



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

Intermarket Securities (Private) 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/124/07 dated October 22, 2007
Date of hearing	November 13, 2007
Present	Mr. M. Yasin Chaudhry and Mr. Shoaib Chamdia
Date of Order	December 14, 2007

ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice SMD-SOUTH/SCN/124/07 dated October 22, 2007 ("**Show Cause Notice**") issued to Intermarket Securities (Pvt.) 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

- c) to identify violations of any other applicable laws, including but not limited to the Brokers Rules and Regulations for Short Selling under Ready Market, 2002 ("**2002 Regulations**") 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 16, 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. 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 November 13, 2007 for a hearing, to be attended either in person and/or through an authorized representative.
6. The hearing was held on November 13, 2007 which was attended by Mr. M. Yasin Chaudhry and Mr. Shoaib Chamdia, 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 reply / during the hearing and findings / conclusions 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 387 instances of blank sales during the Review Period.

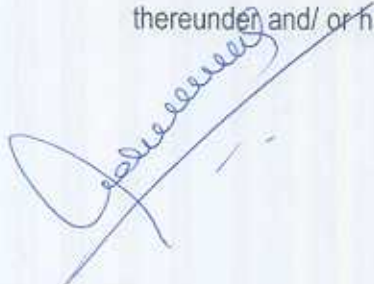
8.2 The Respondent made the following submissions on this Issue ("**Issue No. 1**"):

- The Respondent contended that the instances reported by the Enquiry Officer were not blank sales as the selling quantity of shares is equal to the quantity of shares purchased in that day.
- The Respondent further submitted that due to heavy trading and large volume of transactions, it became difficult for them to prevent occurrence of such instances. The Respondent admitted that some errors were made and were immediately sought to be rectified by purchasing back the shares.

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

- The 2002 Regulations make it absolutely clear that a blank sale is a sale which is made without owning shares, without pre-existing interest or without entering into a contractual borrowing arrangement to meet delivery of shares. Hence, merely the fact that the respective customers have purchased the shares sold on the same day, thus squaring their positions, will not establish that these sales were not blank sales if at the time of making the sale, the pre-requisites mentioned above were not met.

8.4 Considering the above facts and the contentions of the Respondent, it is established that on 387 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 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 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) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.

9. Change in trades

9.1 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."

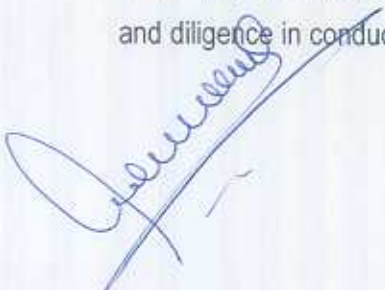
9.2 Findings of the Enquiry Officer revealed various instances where trades entered into KATS on account of a client were subsequently assigned to another client in the Back Office record. ("**Issue No. 2**"):

9.3 The findings of the Enquiry Officer revealed that two accounts were opened in the name of a minor. ("**Issue No. 3**"):

9.4 The Respondent made the following submission on **Issue No. 2**:

- The Respondent contended that the above mentioned instances were a result of errors and were corrected on the same day in the Back Office record. .

9.5 I have considered the contention of the Respondent and the issues raised therein 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, it is imperative that the correct KATS ID are used for



the clients while executing trades. Subsequent modification of trades and their allocation to another customer creates opportunities to disguise any violation of laws and regulations that might have occurred.

9.6 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.

9.7 The Respondent made the following submission on **Issue No. 3**:

- The Respondent contended that these accounts were opened by the guardians of the minor on their behalf and this practice is legally allowed. The Respondent submitted that now these accounts are operated in the names of their guardians.

9.8 I have considered the contentions of the Respondent and the issues raised therein. Considering the corrective measures taken by the Respondent, I will not take any punitive action under Rule 8 of the Brokers Rule. I would further direct the Respondent to ensure full compliance with best practices and applicable laws and regulations.

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 submission on this Issue ("Issue No. 4"):
- The Respondent contended that the register as provided above was not possible to maintain due to practical difficulties and a computerized order book is maintained as a solution.
- 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.
- 10.5 The Commission is 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 Exchange 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 database 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. Customers' securities held in House account for pledge purpose

- 11.1 In terms of CDC Regulations 2.11.1, the term "House Account" is defined as:

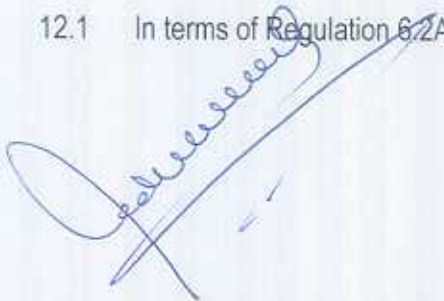
"An account maintained on the CDS by an account holder for recording book entry securities beneficially owned by the account holder".



- 11.2 Findings of the Enquiry Officer revealed that the book entry securities of certain customers were kept in the CDC House Account of the Respondent.
- 11.3 The Respondent made the following submission on this Issue ("**Issue No. 5**"):
- The Respondent submitted that it had a practice of holding customers' shares in the CDC House account of the Respondent so as to pledge the shares and obtain financing for customers from financial intuitions. The Respondent submitted that authority letters have been obtained from the customers.
 - The Respondent also contended that the practice has been adopted in order to safeguard itself in case of default of a client.
- 11.4 I have considered the views of the Respondent and am of the view that placing of customers' shares in the CDC House account of the Respondent for pledge with financial institutions is not an acceptable practice and in order to provide financing to the customers, CFS and margin financing could be utilized. CDC accounts are opened to establish the title and beneficial ownership of the shares and keeping the shares of clients in the House account is a serious violation of the CDC Regulations, as it results in a change in the beneficial ownership of the shares. Furthermore, authority from a client cannot be a defence to a violation of the law.
- 11.5 As far as the matter of safeguarding the interest of Respondent in the case of default is concerned, appropriate risk management system should be developed which is in no way in contravention of the applicable legal framework.
- 11.6 Considering the above mentioned facts, it is established that the Respondent has violated Regulation 2.11.1of the CDC Regulation. 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. Therefore, I am of the view that a penalty of Rs.25,000 (Rupees Twenty Five Thousand) be imposed on the Respondent

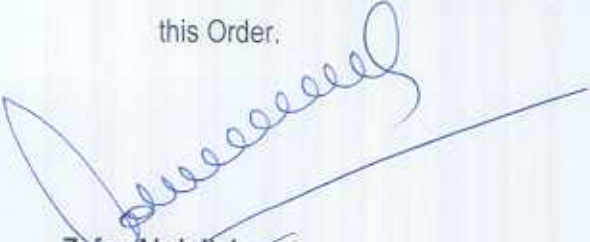
12. CDC Balance statements

- 12.1 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."

- 12.2 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.
- 12.3 The Respondent made the following submission on this Issue ("**Issue No. 6**"):
- The Respondent submitted that it regularly sends CDC Holding statements to its clients through courier service. The Respondent submitted supporting documents for this claim.
- 12.4 Considering the above mentioned facts no punitive action is required under section 28 of the CDC Act.
13. 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. 3, 4 and 6 and a simple caution will suffice in case of Issue No.4. As regards Issues No. 1, 2, and 5, as stated above, penalties of Rs. 75,000 (Rupees Seventy Five Thousand), Rs. 1,000 (Rupees One Thousand) and Rs.25,000 (Rupees Twenty Five Thousand) are respectively 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