

Investors Guide



Government Securities for Retail Investors



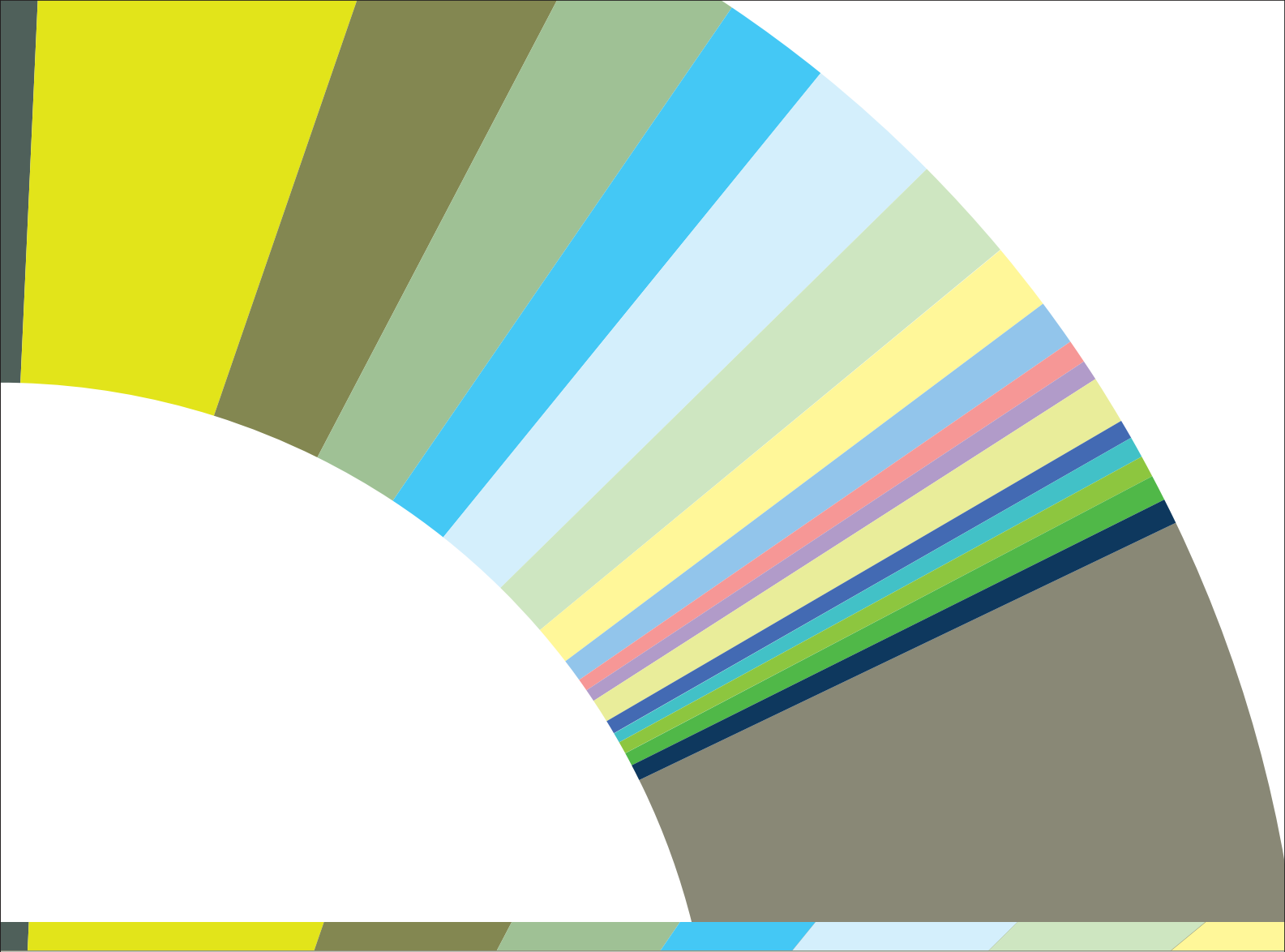
This handbook is designed to help retail investors understand the structure of tradable Government Securities, factors affecting the market price, key risks and what part these Fixed Income Government Securities play in overall portfolio management.

It is the broad objective of the Government of Pakistan to improve the liquidity in the Debt and Capital markets and diversify the investor base of government & corporate debt markets. Small investor, who may not have been able to acquire securities on the primary market through non-competitive bid mechanism, will have additional opportunities to acquire those securities on the secondary market.



