

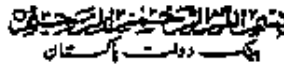


**FINANCIAL MARKET
ASSOCIATION
OF PAKISTAN**

Code of Conduct

APPROVED BY
State Bank of Pakistan

(50007)



STATE BANK OF PAKISTAN

TELEGRAMS
BANKRATE

CENTRAL DIRECTORATE
F1 CHUNDRIGAR ROAD
Post Box No. 4456, KARACHI
174000

FOREIGN EXCHANGE
DEPARTMENT

No. 2701/FRP.16(326)N-99

April 19, 1999.

The Executive Committee
Financial Market Association of Pakistan
C/O Country Treasury, NBP,
1st Floor, NBP H.O Building,
I.I. Chundrigar Road,
Karachi.

Dear Sirs

**Sub: Code of Conduct for the treasuries of Commercial/investment banks,
Brokers etc.**

With the rapidly changing foreign exchange market, there is a need to have a CODE OF CONDUCT to ensure prudent handling of foreign exchange business by the banks.

We have condensed the base document of ACI (Association of Composite International) which is a global association of foreign exchange dealers and FMA, Pakistan is also associated to them.

Some additions and modifications have been made in this CODE OF CONDUCT with the permission of ACI. The enclosed code includes a few international derivative products, which, although, are not available presently in Pakistan but may be introduced in future as the market is expected to grow and develop with time.

Appended to the CODE OF CONDUCT are given some warnings and pieces of practical advice so that the market activities could be made transparent and any malpractice on part of any treasury could be known to the Central bank as well as to the other market participants in advance.

We have already directed the Authorized Dealers vide our FE Circular No. 2 of 1999 to implement code of conduct for foreign exchange dealings. The enclosed Code will not only give uniformity to the market conventions but will also make our market compatible to the international standards.

State Bank is glad to pass on the responsibility to your association of printing, and distributing this CODE OF CONDUCT to the Authorized Dealers for onward distribution to their treasury staff (members of your association) and branches involved in inter-bank activity.

You are therefore advised to distribute this CODE OF CONDUCT under advice to us to all the banks, under your covering letter, mentioning therein that this CODE is to be implemented by them at the behest of the State Bank.

If any future development in the market requires any changes/modifications in the CODE OF CONDUCT, the same may be carried out by you under intimation to SBP.

End:- As above

Yours faithfully,


(Syed Ishtiaq Ali)
Director



FINANCIAL MARKET ASSOCIATION OF PAKISTAN

C/o Country Treasury,
National Bank of Pakistan,
1st Floor, NBP Head Office Building,
1, I. Chundrigar Road,
Karachi, Pakistan.

Affiliated with ACL

May 06, 1999

The Treasurer,
All Commercial Banks,
All Investment Banks,
All Brokers.

Dear Sir,

**Re: Code of Conduct of the Treasuries of Commercial/
Investment Banks, Brokers etc.**

Financial Markets Association of Pakistan is pleased to enclose a copy of "**CODE OF CONDUCT**" for Treasury Operations in the country. It is approved by the State Bank of Pakistan. It has to be meticulously followed and implemented by the institution operating in the Forex and Money Market.

We hope that it will strengthen the market and will help it grow.

Kindly acknowledge receipt,

Yours sincerely,

(M. R. MEHKARI)
Secretary

(NAEEMUDDIN)
President

Encl. As above.

CODE OF CONDUCT

Responsibility for Dealing Activities

Control of the activities of all personnel engaged in dealing (both dealers and support staff) in both banking and brokerage firms is the responsibility of the management of such organizations. Management should clearly set out, in writing, the authorizations and responsibilities within which dealing (and support staff) should operate. These might include:

- a) General dealing policy including reporting procedures.
- b) Persons authorized to deal.
- c) Instruments to be dealt in.
- d) Limits on open positions, mismatch positions, counterparties, stop-loss limits, limit for each dealer etc.
- e) Confirmation and settlement procedures.
- f) Relationships with brokers/banks.
- g) Other relevant guidance as considered appropriate.

Dealing at non-current rates

Deals at non-market rates should generally be avoided. Where, however, the use of non-current market rates may be necessary (as in the swaps market or in certain transactions with corporate clients), they should only be entered into with the prior express permission of senior management, who should ensure that proper controls are in place for the monitoring and reporting of such transactions. Cash flow implications should be taken into account in the pricing. Spot rates should be fixed immediately within the current spread, to reflect current rates at the time the transaction was done.

Dealing after-hours/from premises other than bank

Dealing after normal local hours, particularly from premises other than banks dealing rooms, should not be done

Position Parking

Management should not allow the parking of deals or positions with counterparty and with the understanding to repatriate these dealing position at a given moment and at historical rates.

