



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN  
(Securities Market Division)

Before The Director (Securities Market Division)

In the matter of Show Cause Notice issued to

Escorts Investment Bank 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 dated October 08, 2007
Date of Hearing	October 18, 2007
Present at the Hearing:	Mr. Kamran Nasir – Chief Financial Officer Mr. Jawad Akhtar – Head Capital Markets Division
Date of Order	January 16, 2008

ORDER

1. This order shall dispose of the proceedings initiated through Show Cause Notice bearing No. MSW/SMD/LSE/1(5)2006/2 dated October 08, 2007 (**"the SCN"**) issued to Escorts Investment Bank 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 Brokers 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. Brief facts of the case are that the Respondent is a member of the 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 Sidat 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.



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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 on September 07, 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 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 read with Clause A5 of the Code of Conduct contained in the Third Schedule to 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 Securities & Exchange Commission of Pakistan Act, 1997 (**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 October 08, 2007, the Respondent was called upon to show cause in writing within seven days and appear before the undersigned on October 18, 2007 for a hearing, to be attended either in person and/or through an authorized representative.
6. The hearing was attended by Mr. Kamran Nasir, Chief Financial Officer and Mr. Jawad Akhtar, Head Capital Markets Division of the Respondent who argued the case.
7. A summary of the 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 are 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 revealed 882 instances of Blank Sales during the Review Period.

- 8.3 The Respondent made the following submissions on the issue:

- The Respondent during the hearing stated that in case of some Blank Sales relating to clients M. Saleem and Naheed Khanum Shermani bearing codes 4024 and 7012 respectively, the said clients



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had availed Margin Financing from banks which is reflected in the ledger statements of the clients provided vide letter dated November 15, 2007.

- The Respondent further stated that some of the Blank Sales mentioned in the Annexure – A ("the Annexure") of the SCN were due to use of wrong client codes. In order to substantiate its claim the Respondent provided copies of a number of "Key Punch Error Forms" which showed the wrong and correct client codes and was duly signed by the officials of the Respondent.
- Further, with reference to the Blank Sales relating to Mr. Babar Ali Hamayun, the Respondent stated that the said client undertook to provide deliveries of shares sold by him but later on he squared up his position. The Respondent during the hearing further stated that it had allowed some of its clients to sell small amount of shares over and above their positions as they usually provide delivery from other houses or from their Investor Accounts. However, for high volume trades pre-existing interest is always checked before placing the orders.
- After the hearing, the Respondent vide letter dated November 15, 2007 provided further documents to substantiate its claim that the clients had pre-existing interest against the sales mentioned in the Annexure. With regard to some of the sales given in the Annexure, the Respondent provided "Delivery Arrangement Request" signed by both Respondent and its clients vide which Respondent agreed to provide deliveries to clients who wanted to Short Sell the shares. For the rest of the cases the Respondent provided unilateral authorization letters from Engr. Mian Sajid Masood, member LSE, under which the said member authorized the Respondent's clients to sell his shares and further undertook to provide deliveries to Respondent's clients in case they needed the shares.

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

- With regard to Respondent's assertion that two of its clients M. Saleem and Naheed Khanum Sherwani bearing codes 4024 and 7012 respectively had pre-existing interest in the shares before sale as they had shares available in margin finance. The Respondent provided ledger statements of the said clients which showed that the clients had opening positions. After a review of the clients' trading data it was observed that sale mentioned at serial nos. 117, 118, 123, 481-488 and 834-836 were not Blank Sales and clients had CFS/margin finance position before sales. However, rest of the sales of these clients were made over and above their opening positions. In order to cover the sales over and above the opening balance Respondent provided a number of authority letters/Delivery Arrangement Requests. These authority letters/Delivery Arrangement Requests are discussed in the subsequent paragraphs.
- With regard to the Respondent's assertions regarding use of wrong client codes, after a review of "Key Punch Error Forms", it was observed that sales mentioned at serial nos. 479-480, 637, 638 and 811-813 were not Blank Sales. However, with regard to the Blank Sales mentioned at serial nos. 211-213



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the "Key Punch Error Form" showed that the client had purchased shares in wrong account. However, time of purchase of these shares showed that same were made after sales, therefore, the client did not have any prior purchase position before sales mentioned at serial nos. 211-213. However, in order to cover oversold position, the Respondent provided a number of authority letters/Delivery Arrangement Requests. The Commission's observations on these authority letters/Delivery Arrangement Requests are given in subsequent paragraph.

- With regard to the Respondent's assertion that it allowed some of its clients to execute Short Sale on the assumption that they always provide delivery when required does not hold any weight. It may be noted that it is the responsibility of the Respondent to ensure that its clients have pre-existing interest in the shares being sold by them. The Respondent should always obtain sufficient documentary evidence from its clients for their pre-existing interest in the shares being sold and should not rely merely on the clients' previous record. Since the Respondent is responsible for all the trades executed through its house, therefore, it should ensure that all the orders placed by it on the system are in accordance with the applicable rules and regulations. Therefore, the Respondent's said assertion can not be taken as sufficient evidence to prove that the clients had pre-existing interest against the sales mentioned in the Annexure.
- With regard to the authority letters/Delivery Arrangement Requests provided by the Respondent it may be noted that the copies of authority letters/Delivery Arrangement Requests provided by the Respondent show that same were made on plain paper and not judicial paper. Further, the authority letters/Delivery Arrangement Requests provided by the Respondent did not contain the terms and conditions of the agreement and can not be accepted as valid borrowing agreements/contracts. However, in case if these authority letters/Delivery Arrangement Request are accepted as valid borrowing agreements it may be noted that Regulation 5 of the Short Selling Regulations requires that Short Sales can only be made after fulfilling the pre-requisites which include that trade must be identified as Short Sales at the time of placement of order. For this purpose the trading system of LSE has provided a separate window for Short Sales. Since the Respondent did not use the separate window to identify these trades as Short Sales, therefore, by executing the trades given in the Annexure, the Respondent failed to comply with the Regulation 5(c) of the Short Selling Regulations.