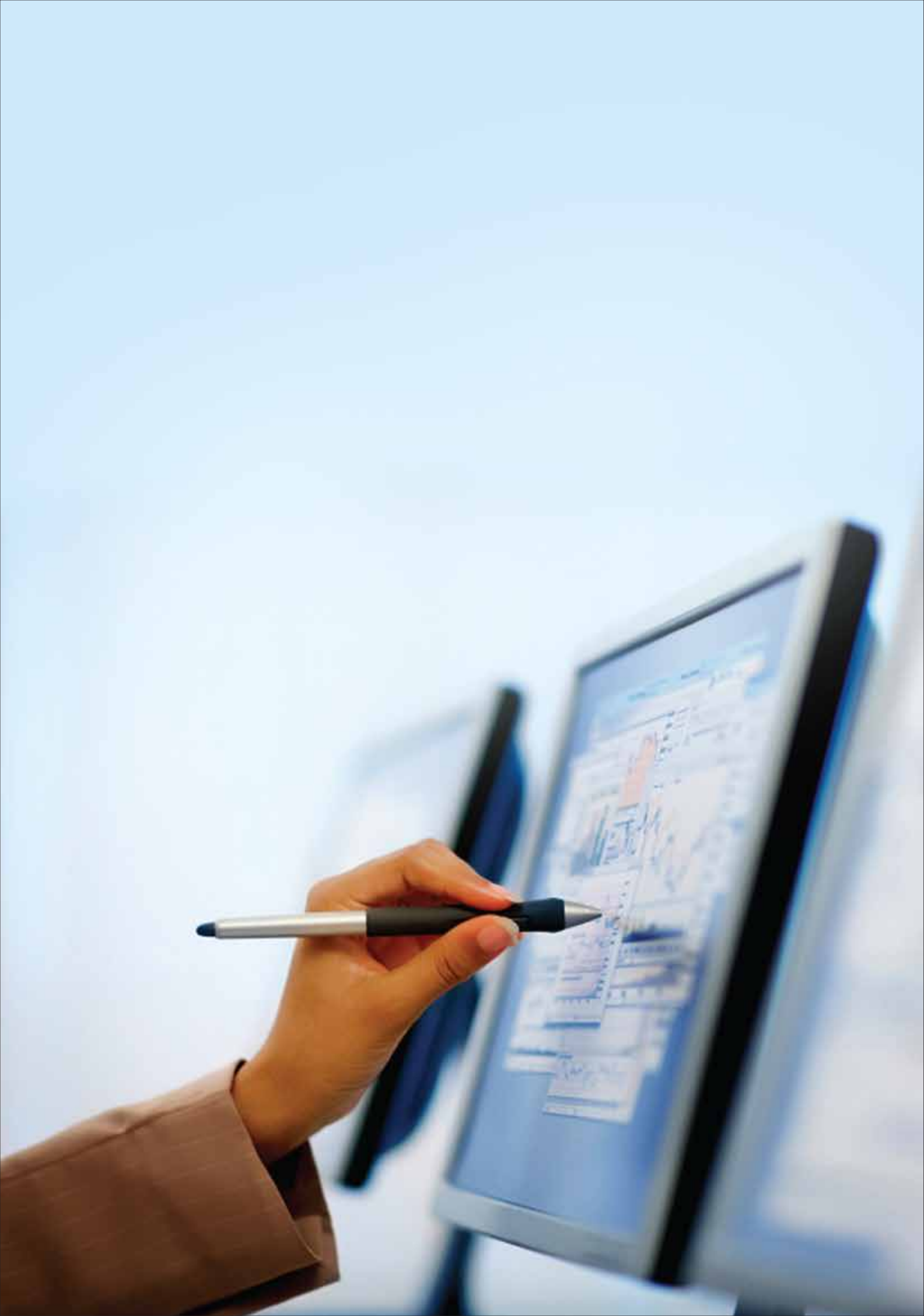
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What are Government Securities?

Government Debt Securities (GDS) are debt instruments issued by the Ministry of Finance, Government of Pakistan. The principal and interest payment are guaranteed by the Federal Government so GDS are considered to be very safe investments. Examples of Government Securities include Government Bonds, Treasury bills and Islamic Ijarah Sukuks.