Stop-loss orders

The terms under which such orders are accepted should be explicitly identified and agreed between the parties concerned and be within any management criteria on such orders. Any dealer handling such an order must have adequate lines of communication

with the counterparty for use in the event of an extreme price/rate movement or other unusual situation.

Dealing for personal account

Employees should not be allowed to trade for their own account in any of the instruments covered by this Code.

Taping

The use of recording equipment in the offices of banks and brokers is strongly recommended. All conversations undertaken by dealers and brokers should be recorded together with back office telephone lines used by those responsible for confirming deals or passing payment or other instructions. Back up should be kept for at least sixty days. It should be ensured that all the disputes are resolved before the back up is discarded.

Entertainment, gifts and gambling

Neither management nor employees should offer inducements to conduct business, or solicit them from the personnel of other institutions.

No gambling at all should be allowed with other market participants.

Abused Substances (including drugs and alcohol)

Management should take all reasonable steps to educate themselves and their staff about possible signs and effects of the use of drugs and other abused substances.

Confidentiality

Dealers and brokers share equal responsibility for maintaining confidentiality of their transactions. They should not disclose or discuss any information relating to deals transacted or in the process of being arranged except to or with the counterparties involved. They should not divulge any information to a third party without explicit permission from the parties involved.

Care should be taken over the use of open loudspeakers to ensure that no breaches of confidentiality occur.

Individual dealers or brokers should not visit each other's dealing rooms except with the express permission of the management of both parties. Dealers should not deal from within a broker's office nor should brokers arrange deals from outside their own offices. A dealer should not place an order with a broker to find out the name of a counterparty in order to make direct contact to conclude the deal.

Dealing procedures

Both dealers and brokers should state clearly at the outset, prior to a transaction being executed, any qualifying conditions to which it will be subject. These include: where a price is quoted subject to the necessary credit approval; finding a counterparty for matching deals, or the ability to execute an associated transaction. For instance, a dealer may quote a rate, which is firm subject to the execution of a hedging transaction. If a dealer's ability to conclude a transaction is constrained by other factors, for example,

opening hours in other centres, this should be made known to brokers and potential counterparties at an early stage and before names are exchanged.

Firmness of quotation

All market participants, whether acting as principal, agent or broker, have a duty to make absolutely clear whether the prices they are quoting are firm or merely indicative. Prices quoted by brokers should be taken to be firm in marketable amounts unless otherwise qualified.

A dealer quoting a firm price (or rate), either through a broker or directly to a potential counterparty, is committed to deal at that price (or rate) in marketable amount provided the counterparty's name is acceptable.

When dealing in fast moving markets (like spot forex or currency options) a dealer has to assume that a price given to a broker is good only for a short length of time - typically a matter of seconds. However, this practice would offer room for misunderstandings about how quickly a price is deemed to lapse if adopted when dealing in generally less hectic markets, for example forward foreign exchange or deposit markets or when market conditions are relatively quiet. Since dealers have prime responsibility for prices put to a broker, the onus is on dealers in such circumstances to satisfy themselves that their prices have been taken off unless a time limit is placed by the dealer on his interest at the outset (e.g. firm for one minute only). Otherwise, the dealer should feel bound to deal with an acceptable name at the quoted rate in a marketable amount.

For their part, brokers should make every effort to assist dealers by checking with them from time to time whether their interest at a particular price or rate is still current. What constitutes a marketable amount varies from market to market, but will generally be familiar to those operating in that market. A broker, if quoting on the basis of small amounts or particular names, should qualify the quotation accordingly. Where dealers are proposing to deal in unfamiliar markets through a broker, it is recommended that they first ask brokers what amounts are sufficient to validate normal quotations. If their interest is in a smaller amount, this should be specified by the dealer when initially requesting or offering a price to the broker.

In the swap market, considerable use is made of indicative interest quotations. When arranging a swap an unconditional firm rate will only be given where a principal deals directly with a client or when such a principal has received the name of a client from a broker. A principal who quotes a rate or spread as firm subject to credit is bound to deal at the quoted rate or spread if the name is consistent with a category of counterparty previously identified for this purpose. The only exception is where the particular name cannot be done, for example, if the principal has reached its credit limit for that name, in which case the principal will correctly reject the transaction. It is not an acceptable practice for a principal to revise a rate which was firm subject to credit once the name of the counterparty has been disclosed.

Brokers and principals should work together to establish a range of institutions for whom the principals rate is firm subject to credit.

Concluding a deal

Dealers should regard themselves as bound to a deal once the price and any other key commercial terms have been agreed. However, holding brokers unreasonably to a price is viewed as unprofessional and should be discouraged by management.

