BEFORE THE
COMPETITION COMMISSION OF PAKISTAN

IN THE MATTER OF PHASE II REVIEW OF

INTEGRATION OF KARACHI STOCK EXCHANGE LIMITED, LAHORE STOCK EXCHANGE LIMITED AND ISLAMABAD STOCK EXCHANGE LIMITED

CASE: 757/Merger-CCP/15

Date of Hearing	27 October, 2015
Commission	Ms. Vadiyya Khalil **Chairperson**
	Mr. Mueen Batlay **Member**
	Mr. Shahzad Ansar **Member**
	Mr. Ikram Ul Haque Qureshi **Member**
Representing KSE, LSE & ISE	Ms. Rahat Kaunain Hassan *Advocate*
	Mr. Syed Ahmed Hassan Shah *Advocate*
	Mr. Nadeem Naqvi *Managing Director, KSE*
	Mr. M Aftab *Managing Director, LSE*
	Mr. M. Ayyaz Afzal *Managing Director, ISE*
Securities and Exchange Commission of Pakistan	Ms. Musarat Jabeen *Executive Director*

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN * ISLAMABAD *

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad

ORDER

1. This order concludes the Phase II review of the pre-merger application (the '**Application**') jointly submitted by Karachi Stock Exchange Limited (KSE), Lahore Stock Exchange Limited (LSE) and Islamabad Stock Exchange Limited (ISE) under Section 11 of the Competition Act, 2010 (the '**Act**') to notify the Competition Commission of Pakistan (the 'Commission') of the proposed integration of the three stock exchanges to create one stock exchange ('**Pakistan Stock Exchange**' or '**PSE**').

2. The Application was submitted before the Commission on 06 October, 2015 and underwent a Phase I review which was concluded vide an order of the Commission dated 22 October, 2015 ('**Phase I Review Order**').

3. The Phase I Review Order determined that the proposed transaction met both the thresholds prescribed under Regulation 4 of the Competition (Merger Control) Regulations, 2007 (CMCR), and the presumption of dominance prescribed under Section 2(1) (e) of the Act.

4. The Order also outlined other competition concerns anticipated by the Commission with respect to the schemes of integration ('**Schemes**'). These were as follows:

   a. the potential impact on listing of companies: a primary competition concern was held to be the reduction in choice available to companies at the time of listing, and further the risk of abuse of market power along with stringent listing requirements which could amount to entry barriers;

   b. the potential impact on brokers: another major concern was the likely impact of the transaction on Trading Right Entitlement Certificate (TREC) holders of LSE and ISE, and the potential bifurcation of brokers into different classes;

   c. the potential impact on future exchanges: the Commission was concerned that in the absence of clear regulatory rules and regulations, the integrated exchange will make the creation of a new exchange extremely difficult if not impossible;

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN * ISLAMABAD *

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

d. the potential impact on other exchanges: the Commission was concerned that after integration, the post-merger entity may be able to influence the working of the Central Depository Company (CDC) or the National Clearing Company of Pakistan Limited (NCCPL).

5. A hearing was therefore held for the Phase II review on 27 October, 2015. During the course of the hearing, further queries in addition to the concerns raised in the First Phase Review Order were also posed by the bench.

NOTIFYING PARTIES

6. **KSE:** Initially incorporated under the Companies Act, 1913 in 1949 as a company limited by guarantee, KSE was re-registered as a public limited company under Companies Ordinance, 1984 ('Companies Ordinance') in 2012. KSE is licensed to operate as a stock exchange under the Securities Act 2015 ('**Securities Act'**), and is an undertaking in terms of Section 2(1) (q) of the Act.

LSE: Incorporated under the Companies Ordinance in 1970 as a company limited by guarantee, LSE was re-registered as a public limited company in 2012. LSE is licensed to operate as a stock exchange under the Securities Act, and is an undertaking in terms of Section 2(1) (q) of the Act.

ISE: ISE was incorporated under the Companies Ordinance in 1989 and became operational in 1992. It was also re-registered as a public limited company in 2012. ISE is licensed to operate as a stock exchange under the Securities Act, and is an undertaking in terms of Section 2(1) (q) of the Act.

