



Before the Director (Securities Market Division)

In the matter of Show Cause Notice issued to

Khalid Javed Securities (Pvt.) 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)2006/76 dated August 30, 2007
Date of Hearing	September 18, 2007
Present at the Hearing:	Mr. Khushnud Ahmed Gulzar, Director Mr. Amjad Ali, Manager Accounts Mr. Asad Ullah Javed, Advocate
Date of Order	February 01, 2008

ORDER

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1. This order shall dispose of the proceedings initiated through Show Cause Notice bearing No. MSW/SMD/LSE/1(5)2006/76 dated August 30, 2007 (**"the SCN"**) issued to Khalid Javed Securities (Pvt.) 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. The brief facts of the case are that the Respondent is a member of LSE 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 (**"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 the Commission from time to time.
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 May 22, 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 Rule 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 and 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 August 30, 2007, the Respondent was called upon to show cause in writing within seven days and appear before the undersigned on September 10, 2007 for a hearing, to be attended either in person and/or through an authorized representative. However, on the Respondent's request the date of hearing was re-fixed for September 18, 2007.
6. The hearing was attended by Mr. Khushnud Ahmed Gulzar, Director, Mr. Anjad Ali, Manager Accounts and Mr. Asad Ullah Javed, Advocate of the Respondent, who argued the case and also submitted written reply to the SCN dated September 06, 2007 to the Commission.
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. **Preliminary Objections**
- 8.1 The objections raised by the Respondent on the Enquiry conducted by the Enquiry Officer are given as under:-
- The Enquiry Officer was not appointed in accordance with the provisions of Section 21 of the Ordinance. For the purpose of enquiry under section 21 of the Ordinance a person has to be

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appointed as enquiry officer, whereas Ford Rhodes Sidat Hyder & Co. is neither a natural person nor a legal person.

- In delegation of powers under Section 10 of the Act on July 07, 2006 the Director (SM) did not have powers to order enquiry under Section 21 of the Ordinance. Further under delegation of powers under SRO 1061 (I)/2005 dated 18th October, 2005, the Director (SM) does not have the power to issue a Show Cause Notice, hear or decide under Rule 8 and 12 of the Brokers Rules.
- The requirement of Section 21 of the Ordinance is that an enquiry can only be conducted by an "order in writing" and it cannot be conducted by mere intimation. The Respondent was never informed about the order, which was passed for conducting its enquiry and neither the Respondent was heard before passing such order of enquiry.
- Section 21 (4) of the Ordinance, provides following procedure of enquiry.

"The person holding an enquiry under sub-section (1) shall, for the purpose of such enquiry have the same powers as are vested in a court under the Code of Civil Procedure, 1908 (Act V of 1908), when trying a suit, in respect of the following matters, namely :-

(a) enforcing the attendance of a person and examining him on oath or affirmation;

(b) compelling the production of documents;

(c) issuing commissions for the examination of witnesses;

and any proceedings before such person shall be deemed to be "judicial proceeding" within the meaning of Sections 193 and 228 of the Pakistan Penal Code (Act XLV of 1860)."

The Enquiry Officer did not follow the aforementioned procedure in conducting the enquiry. Moreover, the Respondent was also not provided a proper opportunity to provide evidence and material in support of the contentions raised in the report. The statements of the persons and the documents marked as provided in Civil Procedure Code were not taken under oath. The Respondent asserted that the use of word "shall" in the abovementioned sub-section makes it mandatory for the Enquiry Officer to exercise these powers and conduct the enquiry accordingly.

- During the hearing and in its written reply to the SCN, the Respondent further asserted that the use of word "and" between the clause 12 and 13 of the Rule 8 of the Brokers Rules connects all the 13 clauses given under the said rule, therefore, action under Rules 8 of the Brokers



Rules can only be taken against the Respondent if it has violated all the 13 clauses of the said rule.

8.2 I have considered the contentions and the preliminary objections raised by the Respondent and the issues raised therein and the same are addressed below:

- The Respondent's assertion that to conduct an enquiry under Section 21 of the Ordinance only a natural or legal person can be appointed as an Enquiry Officer is not correct. In this regard attention of the Respondent was brought during the hearing to the Section 2(1)(j) of the Ordinance which defines the term "person" as follows:

"person" includes a Hindu undivided family, a firm, an association or body of individuals, whether incorporated or not, a company and every other artificial juridical person;

Since Ford Rhodes Sidhat Hyder & Co. is a firm, therefore, it falls under the definition of "person" and can be appointed as Enquiry Officer under Section 21 of the Ordinance.