Where prices quoted are qualified as being indicative or subject to negotiation of commercial terms, dealers should normally treat themselves as bound to a deal at the point where the terms have been agreed without qualification. Verbal agreements are considered binding, the subsequent confirmation is regarded as evidence of the deal, but should not override terms agreed verbally. The practice of making a transaction subject to documentation is not regarded as good practice. In order to minimize the likelihood of disputes arising once documentation is prepared, parties should make every effort to agree all material points quickly during the verbal negotiation of terms and should agree any remaining details as soon as possible thereafter.

Where brokers are involved, it is their responsibility to ensure the principal providing the price or rate is made aware immediately it has been dealt upon. As a general rule, a deal should only be regarded as having been done where the brokers contact is positively acknowledged by the dealer. A broker should never assume a deal is done without some form of verbal acknowledgement from the dealer. Where a broker puts a specific proposition to a dealer for a price (e.g. specifying an amount and a name for which the quote is required), the dealer can reasonably expect to be told almost immediately by the broker whether the price has been hit or not.

Passing of names by brokers

Brokers should not divulge the names of principals prematurely, and certainly not until satisfied that both sides display a serious intention to transact. Principals and brokers should, at all times, treat the details of transactions as absolutely confidential to the parties involved.

Bank dealers should, wherever possible, give brokers prior indication of counterparties with whom, for whatever reason, they would be unwilling to do business (referring as necessary to particular markets or instruments). At the same time, brokers should take full account of the best interests and any precise instructions of the client. In some instruments, dealers may also wish to give brokers guidance on the extent of their price differentiation across broad categories of counterparties.

In all transactions, brokers should aim to achieve a mutual and immediate exchange of names. However, this will not always be possible. There will be times when one principal's name proves unacceptable to another; and the broker will quite properly decline to divulge by whom it was refused. This may sometimes result in the principal whose name has been rejected, feeling that the broker may in fact have quoted a price or

rate which it could not in fact substantiate. In such cases, a neutral body may be formed to establish with the reluctant counterparty that it did have business to do at the quoted price and the reasons why the name was turned down, so that the aggrieved party can be assured the original quote was valid without, of course, revealing the proposed counterparty's name.

In the deposit markets, it is accepted that principals dealing through a broker have the right to turn down a name wishing to take deposits: this could therefore require pre-disclosure of the name before closing the deal. Once a lender (or buyer) has asked the key question Who pays? or Whose paper is it?, it is considered committed to do business at the price quoted with that name or with an alternative acceptable name if offered immediately. The name of a lender (or buyer in respect of Certificates of Deposit) shall be disclosed only after the borrower's (or issuer's) name has been accepted by the lender (or buyer). The proposed borrower may decline the lender's name a) when, in the case of short date deposits, he (the borrower) is not prepared to repay the deposit prior to advice of receipt of the funds from his correspondent bank or b) when he has no lending line for the placer of the funds and does not wish to be embarrassed by being unable to reciprocate. Additionally, in the case of instruments like CDs, where the seller may not be the same entity as the issuer, the broker shall first disclose the issuer's name to the potential buyer. Once a buyer has asked Whose paper is it?, the buyer is considered committed to deal at the price quoted. Once the buyer asks Who sells?, it is considered committed to deal with that particular seller in question (or an alternative acceptable name so long as this name is immediately shown to the buyer by the broker). The name of the buyer shall be disclosed only after the seller's name has been accepted by the buyer. The seller has the right to refuse the particular buyer so long as it is prepared to accept, at that time, sums up to the same amount and at the same price from an alternative acceptable name immediately shown to it by the broker.

Name substitution or switching by brokers

In spot exchange, brokers typically do not reveal the names of counterparties until the amount and exchange rate are agreed upon. It is therefore possible that, after these details are agreed, the name of one counterparty may prove unacceptable to the other due to the unavailability of a credit line. In these circumstances, it is accepted market practice that brokers will attempt to substitute a third name to stand between the two original counterparties to clear the transaction. Because the two offsetting transactions will utilize credit and because they are often executed at an exchange rate that is offmarket due to the time it takes to arrange name substitution, such activities should be identified as switching transactions and they should be monitored and controlled. If requested by a broker to clear a transaction through name switching, a dealer must ensure that such activities have the prior approval of senior management, that he or she has the authority to switch names and that any such transactions are executed within policy guidelines. Finally, a dealer must not seek nor accept favours from the broker for switching names.

Payments / Settlement instructions

Instructions should be passed as quickly as possible to facilitate prompt settlement. The use of standardized payment instructions between counterparties who trade regularly with

each other is recommended as their use can make a significant contribution to reducing both the incidence and size of differences arising from the mistaken settlement of funds. Whether dealing direct or through a broker, principals should ensure that alterations to original payment instructions, including the paying agent where this has been specifically requested, should be immediately notified to the counterparty, and where a broker has been used and at least one of the principals is in another country, to the broker also. This notification should be supported by written, telex or similar confirmation of the new instructions, receipt of which should be acknowledged by the counterparty concerned. Failure to inform the broker of a change in instructions could clearly place the liability for any ensuing difference with the principal.