7. Their objects include *inter alia* to 'assist, regulate or control the business of buying, selling and dealing in securities and to maintain or provide a market place or facilities for bringing together buyers and sellers of securities'.[1] They are further authorized to 'form

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN ISLAMABAD

[1] According to the Memoranda of Association of KSE, LSE and ISE.

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

and operate one or more markets, including but not limited to cash market and derivatives market based on equity, debt and money market instruments'.[2]

TRANSACTION

8. To understand the proposed transaction, it is pertinent to first briefly discuss the legal and economic foundation upon which it is based. As part of the demutualization process which began in 2012 under the Stock Exchanges (Corporatization, Demutualization and Integration) Act, 2012 (the '**Demutualization Act**'), the stock exchanges were required to enter into agreements with strategic investors for sale of up to forty percent (40%) of their respective shares to be held in a blocked account until divestment, and further to sell not less than twenty percent (20%) of their shares to the public, and to sell to local financial institutions any remaining shares. The exchanges were given until 25 August, 2015 to carry out this process, which deadline was extended by six (06) months at the request of the exchanges In pursuance of options for divestment to a strategic investor, the parties became engaged in plans for integration.

9. A memorandum of understanding ('MOU') was signed on 25 August, 2015 by the parties, expressing their intention to proceed with integration. Securities and Exchange Commission of Pakistan (SECP) also agreed to facilitate the process of integration in terms of the Demutualization Act.

10. An outline of the process for potential integration was first provided in the Demutualization Act. In pursuance thereof, the application put forward proposes that the stock exchange businesses of LSE and ISE (collectively referred to as the '**Transferring Parties**') be transferred to and vest in KSE upon the approval of their respective schemes.

11. The Application provides that no change in shareholding will take place in any of the exchanges as a consequence thereof. Furthermore, there is no proposed cash or value consideration. The value of the trading volume that will shift following the transaction is 0.18% of the total value of trade on all exchanges (as per the supporting data provided for the last financial year 2014-2015).

[2] Ibid.

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN * ISLAMABAD *

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

12. All properties, accounts and other assets of the Transferring Parties will remain vested in them. However it has been submitted that purchase of assets and hiring of employees of ISE and/or LSE may take place on commercial terms as agreed between the parties, in accordance with the scheme of integration.

13. All companies and securities listed on either ISE or LSE will be deemed listed on KSE without any further requirements subject to the approval of the schemes by SECP and the effective date specified therein the exchange licenses of LSE and ISE will lapse upon completion of the merger and they will be entitled to operate as non-banking finance companies.

14. Finally, all existing registered TREC holders of the Transferring Parties (197 altogether), in terms of the schemes shall become TREC holders of PSE.

SUBMISSIONS

15. The main submissions made by the applicants during the course of the hearing are as follows:

Potential impact on companies:

a. That one integrated exchange will lead to a reduction in the listing costs of companies;

b. That based on the average of the last three (03) years, one hundred percent (100%) of the trading volume as well as value is concentrated in the securities listed either on all three (03) bourses, or securities listed on the KSE concurrently to either LSE or ISE and there is no potential adverse impact;

c. That regulatory safeguards implemented by SECP ensure that no charges or fees are introduced arbitrarily, and that it remains present to review and regulate any decisions taken by the exchange to ensure fairness and prevent any abuse of dominance;

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN * ISLAMABAD *

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

d. That the integrated exchange will also introduce a number of measures aimed at encouraging small companies to list on the integrated exchange, including a dedicated counter for small and medium enterprises and waived listing fees for a year;

e. That the listing fees of small and medium enterprises have decreased over time, while those of larger companies have increased;

