



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 National Equities Limited

Under Rule 8 read with Rule 12 of the Brokers and Agents Registration Rules, 2001 ("The Brokers Rules")

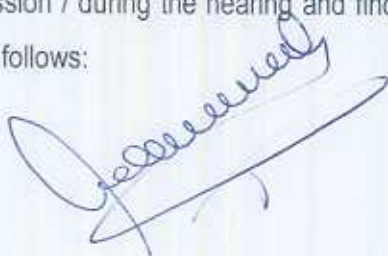
Number and date of Notice	SMD-SOUTH/SCN/115/07 dated August 16, 2007
Date of hearing	August 31, 2007
Present	Mr. Mirza Mehmood Ahmad and Mr. Muhammad Rafique
Date of Order	December 17, 2007

ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice SMD-SOUTH/SCN/115/07 dated August 16, 2007 ("**Show Cause Notice**") issued to First National Equities 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.
2. Brief facts of the case are that the Respondent is a member of the Karachi Stock Exchange (Guarantee) Limited (the "**Exchange/KSE**") 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 Karachi Stock Exchange (Guarantee) Limited, Regulations for Proprietary Trading, 2004 ("**2004 Regulations**").
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, the Show Cause Notice was issued to the Respondent under Rule 8 of the Brokers Rules stating that the Respondent has prima facie contravened *inter alia* 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 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 August 31, 2007 for a hearing, to be attended either in person and/or through an authorized representative.
6. The hearing was held on August 31, 2007 which was attended by Mr. Mirza Mehmood Ahmad and Mr. M. Rafique, the Representatives 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 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 4,847 instances of blank sales during the Review Period.

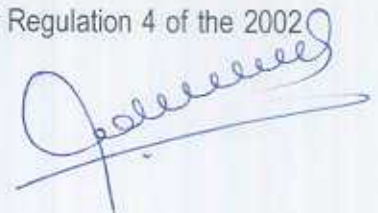
8.2 The Respondent made the following submissions on this Issue ("**Issue No. 1**"):

- The Respondent claimed that majority of these instances were in fact not blank sales and the respective clients had pre-existing interest at the time of sale. Upon the direction of the Commission, the Respondent undertook to provide valid evidence in support of its claim.
- The Respondent also contended that the Enquiry Officer selected the transactions on a 'pick and choose' basis and did not take into account earlier purchases made by the respective clients.
- The Respondent also 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 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. However, no evidence was provided in support of this assertion.

8.3 I have considered the contentions of the Respondent and the same are addressed by me below:

- The perusal of the evidence submitted by the Respondent reveals that 2,787 out of 4,847 instances were not blank sales and the respective customers had pre-existing interest at the time of trade. However, satisfactory evidence was not provided in respect of remaining 2,060 instances of blank sales.
- It is the obligation of the 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 fact that a customer undertakes to deliver securities at the time of sale and later squares up his position cannot be accepted.
- As regards the issues of intra-day trades and earlier purchase, no evidence was provided in support of this assertion; hence the argument cannot be accepted.

8.4 Considering the above facts and the contentions of the Respondent, it is established that on 2,060 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 ("**1997 Act**") 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.

- 8.5 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 Rules 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 Rules. Accordingly, a penalty of Rs.100,000 (Rupees One Hundred Thousand) is hereby imposed on the Respondent under Rule 8 (b) 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 institutional clients were either not maintained by the Respondent or the account opening forms of these clients were not complete in all respect and did not contain all the relevant information required to be filled in.

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

- The Respondent contended that the discrepancies pointed out by the Enquiry Officer were removed and the corrected forms were presented before him. The Respondent further submitted that it has created two separate departments to immediately take action on any discrepancies in the forms.
- The Respondent also submitted account opening forms in support of its claim.

9.4 Considering the fact that non-submission of account opening forms by institutional clients is an industry-wide problem which is faced by all the brokers and the corrective measures taken by the Respondent in this regard, 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 no individual or Institution is admitted as a client unless it submits a duly filled account opening forms with supporting documents and that the Respondent should clearly direct all of its existing clients to submit duly filled account opening forms.

10 Order Register

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

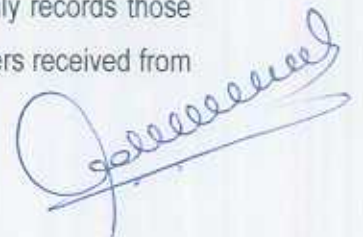
"All orders to buy or sell securities which a member may receive shall be entered, in the chronological order, in a register to be maintained by him in a form which shows the name and address of the person who placed the order, name and number of the securities to be bought or sold, the nature of transaction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

10.2 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 submissions on this Issue ("**Issue No. 3**"):

- The Respondent contended that the purpose of maintaining the above mentioned register is easily served by retrieving the data of 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.