Government Securities provide the central means of financing government deficits. The Government needs funds for spending on a host of activities from running the administrative machinery, including payment of civil servant salaries, maintenance of state assets, recurring expenses, defense to infrastructure development such as dams, power plants, roads, school, hospitals, ports, etc; as well as payment of interest on government debt. Taxation, duties and levies are the main sources of Government revenue. When tax revenue is less than expenditure, the Government borrows to fund the gap (deficit). Government Securities are thus primarily issued for financing part of government expenditure.

Why Invest in Government Securities?

Government Debt Securities provide an additional investment venue for savers/investors. Because the Government guarantees the principal and interest payments, GDS offer the most safe investment in terms of potential default risk. Furthermore, because the overall pool of Government Debt Securities is very large with over PKR 7.53 trillion outstanding and they are easily tradable, GDS are also considered to be one of the most liquid investments.

Individual saver/investor has the choice of investing in several financial asset classes, such as bank savings accounts and term/fixed deposit accounts, national savings schemes (NSS), equities, and term finance certificates (TFCs) issued by companies. In terms of the best combination of return and liquidity, Government Securities have a superior profile. They

typically offer higher return than bank deposits of similar tenure/maturity while being very liquid (i.e. easily sold & purchased). In contrast, while NSS and TFCs may be less liquid. Also, TFCs issued by private sector companies carry potential credit risk which GDS do not have.

Key benefits for Individual Investors

Easily bought and sold (tradable).

A wide range of maturities currently available (from 3 months to 10 years).

No market risk if held to maturity.

Typically provide higher return than bank deposits of equivalent tenure.

Useful as temporary parking venue between sale of one long term investment and purchase of another (e.g. House).

Can help in creating a more balanced risk & return, less volatile yet highly liquid investment portfolio rather than investing in equities only.

Can be held at the Central Depository Company (CDC) in IPS account, similar to Investor Account for equities.

Brokers do not have custody of investor's Government Debt Securities holdings nor do they have access to investor's funds as all payments and securities transfer are directly between investors and the CDC after trade execution at the Karachi Stock Exchange (KSE).

Simple Strategies for Investing in Government Debt Securities

For savers who do not have either the time, knowledge or inclination to assess investments, a simple approach would be to invest in a mutual fund that meets their requirements. For individuals wishing to invest in Government Securities themselves, there are various strategies they can follow when investing. Two examples of simple strategies are given below:

A Simple Passive Investment Strategy

I. Asset Dedication

If the saver knows that he or she will need a certain amount of funds at a certain time in the future for some specific purpose, the saver can dedicate a portion of existing and/or future savings towards that.

Suppose that today the cost of a two-year Masters Degree Programme is Rs. 300,000. Assume that you expect the cost of such a programme to rise to Rs. 800,000 – 900,000 in 10 years time when your daughter would have just graduated with a Bachelors Degree.

Suppose you receive a bonus (after tax) of Rs. 200,000 this year which you do not need to spend now. If you purchase (invest in) a Government bond with annual return of 13.75%, your Rs. 200,000 today in ten years' will give you a guaranteed amount of just over Rs. 875,000. Of course, your expectation that the fees would be Rs. 900,000 in ten years can be wrong. But even if you are partially right, your savings today will give you an assured sum in ten years which can go a long way in fulfilling your wish to send your child for a post-graduate or masters degree.



2. Creating your own 'principal-guaranteed' investment portfolio

You are mainly concerned that the principal amount of your investment remains intact but you would also like to take advantage of any good investment opportunity in the stock market.

Suppose at the beginning of the year you have Rs. 500,000 investable money available and the return on 1-year maturity Treasury-Bill is 9.75%. If you buy such a T-Bill you will have to pay approximately Rs. 455,000 on day one and you will receive Rs. 500,000 at the end of the year. So your principal amount is fully protected.

As you paid Rs. 455,000 for the one year T-Bill you are still left with Rs. 45,000 at the beginning of the year. You feel that you can get a total return of 25% (dividend plus capital gains) in one year from investing in shares. If your expectations prove to be correct, this Rs. 45,000 will become Rs. 56,250 by year-end. Thus, the value of your total investment portfolio in one year would be Rs. 556,250; a return of Rs. 56,250 on original investment of Rs. 500,000, or 11.25% (before taxes), which is significantly higher than pure one year fixed deposit. Even if your return on shares is not 25% or even zero, your principal investment is still fully protected because the investment in T-Bill will become Rs. 500,000 guaranteed.

Types of Government Securities

There are at present, three types of debt securities issued by the Government of Pakistan.