Confirmation Procedures

Verbal Deal Checks

Many dealers now request regular verbal or telex deal checks from brokers (or from other banks with whom they regularly deal by telephone) prior to the exchange and checking of a written or electronically dispatched confirmation. Their use can be an important means of helping to reduce the number and size of differences, particularly when dealing through brokers or for deals involving foreign counterparties. The practice of intra-day deal checks is strongly recommended by the Committee for Professionalism. It is for each firm to agree with their brokers (or counterparties) whether or not it wishes to be provided with this service, and if so, how many such checks a day it requires. If a single check is thought to be sufficient, this should be undertaken towards or at the end of the trading day. As a matter of common sense, the broker (or counterparty) should always obtain acknowledgement from a dealer on completion of the check that all the deals have been agreed or that any identified discrepancies are resolved as a matter of urgency; lack of response should not be construed as acknowledgement.

Confirmations (written or electronic)

Confirmations (whether mailed, telexed or sent by other electronic means) provide an opportunity for dealing errors to be identified and rectified with the minimum of delay and possible cost.

The issue and checking of confirmations is a back office responsibility which should be carried out independently from those who initiate deals. Confirmations must be sent out as quickly as possible (preferably by electronic means) after a deal has been done and should be addressed to the back office or settlement department of the counterparty bank. The format and content of a confirmation will vary according to the instrument dealt in and reference should be made to any applicable Terms and Conditions published in order to ascertain the correct content and format for any particular instrument. As a minimum, however, all confirmations should include the following information:

- (a) Date of transaction
- (b) By which means effected (Broker, phone, telex, dealing system, etc.)
- (c) Name and Location of Counterparty
- (d) Rate, Amount and Currency

- (e) type and Side of Deal
- (f) Value Date, Maturity Date and all other relevant dates (e.g. Exercise Date, etc.)
- (g) All other important, relevant information

Upon receipt, all confirmations must immediately be thoroughly checked and appropriate action taken to rectify any differences. If the counterparty's confirmation is considered incorrect, the counterparty must immediately be informed (preferably in writing by electronic means). A new confirmation (or written agreement to a correction) must be requested from and provided by the bank whose original confirmation was incorrect.

Any bank failing to receive a confirmation must query the matter with the back office (or the management) of the counterparty. Where transactions are arranged through a broker, the broker should send a confirmation to each counterparty.

Fraud

Attempts at fraud occur quite frequently and many are meticulously planned. Great vigilance is required by all staff, particularly so when calls are received on an ordinary telephone line. It is strongly recommended that the details of all telephone deals which do not include pre-agreed standard settlement instructions, should be confirmed by telex or similar means by the recipient seeking an answer- back to ensure the deal is genuine. Funds should not be paid in favour of a third party.

Money laundering

All banks are reminded of the need to know their customer and to take all necessary steps to satisfy themselves that their transactions are not used to facilitate money laundering. Only senior management should decide whether to undertake business with institutions dealing on behalf of clients on a discretionary management basis.

New Bank Holiday

In the event a country or state declares a new national bank holiday or any other occurrence which would prevent settlement of banking transactions on a specific date in the future, the following procedures should be adopted for adjusting the value date on outstanding foreign exchange transactions maturing on that date:

- a) The new value date will be the first common business day (for both currencies of the contract) following the original value date except where a bank holiday is declared on the last business day of a month, in which case the new value date will be the first common business day (for both currencies) prior to month end (ultimo).
- b) Value dates will not be split.
- c) There will be no adjustment of the exchange rate on outstanding contracts.

Market terminology

Management should ensure that individual brokers and dealers are aware of their responsibility to act professionally at all times, and as part of this, to use clear unambiguous terminology.

The use of clear language is in the interests of all concerned. Management should ensure internal procedures (including retraining if necessary) exist and are monitored to alert individual dealers and brokers who act in different markets (or move from one market to another) to any differences in terminology between markets, and to the possibility that any particular term could be misinterpreted. The use of generally accepted concise terminology is undoubtedly helpful. A schedule of Market Terminology and Definitions is attached to this Code of Conduct.

APPENDIX

SOME WARNINGS

In its foreign exchange dealing activities, a bank faces two broad risks that could result in losses:

- a) Unfavorable movements in market prices caused by unanticipated changes in interest rates, exchange rates and/or volatility; and,
- b) The failure (bankruptcy) of counterparties before their dealing commitments are settled.

When dealing activities are conducted with the full knowledge and authority of the general management of the bank concerned, these risks typically are controlled by limits. However, if they are conducted without the full knowledge of general management or beyond their authority, these risks may not be controlled and the potential for loss could be magnified.

