



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

Y.H Securities (Private) Limited

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)

Number and date of Notice	SMD-SOUTH/SCN/104/07 dated August 3, 2007
Date of hearing	September 12, 2007
Present	Mr. Mirza Mehmood Ahmad
Date of Order	November 2, 2007

ORDER

1. This order shall dispose of the proceedings initiated through Show Cause Notice SMD-SOUTH/SCN/104/07 dated August 3, 2007 ("**Show Cause Notice**") issued to Y.H Securities (Pvt.) Limited (formerly Yaqoob Habib) (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. Basic 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

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 Central Depositories Act, 1997.

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 7, 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. 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 12, 2007 for a hearing, to be attended either in person and/or through an authorized representative.
6. The hearing was held on September 12, 2007 which was attended by Mr. Mr. Mirza Mehmood Ahmad, the Representative 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 reply / during the hearing and findings and conclusions of the Commission on the same are as follows:



8. Blank Sales

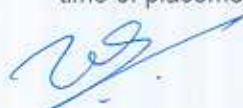
8.1 In terms of Regulation 4 of the 2002 Regulations, blank sales are not permissible. The findings of the Enquiry Officer revealed 21 instances of blank sales during the Review Period.

8.2 The Respondent made the following submissions on this Issue ("**Issue No. 1**"):

- The Respondent claimed that the Enquiry Officer has selected transactions randomly without taking into account the earlier purchase transactions.
- The Respondent also claimed that in certain cases a customer instructs execution of a sale order and undertakes to deliver securities to the broker. Later, the said customer purchases back the shares thus squaring his position.
- The Respondent further claimed that the reported blank sales can be a result of intra-day trading whereby a customer purchases shares in the early hours of trade and may sell in the later hours.
- The Respondent claimed that these instances were in fact not blank sales and contractual borrowing arrangements existed to meet the delivery requirements. In support of this claim, copies of contracts were submitted.

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

- As far as the matter of earlier purchase transactions is concerned, no evidence is provided in support of this claim; hence the argument cannot be accepted.
- The Respondent has also claimed that a customer undertakes to deliver securities at the time of sale and later squares his position. In this regard, it is the obligation 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.
- As regards the matter of intra-day trades, no evidence is provided in support of this claim; hence the contention of the Respondent in this regard cannot be accepted.
- The Respondent has submitted contractual borrowing arrangements to meet delivery of shares in the case of reported 21 instances of blank sales. The existence of contractual borrowing arrangements demonstrate that that these instances were not blank sales rather the same were short sales as provided in Regulation 2(f) of the 2002 Regulations. However, in terms of Regulation 5 of the 2002 Regulations, one of the pre-requisites of a short sale is that "The trade is identified as a Short Sale at the time of placement of order" which was not met by the Respondent.



- 8.4 Considering the above facts and the contentions of the Respondent, it is established that on 21 occasions short sales have been made without meeting the pre-requisite criteria as provided in Regulation 5 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 ("**1997 Act**") 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 short sales without meeting the prescribed pre-requisite, 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 Rule 8 of the Brokers Rule. Accordingly, a penalty of Rs.10,000 (Rupees Ten Thousand) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.

9. Short sales

- 9.1 In terms of Regulation 5 of the 2002 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's report revealed 148 instances of short sales during the Review Period which were made without identifying the trade as a Short Sale at the time of placement of order
- 9.3 The Respondent made the following submission on this Issue ("**Issue No. 2**"):
- In respect of these 148 instances, shares were either available in the customers' CFS account, and/ or shares were made available for delivery by the customers. In other instances, the customers had given an undertaking to the effect that shares would be made available for delivery.



9.4 I have considered the contentions of the Respondent and am of the view that no evidence has been submitted by the Respondent in support of its claims so as to establish that these instances were not short sales. Further the argument raised by the Respondent does not provide a justification for not meeting the pre-requisite for making short sales as provided in Regulation 5 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 1997 Act or the 1969 Ordinance or of any rules or directions 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.

9.5 In light of the above i.e. the fact that the Respondent made short sales without meeting the prescribed pre-requisite, the Respondent has violated the 2002 Regulations thereby attracting sub rule (iii) 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.10,000 (Rupees Ten Thousand) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.

10. Book entry securities of different customers held in a single CDC-sub account

10.1 In terms of Section 2(27) of CDC Act 1997, the term "sub-account" has been defined as:

"sub-account " means a sub-account maintained, as part of the account of a participant, in accordance with the regulations by a central depository in the name of a sub-account holder so as to record the title of the sub-account holder to any book-entry securities entered in such sub-account."

10.2 Findings of the Enquiry Officer revealed that in case of certain customers, sub-accounts were not opened and in the absence of these sub-accounts, the related movements of book entry securities against the transactions undertaken by such customers were affected through a separate CDC sub-account opened in the name of another customer.