I – Treasury Bills (Short Term)

T-Bills are Government Debt Securities with a maturity/tenure of one year or less. T-Bills are typically issued through the State Bank of Pakistan (SBP) with maturities of 3, 6 and 12 months. It is important to note that T-Bills are discount securities. That is to say, they are issued at Below Face Value and reclaimed at Face Value with no intervening interest payment. The difference between the value at which T-Bills are issued and the face value at maturity is the return received by

the investor. For example, if a T-Bill is issued for 12-months (one- year) on January 1, 2014 at a price (value) of PKR 90.91 and the investor will receive PKR 100 on January 1, 2015 (i.e., after one year), the investors return is PKR 8.9 or approx. 10 %. T-Bills are issued in the minimum denomination of PKR 5,000. T-Bill auctions are held by the State Bank of Pakistan every fortnight. At present, outstanding T-Bills are approximately PKR 5.8 trillion or 77% of total outstanding Government Securities.

Maturity Period	Latest Cut-off	Weighted Average	Bids Face Value	Realized Amount	Face Value
	%	%	PKR mn	PKR mn	PKR mn
03 Months	9.9564	9.9215	636,180	617,090	631,180
06 Months	9.9791	9.9764	84,500	80,496	84,500
12 Months	9.9900	9.9873	18,000	16,370	18,000
Total			738,600	713,955	733,680

II – Pakistan Investment Bonds (Long Term)

PIBs are Government Securities issued for tenures/maturities of 3, 5, 7, 10, 15, 20 and 30 years. However, at present, the Government is issuing bonds with maturity of 3, 5 and 10 years only. PIBs are coupon bearing debt securities. That is to say they are issued at

par (face) value, pay interest bi-annually (every six months) and are redeemed at par (face) value. When held upto maturity from the time issued, the return to investors is the coupon payment received over the life of the PIBs. Current stock of outstanding PIBs is roughly PKR 1.3 trillion.

Maturity Period	Latest Cut-off	Weighted Average	Bids Face Value	Realized Amount	Face Value
	%	%	PKR mn	PKR mn	PKR mn
3 Years	12.0915	11.7610	82,730	81,117	81,695
5 Years	12.5501	12.2039	44,161	43,253	44,136
10 Years	12.8944	12.6075	64,906	60,304	62,011
20 Years	12.9000	12.9000	12,773	12,543	11,773
Total			204,570	197,218	199,615

III – Government of Pakistan Ijara Sukuk (Long Term Islamic)

Ijara Sukuks are similar to PIBs in term of their mode of issuance, return and maturity except that they also

comply with Shariah rules and thus are asset-backed too. At present however, Ijara Sukuks offered by the Government have a maturity of 3 years.

Maturity Period	Issue Date	Maturity Date	Current Coupon Rate	Outstanding Amount
			%	PKR mn
3 Years	07-Mar-11	07-Mar-14	9.020	47539.7
3 Years	16-May-11	16-May-14	9.464	45803.7
3 Years	26-Dec-11	26-Dec-14	9.979	70269.1
3 Years	02-Mar-12	02-Mar-15	8.989	38123.9
3 Years	30-Apr-12	30-Apr-15	9.460	29632.0
3 Years	28-Jun-12	28-Jun-15	9.979	48765.8
3 Years	18-Sep-12	18-Sep-15	9.050	47017.8
3 Years	28-Mar-13	28-Mar-16	9.150	43018.0
			Total	370170

Are there any Risks in Investing in Government Securities?

NO

YES

Investment always entails some kind of risk. Investment in fixed income (bonds) securities can entail such risks as loss of principal amount invested; risk of not receiving the interest income from the (bond) investment; the opportunity-cost of not investing (also called reinvestment risk); risk of loss of purchasing power due to inflation; risk of loss in value of investment due to adverse change in interest rates or credit rating; risk of not being able to in-cash when desired (liquidity risk).

However, investment in Government Securities has one of the lowest levels or negligible risks if the investment is held to maturity. For example, there is no risk of loss of principal and interest if held to maturity; there is usually no liquidity risk because of the large size and depth of the secondary market in Government Securities (especially T-Bills). For

T-Bills, the reinvestment risk is usually very low in normal conditions; and loss of purchasing power risks; (due to inflation) is relatively much lesser than in bank deposits.

