



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 Pakistan Securities Limited

Under Rule 8 read with Rule 12 of the Brokers and Agents Registration Rules, 2001 ("the Brokers Rules") and Section 28 of the Central Depositories Act, 1997 (the CDC Act)

Number and date of Notice	SMD-SOUTH/SCN/116/07 dated August 16, 2007
Date of hearing	August 31, 2007
Present	Mr. Mirza Mahmood Ahmad
Date of Order	October 30, 2007

ORDER

1. This order shall dispose of the proceedings initiated through Show Cause Notice SMD-SOUTH/SCN/116/07 dated August 16, 2007 ("**Show Cause Notice**") issued to First Pakistan Securities Limited (the "**Respondent**") by the Securities and Exchange Commission of Pakistan (the "**Commission**") under Rule 8 of the Brokers Rules for violation of Rule 12 of the Brokers Rules and Clause A5 of the code of conduct contained in the Third Schedule to the Brokers Rules and under section 28 of the CDC Act.
2. Brief facts of the case are that the Respondent is a member of the Lahore Stock Exchange (Guarantee) Limited (the "**Exchange / LSE**") and is registered with the Commission under the Brokers Rules. An enquiry was initiated by the Commission in exercise of its powers under Section 21 of the Securities and Exchange Ordinance, 1969 ("**1969 Ordinance**") and KPMG Taseer Hadi & Co. ("**the Enquiry Officer**") was appointed as the Enquiry Officer under the above mentioned section inter alia:
 - a) to enquire into the dealings, business or any transaction by the Respondent during the period from April 1, 2006 to June 15, 2006 ("**the Review Period**");
 - b) to identify any and all the acts or omissions constituting the violation of the 1969 Ordinance and the Rules made thereunder; and

- c) to identify violations of any other applicable laws, including but not limited to the Brokers Rules and Regulations for Short Selling under Ready Market, 2002 ("2002 Regulations") and The Central Depository Company of Pakistan Limited Regulations ("CDC Regulations") read with the CDC Act.

3. The findings of the Enquiry Officer revealed several instances of potential non compliances with applicable laws and regulations. A Show Cause Notice was issued to the Respondent under Rule 8 of the Brokers Rules and under section 28 of the CDC Act, 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 and requirements of the CDC Regulations. Rule 12 of the Brokers Rule and clause A5 of the code of conduct are reproduced as under:

Rule 12- " A broker holding a certificate of registration under this rules shall abide by the code of conduct specified in the Third Schedule"

Clause A5 of the code of conduct-"A broker shall abide by all the provisions of the Act and the rules, regulations issued by the Commission and the stock exchange from time to time as may be applicable to them".

4. The Respondent was called upon to show cause in writing within seven days and appear before the Executive Director (SMD-South) on August 31, 2007 for a hearing, to be attended either in person and/or through an authorized representative.
5. The hearing was held on August 31, 2007 which was attended by Mr. Mirza Mahmood Ahmad, the Representative of the Respondent, who submitted a written reply and argued the case.
6. A summary of the contentions that were raised by the Respondent in the written submission / during the hearing and findings and conclusion of the Commission on the same are as follows:

7. Blank Sales

- 7.1 In terms of Regulation 4 of the 2002 Regulations blank sales are not permissible. The findings of the Enquiry Officer revealed 750 instances of blank sales during the Review Period.

- 7.2 The Respondent made the following submissions on this Issue ("Issue No. 1"):

- The Respondent submitted that majority of these instances relate to a single customer whose account was operated by an employee in the branch office. The Respondent admitted that these blank sales were a result of oversight on its part. The Respondent further submitted that disciplinary action was taken against the same employee as soon as the blank sales came into notice and measures have been taken to ensure that no such activity takes place again.
- In respect of remaining instances of blank sales, the Respondent contended that in certain cases a customer instructs execution of a sale order and undertakes to deliver securities to the broker. Later, the said customer purchases back the shares thus squaring his position.
- The Respondent further contended that the reported blank sales can be a result of intra-day trading whereby a customer purchases shares in the early hours of trade and may sell in the later hours.

