



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

Orix Investment Bank Pakistan Limited

Under Rule 8 of the Brokers & Agents Registration Rules, 2001 for Violation of Regulation
3(b) of the Regulations Governing Futures Contracts of the Karachi Stock Exchange
(Guarantee) Limited

Number and date of Notices	SMD-SOUTH/SCN/62/07 dated March 22, 2007
Date of hearing	March 30, 2007
Present	Mr. Arshad Tayebaly - Legal Counsel Mr. Asif Hasan Siddiqui, General Manager Syed Kashif M. Ehtesham, Head of Operations
Date of Order	April 3, 2007

ORDER

1. I have before me 56 cases involving broadly the same issues in relation to the 56 Show Cause Notices, issued by the Commission to 56 Brokerage Houses, for which I conducted hearings on various dates in relation to same. Since there is a commonality of issues involved, I have addressed the core issues raised by or on behalf of the 56 Brokerage Houses together, given the need to expedite the disposal of these matters. Accordingly, I have decided to issue a common order, which addresses all the core issues raised in the submissions made at these hearings and in the written responses filed by or on behalf of the 56 Brokerage House, even though, in certain instances, some of these core issues may not have been raised by each and every Brokerage House.

2. Accordingly, this order shall dispose of the proceedings initiated through Show Cause Notice No. SMD-SOUTH/SCN/62/07 dated March 22, 2007 issued to the Orix Investment Bank Pakistan Limited (the "Respondent") for violation of Regulation 3(b) of the Regulations Governing Futures Contracts (the "Regulations") of The Karachi Stock Exchange (Guarantee) Limited (the "Exchange") by the Securities and Exchange Commission of Pakistan (the "Commission").
3. Basic facts of the case are that the Respondent is a member of the Exchange and is registered with the Commission under the Brokers and Agents Registration Rules, 2001 (the "Brokers Rules"). Consequent to the submission by Diligence USA, LLC, of the Forensic Report regarding the Exchange events of March 2005, the Commission sought information from the Respondent to determine whether or not in February and March 2005, the Respondent had complied with Regulation 3(b) of the Regulations which requires that no member shall have a sale position in a particular scrip of more than Rs. 50 million, unless the actual shares sold over and above the aforesaid limit, are deposited with the Exchange or the broker gives documentary evidence that the shares are lying in Central Depository Company of Pakistan Limited ("CDC") or with some bank or Development Finance Institution ("DFI"), to the satisfaction of the Exchange management. For the purpose of establishing such sale position, net buy position in T+3, shall be net off from net sale position in Futures Counter.
4. An examination of the information provided by the Respondent revealed that 81 times, during the period from February 21, 2005 to March 25, 2005 the Respondent, had net sale positions in Futures Contracts, which were in excess of the prescribed limit of Rs. 50 million. In contravention of the requirement of Regulation 3(b) of the Regulations, the Respondent had failed to either deposit with the Exchange the actual shares sold over the prescribed limit or submit to the Exchange the documentary evidence that such shares were lying in the CDC or a bank or DFI on the given dates.
5. Based on the findings, a show cause notice No. SMD-SOUTH/SCN/62/07 dated March 22, 2007 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. The Respondent was called upon to show cause in writing within seven days and appear before the undersigned on Friday, March 30, 2007 at 9:00 a.m. the office of the Executive Director for a personal hearing, either in person and/or through its authorized representative/advocate.