At the same time, it should be noted that the value of all fixed income securities, including Government Securities vary inversely with interest rates. Thus if interest rates rise the value of the security will decline and if interest rates fall the value of the security will increase. While this is usually not a problem if the Government security is held up to its full-term/ maturity; it can become a problem if the government security is sold before maturity. This problem can occur especially for government securities of 5 and 10 years tenures. There are ways to mitigate / minimize such potential risks.

The Government Debt Market Structure and Major Players

Fixed Income Securities are divided into two major segments: Primary Market and Secondary Market. In Primary Market, only primary dealers can participate in the notified auction of the new issues of Government Securities.

However, in secondary market, securities are traded in an over-the-counter (OTC) market, which comprises of primary dealers, inter-bank dealers/brokers and other organizations.

Currently, government with the assistance of other

stakeholders is in the process of increasing the provision of the Government Securities through the Stock Exchange of the country. This would allow individuals to earn a higher return than other saving avenues are currently offering.

The Individual Investor & Government Securities

The Government, in order to encourage savings and provide a relatively safe and liquid investment vehicle for individual savers/investors, has encouraged secondary market trading of Government Securities on the Stock Exchange.

In this regard, the Karachi Stock Exchange (KSE) and the Central Depository Company Limited of Pakistan (CDC) have developed the necessary trading platform and clearing & settlement infrastructure to facilitate individual investors in investing in Government Securities through the Stock Exchange.

The trading of Government Securities is conducted on the Karachi Stock Exchange's Bond Automated Trading System (BATS) and market activity data and price are disseminated on real-time basis on KSE's website as well as to all participants of the Government debt securities market through the BATS terminal, making the secondary market more efficient.

Trading of Government Debt Securities through Stock Exchanges will provide retail investors with a more visible pricing benchmark for investments they may wish to make in Treasury Bills (T-Bills) and Pakistan Investment Bonds (PIBs); thereby reducing the risk of retail investor wealth being heavily affected by sharp movements in equity and property prices. Government Debt Market (GDM) will assist in mobilizing domestic savings for investment in infrastructure and corporate expansion, and so reduce Government's reliance on offshore markets for funding requirements. With the

advent of Government Securities trading through Stock Exchange, the Primary dealers/Scheduled banks should have access to yet another pool of liquidity; the issuer of Government Securities should have access to another class of intermediaries and investors; and over 250,000 retail investors of equity market should have easy access to another risk-free asset class.

Individual investors, who are already investing in equities or new entrants interested in the buying or selling of Government Securities are advised to open their IPS accounts with the Central Depository Company of Pakistan and also have an account open with a Stock Exchange Broker. The IPS account holder will intimate his/her KSE broker the IPS account number details, and will enter into an agreement with CDC and his broker (s) in order to commence trading of Government Securities through the Stock Exchange. CDC will provide opening balance position in terms of buying capacity (cash) and/or custody positions (holdings in IPS account) to KSE. The KSE and CDC devised operational framework for trading, clearing and settlement of Government Debt Securities transactions, will ensure that only transactions with good value, i.e. availability of funds/securities are entered into trading interface and RTGS for a transaction to be executed.

What is an IPS Account?

The IPS account is mandatory for investing in Government Securities which includes:

- Market Treasury Bills (T-Bills)
- Pakistan Investment Bonds (PIB)
- GOP Ijara Sukkuk (GIS)

Who can open an IPS Account?

The following are eligible to open IPS account with CDC:

Individual IPS Account

For opening an Individual IPS account, client has to fulfill following requirements / documents:

- a) IPS Account Opening Form (AOF) duly filled and signed by all the account holders. The title account holder and all joint account holders need to sign all pages of AOF. Any correction/overwriting on account opening form must be signed by all account holders. Use of correction fluid is not acceptable on AOF.
- b) Physical presence of all persons desiring to open an IPS account (Title / Joint holders) along with valid original CNICs/NICOPs/Passports is mandatory at the time of submission of account opening form (AOF). In case the IPS customer is fulfilling the following requirements then personal visit can be exempted:
 - Already maintaining an Investor Account with CDC and completed the KYC (Know Your Customer) requirement by visiting CDC office along with original CNIC / NICOP / Passport; and
 - Processed any Investor Account related transaction within the period of last one year excluding cash deposit.
- c) Ensure to provide all the necessary applicable documents as mentioned in Part-G of IPS Account Opening Form.

