



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)

Before The Director (Securities Market Division)
In the matter of Show Cause Notice issued to
AFIC Securities (Pvt.) Limited

Under Rule 8 read With Rule 12 of The Brokers and Agents Registration Rules, 2001

Number and Date of Notice No. MSW/SMD/LSE/1(5)2006/72 dated August 28, 2007
Date of Hearing September 06, 2007
Present at the Hearing: Mr. Sajid Hussain – Chief Executive
Date of Order December 27, 2007

ORDER

1. This order shall dispose of the proceedings initiated through Show Cause Notice bearing No. MSW/SMD/LSE/1(5)2006/72 dated August 28, 2007 ("**the SCN**") issued to AFIC Securities (Pvt.) Limited ("**the Respondent**"), member of the Lahore Stock Exchange (Guarantee) Limited ("**LSE**") by the Securities and Exchange Commission of Pakistan ("**the Commission**") under Rule 8 of the Brokers and Agents Registration Rules, 2001 ("**the Broker Rules**") for violation of Rule 12 of the Brokers Rules and clause A5 of the Code of Conduct contained in the Third Schedule of the Brokers Rules.
2. The brief facts of this case are that the Respondent is a member of LSE and is registered with the Commission under Brokers Rules. An enquiry was initiated by the Commission in exercise of its powers under Section 21 of the Securities and Exchange Ordinance, 1969 ("**the Ordinance**") and Ford Rhodes Sidhat Hyder & Co. ("**the Enquiry Officer**") was appointed as the Enquiry Officer under the above mentioned section for the following:
 - (a) to enquire into the dealings, business or any transaction by the Respondent during the period from April 01, 2006 to June 15, 2006 ("**the Review Period**").
 - (b) to identify any and all the acts or omissions constituting the violation of the Ordinance and the Rules made thereunder.
 - (c) to identify violations of any other applicable laws, including but not limited to the Brokers Rules, Regulations for Short Selling under Ready Market, 2002 ("**Short Selling Regulations**"), General Rules and Regulations of LSE, Securities and Exchange Rules 1971 ("**the 1971 Rules**") and directives issued by Commission from time to time.
3. The findings of the Enquiry Officer revealed several instances of potential non compliances with applicable laws and regulations. A copy of Enquiry Officer's report was sent to the Respondent on May 28, 2007 which



required the Respondent to provide explanations on the observations of the Enquiry Officer together with supporting documents.

4. After perusal of the Respondent's reply to the above mentioned letter, which did not adequately explain the position in respect of some instances, the SCN was issued to the Respondent under Rules 8 of the Brokers Rules stating that the Respondent has prima facie contravened Rule 12 of the Brokers Rules and Clause A5 of the Code of Conduct contained in the Third Schedule of the Brokers Rules which are reproduced as under:

Rule 12- "A broker holding a certificate of registration under these 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 him".

5. On August 28, 2007 the Respondent was called upon to show cause in writing within seven days and appear before the undersigned on September 6, 2007 for a hearing, to be attended either in person and/or through an authorized representative.
6. The hearing was held on September 06, 2007 which was attended by Mr. Sajid Hussain – Chief Executive of the Respondent who argued the case and requested that instead of a new written reply to the SCN its earlier reply dated June 25, 2007 may be treated as reply to the SCN.
7. A summary of contentions and objections that were raised by the Respondent in its written submissions and during the hearing and findings and conclusions of the Commission on the same is as follows:

8. **Blank Sales ("Issue No. 1")**

- 8.1 In terms of Regulation 4 of the Short Selling Regulations, Blank Sales are not permissible and in terms of Regulation 5 of the Short Selling Regulations, it is provided that:

"No Member shall make a Short Sale unless:

- a. Prior contractual borrowing arrangement has been made.
- b. The sale is made at an uptick, and
- c. The trade is identified as a Short Sale at the time of placement of order"

- 8.2 The findings of the Enquiry Officer's report revealed 181 instances of Blank Sales during the Review Period.
- 8.3 The Respondent made the following submissions on the issue:

- With regard to the instances of Blank Sales given in the Annexure – A ("**the Annexure**") of the SCN the Respondent in its earlier reply dated June 11, 2007 stated that some of its clients sold their shares upon promise that they will transfer their holdings from CDC investor account or from other brokerage houses, but once they squared up their positions they did not transfer their shares and it was its mistake to trust the clients as it was new in the business.