It is the responsibility of market participants not only to ensure that they are dealing with the knowledge and authority of their own general management but also to warn their management of irregularities in dealing to prevent unwarranted losses to their own institutions and to counterparties. The purpose of this section is to provide to market participants a guideline for identifying unauthorized dealing or dealing irregularities that might be occurring in counterparty institutions. It is presumed that dealers recognize when unauthorized dealing occurs in their own institutions and that procedures are in place for them to inform their management.

Characteristics of dealing that indicate unauthorized transactions are as follows:

- a) A sudden increase in volume to levels considered too large in relation to the size of the bank or branch concerned. This could be a questionable warning since the total volume of business that a bank can place in the market depends on its reputation, standing, and credit-worthiness and it is practically impossible to ascertain the basis of operations of a bank of undoubted standing.
- b) An unusual increase in the turnover in a bank's clearing/nostro accounts with central bank/correspondent banks, particularly if overdrafts were to occur frequently. As the turnover on clearing accounts aggregates the counter value of any number of deals, which by themselves might not arouse the suspicion of the counterparties to those deals, this could be a useful warning.

- c) A change in the normal pattern of dealing.

Open positions need not be taken only for forward delivery, but can be taken by buying or selling spot currency, which is then swapped from day to day, or for short periods. Such operations will lead to an increased presence in the market and, normally, a consequent increase in turnover on clearing accounts.

Risk of losses also occurs when a bank runs a forward book. Although there is no net open position as total purchases match total sales, there is a risk on the unmatched forward maturities.

- d) failure to receive confirmations of deals;
- e) no satisfactory response to requests for verification of outstanding contracts.
- f) a willingness or desire to deal at a price which is deliberately pitched outside the market level.

It is recommended that anyone noticing any of the above situations should refer the matter to his management for discreet action to be taken.

MARKET TERMINOLOGY AND DEFINITIONS

Set out below are the commonly used expressions and their generally accepted meaning; use of them will do much to reduce misunderstandings and frustration. In all cases, the currency/currencies being dealt in should be clearly specified.

I. FOREIGN EXCHANGE AND CURRENCY DEPOSITS

****Spot***

The purchase (or sale) of a currency for settlement two business days from transaction date (with certain exceptions).

Cross rate

Means the exchange rate for one non US Dollar currency against another non US Dollar currency.

****Forward***

All deals over two business days from transaction date for periods of one month onward fixed at the time of dealing. (All deals for a broken number of days up to the month date are known as shorts or short dates). When the maturity falls on a non-trading day, it takes place on the following business day. When the deal is arranged on a day for which spot delivery occurs on the last business day of the month, it matures on the last business day of the appropriate month in the future.

When dealers are trading for, say, 3 months forward, the maturity date will be taken as 3 months from the spot settlement date. If this maturity date falls on a non business day in the centre of one of the currencies concerned, the maturity date will be on the next business day unless that day is in the following month, in which case it will be the last business day of the month concerned prior to the Bank Holiday or weekend.

Forex Transactions

FX Transactions means any transaction between two parties for the purchase by one party of an agreed amount in one currency against the sale by it to the other of an agreed amount in another currency both such amounts being deliverable on the agreed value date.

Spot value date for forex transactions

Spot value dates should be set taking into consideration only two working days of the two currencies involved. However, there are specific examples of exceptions e.g. USD/CAD and USD/HKD. It is important when dealing into unfamiliar markets that value dates are identified. If spot transactions should be concluded with other value dates it must be agreed by both parties.

* In Pakistan, as FMA has resolved, spot would mean settlement on next working day. Value date for forward transactions would also be computed accordingly. Although with SBP spot transaction will be for value today and value date for forward deals with SBP would also be calculated accordingly.

Swap

The simultaneous purchase and sale of identical amounts of a currency for different value dates.

Outright

The purchase or sale of a currency for delivery on any date other than spot(not being a swap transaction).

Forward/forward

A forward sale (purchase) against a forward purchase (sale).

Par

Price is the same on both sides of the swap.

Premium

The margin by which the forward exchange rate is more expensive (dearer) than the near date.

Discount

The margin by which the forward exchange rate is less expensive (cheaper) than the near date.

Value today

Same day value.

Value tomorrow

Value the next working or business day.

Broken date: Odd date

A value date which is not a regular forward date.

Overnight - Today/Tomorrow

Deposit or swap transaction for settlement on transaction date to or against the next business day after transaction date.

Tomorrow/next: Tom/next

Deposit or swap transaction for settlement on the next business day against the second business day after transaction date.

Spot/Next

Deposit or swap transaction for settlement on the second business day against the third business day after transaction date.