Potential impact on brokers:

f. That the Schemes expressly require brokers of LSE and ISE to be treated at par with brokers of KSE;

g. That the TREC holders of all exchanges will have their TRECs converted into TRECs of the integrated exchange without incurring any additional cost;

h. That the requirement of base minimum capital (BMC) exists to ensure risk management and investor protection, and cannot be considered an entry barrier;

i. That Section 16 of the Demutualization Act requires the issuance of fifteen (15) TRECS per annum until 2019;

j. That a bifurcation in the classes of TREC Holders already exists under the current scenario, but also that the Demutualization Act stipulates that brokers cannot hold more than forty percent (40%) of the total paid up capital of the integrated exchange;

k. That already there are 25-30 non shareholder TREC holders at the KSE;

l. That the deadline for divestment has been extended but the requirement that the investor be international has been waived;

m. That six (6) of the directors on the board of PSE are to be independent and nominated by SECP;

n. That the reform agenda of SECP for PSE remains to be shared, wherein committees are to be formed under the board and management to be segregated;

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN * ISLAMABAD *

Attested To Be True Copy

Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

Potential impact on other investments:

o. That the Schemes do not envisage any change in shareholdings or compulsory divestment or reduction in shareholdings of any party in the CDC or the NCCPL ;

Potential ramifications for future exchanges:

p. That the Securities Act provides a comprehensive licensing framework under which future exchanges may be created, and that secondary legislation regarding the same shall be finalized and enacted by December 2015;

16. In view of the submissions, read along with the Application and the strategic and economic rationale provided in Annex K to the Application, briefly it was argued and reiterated that the proposed Schemes will enable optimal utilization of available resources; rationalization of overlapping facilities, infrastructure and regulatory mechanism; improve overall competitiveness of the business at the national as well as regional level; improve governance standards, increase efficiency and encourage true competition in terms of best price discovery and order execution; and help the Acquiring Party or the Successor Exchange to better face the current and future challenges and opportunities. It was also emphasized during the hearing/presentation given that in effect there shall be no substantial lessening of competition as a result of the merger/integration and that the positive and pro-competition outcomes outweigh competition concerns, if any.

ANALYSIS

MARKET DEFINITION

17. The relevant product market has been defined in Paragraph 10 of the Phase I Review Order as the '*trading platform for the sale, purchase and exchange of listed securities*'. Under consideration in this order therefore, are the financial markets where securities are bought, sold and exchanged. A total of 1219 companies are registered on the three exchanges, with a total market capitalization of Rs. 20,594,100.82 million as of June 2015.

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

18. The exchanges currently operating in this market cater to companies across the country and compete nationally. There are no territorial restrictions with regards to such trade. Furthermore, technological developments such as the creation of online trading mechanisms have further removed any geographical barriers to trading. KSE operates an online trading platform known as the Karachi Internet Trading System (KITS) which enables real time stock trading to investors. LSE and ISE jointly operate a Unified Trading System (UTS) to the same effect. The relevant geographical market has therefore been defined as the whole of Pakistan.

19. The market players in the defined market consist of the notifying parties, i.e. KSE, LSE and ISE, all of which operate as a platforms for the sale, purchase and exchange of various instruments, including but not limited to shares, scripts, stocks, bonds, debentures, government papers, certificates and similar.

20. All three exchanges are also self regulatory organizations , and have as part of their objects the power to make and enforce rules and regulations relating to:

i. the manner in which, and the conditions subject to which, any business or activity will be conducted;

ii. conduct of TREC holders, sub-brokers, agents, investors, issuers, listed entities, and/or other intermediaries and participants in the securities and capital markets;

iii. the classes of shares with voting rights and non-voting rights, and the rights, privileges, limitations and conditions on voting rights;

iv. code of conduct and business ethics of shareholders;

v. qualifications for TREC holders as well as financial responsibilities whether by way of base minimum capital or a ratio between net capital or aggregate indebtedness;

vi. listing and delisting of securities, both debt based and equity based and the procedures for registration of issuers and the formalities to be fulfilled in connection therewith;

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN * ISLAMABAD *
Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