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

- It is the obligation of a brokerage house to ensure compliance with all applicable rules and regulations and appropriate internal control procedures need to be in place to prevent a customer from making a sale without holding pre-existing interest. Hence, the contentions that the blank sales were made due to the negligence of an employee or that a customer undertakes to deliver securities at the time of sale and later squares up his position cannot be accepted.
- As regards the matter of intra-day trades, no evidence was provided in support of this claim; hence this argument cannot also be accepted.

7.4 Considering the above facts and the contentions of the Respondent, it is established that on 750 occasions blank sales have been made in violation of Regulation 4 of the 2002 Regulations. In terms of Rule 8 of the Brokers Rules, more particularly sub rule (ii), sub rule (iii) and sub rule (iv) thereof, where the Commission is of the opinion that a broker has inter alia failed to comply with any requirements of the Securities & Exchange Commission of Pakistan Act, 1997 or the 1969 Ordinance or of any rules or direction made or given thereunder and/ or has contravened the rules and regulations of the Exchange and/or has failed to follow any requirement of the code of conduct laid down in the Third Schedule, it may in the public interest, take action under Rule 8(a) or (b) of the Brokers Rules.



7.5 In light of the above i.e. the fact that the Respondent made blank sales, the Respondent has violated the 2002 Regulations thereby attracting sub rule (iii) of Rule 8 of the Brokers Rule and has also failed to comply with Clause A5 of the code of conduct contained in the Third Schedule to the Brokers Rules, thereby attracting sub rule (iv) of Rule 8 of the Brokers Rule. Accordingly, a penalty of Rs.75,000 (Rupees Seventy Five Thousand) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.

8. Order Register

8.1 In terms of Rule 4(1) of the Securities and Exchange Rules 1971 ("**1971 Rules**"), it is provided that:

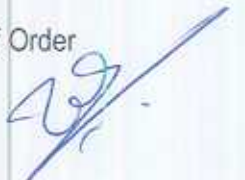
"All orders to buy or sell securities which a member may receive shall be entered, in the chronological order, in a register to be maintained by him in a form which shows the name and address of the person who placed the order, name and number of the securities to be bought or sold, the nature of transaction and the limitation, if any, as to the price of the securities or the period for which the order is to be valid."

8.2 Findings of the Enquiry Officer revealed that the register as mentioned above was not maintained by the Respondent during the Review Period.

8.3 The Respondent made the following submissions on this Issue ("**Issue No. 2**"):

- The Respondent contended that the purpose of maintaining the above mentioned register is easily served by retrieving the data of the KSE Stock system and the information is also available from its "Ultra Trade System".
- The Respondent also emphasized the practical difficulties associated with the maintenance of such a register due to quantum of orders received and stressed that the register has become obsolete with the introduction of computerized system at the KSE.

8.4 I have considered the contentions of the Respondent and am of the view that the order book as mentioned by the Respondent is not a substitute for the Order Register as required under the Rule 4(1) of the 1971 Rules, since the order book only records those orders that are placed by the brokerage house into KATS and not the orders received from the clients. Same holds true for the computerized system at KSE and in absence of Order



Register, several requirements of the Regulations for Proprietary Trading, 2004 also cannot be complied with. Hence, it is absolutely incorrect to assume that the Order Register has become obsolete.

8.5 The Commission is however cognizant of the practical difficulties associated with the maintenance of such an Order Register manually and in order to facilitate the brokerage houses in meeting the requirements of the said rule, the KSE is developing a system which will be provided in due course. However, it is noted with disappointment that the brokerage houses and exchanges were not able to keep pace with evolution in technology and significant increase in trading activities whereby a system should have been developed to enable simultaneous recording of orders received from clients and their incorporation in a database to generate the order register as required under the requirements of the Rule 4(1) of the 1971 Rules.