End/End

Deposit or swap transaction for settlement on the last business day of a month against the last business day of a future month.

Seller – Buyer

Lender - Borrower Spot, Outright, FRA Deposit Swaps

Seller- I sell at, I lend at, I sell and

of currency I give at, I give at, buy

or Lender- I offer at, I offer at

Buyer- I buy at, I borrow at, I buy and

of currency I bid at, I take at, sell

of Borrower I take at I bid at I pay at

Open position

Difference between total spot and forward purchases and sales in a currency on which an exchange risk is run.

Long

Excess of purchases over sales.

Short

Excess of sales over purchases.

Square

Purchases and sales are equal.

Firm

1) Refers to a currency which is appreciating or has appreciated in value.

2) A term rarely used in direct interbank dealing but which, when used, indicates that the user is prepared to deal in either

a) A normal market amount or

b) In an amount/for a period of time specified by him at the time of making the price or as previously arranged.

At your risk, your risk, risk

Quoted rates are subject to change at the risk of the receiver.

For indication (only) - For information (only)

Quotations which are not firm, and intended as an indication of unwillingness or inability to deal.

Under reference

A deal cannot be finalised without reference to the bank which placed the order, whose name should not be mentioned until reference has been made to that bank.

Mine

The dealer takes the offer which has been quoted by his counterparty. It has to be qualified by the amount.

Yours

Opposite to mine. The dealer gives at the bid which has been quoted by his counterparty. It has to be qualified by the amount.

Point/Pip

The last decimal place of a quotation.

Basis point

One hundredth of 1 per cent, used in interest rate related instruments.

Mio

One million.

Yard

One thousand million (1,000,000,000).

Spread

Difference between the buying and selling rates of a foreign exchange quotation or between the borrowing and lending rates in deposit.

Margin

This expression is used in loans to determine the rate of interest charged to the borrower over and above the basic rate of interest which is fixed at the commencement of each rollover period (normally every three or six months).

Call deposit

Interest bearing deposit, which is repayable on demand.

Notice deposit/Notice money

An interest bearing deposit with the period of notice required to be specified at the outset, e.g. 48 hours. 7 days.

Orders (Limit order, Stop loss, etc.)

Firm order given by a dealer to a counterparty to execute a transaction under certain specified conditions.

Limit order

As an order given at a certain price.

Stop loss order

Becomes an order at best after a certain rate has been reached or passed or dealt depending upon the specified conditions previously agreed between the two parties involved.

These orders create a potential for loss or liability which can be substantial if they are mishandled or there is a misunderstanding about the terms and conditions for their execution and confirmation.

Payment Instructions

- Account: means settlement by debit or credit of the account one counterparty runs in his book in the name of the other counterparty.
- Clearing: means settlement through the local clearing system of the country of the currency concerned.
- Pay to my account with bank XY.
- Standing instructions: settlement to be as previously agreed between the two parties (e.g. netting).
- Direct can mean different things in different centres. It should therefore be avoided unless there is a specific understanding between the two parties concerned.

Use of funds

In case of error the settlement for use of funds should be fixed in the most co-operative way avoiding undue enrichment.

II. FOREIGN CURRENCY OPTIONS***Call (option)***

This term refers to the right to purchase a specified amount of a specified currency at a specified price (strike price) within a specified number of days. The seller has the obligation to perform.

Put (option)

This term refers to the right to sell a specified amount of a specified currency at a specified price within a specified number of days. The buyer has the obligation to perform.

Premium

The purchase price of the option as agreed upon by the parties and payable by the buyer to the seller value spot.

At the Money

An option is at the money when the price of the underlying instrument is very close to or equal to the options strike price.

Expiration date

The date on which the exercise right of the buyer of an option to notify the seller of his intention to exercise his right shall lapse.

Expiration time

The latest time on the expiration date on which the seller will accept a notice of exercise (in Europe it is usually 3 p.m. London time).

European style option

An option which can only be exercised on the options expiration date. (They are the most usual option).

American style option

An option which may be exercised on any business day up to and including the expiration day.

Notice of exercise

Telex, telephonic or facsimile transmission providing assurance of notification which shall be irrevocably given by the buyer prior to or at the expiration time of the exercise of an option.

Exercise

To make use of the right (to do something) which is possessed by a party to an option contract, e.g. the right to buy. Upon receipt of notification of intention to exercise the right, the seller of the option is obligated to the buyer on the terms already agreed.

The writer of an option shall not use failure of receipt of notice of exercise as an opportunity for undue enrichment.

Price quotation for a currency option

Either in the form of a premium, e.g. a percentage of either currency or as one currency in terms of the other. Or in the form of volatility, which, combined with the spot rate, interest factors of the currency pair, the days to expiry of the option and the strike price, is used to compute the premium.