- The assertion of the Respondent that Director (SM) does not have the power to order enquiry under Section 21 of the Ordinance, issue a show cause notice, to hear or decide under Rule 8 and 12 of the Brokers Rules is also not correct. The powers under Section 21 of the Ordinance were delegated to Director (SM) by the Commission under Section 10 of the Act vide S.R.O. 1075(1)2005 dated October 21, 2005.
- The Respondent's assertion that the Commission should have heard it before passing of Enquiry Order is not correct. The Section 21 of the Ordinance does not suggest that the broker, against whom the enquiry is being ordered, should be heard before passing of the order. The enquiry is a fact finding mission and not a punitive action and therefore, hearing the broker before conducting enquiry is not necessary under the aforementioned Section of the Ordinance.
- The contention of the Respondent that the Enquiry does not stand valid or enforceable as the Enquiry Officer did not conduct the Enquiry in accordance with the procedure laid down in the Section 21(4) of the Ordinance, is not correct. It is not mandatory for the Enquiry Officer to exercise the powers conferred under the Section 21(4) of the Ordinance. It is his discretion to adopt a suitable method for carrying out an enquiry.
- With regard to the Respondent's assertion that action against the Respondent under Rule 8 of the Brokers Rules can only be taken if the Respondent has violated all the 13 clauses of the said Rules is not correct. The use of word "and" between clause 12 and 13 of the Rule 8 of the Brokers Rules does not mean that all the 13 clauses are connected to each other. This is a self serving interpretation and is not the intention and spirit of the law.



9. **Blank Sales ("Issue No. 1")**

9.1 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"

9.2 The findings of the Enquiry Officer revealed 42 instances of Blank Sales during the Review Period.

9.3 The Respondent made the following submissions on the issue

- The Respondent in its reply dated September 06, 2007 stated that the sales mentioned in the Annexure – A (**the Annexure**) of the SCN are not Blank sales. The Respondent further stated that quoted instances in the Annexure are either misreported, sale of carry-over positions or there were pre-existing contractual arrangements to meet the delivery requirements.
- However, during the hearing the Respondent stated that trades given at serial nos. 1-3 and 28-32 of the Annexure do not exist. Whereas, the sales given at serial no. 33 of the Annexure was made against COT position of the client. In case of instance given at serial no. 4 of the Annexure, the Respondent stated that same is of 300 shares and not 500 shares. As for the rest of the instances the Respondent stated that same were of small quantities and were squared up within a short time of execution.

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

- With regard to the Respondent's contention regarding non existence of the instances given at serial nos. 1-3 and 28 - 32, the record available with the Commission was checked and it is confirmed that the said trades do not exist. However, it is surprising to note that the Respondent did not brought up the issue before when the Enquiry Report was initially forwarded to the Respondent. Further, with regard to the Respondent's contention that the instance given at serial no. 4 is of 300 shares and not of 500 shares as reported in the Enquiry Report, the Respondent's contention is also accepted as same has also been confirmed with the record available with the Commission. However, the Respondent's contention regarding instance given at serial no. 33 of the Annexure is not accepted as no supporting document was provided to prove that the client made the sale against his CFS position. The ledger statement provided earlier did not show any trade by the client in scrip of BOSI on April 18, 2006.



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Therefore, in the absence of any documentary evidence the said instance will be treated as Blank Sale. With regard to the rest of the instances given in the Annexure it is clear from the Respondent's assertion that same are Bank Sales as the clients did not have any pre-existing interest against the said sales.

9.5 Considering the above facts and the contentions of the Respondent, it is evident that on 34 occasions Blank Sales have been made in violation of Regulation 4 of the 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.

9.6 In light of the above i.e. the fact the Respondent by making Blank Sales has violated the 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. 25,000 (Rupees Twenty Five Thousand only) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.

10. **Account Opening Forms ("Issue No. 2")**

10.1 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(s) (**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) List of Transaction fee, commission to be charged by the Broker and other CDC charges to be levied should be attached with the AOFs.