21. The table below provide a brief overview of the current share of turnover and value of trading held by the parties:

	Description	Financial Years.	Turnover (in millions)	Turnover %	Value (in millions)	Value %
1.	**KSE**	2012-13	54,319.00	98.17	1,421,236.15	99.05
		2013-14	56,581.00	99.05	2,156,209.15	99.60
		2014-15	57,204.00	99.39	2,731,205.29	99.82
2.	**LSE**	2012-13	977.38	01.77	13213.89	00.92
		2013-14	497.99	00.87	7,364.28	00.30
		2014-15	325.25	00.57	4,281.01	00.16
3.	**ISE**	2012-13	33.56	00.06	463.2	00.00
		2013-14	46.24	00.08	926.87	00.00
		2014-15	25.89	00.04	626.59	00.02

Figure 1.2

22. The Pakistan Mercantile Exchange (PMEX) is noticeably absent from this discussion as it is a platform for the sale and exchange of commodities futures, and will thus not be considered a market participant. It was formed in 2002 and formally became operational in May 2007. Its object is to be a leading mercantile exchange in the Asian region.

23. As the oldest exchange located in the commercial hub of the country, KSE has historically been the dominant player in the relevant market. The data provided in Figure 1.1 illustrates how this continues to remain the case, both in terms of share of trading volume as well as share of turnover. According to figures available for the last financial year, KSE held 99.82% of the market share by trading value, while LSE and ISE held 0.16% and 0.02% respectively. Following the transaction, PSE will be the sole dominant undertaking holding 100% of the market share. To be determined in this order is if and how such strengthening may substantially lessen competition.

24. An integral subset of this market is the broker to broker interaction, which is carried out by TREC holders. According to figures available for the last financial year, broker to

SEAL OF COMPETITION COMMISSION OF PAKISTAN * ISLAMABAD *
Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

broker transactions worth Rs. 265,363 million were carried out between LSE and KSE, while transactions worth Rs. 99,998.76 million were carried out from ISE to KSE. The proposed transaction thus also contains elements of vertical integration, the potential impact of which was one of the major concerns raised by the Commission during the Phase I review.

COMPETITIVE ASSESSMENT

25. In assessing the competitive effects of a merger, the Commission takes into consideration a variety of legal and economic factors. The assessment compares the competitive conditions that are reasonably expected to result from the proposed transaction with the conditions that would have prevailed without it[3], while also taking into account future changes to the market that can reasonably be predicted.

26. The substantive test provided under Section 11 (8) of the Act provides as follows:

> *On initiation of the second phase review the Commission shall, within ninety days of receipt of the requested information under sub-section (6), review the merger to assess whether it substantially lessens competition by creating or strengthening a dominant position in the relevant market, and shall give its decision on the proposed transaction [...]*

For purposes of clarity, it is relevant also to provide the definition of dominant position as given in Section 2(1) (e) of the Act:

> *"dominant position" of one undertaking or several undertakings in a relevant market shall be deemed to exist if such undertaking or undertakings have the ability to behave to an appreciable extent independently of competitors, customers, consumers and suppliers and the position of an undertaking shall be presumed to be dominant if its share of the relevant market exceeds forty percent;*

---

[3] The current competitive conditions existing in the relevant market will therefore constitute the relevant comparison for evaluating the effects of the merger.

Attested to be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

27. The assessment regarding the strengthening of a dominant position has already been made in the Phase I Review Order. It was stated that KSE held the dominant position in the relevant market with 99.05% market share, which will be increased to 100% in the post-merger scenario.

28. The factors taken into consideration to determine whether the proposed merger will substantially lessen competition by said strengthening will include consideration of two distinct theories of harm. The proposed transaction is a horizontal merger, with both unilateral horizontal effects expected to emanate from it, as well as an aspect of vertical integration related to the potential effects of the transaction on brokers. Countervailing factors will also be considered before a final assessment of the merger is made.

I. Substantial lessening of competition

Vertical Effects

29. The predominant apprehension with vertical mergers is the risk of 'foreclosure' in a market. Internationally, different jurisdictions hold widely varying views with regards to the harmful effects of vertical mergers especially with reference to inefficiencies that result from market control.

30. The unique nature of the proposed transaction would see TREC holders from the Transferring Parties gain the same rights as current TREC holders of KSE. At the same time, current TREC holders of LSE and ISE will find their original trading platforms foreclosed. Where previously a new broker had three (03) markets to choose from, there will only be one in the post-merger scenario.