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)

- However, during the course of hearing accepted that it allowed some of its clients to sell over and above their holdings/positions as it was not aware of the requirements of the relevant rules and regulations. However, during the hearing the Respondent was again asked to provide documentary evidence to show that clients had pre-existing interest in shares mentioned in the Annexure. The Respondent vide letter dated September 12, 2007 submitted a number of documents like CDC Statements of House account, ledger statements and LSS System Reports to substantiate that clients had pre-existing interest.
- The Respondent stated that it is in brokerage business only for the last three years, therefore, requested to take a lenient view keeping in view as it is new in the business.

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

- The Respondent during the course of hearing accepted the execution of Blank Sales and stated that he was not aware of requirements of law relating to Blank/Short Sales. However, later on the Respondent in his written reply dated September 12, 2007 submitted documents to show that the clients had pre-existing interest against the sales mentioned in the Annexure. However, after a review of said documents it did not prove that the clients had pre-existing interest in the shares before sale except for the instances of Blank Sales given at serial no. 34-62 and 87-104 of the Annexure. The Respondent provided CDC Balance Report of house account to show that the Respondent had delivery in house account, however, the Respondent failed to provide any documentary evidence to establish that the shares placed in House Account belonged to the clients mentioned in the Annexure. Therefore, out of 181 instances of Blank Sales mentioned in the Annexure of the SCN the Respondent failed to prove pre-existing interest of clients in 141 instances and therefore, there is no doubt in my mind that the Respondent executed Blank Sales in violation of Regulation 4 of the Short Selling Regulations.
- The Respondent's assertion that it allowed some of its clients to sell shares upon promise that they will transfer the shares from other brokerage houses or from their CDC Investor Account also does not absolve the Respondent from his obligation to ensure that the clients had pre-existing interest in the before selling the shares. The Respondent should have obtained documentary evidence of the pre-existing interest before placement of sale order into the system, in order to ensure compliance with applicable rules and regulations.
- It may be noted that Respondent is responsible for all the trades executed through its terminals, therefore, it was the duty of the Respondent to ensure that all the orders executed through its house are in conformity with the applicable rules and regulations. Before placing any order on its terminal the Respondent should ensure its clients have sufficient pre-existing interest in the shares being sold. In case any client desires to Short Sale in a scrip he may be allowed to do so in futures market or in case



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)

of ready market the broker should ensure that requirements of Short Selling Regulations have been met.

8.5 Considering the above facts and the contentions of the Respondent, it is an established fact that on 162 occasions Blank Sales have been made in violation of Regulation 4 of the Short Selling Regulations. In terms of Rule 8 of the Brokers Rules, sub rule (ii) where the Commission is of the opinion that a broker has inter alia failed to comply with any requirements of the Act or the Ordinance or of any rules or directions made or given thereunder, in terms of sub rule (iii) has contravened the rules and regulations of the exchange and in terms of sub rule (iv) has failed to follow any requirement of the Code of Conduct laid down in the Third Schedule, the Commission may in the public interest, take action under Rule 8(a) or (b) of the Brokers Rules.

8.6 In light of the above i.e. the facts the Respondent by making Blank Sales has violated the Short Selling Regulations thereby attracting sub rule (iii) of the 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 the Rule 8 of the Brokers Rule. Accordingly, a penalty of Rs. 50,000 (Rupees Fifty Thousand only) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.

9. **Account Opening Forms not signed by Respondent ("Issue No. 2")**

9.1 In terms of Commission's Directive No. SMD/SE/2(89) 2003 dated July 23, 2003 which requires all the members-brokers to maintain Account Opening Form(s) ("the AOF(s)") in conformity with the Standardized Account Opening Form ("the SAOF") prescribed by the Commission and subsequent changes made to the SAOF vide letters No. SMD/SE/2(89) 2003, dated November 19, 2003 and January 20, 2004. Subsequently this SAOF was also made part of LSE General Rules and Regulations as Chapter VIII. The said directives of the Commission require that not applicable fields of the AOFs must be marked as "N/A".

9.2 Findings of the Enquiry Officer revealed that fields not applicable were not marked as "NA" as required.

9.3 The Respondent made the following submission on this issue:

- The Respondent in his written reply stated that it has recently updated all the AOF.
- Whereas during the hearing the Respondent accepted this mistake.

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

- With regard to the violation of not properly filling the AOFs the Respondent accepted its mistakes and stated that the same has been rectified and assured that it will be careful in future. It may be noted that AOFs is the basic agreement between the broker and its clients and all the transactions executed by broker on behalf of its clients are governed by the clauses of the AOF, therefore, a complete AOF not only safeguards the rights of the clients but also the broker in case any dispute arises between them. Although the error appears to be very trivial in nature, however, it give rise to the risk that AOFs



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)

may be amended later on with out the consent of the account holder thus jeopardizing client's rights. Therefore, to eliminate the said risk the SAOF requires that the AOFs should be complete in all respect. Thus by not properly filling the AOFs the Respondent has failed to comply with the directives of Commission issued in this regard from time to time.