6. The hearing was scheduled on Friday, March 30, 2007 at 9:00 a.m. and attended by Mr. Arshad M. Tayebaly - Legal Counsel, Mr. Asif Hasan Siddiqui - General Manager and Syed Kashif Ehtesham (the "Representatives") on behalf of the Respondent who submitted a written reply and argued the case.
7. A summary of the contentions raised by the Respondent in the written submissions are as follows:
 - It has been argued that the Show Cause Notice is not based on facts and the allegation, that the shares sold in excess of the limits prescribed under Regulation 3(b) were not deposited with the Exchange for most of the instances as mentioned in Annexure 'A' to the Show Cause Notice is incorrect. It is evident on the face of the record that in all the transactions mentioned in Annexure 'A', either the shares were deposited with the Exchange or were lying with the CDC or with some bank or DFI to the satisfaction of KSE management.
 - The bare perusal of the Regulation 3(b) shows that a restriction has been imposed on a member not to take a sale position in a particular scrip of more than Rs. 50 million, unless the actual shares are deposited with the Exchange or, "the broker gives documentary evidence that the shares are lying in CDC or with some bank or DFI, to the satisfaction of the KSE management." As mentioned in above, in all the instances mentioned in Annexure 'A', either the shares were deposited with the Exchange or were lying with CDC or with some bank or DFI and it appears that the Commission did not properly verify the facts before issuing this Show Cause Notice.
 - The purpose and intent of the Regulation 3(b) was to insure that no short sale position is taken by a member in particular scrip of more than Rs. 50 million and if there is a sale of greater amount than that is backed by availability of shares in CDC or with

some Bank or DFI. Had SECP examined and verified each sale position in Future contracts as stated in Annexure 'A' to Show Cause Notice it would have found that in each of sale positions the shares were either deposited with Exchange or were lying in CDC or with the Bank or DFI. In view of this fact, it is quite clear that if we examine Regulation 3(b) in letter and spirit we will find there is no failure or breach on part of our client.

- The documentary evidence required to be provided under Regulation 3(b) had to be, to the satisfaction of the KSE management. In this regard, the Exchange followed a practice whereby KSE advises to furnish documentary evidence to brokers who take a sale position in a particular scrip of more than Rs. 50 million. Although the KSE management was fully aware of such cases and collecting mark to market losses against exposure on a daily basis. Hence KSE was fully aware of the sale positions taken by the broker.
- The Regulation 3(b) had to be the satisfaction of KSE management. It is pertinent to point out that not on a single occasion has the KSE management ever made any complaint or grievance against the broker for alleged violation of Regulation 3(b) and it is clear that the requirement of Regulation 3(b) has been complied with as the same has been to the satisfaction of KSE management.
- It is pertinent to point out the Regulation 3(b) does not provide for any procedure of providing documentary evidence and there is no requirement that such documentary evidence is required to be made within a specified period or in what manner and the only requirement is to provide documentary evidence to the satisfaction of KSE management and for the reasons discussed above that requirement has been fully complied with.
- It has submitted that without prejudice to the contentions of the broker that it has not committed any violation of regulation 3(b) of the Regulations, in any event the Commission can impose a penalty only if it considers necessary in the "Public Interest" to do so, as provided in rule 8 of the Brokers Rules. That in the Show Cause Notice the Commission has stated that it may be in the public interest to take action under Rule 8 (a) or (b) of the Brokers Rules, however, no details as to how it would be in the public interest are provided in the Show Cause Notice. Furthermore, during the

hearing the Counsel had specifically requested the Commission to give details as to what public interest is envisaged by the Commission, however, no details were provided during the hearing also and the Supplementary Show Cause Notice without providing any details of the alleged public interest involved is not maintainable and the Commission is required to first provide details and particulars in this regard and thereafter give an opportunity to the broker to explain its position.