31. Another apprehension in this regard is the potential for bifurcation of PSE TREC holders into two different classes, i.e. TREC holders of KSE and TREC holders of the Transferring Parties. Since the Schemes do not include a change in shareholding, the current situation has forty percent (40%) of KSE shares held by existing brokers. A further forty percent (40%) of shares are required to be issued to a strategic investor. In the absence of such investment, by virtue of their shareholding the dominance or control directly/indirectly remains with the brokers of KSE. The risk for abuse thus becomes

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN * ISLAMABAD * imminent, as TREC holders who are shareholders of KSE will be in a position to influence company policy by being dominant on the board against non-shareholder TREC holders.

32. The Schemes envisage a seamless transfer, with no new regulatory requirements of registration, additional costs or fees. The parties have contended that various safeguard mechanisms are already in place to guard against any risk of abuse by shareholding TREC holders of KSE. The following defences have been provided to counter the concerns raised by the Commission during the Phase I Review. These defences help in addressing some of the competition concerns.

a. SECP remains present as a vigilant sector regulator: important assurances are being provided by SECP in this regard including a reform agenda to be shared shortly in the future which will provide for the commercial and regulatory sections of the management of PSE to be segregated. The board of the integrated exchange is also proposed to include six (6) directors to be nominated/approved by SECP. Even otherwise, regulatory safeguard exists as no market-related fee or changes can be introduced unilaterally.

b. Encouraging trend towards non-shareholding TREC holders: the parties submitted that twenty-five to thirty (25-30) out of a total of one hundred and ninety-four TREC (194) holders at KSE are currently not shareholders, and that the trend is expected to continue.

c. BMC requirements are related to ensuring the financial reliability of brokers: presently brokers are registered under the Brokers and Agents Registration Rules, 2001 devised by SECP. The draft Securities Brokers Regulations, 2015 ('Brokers Regulations') are currently under review and will be the governing legislation regarding the eligibility criteria of brokers.

d. The required divestment to a strategic investor is expected to be expedited post-integration. Assurances have been provided to the Commission by KSE with regards to the accelerated pursuit of investors.

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

33. Another concern in the downstream market is the impact of the transaction on CDC and NCCPL. With the exchanges being integrated, further concentration in shareholding of the two could reasonably be expected in the future. The table below shows the current shareholding pattern of the depository and settlement companies.

Exchange	Shareholding in CDC (%)	Shareholding in NCCPL (%)
KSE	39.81	47.06
LSE	10	23.53
ISE	2.5	11.47
Total	**52.31**	**82.06**

Figure 1.2

34. Had the merger followed a traditional pattern, the acquisition of shares of LSE and ISE by KSE would automatically have resulted in PSE becoming the major shareholder in both CDC and NCCPL. However, since the proposed transaction does not at this point envisage such acquisition, it is premature at this stage to predict how such integration would affect the market as whole. A relevant discussion at this point however is whether future integration could possibly become a barrier to entry for new entrants in the market. This point is considered in detail in the section titled '*Entry*'.

Unilateral Horizontal Effects

35. The first element to be considered here is whether the creation of PSE will result in the elimination of important competitive forces from the market. At the very outset, it appears that following the merger, the role of LSE and ISE as competitors will be eliminated. Where previously companies had three exchanges to choose from, there will only be one post-integration. While the elimination of a competitor's position in a market is in itself an important consideration, an analysis of the overall situation may help in a final determination of the matter.

36. With regards to the current situation, it is apparent that KSE holds a distinctly dominant position. This dominance is demonstrated in multiple ways: KSE holds more than 99% of the current market share by trading value and trading volume. Similarly, KSE carries the

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN * ISLAMABAD *

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

largest amount of listed companies, i.e. 560 whereas LSE and ISE have 433 and 217 respectively. KSE also has the largest market capitalization, and is able to offer more products than either of the Transferring Parties.