- 9.5 Considering the above facts and the contentions of the Respondent, it is established that the Respondent has failed to comply with Commission's directive and General Rules and Regulations of LSE. In terms of Rule 8 of the Brokers Rules, more particularly sub rule (iii) and sub rule (v) therefore, where the Commission is of the opinion that a broker has inter alia failed to comply with requirements of the any directions of the Commission 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, to take action under Rule 8(a) or (b) of the Brokers Rules.
- 9.6 In light of the above i.e. the fact the Respondent failed to comply with Commission's directive thereby attracting sub rule (v) of the Rule 8 of the Brokers Rule. However, based on the Respondents statement that he has already taken corrective actions and assured the Commission that such violations will not occur in future, 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 these instances to the Respondent would suffice and I would further direct the Respondent to ensure that full compliance be made of all rules, regulations and directives of the Commission in the future for avoiding any punitive action under the law.
10. **Order Register ('Issue No. 3')**
- 10.1 In terms of Rule 4(1) of the 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, the 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."
- 10.2 The findings of the Enquiry Officer revealed that the register as mentioned above was not maintained by the Respondent during the Review Period.
- 10.3 The Respondent made the following submission on this issue:
- The Respondent in its written reply asserted that Order Register is being maintained by ULTRA TRADE SYSTEM and all trades information is available with the LSE.
 - During the hearing the Respondent assured that it will now maintain the Order Register as required under the aforementioned Rule of 1971 Rules.



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)

10.4 I have considered the contentions of the Respondent and I am of the view that electronic ledgers or the Daily Activity Log as mentioned by the Respondent is not a substitute for the Order Register as required under the Rule 4(1) of the 1971 Rules. The aforementioned Logs only record those orders that are placed by the Respondent into LOTS and not all the orders which were received from the clients and not entered into LOTS. Further, the said Log only records the time of placement of orders into the system and not the time of receipt of orders.

10.5 The Commission is also cognizant of the practical difficulties associated with the maintenance of such an Order Register manually. However, it is noted with disappointment that the brokerage house and LSE 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 Rule 4(1) of the 1971 Rules.

10.6 Considering the above mentioned fact 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 that a caution in this instance to the Respondent would suffice and I would further direct the Respondent to ensure that full compliance be made of all the laws, regulations and directives of the Commission in future for avoiding any punitive action under the law.

11. **Separate Bank Account for Clients Funds (Issue No. 4)**

11.1 In terms Commission's directive No. SMD/SE 2(20)/2002 dated March 4, 2005 which states that;

"The exchanges are to ensure that brokers follow the practice of segregating clients' assets from the broker's assets in order to ensure that clients' assets are not misused.

For this purpose brokers should have one separate bank account which includes all the cash deposits of their clients along-with records/breakdown of client positions."

11.2 The findings of the Enquiry Officer revealed that the Respondent was not maintaining separate bank account for clients' funds.

11.3 The Respondent made the following submission on this issue;

- The Respondent acknowledged that during the Review Period separate bank account was not being maintained by it, however, after the enquiry new bank account for clients' funds has been opened and same is being maintained for the last seven to eight months

11.4 I have considered the contentions of the Respondent and I am of the view that the Respondent has failed to comply with the Commission's directive no. SMD/SE 2(20)/2002 dated March 4, 2005. The said directive requires the members to maintain one separate bank account in which only the client's funds are to be placed in order to stop the members from using clients' funds for their own purposes. The same fact were also put



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)

before the Respondent during the hearing to which the Respondent said that it has already started to maintain a separate bank account for client's funds as required under the said directive.

- 11.5 Considering the above mentioned fact 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 that a caution in this instance to the Respondent would suffice and I would further direct the Respondent to ensure that full compliance be made of all the laws, regulations and directives of the Commission in future for avoiding any punitive action under the law.
12. As stated above, the Respondent is penalized as follows:
- As regards Issue No1, as stated above, a penalty of Rs. 50,000/- (Rupees fifty Thousand only) is imposed.
 - No punitive action is taken in relation to Issue No. 2, 3 and 4 and a simple caution will suffice.
13. The matter is disposed of in the above manner and the Respondent is directed to deposit the fine with the Commission not later than fifteen (15) days from the receipt of this Order.

Imren Inayat Butt
Director (SM)
Securities Market Division