- Without prejudice to the above, even otherwise it is submitted that there is no question of any public interest being involved in the particular case as admitted, no harm or loss whatsoever has been caused to any person or public in general and no rights have been affected of the public even if assuming an violation of Regulation 3(b) was committed by the broker. It is submitted that the fact of the matter is, that there was admittedly no short selling and all the shares sold were in fact, in the CDC account. In fact, the Commission has itself only alleged failure of not providing documentary evidence and as such it is reiterated that public in general has not been affected in any manner and there can be no necessity for taking any action in the public interest.
- The scope of public interest was presented and well explained with reference to the decisions of supreme courts during the hearing. In the light of this, it is evident that in the present case there is no “public interest” involved and no penalty can be imposed by the Commission unless they are certain that it is necessary to do so in the public interest. It is expected by the broker that the regulatory body would do justice in the circumstances.
- It is stated that the broker has violated Rule A-5 of the code of conduct which is a general provision and provides that the broker will comply with all statutory requirements. Attention is sought on Rule D-1 (2) of the code of conduct which is a similar provision and states that a broker shall faithfully comply with the general or specific directives issued by the Commission. It is quite clear that the purpose of the code of conduct is, that the broker shall faithfully comply with the directives issued by the Commission. It is submitted that the faithful compliance was achieved as the Exchange was at all times satisfied with the requirement of Regulation 3(b) and has admittedly not complained in any manner to the Commission nor have ever written any letter to the broker complaining of any violation of Regulation 3(b) and in fact, all

correspondence done by the Exchange reinforces the reporting practice followed by the broker under Regulation 3(b), and, therefore, for the reasons stated above, it is clear that the broker has faithfully complied with the directives of the Commission and has acted in accordance with the requirements of the Regulation 3(b) with regard to its true intention.

- It was reiterated that the broker is one of the most well-reputed companies in brokerage business and the issuance of Show Cause Notice and later on the Supplementary Show Cause Notice is adversely affecting the reputation of the broker. The broker continues to be adversely affected by these proceedings

8. Following arguments were made during the course of hearing:

- The Legal Counsel while referring to the earlier hearings regarding the Show Cause Notice stated that the detailed verbal submissions have already been made to the Commission. However, he reiterated the argument that the term “public interest” has not been defined and elaborated in the Show Cause Notice. He contended that the Show Cause Notice does not explain the impact of the violation of Regulation 3(b) with respect to “public interest”.
- The Legal Counsel argued that the spirit of Regulation 3 (b) of the Regulations is to systematically control short selling, and therefore the said Regulation must be seen in its true letter and spirit. However, the Show Cause Notice does not focus on the true spirit of Regulation 3(b) of the Regulations, rather objection is made on a supplementary issue of a procedural requirement.
- While referring to reporting formats provided for various submission purposes in the Companies Ordinance 1984, he contended that no such format for the compliance of Regulation 3(b) is available in the Regulations.

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

- In relation to the Respondents' contention that there has not been a violation of Regulation 3(b) of the Regulations, it may be noted that Regulation 3(b) has two limbs. The first pertains to regulating the underlying mischief, i.e. to ensure that no member

indulges in 'short selling' over and above the Rs. 50 million threshold by providing that no member shall have a sale position in a particular scrip of more than Rs. 50 million, unless (a) the actual shares sold over and above the aforesaid limit are deposited with the Exchange or (b) the broker gives documentary evidence that the shares are lying in CDC or with some bank or DFI to the satisfaction of the Exchange. The second pertains to complying with the reporting requirement / action to be taken by each broker, every time that a broker exceeds the Rs. 50 million threshold, i.e. by either depositing the shares or providing documentary evidence for same. Therefore, it will follow that the reporting requirement / action is an independent obligation under Regulation 3(b) and is meant to ensure that there is no 'short selling' by placing on the broker an obligation to deposit shares or provide documentary evidence for same. Failure by a broker to comply with the above would infer that the Broker has indulged in 'short selling'. Therefore, the fact that at the material time (i.e. when a member had taken a sale position in a particular scrip of more than Rs. 50 million), the Respondent did not deposit shares or provide documentary evidence, and only did so subsequently at the request of the Commission, resulted in non-fulfilment of Regulation 3(b).

