be suffered by the client including those due to the misuse of client information and affairs by unscrupulous person(s). Alternatively; in failure of Electronic/Online Trading orders can be placed via the KATS Terminal.

The Broker may, from time to time at the request of the client or of its own volition, provide to the client information relating to investment opportunities in the market and/or of a financial/economic nature. The Broker however does not guarantee the accuracy/veracity/reliability of such information. Any steps or instructions issued by the client, in reliance of such information, shall be deemed to have been unilaterally taken/issued by the client at his/her/their sole risk and responsibility in respect of the consequences emanating there from. The decision to sell or purchase any Securities or to make any investments or disinvestments, shall be deemed to have been made only by the client based on his/her/their own acumen and judgment, without any representation or assurance from the Broker as to its profitability or viability.

9. Dispute Resolution Procedure.

In the event of any disputes, differences or controversies arising between the Broker and the client out of any transaction(s) and other matters related thereto, including as to the rights and obligations of the client and the Broker and the interpretation of the provisions of the Contract and the Terms and Conditions (agreed by the Broker and the client) or any other matter related thereto, the same shall be referred to the pertinent Stock Exchange where the transaction has taken place. In case for any reason(s) the Stock Exchange and/or the Arbitration Committee thereof is/are unable to arbitrate upon the matter due to any legal infirmity or otherwise, the matter shall then be referred to arbitration by two Arbitrators, one to be appointed by each party, and on the lack of consensus between the two Arbitrators, the matter shall be referred to an Umpire, to be selected by the two Arbitrators before the commencement of the reference in accordance with the Arbitration Act, 1940 or any amendments thereof. The decision of the Arbitration Committee of such Exchanges or the Arbitrators or the Umpire, as the case may be, shall be final and binding upon both Parties.

10. Important Links

Karachi Stock Exchange
www.kse.com.pk

Lahore Stock Exchange
www.lse.com.pk

Security & Exchange Commission of Pakistan
www.secp.gov.pk

National Clearing Company of Pakistan
www.nccpl.com.pk

FAQs (SECP)
http://www.secp.gov.pk/eServices/faqs.pdf

CDC Access
http://www.cdcpakistan.com/UserPanel/AboutUs/ViewContent.aspx?m=au&type=0058

Appendix A - Customer Information

1. Securities Trading

Securities trading is buying or selling of shares of publically listed companies in stock exchanges. Securities trading in stock exchange can only be carried out through stock exchange members (brokers). Individual investors must have an account with a broker to buy or sell shares.

2. Glossary

2.1 Order

An instruction issued by the investor to his broker to buy or sell one or more shares of a particular security at a specific price.

2.2 Buy Order

An 'Order' to purchase shares.

2.3 Sell Order

An 'Order' to sell shares available in investor's custody.

2.4 Short Sell Order

An 'Order' to sell shares which the investor does not own.

2.5 Trade (Transaction/Execution)

A transaction of purchase or sale of shares that must be completed with delivery of money and shares respectively. An 'Order' may result in multiple trades possibly at different prices.

2.6 Pending order

Any Order which is placed in stock exchange but still not completely filled by trades.

2.7 Limit Order

Order to buy or sell at a specified price or better. Limit orders are queued and does not execute until market reaches the specified price levels. It is guaranteed that order cannot be traded at a price worse than the specified trade but the downside is that the order may never be executed.

2.8 Market Order

Order without any specific price. Market orders are traded immediately at available price provided that there is sufficient volume available in the market. If volume is not available in the market, they are queued at last trade price.
Market orders may be filled (traded) at a price which is far off the quoted price displayed at the time of order placement.

2.9 Stop Loss Order

Order to buy or sell which activates when the price of the share drops to or below the trigger price.
Stop loss sell order is only accepted if the trigger price is less than the last trade price. Among the two price levels i.e. trigger price and limit price the trigger price should be greater than or equal to the limit price.
Stop loss buy order is only accepted if the trigger price is greater than the last trade price. Among the two price levels i.e. trigger price and limit price the trigger price should be less than or equal to the limit price.

2.10 Market If Touch Order (MIT Order)

Order to buy or sell which activates when the price of the share reaches a specific price. MIT Sell order would only be accepted if the Trigger price is greater than the last trade price. Among the two price levels i.e. trigger price and limit price the trigger price should be less than or equal to the limit price.
MIT Buy order would only be accepted if the trigger price is less than the last trade price.

Among the two price levels i.e. trigger price and limit price the trigger price should be greater than or equal to the limit price.

2.11 Undisclosed volume

An undisclosed volume is to hide the order volume in the market. Only the total order volume undisclosed volume will be visible in the market.

2.12 Pre –Open

A market session in which order are not executed but only queued for price discovery. Only limit orders are allowed during pre-open session.

2.13 Order Modification

A process to modify a queued order. If an order is modified, it is re-stamped and queued at the bottom. It is like cancelling an existing order and placing a new order.

2.14 Cancel Order

A process to remove an order from the queue.

2.15 Equity

Total value of cash and custody available in investor's account.

2.16 Margin

Value of equity can be used as a margin.

2.17 Margin Trading

Buying or Selling shares by using the money borrowed from the broker (financier).

2.18 Holding Value

Value of stocks in investor's portfolio as per prevailing price. Holding value may be reduced by a certain percentage (haircut) to adjust the price fluctuation and potential loss in value while selling the stock.

2.19 Exposure

Value of open (unsettled trades and orders).

2.20 Exposure Limit

Maximum exposure that investor can take in the market. The limit primarily depends on the size and type of deposited equity with the broker.

2.21 Maintenance Margin

Minimum equity required as a margin against market exposure.

2.22 Margin Call

Any shortfall in the minimum equity required. If margin falls below the required margin, broker reserves the right to sell some or all securities of the investor to meet the requirements.