- d) Name of Account Holder(s) / Attorney / Authorized Signatory provided in AOF must be as per CNIC/NICOP/Passport.
- e) All account holders in an account must be of same residential status i.e. Resident Pakistani/Non-Resident Pakistani/Foreigner.
- f) Contact person in an account can only be any joint account holder or legally authorized attorney.
- g) Once IPS account is opened, any addition / deletion of joint holder is not allowed.
- h) Any person authorized by all the joint account holders can operate the account on their behalf. However, a power of attorney on non-judicial stamp paper of Rs. 200 duly signed on all pages by all the joint account holders and notarized along with a covering letter on the prescribed format will be required.
- i) Only one IPS account for a title account holder can be specified for settlement of trades executed through Stock Exchange.

Corporate IPS Account

- a) Original Account Opening Form (AOF) duly filled in, stamped and signed by the authorized signatories on all the pages of AOF.
- b) Ensure to provide all the necessary applicable documents as mentioned in Part-G of IPS Account Opening Form.
- c) True certification / attestation of documents pertaining to corporate entities must be done in the following manner:
 - In case of local companies by the company secretary or by two directors jointly.
 - In case of local trusts by two trustees jointly.
- d) Only one IPS account for a title account holder can be specified for settlement of trades executed through Stock Exchange.

Investment Procedure

The retail segment trading of Government Securities has three distinct areas which include; trading on the exchange, clearing and settlement of the trades, and safe custody at depository.

In order to invest and/or trade Government Securities, it is mandatory for an investor to open an IPS (Investor Portfolio Securities) Account with Central Depository Company (CDC); as the job of clearing & settlement of the Government Securities traded through Stock Exchange has been entrusted to CDC. Currently, Primary dealers/Scheduled banks hold Government Securities in IPS accounts on behalf of their customers. Please see Annexure A for detailed investment procedure in Fixed Income Securities.

Given below is the macro level view of investment procedure for investing in Government Debt Securities Market:

- (i) It is mandatory for the IPS account holder to execute a onetime Facilitation Agreement for a broker on the standard format prior to a trade at the Stock Exchange. In case of multiple brokers, multiple onetime Facilitation Agreement will be required.
- (ii) IPS account holder must ensure the availability of sufficient funds or securities in his/her IPS account with CDC a day prior to the trade date with stock broker.
- (iii) CDC will settle the transactions based on the trade feed received from the Stock Exchange subject to availability of funds or securities, as applicable, without obtaining any instructions from the IPS account holder. However, settlement through SBP Real Time Gross Settlement System (RTGS) will be subject to the initiation / confirmation of the transaction by the counterparty in RTGS.

Payment to CDC

- a) All payments to CDC are required to be paid via following modes:
 - Online / electronic fund transfer through the bank account of the title account holder of the IPS account.
 - Submission of physical instrument at the branch of the designated bank of CDC, such as, cheque / pay order / demand draft of the bank account of the title account holder of the IPS account.

Further, IPS account holder needs to immediately intimate the details of payment to CDC through the registered email address duly mentioning the Transaction ID for online / electronic transfer or cheque / pay order / demand draft number for physical instrument or duly signed physically request along with proof of payment.

- b) The payment to be made to CDC in the designated settlement bank account with UBL as per the details mentioned below:

Title of Account: Central Depository Company of Pakistan Limited

Account Number: 206325361

Bank Name: United Bank Ltd.,
Karachi Stock Exchange Branch

- c) No third party payment will be accepted and credit will be given to the respective IPS account with CDC upon realization of amount in CDC's designated settlement bank account.

Payment to IPS A/C Holder

- a) Payments will be made to IPS account holder in the following cases through online / electronic fund transfer:
- Sale Proceeds
 - Maturity of Coupons (in case of PIB & GOP Ijarah Sukuk)
 - Maturity of Securities
- b) All payments will be made to client's designated bank account directly. In case client is maintaining a bank account with UBL, the amount will be transferred online without the levy of any bank charges. In case client is maintaining bank account with any other bank, then the amount will be transferred electronically with the applicable levy of bank charges.

Payment of Interest

To compensate the IPS account holders for the condition of providing funds to CDC, one day prior to trade date, profit earned will be passed on to the IPS account holders for one day only. Distribution of profit will be on a quarterly basis and will be distributed for the amount exceeding Rs.100.

