



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

Eastern Capital 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")

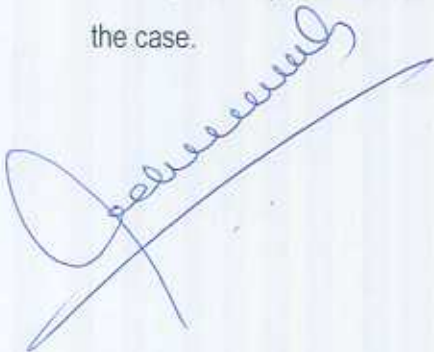
Number and date of Notice	SMD-SOUTH/SCN/122/07 dated August 31, 2007
Date of hearing	September 17, 2007
Present	Mr. Rasheed Ahmad, Chief Operating Officer
Date of Order	December 14, 2007

ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice SMD-SOUTH/SCN/122/07 dated August 31, 2007 ("**Show Cause Notice**") issued to **Eastern Capital 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 Karachi Stock Exchange (Guarantee) Limited (the "**Exchange**") 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

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- 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 ("**2002 Regulations**"), General Rules & Regulations of the Karachi Stock Exchange (Guarantee) Limited 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 copy of the Enquiry Officer's report was sent to the Respondent under cover of a letter dated May 25, 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 replies to the above mentioned letter, which did not adequately explain the position, 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 Act and 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 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 them".
5. The Respondent was called upon to show cause in writing within seven days and appear before the Executive Director (SMD-South) on September 17, 2007 for a hearing, to be attended either in person and/or through an authorized representative.
6. The hearing was held on September 17, 2007 which was attended by Mr. Rasheed Ahmad, the Representative of the Respondent, who submitted a written reply and argued the case.



7. A summary of the contentions that were raised by the Respondent in the written submission / during the hearing and the findings / conclusion of the Commission on the same are as follows:

8. Blank Sales

- 8.1 In terms of Regulation 4 of the 2002 Regulations, blank sales are not permissible. The findings of the Enquiry Officer revealed 41 instances of blank sales during the Review Period.

- 8.2 The Respondent made the following submission on this Issue ("**Issue No. 1**"):

- The Respondent claimed that majority of these instances were in fact not blank sales and proper evidences were submitted to the Enquiry Officer to verify same.

- 8.3 The Respondent, upon the direction of the Commission, submitted evidences in support of its claim, perusal of which revealed that the 41 instances were not blank sales. Hence, no punitive action is required under Rule 8 of the Brokers Rules.

9. Missing Account Opening Forms

- 9.1 In terms of Regulation 74 of the General Rules & Regulations of Karachi Stock Exchange (Guarantee) Limited ("**KSE Regulations**") it is provided that:

"The Members of the Exchange shall adopt the Standardized Account Opening Form, attached as Form-I to these Regulations, for their new Account Holders with immediate effect and for the existing operating accounts, the same shall be brought into conformity with Standardized Account Opening Form effective from March 31, 2004".

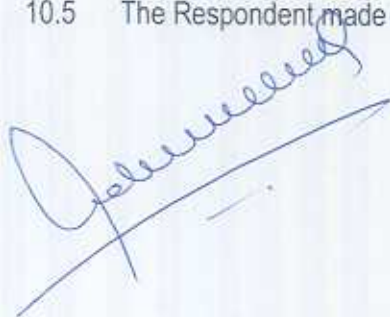
- 9.2 Findings of the Enquiry Officer revealed that the Account Opening Forms of certain customers were not available with the Respondent.

- 9.3 The Respondent made the following submission on this Issue ("**Issue No. 2**"):

- The Respondent contended all the forms in its possession were provided to the Enquiry Officer and remaining forms pertained to old and inactive clients.



- 9.4 In the above 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 rules and regulations in the future for avoiding any punitive action under the law.
10. **Book entry securities of various clients held in the CDC House account and CDC sub account of another customer**
- 10.1 In terms of Regulation 2.11.1 of the CDC Regulations, the term "House Account" is defined as:
- "An account maintained on the CDR by an account holder for recording book entry securities beneficially owned by the account holder".
- 10.2 In terms of Section 2(27) of the CDC Ac, the term "sub-account" has been defined as:
- "sub-account" means a sub-account maintained, as part of the account of a participant, in accordance with the regulations by a central depository in the name of a sub-account holder so as to record the title of the sub-account holder to any book-entry securities entered in such sub-account.
- 10.3 Findings of the Enquiry Officer revealed certain cases of customers where no sub-accounts were opened and in the absence of these accounts, the related movements of securities against the transactions undertaken by such customers were affected through either the House Account or a CDC sub account opened in the name of another customer.
- 10.4 Findings of the Enquiry Officer revealed that in case of certain customers no sub-accounts were opened. The trading on behalf of these customers was performed by the Chief Executive Officer (CEO) of the Respondent and in the absence of the respective CDC sub-accounts, the related movements of securities against the transactions undertaken by such customers were affected through the CDC sub-account of the CEO.
- 10.5 The Respondent made the following submissions on this Issue ("**Issue No. 3**"):



- The Respondent contended that under the CDC Act, it is not mandatory to open the CDC account of a customer. However, the Respondent submitted that it has corrected its practice and has opened CDC sub account of all of its customers.
- The Respondent also submitted that the practice of trading through the CEO's account has also been terminated.

