



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
SECURITIES MARKET DIVISION

Before the Executive Director (Securities Market Division)

In the matter of Show Cause Notice issued to

First Capital Equities Limited

Under Rule 8 of the Brokers & Agents Registration Rules, 2001 for Violation of Regulation
3(b) of the Regulations Governing Futures Contracts of the Karachi Stock Exchange
(Guarantee) Limited

Number and date of Notices	SMD-SOUTH/SCN/47/07 dated March 16, 2007
Date of hearing	March 28, 2007
Present	Mr. Farooq Bin Habib - CEO Mr. Muhammad Tariq - Head of Settlement First Capital Equities Limited
Date of Order	April 3, 2007

ORDER

1. I have before me 56 cases involving broadly the same issues in relation to the 56 Show Cause Notices, issued by the Commission to 56 Brokerage Houses, for which I conducted hearings on various dates in relation to same. Since there is a commonality of issues involved, I have addressed the core issues raised by or on behalf of the 56 Brokerage Houses together, given the need to expedite the disposal of these matters. Accordingly, I have decided to issue a common order, which addresses all the core issues raised in the submissions made at these hearings and in the written responses filed by or on behalf of the 56 Brokerage House, even though, in certain instances, some of these core issues may not have been raised by each and every Brokerage House.

2. Accordingly, this order shall dispose of the proceedings initiated through Show Cause Notice No. SMD-SOUTH/SCN/47/07 dated March 16, 2007 issued to First Capital equities Limited_(the "Respondent") for violation of Regulation 3(b) of the Regulations Governing Futures Contracts (the "Regulations") of The Karachi Stock Exchange (Guarantee) Limited (the "Exchange") by the Securities and Exchange Commission of Pakistan (the "Commission").
3. Basic facts of the case are that the Respondent is a member of the Exchange and is registered with the Commission under the Brokers and Agents Registration Rules, 2001 (the "Brokers Rules"). Consequent to the submission of the Forensic Report regarding the Exchange events of March 2005 by Diligence USA, LLC, the Commission sought information from the Respondent to determine whether or not in February and March 2005, the Respondent had complied with Regulation 3(b) of the Regulations which requires that no member shall have a sale position in a particular scrip of more than Rs. 50 million, unless the actual shares sold over and above the aforesaid limit, are deposited with the Exchange or the broker gives documentary evidence that the shares are lying in Central Depository Company of Pakistan Limited ("CDC") or with some bank or Development Finance Institution ("DFI"), to the satisfaction of the Exchange management. For the purpose of establishing such sale position, net buy position in T+3, shall be net off from net sale position in Futures Counter.
4. An examination of the information provided by the Respondent revealed that 14 times, during the period from March 09, 2005 to March 25 2005 the Respondent, had net sale positions in Futures Contracts, which were in excess of the prescribed limit of Rs. 50 million. In contravention of the requirement of Regulation 3(b) of the Regulations, the Respondent failed to either deposit with the Exchange the actual shares sold over the prescribed limit or submit to the Exchange the documentary evidence that such shares were lying in the CDC or a bank or DFI on the given dates.
5. Based on the findings, a show cause notice No. SMD-SOUTH/SCN/47/07 dated March 16, 2007 was issued under Rule 8 of the Brokers Rules stating that the Respondent has prima

facie contravened Rule 12 of the Brokers Rules read with Clause A5 of the code of conduct contained in the Third Schedule to the Brokers Rules. The Respondent was called upon to show cause in writing within seven days and appear before the Executive Director (SMD-South) on Wednesday, March 28, 2007 at 3:00 p.m. for a hearing, to be attended either in person and/or through an authorized representative.

6. The hearing was held on Wednesday, March 28, 2007 at 3:00 p.m. Which was attended by Mr. Farooq bin Habib Chief Executive (“the representative”) of the Respondent who submitted a written reply and argued the case.

7. A summary of the contentions raised by the Respondent in the written submissions are as follows:

- The Respondent contended that as per the practice of the Exchange they were used to provide information as and when demanded by the Exchange.
- They further argued that few instances where the Respondent did not report were those where the Exchange did not demand the said information and it was nothing more than a procedural mistake without any malafide intentions.
- They finally stated that there is no short selling in the case as the evidences have already been provided to the Commission to the best of their satisfaction.

8. The Following arguments were made by the Representative during the course of hearing:

- The representative started his submission stating that the alleged violation was just a procedural non-compliance and there was no malafide intention on the respondent behalf.

