



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)

Before The Director (Securities Market Division)

In the matter of Show Cause Notice issued to

128 Securities (Pvt.) Limited – formerly Shahid Mahmood

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 dated October 31, 2007
Date of Hearing	November 19, 2007
Present at the Hearing:	Mr. Shahid Mahmood, Chief Executive Officer (CEO)
Date of Order	December 27, 2007

ORDER

1. This order shall dispose of the proceedings initiated through Show Cause Notice bearing No. MSW/SMD/LSE/1(5)2006 dated October 31, 2007 (**the SCN**) issued to 128 Securities (Pvt.) Limited (**the Respondent**), Member of the Lahore Stock Exchange (Guarantee) Ltd (**LSE**) by the Securities and Exchange Commission of Pakistan (**the Commission**) under Rule 8 of the Brokers and Agents Registration Rules, 2001, (**the Broker 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 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.



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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 September 26, 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 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 October 31, 2007, the Respondent was called upon to show cause in writing within seven days and appear before the undersigned on November 12, 2007 for a hearing, to be attended either in person and/or through an authorized representative, however, on the Respondent's request the hearing was re-fixed for November 19, 2007.

6. The hearing was attended by Mr. Shahid Mahmood, CEO of the Respondent who argued the case and also submitted written reply dated November 17, 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 are 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 117 instances of Blank Sales during the Review Period.

8.3 The Respondent made the following submissions on the issue:



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- The Respondent in his earlier written reply dated November 17, 2007 stated that all the instance of Blank Sales given in Annexure-A ("the Annexure") of the SCN were mistakes.
- In respect of instances given at serial nos. 1-6 of the Annexure the Respondent stated that the client had CFS position of 20,000 in NBP shares before sale. For this the Respondent provided ledger statements for client bearing code 1207, which showed opening balance of 20,000 NBP shares.
- With regard to instances of Blank Sales given at serial nos. 7-9 of the Annexure, the Respondent asserted that client bearing code 1999 had opening position of 55,000 in OGDC shares on April 14, 2006. In this connection the Respondent provided ledger statement of said client which showed an opening balance of 55,000 shares.
- In case of instances given at serial nos. 39-41 of the Annexure, the Respondent provided back office holding position of the client bearing code 1574 which showed that the said client had opening position of 20,000 shares of DSFL.
- As for the remaining instances of Blank Sales are concerned the Respondent asserted that same were result of mistakes as it had not installed Client's Trade Risk Filter ("the CTRF"), therefore, these trades could not be noticed at the time of execution. Further, the Respondent asserted that the volume of trades given in the Annexure constitutes a very minor percentage of the total volume executed by the house during the Enquiry Period and in no way same could manipulate the market.

8.4 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 instances of Blank Sales the Respondent in his reply dated November 17, 2007 accepted the execution of Blank Sales, however, the Respondent asserted that the same were result of mistakes as it failed to keep track of clients pre-existing interest in the shares being sold by them. It may be noted that it was the Respondent's responsibility to make sure that all trades executed through it must comply with all the applicable rules and regulations. It was the duty of the Respondent to ensure that the clients on behalf of whom the Respondent is executing sales transactions have sufficient pre-existing interest in the shares being sold. The said statement of the Respondent clearly shows that the trades given in the Annexure are Blank Sales thus the Respondent has violated the Regulation 4 of the Short Selling Regulations.
- As for the ledger statement provided by the Respondent pertaining to client 1207 it is accepted that the said client had an opening position of 20,000 shares of NBP on May 12, 2006, however, his trading detail on May 12, 2006 shows that he sold a total of 60,000 shares i.e 40,000 shares above his opening position. The said sale of 40,000 shares is mentioned in Annexure as Blank Sales.
- As for the Blank Sales mentioned at serial nos. 7-9 and 39-41 of the Annexure the Respondent has provided sufficient evidence to prove pre-existing interest of the clients before sale.



8.5 Considering the above facts and the contentions of the Respondent, it is established that 111 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.

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. 50,000 (Rupees Fifty Thousand only) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.

9. Account Opening Forms ("Issue No. 2")

9.1 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.
- ii) Percentage of margin to be maintained by the client must be mentioned on AOFs.
- iii) Attested copies of accountholders CNICs must be attached with AOFs.

