



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

Ismail Abdul Shakoor Securities (Private) Limited (Formerly Ismail Abdul Shakoor)

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)

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| Number and date of Notice | SMD-SOUTH/SCN/106/07 dated August 03, 2007 |
| Date of hearing | September 13, 2007 |
| Present | Mr. Furqan Hanif-Director and Mr. Shoaib Chamdia -Internal Auditor |
| Date of Order | October 31, 2007 |

ORDER

1. This order shall dispose of the proceedings initiated through Show Cause Notice SMD-SOUTH/SCN/106/07 dated August 03, 2007 ("**Show Cause Notice**") issued to Ismail Abdul Shakoor Securities (Pvt.) Limited, (Formerly Ismail Abdul Shakoor) (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 Ford Rhodes Sidat Hyder & 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 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 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, 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 13, 2007 for a hearing, to be attended either in person and/or through an authorized representative.
6. The hearing was held on September 13, 2007 which was attended by Mr. Furqan Hanif-Director and Mr. Shoaib Chamdia-Internal Auditor, 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 and 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 234 instances of blank sales during the Review Period.
- 8.2 The Respondent made the following submission on this Issue ("**Issue No. 1**"):
- The Respondent submitted that these instances were either a result of mistake by the clients who squared up their positions before the end of trading or represented trading by a group of individuals who had mutual understanding to perform trading and meet delivery of shares.
- 8.3 I have considered the contention raised by the Respondent and am of the view that so far the matter of meeting the delivery requirements through mutual understanding is concerned, the regulatory framework provides an appropriate mechanism for such form of trading through the options of opening joint accounts and performing short sales by fulfilling the conditions prescribed in the 2002 Regulations. As far as the matter of blank sales made due to mistake is concerned, it is the responsibility 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.
- 8.4 Considering the above facts and the contentions of the Respondent, it is established that on 234 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 Rules 8 of the Brokers Rule. Accordingly, a penalty of Rs.50,000 (Rupees Fifty Thousand) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.



9. Customers' securities held in House account for pledge purpose

9.1 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".

9.2 Findings of the Enquiry Officer revealed that the book entry securities of certain customers were kept in the CDC House Account of the Respondent

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

- 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 the practice has now been stopped.

9.4 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.

9.5 Considering the above mentioned facts, it is established that the Respondent has violated Regulation 2.11.1 of 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

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. 3**"):
- The Respondent contended that the register as provided above was not possible to maintain due to practical difficulties and a Daily Activity Log 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 however 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. CDC Balance statements

- 11.1 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."

- 11.2 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.
- 11.3 The Respondent made the following submission on this Issue ("**Issue No. 4**"):
- The Respondent submitted that the majority of its clientele constituted retail clients who collect the CDC Balance statements by hand and the Respondent also disseminates the CDC balance statements to other customers through courier.
- 11.4 Considering the above mentioned facts I 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 take measures to obtain acknowledgments of its clients and maintain evidences of dispatch of CDC Balance statements to demonstrate compliance with the CDC Regulations.
12. 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 and 4 and a simple caution will suffice. As regards Issues No. 1 and 2 as stated above, penalties of Rs. 50,000 (Rupees Fifty Thousand) and Rs.25,000 (Rupees Twenty Five Thousand) are imposed respectively, which should be deposited with the Commission not later than fifteen (15) days from the date of receipt of this Order.



Zafer Abdullah
Executive Director
Securities Market Division