8.5 Considering the above facts and the contentions of the Respondent, it is established that 861 trades were executed by the Respondent in violation of 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.



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8.6 In light of the above i.e. the fact the Respondent made sales in violation of 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. 75,000/- (Rupees Seventy Five Thousand only) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.

9. **Account Opening Forms ("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 ("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:

- i) AOF of all the clients should be maintained by the members.
- ii) Each page of AOF should be signed by the client and the member or his authorized representative.
- iii) Copy of client's CNIC should be attached with AOFs.
- iv) Attested copy of CNIC of the client should be attached with the AOFs.
- v) List of Transaction fee, Commission to be charged by the Broker and other CDC charges to be levied should be attached with the AOFs.

9.2 Findings of the Enquiry Officer revealed that:

- i) The AOFs of 17 clients were not available with the Respondent.
- ii) Each page of AOFs was not signed by the Respondent or its authorized representative.
- iii) Copies of CNICs of clients were not attached with AOFs.
- iv) Copies of clients' CNICs enclosed with AOF were not attested.
- v) List of Transaction fee, Commission to be charged by the Broker and other CDC charges to be levied was not attached with the AOFs.

9.3 The Respondent made the following submission on these issues;

- With reference to the missing AOFs the Respondent stated that these belonged to corporate clients and during the review period these accounts were inactive.
- With reference to the Respondent's missing signatures on the AOFs, the Respondent stated that all the pages of AOFs are signed by the clients and Respondent. However, in some cases its signatures were missing due to mistake. However, after the enquiry the errors have been rectified.



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- With regard to missing CNICs of the clients, the Respondent asserted that in some case CNICs of old and inactive accounts are missing. Since these clients are inactive and out of contact, therefore, the Respondent could not obtain the new CNICs of these clients.
- With reference to violation of unattested copies of clients' CNICs, the Respondent asserted that instead of obtaining attested copies of clients' CNICs it has been seeing the original CNICs at the time of opening of account.
- With reference to violation of not attaching list of charges with the AOFs, the Respondent stated that transaction fees are mentioned on the account statements which are accepted by the clients. However, after enquiry it has started to attach list of transaction fee with the AOFs.
- During the hearing the Respondent informed that after enquiry it has put in place proper system to ensure full compliance with the requirements of SAOF.

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

- In case of missing AOFs it is generally observed that non-submission of AOF by institutional clients is an industry-wide problem which is faced by all the brokers. Further, the Respondent also stated that the missing AOFs belonged to the accounts which are inactive since long.
- The Respondent during the hearing and in its written reply acknowledged that in some cases its signatures were missing on each page of some of the AOFs. It may be noted that SAOF requires that each page of AOF should be signed by the clients and the member. Therefore, by not signing each page of AOFs the Respondent has failed to comply with the above mentioned directives of the Commission.
- With regard to the Respondent's assertion on violation of un-attested copies of clients' CNICs copies I do not agree that by just seeing the original CNIC of the client the Respondent is complying with the SAOF requirement of obtaining attested copies of CNICs. The enclosure requirements of the SAOF clearly state that attested copy of the client's CNIC should be attached with AOFs. Therefore, it was the responsibility of the Respondent that before opening an account it should obtain attested copy of client's CNIC.
- I have considered the contentions of the Respondent regarding missing list of charges with AOFs and do not agree with the Respondent's argument that giving commission rates on the account statement/trade confirmation suffices the requirement of attaching the list of charges with the AOF. It may be noted that enclosing the list of charges with the AOF makes it part of the AOF which is the basic agreement between the broker and its clients. In case any dispute arises between them all the matters are resolved on the basis of clauses of the AOF. Therefore, by not attaching the said list with the AOF the Respondent has failed to comply with the directives of the Commission.



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9.5 Considering the above facts and the contentions of the Respondent, it is established that Respondent has failed to comply with Commission's Directive and General Rules and Regulations of the LSE. In terms of Rule 8 of the Brokers Rules, more particularly sub rule (iii), (iv) and sub rule (v) therefore, where the Commission is of the opinion that a broker has inter alia failed to comply with requirements of 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 Respondent's statement that it has already taken corrective actions and assured 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 order 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 stated that most of the orders are placed by its clients on telephones connected to a voice recording system. The voice recording system maintains time wise record of all the calls. Thus the voice recording system complies with the requirement of the Rule 4(1) of the Securities and Exchange Rules 1971.

10.4 I have considered the contentions of the Respondent and I am of the view that the voice recording system does not record the orders placed by clients present in the house. However, the Respondent's effort to meet the requirement of law through other means is laudable. The Commission is also cognizant of the practical difficulties associated with the maintenance of such Order Register manually.

10.5 Considering the above motioned 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



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instance to the Respondent would suffice and I would further direct the Respondent to ensure that full compliance is made of all the laws, regulations and directives of the Commission in future for avoiding any punitive action under the law.

11. As stated above, the Respondent is penalized as follows:
- a) As regards Issue no 1, as stated above, a penalty of Rs. 75,000/- (Rupees Seventy Five Thousand only) is imposed.
  - b) No punitive action is taken in relation to Issue nos. 2 and 3 and a simple caution will suffice.

11.1 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.

Imran Inayat Butt  
Director  
Securities Market Division