



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

Aba Ali Habib

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 Notice	SMD-SOUTH/SCN/29/07 dated March 16, 2007
Date of hearing	March 27, 2007
Present	Mr. Zahid Ali Habib
Date of Order	April 05, 2007

ORDER

1. I have before me 64 cases involving broadly the same issues in relation to the 64 Show Cause Notices, issued by the Commission to 64 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 64 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 64 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/29/07 dated March 16, 2007 issued to Aba Ali Habib (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 4 times, during the period from March 11, 2005 to March 17, 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/29/07 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 Tuesday, March 27, 2007 at 11:30 a.m. for a hearing, to be attended either in person and/or through an authorized representative.

6. The hearing was held on Tuesday, March 27, 2007 at 11:30 a.m. which was attended by Mr. Zahid Ali Habib the Representative of the Respondent ("the Representative"), 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 Regulation 3(b) of the Regulations applies "to the satisfaction of the KSE management" which implies that the concern must be raised by the KSE management after which it is to be evidenced that the actual shares "are deposited with the Exchange or the broker gives documentary evidence that the shares are lying in CDC or with some bank or DFI".
 - In the past, certain brokers have received written requests for information from the Exchange pursuant to an alleged violation of Regulation 3(b) of the Regulations for which the Exchange's management was wholly and sufficiently satisfied, prior to any declaration that a violation has occurred. It has at all times been the responsibility of the KSE management for the interpretation of and the enforcement of Regulation 3(b) and in this regard, evidence to the effect may be obtained from the management of the Exchange.
 - Documentary evidence in respect of availability of requisite holdings has already been provided to the Commission, which confirms that the shares were available with the Respondent against the Future sales which the Commission has not taken into account prior to issuing the Show Cause Notices.
 - Regulation 3(b) of the Regulations can not possibly be violated for each day that documentary evidence is not provided to the KSE once the sale position of a particular scrip is more than Rs. 50 million and such an interpretation of the Regulation 3(b) requiring daily disclosures of evidence in terms of the Regulation is wholly untenable, impracticable, false in terms of the letter and spirit of the Regulation and certainly not the practice at any time.

- Regulation 3(b) of the Regulations does not provide for the submission of such evidence on the date of the transaction and it is respectfully submitted that the Commission cannot assume that it is the date of the transaction.
8. The Following arguments were made by the Representative during the course of hearing:
- The Representative of the Respondent asserted that satisfaction of the Exchange was the main concern as far as the compliance of the Regulation 3(b) is concerned and since the Exchange had not issued any notice to the Respondent, therefore, there is no violation of the Regulation 3(b) of the Regulations by the Respondent.
 - The Representative of the Respondent submitted that all four instances of sales positions were backed by the net buy open positions in COT market. In this regard, he stated that the information already provided by the brokerage house can be further corroborated with the Exchange records, and hence after taking into account the COT positions, in all four instances, sale position did not cross Rs.50 million.
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 the Respondent did not cross the threshold of Rs.50 million as prescribed under the regulation 3(b), there was no non-compliance of the said Regulation by the Respondent..

- 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 since the Respondent did not at the material time cross the Rs.50 million threshold provided under Regulation 3(b) considering the Respondent's positions in COT, therefore, I am of the view that there was no non-compliance of Regulation 3(b). Hence no action is being taken against the Respondent. .

Zafar Abdullah
Executive Director