37. Since their creation, neither LSE nor ISE have been able to attract any significant portion of the total trading volume. Neither have the Transferring Parties managed to compete by offering different and/or specialized products and services. This is not to say that the existence of competitors has been entirely without benefit to the market. Technical innovation in the form of automated trading and the provision of remote access terminals was first initiated by LSE. Similarly, LSE also took other measures to attract listings through lowering of listing fees and after-hours trading.[4] Such measures have however been too few to be considered of significant competitive value.

38. A possible scenario to be considered could be if only LSE and ISE were to merge. To be noted is the fact that LSE & ISE are already integrated through the UTS jointly operated by them, which has so far not posed any competitive threat to KSE. Furthermore, unless the exchanges specialized in a different market segment, based on the historical pattern, competition with KSE in the regular market would remain difficult.

39. A useful comparison to be drawn at this point is of a 'without merger' scenario with the predicted post-merger scenario. Assuming that either or both LSE and ISE were able to find the investors to fulfill the legal shareholding requirements, the exchanges might had the chance to improve their efficiencies and compete more vigorously with KSE.

40. Keeping in view however the fact that the original deadline set for this process has already lapsed once, it is likely that the Transferring Parties might be at risk of winding up in case of failure to meet the requirements set. The consistently decreasing share of trading of both the Transferring Parties,[5] also suggests that the two bourses could reasonably be expected to eventually have wound up naturally, barring any unforeseeable or extraordinary circumstances.

[4] According to the Report of the Expert Committee on Demutualization, and Integration/Transformation.
[5] As shown over a review of the last three years in Figure 1.1

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

41. We are therefore of the opinion the proposed transaction will not result in the elimination of an important or effective competitor from the market.

42. The second major concern in the case of horizontal mergers is the threat of abuse of market power. The potential for increased prices and reduced quality of services as well as removal of impetus for innovation here become relevant considerations. In the case of the proposed transaction, our first concern is the potential effect on companies currently listed on LSE and ISE, as well as companies that may list on PSE in the future. Under the Schemes, the companies listed on the Transferring Parties will be deemed listed on PSE upon its creation, without any additional cost or regulatory requirements. In any case, it must be emphasized that there was no trading on the companies singly listed on ISE or LSE. So in any case the efficiency and listing cost and affiliated cost of compliance with listing regulations shall also decrease.

43. With regards to new companies, SECP remains responsible to ensure listing fees are not set arbitrarily and to review any instances of unfair refusal to list a company. The reduction in choice of listings available must be countered by strong efficiencies which are discussed further under the head of '*Efficiencies*' below.

II. COUNTERVAILING FACTORS

ENTRY

44. One of the most important considerations in a determination under a Phase II Review is if and how entry to the relevant market by a new entrant will be affected by the merger.

45. Under the current legal framework, there is no bar on another exchange entering the market. The licensing framework for such entrant is provided under the Securities Act. SECP has further submitted that all subsidiary legislation regarding the same shall be finalized and enacted by December 2015. Since financial markets are internationally a highly regulated industry, the existence of prerequisites for entry set by the industry regulator cannot be considered an extraordinary barrier to entry, especially since PSE will also be licensed as a stock exchange under the same standards.

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN * ISLAMABAD *

46. PSE, as a dominant undertaking in the market will not be able to create any legal hurdles for a new entrant, either in the same segment or even in other specialized areas of financing.

47. However, if at any time in the post-merger scenario, the Commission finds it to be engaging in abuse of its position, it has the power to penalize the undertaking and rectify such a situation under the provisions of Section 3 of the Act.

48. With regards to ease of entry for new brokers, it is pertinent to mention that a criterion for the registration of TREC holders has been provided by SECP in the Brokers Regulations. BMC requirements are expected to be assessed and decided by SECP to ensure that all TREC holders of PSE are treated in the same manner. Guidelines to this effect are expected to be circulated by SECP by December 2015. If the new requirements are significantly increased and hence burdensome, as compared to the existing requirements, an unintended effect may be the creation of a barrier to entry or a barrier to continuing in business. Hence, it is essential that proper care be taken, and international best practices be followed to ensure that this barrier to entry or barrier to continuing in business is not created.