10.4 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.

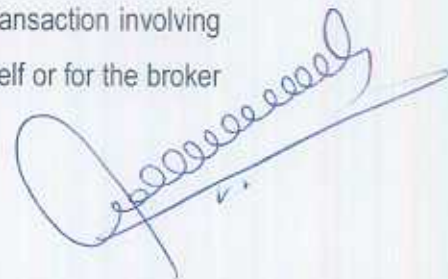
10.5 However, the Commission is also cognizant of the practical difficulties associated with the maintenance of such an Order Register manually and in order to facilitate the brokerage houses in meeting the requirements of the said rule, the KSE is developing a system which will be provided in due course. 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 data base to generate the order register as required under the requirements of the Rule 4(1) of the 1971 Rules.

10.6 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.

11. Non-compliance with Regulation 4 (ii) of the 2004 Regulations

11.1 In terms of Regulation 4 (ii) of the 2004 Regulations it is provided that:

- a) A broker, agent or an associated person who has an "at best" order from a customer to buy or sell a security shall not, while such order remains unexecuted, engage in proprietary trade transaction involving the purchase or sale of that security for himself or for the broker for which he is a partner or for the account of any of the partners therein or for any account in which he, such broker or partner, directly or indirectly, has an interest. Provided, if a broker, agent or an associated person who has his own "at best" order to buy or sell a security prior to an order from a customer, the same shall have priority over the "at best" order of a customer subject to disclosure of such an order by the broker, agent or an associated person to his customer.
- b) A broker who has a limit order from a customer to buy a security shall not while such order remains unexecuted, engage in proprietary trade transaction involving the purchase of that security at or below the limit price for himself or for the broker



for which he is a partner or for the account of any of the partners therein or for any account in which he, such broker or partner, directly or indirectly, has an interest.

- c) A broker who has a limit order from a customer to sell a security shall not while such order remains unexecuted, engage in proprietary trade transaction involving the sale of that security at or above the limit price for himself or for the broker for which he is a partner or for the account of any of the partners therein or for any account in which he, such broker or partner, directly or indirectly, has an interest.
- 11.2 Findings of the Enquiry Officer revealed that the Chief Executive Officer of the Respondent took decisions regarding investments, whereas, the Head of the Sales Department obtained the orders of customers during the Review Period. Both personnel directly conveyed orders to equity dealers without any coordination with each other. As a result, the above mentioned Regulation could not be complied with.
- 11.3 The Respondent made the following submission on this Issue ("Issue No. 4"):
- The Respondent contended that it keeps its proprietary trading separate from customers' trading and for this purpose has created a Chinese wall between the two functions so as to follow the above mentioned Regulation in spirit. The Respondent further claimed that no proprietary trading is carried out in its branches.
- 11.4 I have considered the contention raised by the Respondent and am of the view that although the Respondent is following the law in its spirit, the objective of the law requires it to be followed in letter as well as in spirit. The Respondent is therefore, advised to adopt the practice so that the requirements of the above mentioned Regulation are adequately followed. In light of the same, no punitive action is being taken.

12. Non-compliance with Regulation 6 of the 2004 Regulations

12.1 In terms of Regulation 6 of the 2004 Regulations it is provided that:

- (i) The broker shall disclose to his customer placing an order in a particular security, while accepting such order, whether he intends to or is carrying out proprietary trading in that security on that particular day.
 - (ii) The broker, if doing proprietary trading through agents/traders, shall disclose the name(s) of such persons to his customers.
- 12.2 Findings of the Enquiry Officer revealed that the above mentioned Regulation was not complied with by the Respondent:



- 12.3 The Respondent made the following submissions on this Issue ("**Issue No. 5**"):
- The Respondent reiterated its stance as mentioned in paragraph 11.3 above and stated that it is following the requirements of the Regulation in spirit.

12.4 I have considered the contention raised by the Respondent and am of the view that although the Respondent is following the law in its spirit, the objective of the law requires it to be followed in letter as well as in spirit. The Respondent is therefore, advised to adopt the practice so that the requirements of the above mentioned Regulation are adequately followed. In light of the same, no punitive action is being taken.

13. **Difference in the Back Office record and CDC Statements**

13.1 In terms of Rule 8 (1) (a) and (c) 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:-

- 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".

13.2 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.

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

- The Respondent contended that the differences were attributable to various factors such as slow speed of internet service, repeated disconnections with the CDC and time lag in communication. The Respondent further contended that these differences were temporary in nature and were corrected immediately.

13.4. 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 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.

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. 2, 3, 4, 5 and 6 a simple caution will suffice in case of issue No. 2, 3 and 6. As regards Issue No. 1, as stated above, a penalty of Rs. 100,000 (Rupees One Hundred Thousand) is 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*