9.1 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 was not attached with the AOFs.
- ii) Percentage of margin to be maintained by the client was not mentioned on AOFs.
- iii) Copies of CNIC's of the customers' enclosed with AOFs were not attested.

9.2 The Respondent made the following submission on these issues:

- With reference to the missing List of Transaction fee the Respondent asserted that previously it was in practice to hand over a copy of list of transaction fee to the clients but copy of same was not being attached with the AOFs. However, after the enquiry and conversion to corporate status it has now started to maintain the said list with AOFs and currently it is complying with the requirement of SAOF.



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- With regard to non-mentioning of margin percentage on AOF the Respondent asserted that in some cases same is mentioned on AOF. However, in some case it is very difficult to fix margin percentage as it varies with market volatility.
- With regard to the violation of not obtaining attested copies of clients CNICs the Respondent stated that it is now complying with the requirements of AOF.

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

- I have considered the contentions of the Respondent regarding missing list of transaction fee with AOFs and I am of the opinion that it is requirement of the SOAF that same should be attached with the AOF. It may be noted that enclosing the list of charges with the AOFs makes it part of the AOFs which is the basic agreement between the broker and its clients and in case of dispute arise between them all the matters are resolved on the basis of clauses of the AOFs. Further, the point 5 of the enclosure requirements given at the end of the SOAF requires that the said list should be attached with the AOFs. Therefore, by not attaching the said list with the AOFs the Respondent has failed to comply with the directives of the Commission.
- With regard to the Respondents assertion about non-mentioning of margin percentage on AOFs it may be noted that it is the requirement of the SOAF to mention percentage of margin to be maintained by clients. The SAOF also requires that all the fields of the AOF should be filled in and any not applicable field should be marked as "N/A" as blank fields provides an opportunity to the broker to amend the AOFs as per his own will, thus jeopardizing the interest of the clients.
- With regard to un-attested copies of client's CNICs, the Respondent has accepted the violation. However, the Respondent assured that it is now complying with the requirement of SOAF.

9.4 Considering the above facts and the contentions of the Respondent, it is established that Respondent has failed to comply with 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) and sub rule (v) therefore, where the Commission is of the opinion that a broker has inter alia failed to comply with requirements of the any directions of the Commission 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, to take action under Rule 8(a) or (b) of the Brokers Rules.

9.5 In light of the above i.e. the facts 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 Respondents 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.

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and I would further direct the Respondent to ensure that full compliance be made of all rules, regulations and directives of the Commission in the future for avoiding any punitive action under the law.

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

10.1 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."

10.2 The findings of the Enquiry Officer revealed that the register as mentioned above was not maintained by the Broker during the Review Period

10.3 The Respondent made the following submission on this issue:

- The Respondent in its written reply asserted that electronic ledger as maintained today fulfills the requirements of abovementioned section. The Respondent further asserted that the said Section was incorporated when manual trading systems were prevalent in the stock market.
- During the hearing the Respondent stated that due to high volume and speed of trading it is practically impossible to maintain order register.

10.4 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.

10.5 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.

10.6 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.



11. **Separate Bank Account for Clients Funds (*Issue No. 4*)**

11.1 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 "

11.2 The findings of the Enquiry Officer revealed that the Respondent was not maintaining separate bank account for clients' funds.

11.3 The Respondent made the following submission on this issue:

- Respondent stated that due to mistake it over looked the said requirement of Commission's directive. However, it is now complying with the requirement.

11.4 I have considered the contentions of the Respondent and of the view that the Respondent failed to comply with the Commission directive no. SMD/SE 2(20)/2002 dated March 04, 2005. The said directive requires the members to maintain one separate bank account in which only clients' funds are placed. The rationale behind maintenance of a separate account for clients' funds is to stop the member from using clients' funds for his own purposes.

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 be made of all the laws, regulations and directives of the Commission in future for avoiding any punitive action under the law.

12. As stated above, the Respondent is penalized as follows:

- a) As regards Issue No1, as stated above, a penalty of Rs. 50,000/- (Rupees Fifty Thousand only) is imposed.
- b) No punitive action is taken in relation to Issue No. 2, 3 and 4 and a simple caution will suffice.

12.1 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