



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN  
(Securities Market Division)

Before The Director (Securities Market Division)

In the matter of Show Cause Notice issued to

KHS Securities (Pvt.) Limited

Under Rule 8 read with Rule 12 of The Brokers and Agents Registration Rules, 2001

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Number and Date of Notice	No: MSW/SMD/LSE/1(5)2006 dated November 06, 2007
Date of Hearing	November 19, 2007
Present at the Hearing:	Mr. Rahman Saleem - Chief Executive Mr. Zulfikar Ahmed Bhatti - Account Manager Mr. Ali Mudassar - Legal Advisor
Date of Order:	January 17, 2008

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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 dated November 06, 2007 (**the SCN**) issued to KHS Securities (Pvt.) Limited (**the Respondent**), member of the Lahore Stock Exchange (Guarantee) Limited (**the 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 this case are that the Respondent is a member of 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



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN  
(Securities Market Division)

Rules and Regulations of LSE, Securities and Exchange Rules 1971 ("the 1971 Rules") and directives issued by 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 October 04, 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 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 November 06, 2007, the Respondent was called upon to show cause in writing within seven days and appear before the undersigned on November 15, 2007 for a hearing, to be attended either in person and/or through an authorized representative. However, on Respondent's request the date of hearing was re-fixed for November 19, 2007.

6. The hearing was attended by Mr. Rahman Saleem, Chief Executive, Mr. Zulfiqar Ahmed Bhatti, Accounts Manager and Mr. Ali Mudassar, Legal Advisor of the Respondent who argued the case and also submitted written reply dated November 12, 2007.

7. A summary of 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 is 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 366 instances of Blank Sales during the Review Period.



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN  
(Securities Market Division)

444

8.3 The Respondent made the following submissions on the issue:

- The Respondent asserted that the trades mentioned in Annexure – A (**the Annexure**) of the SCN were the result of mistake by its employees. These trades were in fact 80 orders placed by it, on behalf of three of its clients, which were executed in parts and resulted in 366 instance/trades.
- During the hearing the Respondent asserted that the clients, on behalf of which the said Blank Sales were executed, are its old clients and usually provided delivery in past from their CDC accounts with other brokerage houses or their CDC Investor Accounts. Therefore, based on the clients' past history, the Respondent allowed the said clients to sell over and above their positions with the assertion that they will provide delivery from their Investor Accounts or CDC accounts maintained with other brokerage houses. The Respondent further asserted that after receipt of Enquiry Report from the Commission, it has written letters to the clients requesting them to provide documentary evidence of pre-existing interest in the shares mentioned in the Annexure, however, no reply has been received from them. However, vide letter dated November 23, 2007 the Respondent provided a number of borrowing agreements claiming that the clients had prior borrowing agreements against the sales mentioned in the Annexure.

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

- The Respondent's assertion that the Blank Sales in question were result of mistake of its employees does not hold any weight. It may be noted that the Respondent is responsible for each and every order placed through its terminals and it must ensure that all the orders placed by it comply with applicable laws. Further, it is the duty of the Respondent to put in place proper system and controls to check execution of trades which are in violation of applicable rules and regulations.
- Further, the Respondent's assertion that in the past these clients provided deliveries from their Investor Accounts or CDC accounts with other brokerage houses when required does not absolve it from its duty to ensure that the clients had pre-existing interest in the shares being sold by them. The Respondent should have obtained documentary evidence to ensure that these clients had pre-existing interest in the shares before placing sales orders. Further, in case the clients wanted to Short Sell then the Respondent should have ensured that all the requirements of the applicable rules and regulations have been complied with.
- With regard to the Borrowing Agreements provided by the Respondent it may be noted that the agreements provided were on plain paper, without signatures of witnesses and did not mention the date when the same were made. Further, in case the Borrowing agreements are accepted as valid agreements it may be noted that Regulation 5 of the Short Selling Regulations set forth prerequisites for execution of Short Sales which includes that Short Sales should be identified as Short Sales at the



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN  
(Securities Market Division)

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time of placement of orders and for this purpose the LSE trading system has provided a separate window which should be used for placement of Short Sales orders. However, the Respondent did not use the Short Sale window thus violating the Regulation 5 of the Short Selling Regulations.

8.5 Considering the above facts and the contentions of the Respondent, it is established that 366 trades have been made in violation 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.

8.6 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. 75,000 (Rupees Seventy Five Thousand only) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.

9. **Order Register ("Issue No. 2")**

9.1 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."

9.2 The findings of the Enquiry Officer revealed that the order register as mentioned above was not maintained by the Respondent during the Review Period.

9.3 The Respondent made the following submissions on this issue:

- The Respondent asserted that it is maintaining Order Register as required and also provided a print out of Order Register generated through the Lahore Stock Services ("LSS") system.
- During the hearing the Respondent stated that now-a-days due to high volume and speed of trading it is practically impossible to maintain manual order register.

9.4 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.



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN  
(Securities Market Division)

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Further, the said Logs only record the time of placement of orders into the system and not the time of receipt of orders.

- 9.5 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 exchanges were unable 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.
- 9.6 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 instance to the Respondent would suffice and I would further direct the Respondent to ensure that full compliance be made of all the laws, regulations and directives of the Commission in future for avoiding any punitive action under the law.
10. 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 no. 2 and a simple caution will suffice.
- 10.1 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