10.6 I have considered the contentions of the Respondent and am of the view that CDC accounts are opened to establish the title and beneficial ownership of the shares and therefore, a brokerage house should either open the CDC sub account of its customers, or the customer should have its own CDC Investor account or CDC participant account. In the absence of relevant CDC sub accounts, keeping the shares of clients in a CDC sub account opened in the name of another customer or in the CDC House account is a serious violation of the CDC Act, as it results in the change in the beneficial ownership of the shares.

10.7 In terms of Section 28 read with Section 3 of the CDC Act, it is provided that the Commission can impose a penalty for contravention or an attempt to contravene any provision of the CDC Act or CDC Regulations. Since by keeping the book entry securities of different clients in a single CDC sub account opened in the name of another client, the Respondent has violated Section 2(27) of the CDC Act and Regulation 2.11.1 of the CDC Regulations, I am of the view that a penalty of Rs.25,000 (Rupees Twenty Five Thousand) be imposed on the Respondent.

11. Change in trades

11.1 In terms of Clause A 1 and A2 of the code of conduct contained in the Third Schedule read with Rule 12 of the Brokers Rules, it is provided that:

A1-"A broker shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business"

A2-"A broker shall act with due skill, care and diligence in the conduct of all his business."

11.2 Findings of the Enquiry Officer revealed various instances where trades entered into KATS on account of a client were subsequently assigned to another client in the Back Office record.



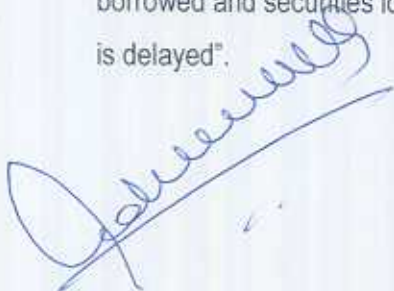
- 11.3 The Respondent made the following submissions on this Issue ("**Issue No. 4**"):
- The Respondent contended that the above mentioned instances were a result of errors by the KATS operator and occurred due to constraints of time. The Respondent submitted that it has taken measures to ensure that the same does not occur in future.
- 11.4 I have considered the contentions of the Respondent and am of the view that in order to ensure the practice of fair trade and due skill as well as care and diligence in conduct of business, the Respondent should have entered correct KATS ID for its clients. Subsequent modification of trades and their allocation to another customer creates opportunities to disguise any violation of laws and regulations that might have occurred.
- 11.5 In light of the above the Respondent has failed to comply with Clause A1 and A2 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.1,000 (Rupees one thousand) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.

12. Difference in the Back Office record and CDC statements

- 12.1 In terms of Rule 8 1(a) and (c) of the Securities and Exchange Rules, 1971 ("**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:-

- (a) journal (or other comparable record), cash book and any other books of original entry, forming the basis of entries into any ledger, the books of original entry being such as contain a daily record of all orders for purchase or sale of securities, all purchases and sales of securities, all receipts and deliveries of securities and all other debits and credits;
- (c) ledgers (or other comparable records) reflecting securities in transfer, securities borrowed and securities loaned and securities bought or sold, of which the delivery is delayed".



12.2 Findings of the Enquiry Officer revealed differences between the holdings of book entry securities by client as per the back office record and as per the CDC Balance statements.

12.3 The Respondent made the following submission on this Issue ("**Issue No. 5**"):

- The Respondent contended that the differences were temporary in nature and occurred only due to constraints of time. The Respondent submitted that it has taken measures to ensure that the same does not occur in future.

12.4 Considering the above mentioned facts and the corrective measures taken by the Respondent, 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 design and implement a sound system of internal controls in order to ensure that full compliance is made of all the rules and regulations in future for avoiding any punitive action under the law.

13. CDC Balance statements

13.1 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."

13.2 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.

13.3 The Respondent made the following submission on this Issue ("**Issue No. 6**"):



- The Respondent contend that the CDC Balance statements were provided to its clients on regular basis and any failure in this regard would be of isolated nature and due to bona fide error. However, evidences of dispatch of CDC Balance statements were impractical to maintain.

13.4 Considering the above mentioned facts no punitive action is required under section 28 of the CDC Act. However, I would direct the Respondent to take measures to obtain acknowledgments of its clients to demonstrate compliance with the CDC Regulations.

14. 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. 1, 2, 5 and 6 and a simple caution will suffice in case of Issues No. 2 and 5. As regards Issues No. 3 and 4, as stated above, penalties of Rs. 25,000 (Rupees Twenty Five Thousand) and Rs.1,000 (Rupees One Thousand) respectively are imposed, 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