- As to the Respondent's next contention that only the Exchange is empowered to take action under the Regulations, I do not find substance in same, more so since the Regulations have been notified by the Exchange under Section 34 of the Ordinance. Under the Ordinance and indeed under the Securities and Exchange Commission of Pakistan Act, 1997, the Commission, inter alia, has wide powers to regulate all matters relating to capital markets, securities and ancillary issues. In any event, more specifically, under Rule 8(iii) of the Brokers Rules, the Commission can take action under Rule 8(a) or (b) of the Brokers rules if "...the Commission is of the opinion that a broker-... has contravened the rules and regulations of the stock exchange". The Commission as the apex regulator of all corporate activities is not precluded from taking appropriate action where there is any violation or non-compliance of the laws, rules or regulations. Hence, even if the Exchange may not have acted against any non-compliance of Regulation 3(b) in letter and spirit or may have allowed a certain practice to develop in this context, would not absolve the Respondent from the consequences of any non-compliance of the said Regulation, or indeed preclude the

Commission from taking remedial action. The Respondent has an independent obligation to comply with the legal requirement as it is settled law that there cannot be an estoppel against the law.

- In this context, I now refer to the Respondent's related contention that documentary evidence to the satisfaction of the Exchange had been provided from time to time. However, the said information was provided before and after March 2005, but it is noteworthy that during March 2005, no information was provided by the Respondent in terms of Regulation 3(b). Lastly, on a related point, it has been argued that there was no specific procedure set out in Regulation 3(b) nor any timeframe was given within which the evidence was to be forwarded to the Exchange. In my view, there was no requirement for any specific procedure to be provided, as the language of Regulation 3(b) is clear, as stated above, inasmuch as it presupposes that no member shall have a sale position in a particular scrip of more than Rs. 50 million unless the actual shares sold over and above the aforesaid limit are deposited with the Exchange or documentary evidence relating to same are furnished.
- The Respondent has next contended that imposing any form of a penalty would not be in the "public interest". I have perused the case law cited by the Respondent and in my view, in fact it supports the position of the Commission. The entire purpose of this enquiry leading to issuance of Show Cause Notices, not only to the Respondent, but also to other Brokerage Houses was done, keeping the "public interest" in mind. Ensuring compliance of the Regulations and indeed compliance of all the corporate laws is the primary duty and function of the Commission, which is discharged in the public interest. The action in this instance is all the more necessary, particularly bearing in mind the recent history of the stock market crisis, which seriously compromised the interest of the public at large and particularly the small investors. Hence, these proceedings were initiated to enquire as to whether there had been any violation of Regulation 3(b) in March 2005 and were conducted in public interest.
- As regards the contention that no loss has been caused, nor there was any short selling beyond the threshold of Rs. 50 million, I have already held above that there are two elements of Regulation 3(b), i.e. the first being to ensure that there is no 'short selling' and the second being a reporting requirement / action. Hence the fact that

there has been no loss or 'short selling' would not absolve the Respondent from its obligation at the material time to comply with the reporting requirement, envisaged under Regulation 3(b) by either depositing the concerned shares or providing documentary evidence to that effect as prescribed in the said Regulation 3(b). In this instance, in relation to the issue of short selling, my perusal of the evidence provided by the Respondent substantiated the existence of the required shareholding in compliance of Regulation 3(b), in which context, I am satisfied to the extent that there was no short selling beyond the prescribed limit in Regulation 3(b) at the material time.

10. In view of what has been discussed above, and my considering the arguments presented before me in writing, as well as at the time of hearing and my having perused the documents and information placed on record, I am of the view that the Respondent has not fulfilled the requirement of reporting / taking action as envisaged under the said Regulation 3(b). However, certain extenuating circumstances have emerged from the Respondent's practice of supplying the requisite evidence under Regulation 3(b) only when required by the Exchange, which may have persuaded the Respondent to believe that it had discharged its obligation under Regulation 3(b), which clearly it did not for reasons stated above. I am also mindful of the fact that no evidence of 'short selling', has been revealed from the examination of the records provided by the Respondent.

11. In this background, 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.

Zafar Abdullah
Executive Director