49. Subject to necessary approvals, in the situation that CDC and NCCPL are acquired by PSE, another hurdle may be created for a new exchange if there are no other clearing houses operating in the market at that point in time. However, SECP may intervene in such scenario, barring which the Commission is also available to reassess discriminatory behavior by PSE.

50. Finally, the example set by this merger may itself also act as a deterrent to future potential entrants. The existence of PMEX however indicates that a market for specialized instruments already exists, and is available for diversification.

EFFICIENCIES

51. Where the parties involved can demonstrate that the increased efficiencies are directly beneficial to the stakeholders, are causally connected to the intended transaction, and may be expected to take effect without major delay, the Commission may conclude that the

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN * ISLAMABAD *

Attested To Be True Copy

Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad

increased efficiencies outweigh the feared anti-competitive effects of the proposed merger.

52. We will now therefore consider the predicted benefits of the intended merger. Clause 4 of the Schemes provides an outline of the integration-specific efficiencies which are expected to be achieved. Further claims were also made by the Parties during the course of the hearing held. In light of the submissions made, as well as the prevalent market conditions, the Commission is of the view that the following efficiencies can reasonably be expected to be achieved:

a. Benefits to relevant market:

53. The proposed integration will enable a decisive unification of trading and listing services across the country. This can be expected to reduce fragmentation of the domestic capital market and enhance liquidity[6] of the merged entity, which will also eliminate inter-exchange arbitrage.

54. Perhaps the greatest intangible asset attached to the Transferring Parties is that of the value attached to their geographical locations. Since the raison d'etre of both LSE and ISE can be traced in part to a desire to provide capital markets which would cater to the industries of Punjab and the north and north-western regions of Pakistan, a 'home bias' currently in place can now be expected to be eliminated. Investors currently reluctant to invest outside their geographic regions will be facilitated in trading beyond territorial boundaries. More companies will thus be encouraged to list publicly, thereby having a positive impact on volume through increased trading.

---

[6] *'There are several reasons why firms may gain in terms of stock liquidity following a stock exchange merger. First, the market may become broader, in the sense that there are more market participants trading in listed firms. In other words, each individual firm faces a bigger pool of potential investors. Second, the market may deepen, meaning that larger quantities are available at a price marginally above and below the prevailing market price. This makes the market more liquid in the sense that large, individual trades are less likely to drive price movements. Third, there are various cost channels through which liquidity may increase after stock exchange merger. These include lower information and indirect (non-monetary) transactions costs, such as ease of transaction due to unification of trading and clearing systems. A stock exchange merger may also lower direct transactions costs'.*
Nielsson, Ulf, Stock Exchange Merger and Liquidity: The Case of Euronext. Journal of Financial Markets, Vol. 12, No. 2, 2009. Available at SSRN: http://ssrn.com/abstract=1427430

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN * ISLAMABAD *

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

55. Foreign investment is also expected to be encouraged through the creation of a single integrated exchange, and the harmonized regulatory framework that it will engender. An integrated stock exchange may be seen as progressive and in line with international trends.

56. The parties, during the course of the hearing also submitted that a counter for small and medium enterprises (SMEs) set up will be activated soon under the integrated exchange. This is especially beneficial to companies being transferred from LSE and ISE as a substantial share of listed companies on these exchanges was comprised of SMEs. Listing fees for the same would be waived for a year.

57. Clients of brokers at ISE and LSE who under the pre-merger scenario were trading through brokers at KSE will be ensured proper custody of their securities and execution of their trades, and further be granted full legal recourse in case of mismanagement.

58. An integrated exchange will have full access to information pertaining to all market segments and intermediaries and would thus be better placed to carry out integrated surveillance and risk management.

59. Finally, one exchange will allow SECP to focus its regulatory resources thus enhancing the effectiveness and quality of supervision.

b. Benefits to brokers:

60. Brokers from across the country will be afforded access to a nation-wide securities market, with a much larger pool of liquidity and opportunity for efficient price discovery. Uniform access to a single trading platform will allow them to save on both hardware and software costs, as it eliminates the duplication of costly infrastructure. This requirement was previously articulated by the Commission in its Order in the Matter of M/s Karachi Stock Exchange (Guarantee) Limited[7].