8.6 Considering the above mentioned facts 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.

9. Duplicates or counterfoils of memos of confirmation issued to customers

9.1 In terms of Rule 8 (1) (g) of the 1971 Rules, it is provided that:

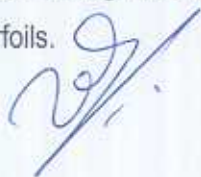
"Every member shall prepare and maintain, as required by sub-section (1) of section 6, the following books of account and other documents in a manner that will disclose a true, accurate and up-to-date position of his business, namely:-

(g) duplicates or counterfoils of memos of confirmation issued to customers".

9.2 Findings of the Enquiry Officer revealed that duplicates or counterfoils of memos of confirmation issued to customers were not maintained by the Broker.

9.3 The Respondent made the following submission on this Issue ("**Issue No. 3**"):

- The Respondent contended that the memos of confirmations of contracts are sent to customers through courier and the receipts of courier are maintained as a substitute of counterfoils.



- 9.4 I have considered the contentions of the Respondent and am of the view that the receipts of courier maintained by the Respondent merely demonstrate the fact that some information was disseminated to the clients and does not provide information about the contents of the information disseminated. Hence, the spirit of the above mentioned Rule is not being followed.
- 9.5 In light of the above it is established that the Respondent has violated the requirements of Rule 8 (1) (g) of the 1971 Rules, thereby attracting sub rule (ii) of Rule 8 of the Brokers Rule and has also failed to comply with Clause A5 of the code of conduct contained in the Third Schedule to the Brokers Rules, thereby attracting sub rule (iv) of Rule 8 of the Brokers Rule. Accordingly, a penalty of Rs.1,000 (Rupees One Thousand) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules

10. CDC Balance statements

- 10.1 In terms of Regulation 6.2A.1 of the CDC Regulations, it is provided that:


"Every Participant shall send by the 10th day of every month to all Sub- Account Holders maintaining Sub-Accounts under the control of such Participant Holding Balance statements showing the number of every Book-entry Security entered in every such Sub-Account as of the end of the preceding month. Such Holding Balance statements shall be generated from the CDS and shall be sent to the Sub-Account Holders in the manner set out in Regulation 2.6.4."

- 10.2 Findings of the Enquiry Officer revealed that the Respondent did not have a practice to send the CDC Balance statements to all of its customers by the 10th of each month as required under the CDC Regulations and where the CDC Balance statements were sent, the same were not generated from the CDS, instead the statement was sent on the Respondent's own format.
- 10.3 The Respondent made the following submission on this Issue ("**Issue No. 4**"):
- The Respondent contended that the CDC report appears at the end of its ledger statement and is thus accessible to its customers. Further, the Respondent contended that the customers are regularly informed of their CDC positions.
- 10.4 I have considered that contentions of the Respondent and am of the view that the CDC position as appearing in the back office record of the Respondent cannot be a substitute for the CDC balance statement as generated from the CDS. Further, the CDC balance statements must be sent to all customers strictly by the 10th of each month and the Respondent must have measures in place to establish compliance with this requirement.



However, considering the practical difficulties in sending the CDC balance statements to all of the clients of the Respondent, including the dormant accounts, I am inclined, on this occasion, to take a lenient view in the matter and will not take any punitive action under section 28 of the CDC Act. 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 rules and regulations in future for avoiding any punitive action under the law.

11. In view of what has been discussed above, I am of the considered view that no punitive action is necessary in relation to Issues No. 2 and 4 and a simple caution will suffice. As regards Issues No. 1 and 3, as stated above, penalties of Rs. 75,000 (Rupees Seventy Five Thousand) and Rs. 1,000 (Rupees One Thousand) are imposed respectively, which should be deposited with the Commission not later than fifteen (15) days from the date of receipt of this Order.



Zafar Abdullah
Executive Director
Securities Market Division