Note

1. Payment of maturity / profit will be made after deduction of withholding tax as per the prevailing rate. However, CDC will provide a copy of tax challan to the IPS account holders on their registered mailing address.
2. For tax exemption, certified true copy of valid tax exemption certificate will be required otherwise tax will be deducted as per the prevailing rate.
3. Funds available in an IPS account are not transferable to any other IPS account and can only be transferable to the bank account given by the IPS account holder as bank mandate on the written request of IPS account holder and subject to the applicable bank and CDC transaction charges.

Balance / Activity Confirmation

CDC will send the Account Balance Statements to IPS account holders on a monthly basis. IPS account holder will receive Account Activity Report on a quarterly basis, in case of any activity during the quarter.

Investment by Non-Resident Pakistani / Non-Resident Investors

Like local investors, foreign investors/NRPs can also invest in the Government Securities by opening an IPS with State Bank of Pakistan authorized custodian banks or CDC and a local brokerage house account. Foreign investors/NRPS are also required to open a Special Convertible Rupee Account (SCRA) with any designated authorized dealer bank in Pakistan. The

SCRA is opened by foreigners in Pakistani Rupee. The amounts are credited to these accounts after conversion of foreign currency into Pakistani Rupee, for the purpose of investment in Government Securities. Balances in these accounts can be sent abroad at any time outside the country after conversion into foreign currency.

GDS Trading : Process Flow

RETAIL INVESTOR PRE-REQ

Open an IPS account with CDC at least one day before, in order to trade Government Securities through Stock Exchange.

Open bank account with CDC designated banks at least one day before, in order to be able to trade Government Securities through Stock Exchange.

Authorize CDC to disclose his/her good value positions to KSE on daily/need basis.

Open an account with KSE eligible Members

CDC

CDC to send confirmed buying capacity and confirmed custody position to KSE on each end of day for those clients only which have executed a tripartite agreement.

CDC to also act as Clearing participant

KSE

Trades to match through RFQ only up to the extent of Buying Capacities and confirmed custody positions & transmission of trades



RETAIL SEGMENT TRADING OF GOVERNMENT SECURITIES THROUGH Stock Exchange HAS SOME PRE-REQUISTES AND CERTAIN ACTIONS ARE REQUIRED TO FOLLOW THROUGH A SEAMLESS TRADING, CLEARING AND SETTLEMENT CYCLE ON T+0 i.e. trading day.

Redemptions and Profit Payments

Treasury Bills

Redemption: Treasury Bills are only redeemable at maturity. However, any investor can sell Treasury Bills in secondary market through its broker/bank. If an investor holds the Treasury Bill till maturity, the PKR value equivalent to face value of the MTB will be credited to the account of the investor through its bank on the maturity of Treasury Bills.

paid in the form of coupon payments which are paid at a fix rate of face value of PIBs on semiannual basis. The Amount of Profit will be credited to the account of the investor through its bank on maturity PIB.

Redemption: Treasury Bills are only redeemable at maturity. However, any investor can sell PIBs in the secondary market before the maturity. If an investor holds the PIB till maturity, the PKR value equivalent to face value of the PIB will be credited to the account of the investor through its bank on the maturity of PIBs.

Pakistan Investment Bonds

Profit Payment: The profit on Investment in PIBs is

Maturity / Coupon Proceeds



← Receives Funds from SBP in CDC Current A/c

Transfer Funds from CDC Current A/c to CDC Normal Bank A/c

Any Commercial Bank

Transfer of proceeds to the Investor(s) Bank A/c

Shut period

Shut period means a duration as notified by Stock Exchange prior to the maturity of coupon or security during which no movements or transfers of Government Securities are allowed. During shut period clients' investment details are shared with SBP for their necessary processing of distribution of redemption or profit.

Tariff

KARACHI STOCK EXCHANGE:

- A onetime (nonrefundable) fee of PKR 25,000/= is to be paid by the SBP approved Primary Dealer, seeking to get Government Debt Market Terminal.
- An annual fee of PKR 25,000/= is to be paid by the SBP approved primary dealers.
- In order for this market to develop, the KSE Board has initially waived the transaction levy.

CDC CHARGES

Following is the tariff structure for maintenance, settlement and custody of Government Securities:

- IPS Account maintenance Fee
Rs. 750/- per annual

- Custody Fee of 0.15% per annum of the face value subject to ceiling of Rs. 150,000 per client per year
- Transaction Fee Rs. 100 per transaction (incoming and outgoing) including maturity proceeds and coupon payments

OTHER CHARGES

Following charges will also be borne by the IPS account holders:

- SBP charges on transfer of funds / purchase of securities.
- Any other bank charges, such as, any payment or collection charges/ duties / fees / taxes.