10.2 Findings of the Enquiry Officer revealed that,

- i) List of Transaction fee, commission to be charged by the Broker and other CDC charges to be levied were not attached with the AOFs.

10.3 The Respondent made the following submission on these issues.



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- With reference to violation of not attaching list of charges with the AOFs, the Respondent in its written reply contended that "formal approval of commission rates" is available on the account statements which are accepted by the clients.

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

- With regard to the Respondent's assertion regarding missing list of charges with AOFs, I do not agree with the Respondent 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 his clients. In case of 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 AOFs, the Respondent has failed to comply with the directives of the Commission.

10.5 Considering the above facts and the contentions of the Respondent, it is established that Respondent has failed to comply with the 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 contravened the rules and regulations of the stock exchange and/or has failed to follow any requirement of the Code of Conduct laid down in the Third Schedule and/or failed to comply with directives of the Commission in respect of business conduct, dealings with clients and financial prudence, it may in the public interest, to take action under Rule 8(a) or (b) of the Brokers Rules.

10.6 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 he has already taken corrective actions and assured the Commission 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 is made of all rules, regulations and directives of the Commission in the future for avoiding any punitive action under the law.

11. **Order Register ("Issue No. 3")**

11.1 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."

- 11.2 The findings of the Enquiry Officer revealed that the register as mentioned above was not maintained by the Respondent during the Review Period.
- 11.3 The Respondent made the following submission on the aforementioned issue:
- The Respondent in its written reply asserted that electronic ledger as maintained today fulfills the requirement of abovementioned Rule. The Respondent further asserted that the said Rule was incorporated when manual trading was prevalent in the stock market.
 - During the hearing the Respondent stated that now-a-days due to high volume and velocity of trading it is practically impossible to maintain manual order register.
- 11.4 I have considered the contentions of the Respondent and I am of the view that electronic ledgers or the Daily Activity Log as mentioned by the Respondent is not a substitute for the Order Register as required under the Rule 4(1) of the 1971 Rules. The aforementioned Logs only record those orders that are placed by the Respondent into LOTS and not all the orders which were received from the clients and not entered into LOTS. Further, the said Log only records the time of placement of orders into the system and not the time of receipt of orders.
- 11.5 The Commission is also cognizant of the practical difficulties associated with the maintenance of such an Order Register manually. However, it is noted with disappointment that the brokerage house and LSE 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 Rule 4(1) of the 1971 Rules.
- 11.6 Considering the above mentioned 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 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.

12. Separate Bank Account for Clients Funds ("Issue No. 4")

- 12.1 In terms Commission's directive No. SMD/SE 2(20)/2002 dated March 4, 2005 which states that;

"The exchanges are to ensure that brokers follow the practice of segregating clients' assets from the broker's assets in order to ensure that clients' assets are not misused.

For this purpose brokers should have one separate bank account which includes all the cash deposits of their clients along-with records/breakdown of client positions."



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- 12.2 The findings of the Enquiry Officer revealed that the Respondent was not maintaining a separate bank account for clients' funds.
- 12.3 The Respondent made the following submission on the aforementioned issue:
- The Respondent stated that it is the client who always directs the Respondent and according to the directions of the client the funds are transferred fairly and transparently as prescribed under the law.
 - However, during the hearing the Respondent stated that it misunderstood the abovementioned directive of the Commission as it thought that separate bank account has to be maintained for every client.
- 12.4 I have considered the contentions of the Respondent and it is clear that the Respondent has failed to understand the Commission's directive No. SMD/SE 2(20)/2002 dated March 4, 2005. The said directive requires the members to maintain one separate bank account in which only the clients' funds are to be placed in order to stop the members from using clients' funds for their own purposes. The same fact was also put before the Respondent during the hearing to which the Respondent agreed to maintain a separate bank account as required under the said directive.
- 12.5 Considering the above mentioned 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 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.
- 13 As stated above, the Respondent is penalized as follows:
- a) As regards Issue No. 1, as stated above, a penalty of Rs. 25,000/- (Rupees Twenty Five Thousand only) is imposed.
 - b) No punitive action is taken in relation to Issue Nos. 2, 3 and 4 and a simple caution will suffice.
- 13.1 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 (SM)
Securities Market Division