Delta

Also known as the hedge ratio, this term refers to the ratio of change in the option premium compared with change in the price of the currency amount in question, when all other conditions are fixed.

Volatility

The price variability of the underlying instrument of an option contract, and defined as the standard deviation in the logarithm of the price of the underlying instrument expressed at an annual rate. Expected volatility is a variable used in pricing options.

Implied Volatility

The degree of volatility »implied« by the market price of an option.

Intrinsic Value

The amount by which an option is in the money.

Time Value

That portion of an options value that equals option current price minus the intrinsic value.

Straddle

This term refers to a combination of call option with put option with the same type (put/call), same time period and same exercise price, whereby the seller is simultaneously a buyer.

Strangle

This refers to a combination of call option and put option with same type and same time period, but in which the exercise prices are different and put and call are both out of the money by the same amount.

III. INTEREST RATE DERIVATIVE PRODUCTS

1. Forward Rate Agreement (FRA)

An FRA is an agreement between two parties who wish to protect themselves against a future movement in interest rates. The parties involved agree on an interest rate for a specific period of time from a specified future settlement date based on an agreed principal amount, but no exchange of principal takes place.

The Buyer

Is the party to the FRA wishing to protect itself against a future rise in the relevant interest rate.

The Seller

Is the party to the FRA wishing to protect itself against a future fall in the relevant interest rate.

If the settlement rate is higher than the agreed rate, the buyer will receive the difference from the seller or vice versa.

2. Swaps

An interest rate swap is a contract between two participants or counterparties, in which interest payments are made based on the notional principal amount, which itself is never paid or received. The fixed-rate payment in the swap (often called the fixed-rate coupon) is made by the fixed-rate payer to the floating-rate payer. Similarly, the floating-rate payment in the swap is made by the floating-rate payer (or variable-rate payer) to the fixed-rate payer. Both fixed and floating interest are calculated from the swaps effective date. The trade date is the date on which the counterparties commit to the swap.

A Fixed-Rate Payer:

Pays fixed in the swap.

Receiving floating in the swap

Has established the price sensitivities of a longer-term fixed rate liability and a floating-rate asset.

A Floating-Rate Payer:

Pays floating in the swap.

SOME PRACTICAL ADVICE

INTERNATIONAL MARKET

Typical dealing system/telex conversation

(but not to be followed).

DEM 10*

20-30

10 yours

OK BIBI

This conversation is supposed to mean that the calling bank asked for a quotation in USD/DEM for 10 million dollars and then sold 10 million at 20.

Both parties are convinced that they know the big figure, the value date and the payment instructions.

Although this a usual practice in the market but dealers are strongly advised to be more specific in quoting and concluding a deal. Some examples are suggested below. In any case it is absolutely necessary to confirm each deal with all details in full before the end of the conversation.

1. SPOT DEAL

SPOT USD/DEM*

1.7470 - 75

I BUY 5

5 MIO AGREED

VAL 28 NOV. 97

TO CONFIRM AT 1.7475 I SELL 5 MIO USD

MY DEM TO BANK A FRANKFURT

MY USD TO BANK B N.Y.

Note*: A number after the currency expresses the amount of the first currency in Million, e.g. spot USD/DEM 2. Alternatively you must add the currency after the number, e.g. spot USD/DEM for 3.5DEM.

2. SWAP DEALS

A.) SWAP USD/DEM 3 M (= SWAP USD/DEM FOR 3 MONTHS).

36 - 40

AT 36 I BUY AND SELL 15 MIO USD*

AGREED, RATES ARE 1.7475 AND 1.7511

VAL 26 FEB. 91 AND 28 MAY 91

TO CONFIRM AT = 36 I SELL AND BUY 15 MIO USD

MY DEM TO BANK B FRANKFURT

MY USD TO BANK C N.Y.

MY USD TO BANK X N.Y.

MY DEM TO BANK Y FRANKFURT

Note*: If dealing swap with the other currency (here DEM), a dealer will use MIO DEM and I sell and buy 15 Mio DEM.

The bank which has quoted the price should immediately fix the spot rate within the current spread.

3. DEPOSIT DEALS

DEPO XEU 1, 2, 3 MTHS

91/8 - 1/4 / 93/16 - 95/16 93/8 - 1/8

I TAKE 10 AT 5/16 FOR 2 MTHS

10 MIO AGREED

VALUE 28 FEB. 91 AND 30 APRIL 91

TO CONFIRM AT 95/16 1 GIVE 10 MIO XEU

MY XEU BANQUE B LUXEMBOURG

MY XEU BANQUE A PARIS.

Note: A deposit quotation is usually a bid/offered rate (from low to high e.g. 91/8 - 1/4)

Some centres quote in the reverse form offered/bid (from high to low e.g. 91/4 - 1/8).