9. I have considered the contentions of the Respondent and the core issues raised therein and the same are addressed by me below:

- In relation to the Respondents' contention that there has not been a violation of Regulation 3(b) of the Regulations, it may be noted that Regulation 3(b) has two limbs. The first pertains to regulating the underlying mischief, i.e. to ensure that no member indulges in 'short selling' over and above the Rs. 50 million threshold by providing that no member shall have a sale position in a particular scrip of more than Rs. 50 million, unless (a) the actual shares sold over and above the aforesaid limit are deposited with the Exchange or (b) the broker gives documentary evidence that the shares are lying in CDC or with some bank or DFI to the satisfaction of the Exchange. The second pertains to complying with the reporting requirement / action to be taken by each broker, every time that a broker exceeds the Rs. 50 million threshold, i.e. by either depositing the shares or providing documentary evidence for same. Therefore, it will follow that the reporting requirement / action is an independent obligation under Regulation 3(b) and is meant to ensure that there is no 'short selling' by placing on the broker an obligation to deposit shares or provide documentary evidence for same. Failure by a broker to comply with the above would infer that the Broker has indulged in 'short selling'. Therefore, the fact that at the material time (i.e. when a member had taken a sale position in a particular scrip of more than Rs. 50 million), the Respondent did not deposit shares or provide documentary evidence, and only did so subsequently at the request of the Commission, resulted in non-fulfilment of Regulation 3(b).
- As to the Respondent's next contention that only the Exchange is empowered to take action under the Regulations, I do not find substance in same, more so since the Regulations have been notified by the Exchange under Section 34 of the Ordinance. Under the Ordinance and indeed under the Securities and Exchange Commission of Pakistan Act, 1997, the Commission, inter alia, has wide powers to regulate all matters relating to capital markets, securities and ancillary issues. In any event, more specifically, under Rule 8(iii) of the Brokers Rules, the Commission can take action under Rule 8(a) or (b) of the Brokers rules if "...the Commission is of the opinion that a

broker-... has contravened the rules and regulations of the stock exchange". The Commission as the apex regulator of all corporate activities is not precluded from taking appropriate action where there is any violation or non-compliance of the laws, rules or regulations. Hence, even if the Exchange may not have acted against any non-compliance of Regulation 3(b) in letter and spirit or may have allowed a certain practice to develop in this context, would not absolve the Respondent from the consequences of any non-compliance of the said Regulation, or indeed preclude the Commission from taking remedial action. The Respondent has an independent obligation to comply with the legal requirement as it is settled law that there cannot be an estoppel against the law.

- In this context, I now refer to the Respondent's related contention that documentary evidence to the satisfaction of the Exchange had been provided from time to time. However, the said information was provided before and after March 2005, but it is noteworthy that during March 2005, no information was provided by the Respondent in terms of Regulation 3(b). Lastly, on a related point, it has been argued that there was no specific procedure set out in Regulation 3(b) nor any timeframe was given within which the evidence was to be forwarded to the Exchange. In my view, there was no requirement for any specific procedure to be provided, as the language of Regulation 3(b) is clear, as stated above, inasmuch as it presupposes that no member shall have a sale position in a particular scrip of more than Rs. 50 million unless the actual shares sold over and above the aforesaid limit are deposited with the Exchange or documentary evidence relating to same are furnished.
- The Respondent has next contended that imposing any form of a penalty would not be in the "public interest". I have perused the case law cited by the Respondent and in my view, in fact it supports the position of the Commission. The entire purpose of this enquiry leading to issuance of Show Cause Notices, not only to the Respondent, but also to other Brokerage Houses was done, keeping the "public interest" in mind. Ensuring compliance of the Regulations and indeed compliance of all the corporate laws is the primary duty and function of the Commission, which is discharged in the

public interest. The action in this instance is all the more necessary, particularly bearing in mind the recent history of the stock market crisis, which seriously compromised the interest of the public at large and particularly the small investors. Hence, these proceedings were initiated to enquire as to whether there had been any violation of Regulation 3(b) in March 2005 and were conducted in public interest.

- As regards the contention that no loss has been caused, nor there was any short selling beyond the threshold of Rs. 50 million, I have already held above that there are two elements of Regulation 3(b), i.e. the first being to ensure that there is no 'short selling' and the second being a reporting requirement / action. Hence the fact that there has been no loss or 'short selling' would not absolve the Respondent from its obligation at the material time to comply with the reporting requirement, envisaged under Regulation 3(b) by either depositing the concerned shares or providing documentary evidence to that effect as prescribed in the said Regulation 3(b). In this instance, in relation to the issue of short selling, my perusal of the evidence provided by the Respondent substantiated the existence of the required shareholding in compliance of Regulation 3(b), in which context, I am satisfied to the extent that there was no short selling beyond the prescribed limit in Regulation 3(b) at the material time.

10. In view of what has been discussed above, and my considering the arguments presented before me in writing, as well as at the time of hearing and my having perused the documents and information placed on record, I am of the view that the Respondent has not fulfilled the requirement of reporting / taking action as envisaged under the said Regulation 3(b). However, certain extenuating circumstances have emerged from the Respondent's practice of supplying the requisite evidence under Regulation 3(b) only when required by the Exchange, which may have persuaded the Respondent to believe that it had discharged its obligation under Regulation 3(b), which clearly it did not for reasons stated above. I am also mindful of the fact that no evidence of 'short selling', has been revealed from the examination of the records provided by the Respondent.

11. In this background, I am inclined, on this occasion, to take a lenient view in the matter and will not take any punitive action under Rule 8 of the Brokers Rules. As such, I believe a 'caution' in this instance to the Respondent would suffice and I would further direct the Respondent to ensure that full compliance is made of all the Regulations in future for avoiding any punitive action under the law.

Zafar Abdullah
Executive Director