Receives Funds from
SBP in CDC Current A/c

Other
Custodian
Banks (OCD)

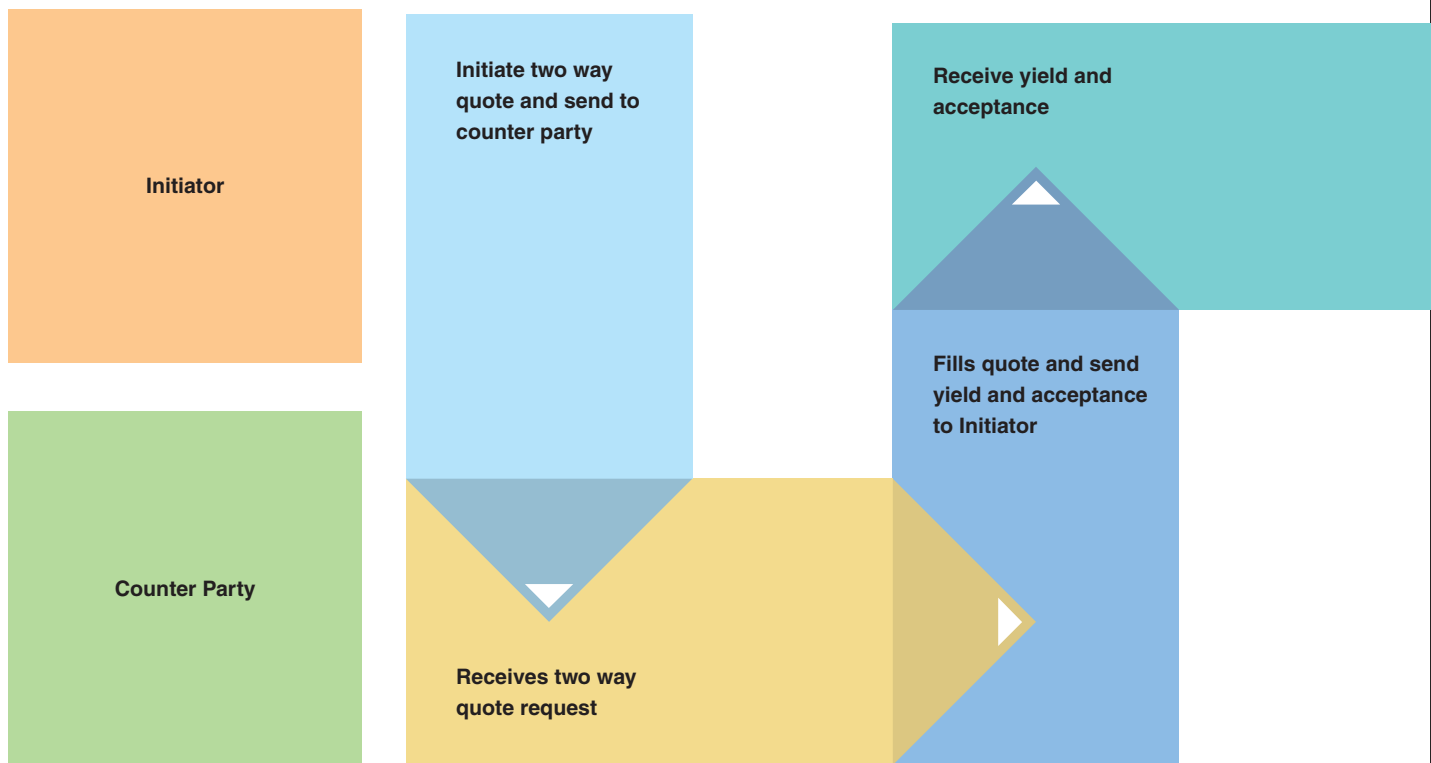
Transfer Funds from CDC
Current A/c to Investor(s) Bank A/c



Investor

GDS-RFQ Messaging System: Overview

In the RFQ, the initiator registers an interest to buy and/or sell a government security to a number of counter-parties. Any of these counter-parties may either accept or enter fresh quotes i.e. yield and value in million to buy or sell, when accepted, an interactive message of re-affirmation from both parties locks the deal.





KSE and CDC's ongoing Commitment to You

We are committed to supporting you at every step on the way and for this purpose, we have a team of experienced individuals to assist you with any queries that you may have. For any further information please contact:



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