4. FRA DEAL (OF 28 JANUARY 1991)

FRA USD 3 AG 6

7,65 - 70

(AT 70)1 BUY 25

25 MIO AGREED

TO CONFIRM AT 7,70 1 SELL 25 MIO USD 30 APRIL 91 AG. 30 JULY 91.

FRABBA 26 APRIL 91

MY USD TO BANK A N.Y.

MY USD TOBANK X N.Y.

FRABBA are standard terms agreed by the British Bankers Association for interbank trading of FRAs.

The normal Contract Periods for FRA quotations, unless otherwise specified, are based on the conventional value dates applicable to each subsequent month for the currency concerned in the interbank deposit market on the day of negotiation.

Any FRA having a Contract Period either (a) with a duration different from the

normal Contract Period as described above or (b) with a Contract Period exceeding 1 year, will be construed as a Broken Date FRA.

5. CURRENCY OPTION

PUT USD/CALL DEM (STRIKE) 1,5200 EXP APRIL 15TH VAL 17TH IN 20

MIO USD (IN VOL.) ABOUT 38 DELTA

11° AT 115

11S 1 BUY 20 MIO USD # OK SPOT 1.5350 # I SEE 1,5 % OF USD AMT

DELTA 38 %

AGREED. PREMIUM 300.000 USD VAL. FEB 17TH

HEDGE I BUY USD 7.600.000 AT 1,5350 VAL FEB 17TH. MY USD TO BANK A N.Y.

OK ON THE PREMIUM MY USD TO BANK X N.Y.

AND ON THE HEDGE MY DEM TO BANK Z FFT.

This is a true conversation between two dealers:

an example not to follow

TO ... DEPOSIT'S 09428MT 2104921/242

III FRIENDS

6 AND 12 MONTHS CHIF PS

SRV FOR KEEPING HAD A PROBLEM MOM PLS

7 / -9 / 19

3 / -5 / 16

CAN OFFER U YOU UP TO 50 MIO IN 6 MONTHS

THATS OK FRNDS 23 / 4-25 / 10 UBS ZURICH PLS

THKS FRIENDS FOR ME PSE CS ZURICH BACK

OK TKS ANYTHING IN 3 M DEM

SORRY NTG THERE FRIEND

SRRY ???????? EVER HEARD FROM

RECIPROCTY ????????

? IF U WONT QUOTE I WILL CANCEL PREVIOUS DEAL

MOM

REALLY SORRY BUT NTG IN DEM FOR THE MOM SO NOTH. DONE IN CHF
FRNDS

CONSIDER THIS RELATIONS AS FINISHED BIBI

INTERRUPT

END

LOCAL MARKET

Repo / Reverse Repo

Repo / R Repo is a sell - buy / buy - sell agreement whereby the borrower / lender sell/buy the GoP (Government of Pakistan) securities at an agreed price which may be par for STFB's (Short Term Federal Bonds) / FIB's (Federal Investment Bonds) or a derived price for T-Bills and buy/sell at a calculated price on the maturity date of the transaction based on the mark-up rate and the number of days.

READY USD / PKR

The purchase / sale of a currency for settlement on the transaction date i.e. same day value date.

1. READY DEALS

READY USD/PKR IN 5

44.2650 -- 00

* URS

OK I BUY USD 5MIO AT 44.2650. MY USD TO XY, NY, YOUR PKR TO SBP.

* ALL AGREED, BIFN

2. 3 MONTHS FORWARD O/RITE USD /PKR

HI FRNDS

USD /PKR 3MNTH O/R IN 5

* 50 / 55

YRS

State Bank of Pakistan

* OK. I BOT USD 5 MIO AT 45.50 VAL. 16/3/98

* MY USD TO AB, NY YR RS. TO SBP

ALL AGREED

THINKS FOR THE DEAL BIFN

3. SWAP DEALS:

*SWAP USD/PKR 1MNTH

23 - 24

* 5 AT 24

OK., I BUY SELL USD 5 MIO , 26/11 , 26/12/97.

RATES ARE 44.26 AND 44.50. MY USD XYZ, NY . SBP BOTH WAYS

WHERE FOR UR USD?

* MY USD TO B BANK, NY.

* ALL REST FINE THKS FOR THE DEAL. BIFN

4 . REPO

HI HI THERE FRNDS

AB BANK HERE

#HOWS UR 3MNTH REPO PLS

* 12.00 - 25

AT 25 I TAKE PKR 300 MIO

* AGREED , I LEND PKR 300MIO UNDER REPO AT 12.25

* DATES 26/11 AG 26/2/98

* PRICES 100 AG 103.0877

* SECUR PLS

STFB 7/11/97

SETTLEMENT C/A AND SGLA WITH SBP

#TIKS FOR DEAL AND BIFN

Subsidiary General Ledger Account