[7] Available at cc.gov.pk: Re order dated 29-05-2009 (F. No. 12/ISE/Sec.3/CCP/2007)

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN * ISLAMABAD *

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

61. Brokers from the Transferring Parties will benefit from all market products, services and facilities available currently to KSE TREC holders only. These include derivatives, government securities trading, the SME market segment as well as the recently launched KITS trading platform. Large TREC holders will be able to rationalize their trading policies and back-office functions, possibly including restructuring of their resources resulting in reduced costs.

c. Benefits to investors:

62. In the post-integration scenario, the existence of one exchange will reduce the listing fees for companies, as well as other administrative costs. Savings made by brokers can be expected to be passed on to investors, who will no longer have to account for extra-brokerage costs related to internal operating costs, costs of access to another trading platform and of maintaining a continuous market presence. The costs of adverse-selection and inventory holding costs will also be reduced, which efficiencies can be expected to be passed on to investors.

63. A broader national market will further allow companies to hold diversified portfolios.

64. PSE will also operate branch offices at the existing premises of the Transferring Parties for a specified time period for ease of access.

APPROVAL AND CONDITIONS

65. In view of the analysis above, we are of the considered opinion that the proposed transaction does not substantially lessen competition in the relevant market. Furthermore the efficiencies to be gained by the proposed transaction far outweigh the possible anti-competitive effects which may result from the elimination of competitors in the market. It is pertinent to mention that the availability of *ex-post facto* remedies is also an influential factor in the Commission's determination. Nevertheless, some competition concerns remain to be addressed.

66. The Commission is, therefore, approving the integration subject to the following conditions:

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

SEAL OF THE COMPETITION COMMISSION PAKISTAN * ISLAMABAD *

i. Upon integration, PSE must expedite its search for a strategic investor or financial institution for the divestment of forty percent (40%) of shares currently in the blocked account. The same must be carried out by PSE in terms of the provisions of the Demutualization Act within a period of one year from the date of integration, failing which SECP must review the structure of PSE and require divestment and/or appropriate changes *inter alia* to protect the interests of non-member brokers and to ensure that main objective of integration is duly served. The sale of twenty percent (20%) of the shares of the integrated exchange to the public must also be carried out within the timelines specified.

ii. PSE shall establish the proposed SME counter within one year, with a view to facilitating the listing of SMEs on reasonable terms and conditions.

iii. More than fifty-percent of the directors on the board of PSE shall be independent and shall be nominated/approved by SECP until the divestment is made to the strategic investor.

RECOMMENDATIONS

67. Finally, to safeguard competition in the post-merger scenario, it is crucial for SECP to exercise the utmost vigilance as the sector regulator. The following recommendations are being made to suggest measures that SECP should take in the post-merger scenario:

i. Irrespective of the shareholding of PSE in CDC and NCCPL, SECP should ensure that any new exchanges entering the market are provided due access to the clearing and settlement functions (commercial terms and conditions), unless new depositories and clearing houses are established.

ii. SECP should facilitate the entry of new exchanges to the market as and when may be deemed appropriate. It should further ensure that no artificial or behavioral barriers are faced by new entrants.

iii. With respect to the new financial requirements being specified in the Brokers Regulations, it is essential for SECP ensure that they are not burdensome, in order

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN * ISLAMABAD *

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.

to prevent any entry barriers. At the same time, investor protection must also be ensured and the new requirements should be in line with international best practices.

68. Order accordingly.

(Ms. Vadiyya Khalil)	(Mr. Mueen Batlay)	(Dr.Shahzad Ansar)	(Mr. Ikram Ul Haque Qureshi)
Chairperson	***Member***	***Member***	***Member***

SEAL OF THE COMPETITION COMMISSION OF PAKISTAN

ISLAMABAD, 27 November, 2015

Attested To Be True Copy
Syed Umair Javed
Registrar
Competition Commission of Pakistan
Government of Pakistan
Islamabad.