10.3 The Respondent made the following submission on this Issue ("**Issue No. 3**"):

- The Respondent submitted that this was due to the negligence of two of its employees who had failed to comply with the regulatory requirements and

disciplinary action was taken against them. The Respondent also submitted that now full compliance was being made.

- 10.4 I have considered the contentions of the Respondent and am of the view that CDC accounts are opened to establish the title and beneficial ownership of the shares and keeping the shares of clients in a CDC sub account opened in the name of another customer is a serious violation of the CDC Act, as it results in the change in the beneficial ownership of the shares.
- 10.5 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. Since by keeping the book entry securities of different clients in a single CDC sub account opened in the name of another client, the Respondent has violated Section 2(27) of CDC Act 1997, I am of the view that a penalty of Rs.25,000 (Rupees twenty five thousand) be imposed on the Respondent.

11. Change in trades

- 11.1 In terms of Clause A 1 and A2 of the code of conduct contained in the Third Schedule read with Rule 12 of the Brokers & Agents Registration Rules, 2001, it is provided that:

A1-"A broker shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business"

A2-"A broker shall act with due skill, care and diligence in the conduct of all his business."

- 11.2 Findings of the Enquiry Officer revealed various instances where trades entered into KATS on account of a client were subsequently assigned to another client in the Back Office record. Findings of the Enquiry Officer also revealed that in various instances KATS ID assigned to customers by the Respondent for trading did not exist in the back office record or KATS ID were not entered by the Respondent while executing the transactions.

- 11.3 The Respondent made the following submissions on this Issue ("**Issue No. 4**"):

- The Respondent contended that the above mentioned instances were a result of errors by one of its employees. Further, the alleged irregularities were not discovered upon enquiry by the Enquiry Officer but were already reported to the Exchange by the Respondent.

- The Respondent also submitted that it is not involved in any practice that is not in conformity with high standards of integrity, promptitude and fairness and in performance of its business, it displays due diligence, care and skill.

11.4 I have considered the contentions of the Respondent and the issues raised therein and am of the view that notwithstanding Respondent's claim that the above mentioned instances were reported to the Exchange, the fact remains that in order to ensure the practice of fair trade and due skill, care and diligence in conduct of business, it is imperative that correct KATS ID are used for the clients while executing trades. Subsequent modification of trades and their allocation to another customer creates opportunities to disguise any violation of laws and regulations that might have occurred.

11.5 In light of the above the Respondent has failed to comply with Clause A1 and A2 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.1,000 (Rupees One Thousand) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.

12. Order Register

12.1 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."

12.2 Findings of the Enquiry Officer revealed that the register as mentioned above was not maintained by the Respondent during the Review Period.

12.3 The Respondent made the following submissions on this Issue ("**Issue No. 5**"):



- The Respondent contended that the purpose of maintaining the above mentioned register is easily served by retrieving the data of KSE Stock system and the information is also available from its "Ultra Trade System".
- The Respondent also emphasized the practical difficulties associated with the maintenance of such a register due to quantum of orders received and stressed that the register has become obsolete with the introduction of computerized system at the KSE.

12.4 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 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. The same holds true for the computerized system at KSE and in absence of Order Register, several requirements of the Regulations for Proprietary Trading, 2004 also cannot be complied with. Hence, it is absolutely incorrect to assume that the Order Register has become obsolete.

12.5 The Commission is 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 KSE 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) 1971 Rules.

12.6 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.

13. Non-provision of information to the Enquiry Officer

13.1 In terms of section 21 (2) of the 1969 Ordinance, it is provided that:



"Where any enquiry under sub-section (1) has been undertaken every past or present member, director, manager or other officer of the Stock Exchange to which the enquiry relates, and every other person who has had any dealing in the course of his business with such Stock Exchange or with the director, manager or officer thereof, shall furnish such information and documents in his custody or power or within his knowledge relating to or having bearing on the subject-matter or the enquiry as the person conducting the enquiry may require."

- 13.2 Findings of the Enquiry Officer revealed that the Enquiry Officer was not provided with a breakup/ reconciliation of the securities held in the CDC House account by the Respondent against in house COT.
- 13.3 The Respondent made the following submissions on this Issue ("**Issue No. 6**"):
- The Respondent admitted that the above mentioned information was not provided to the Enquiry Officer. However, this was not due to any intentions of concealing information from or not cooperating with the Enquiry Officer, but rather due to the fact that a broker is only required to comply with the relevant COT regulations imposed by the KSE, which do not require formal documentation of COT transactions. Further, all COT transactions are mentioned in the ledger statements of the customer.
- 13.4 Considering the fact that individual ledger statements provide the detail of COT transactions, and there was no intention of willfully concealing information from the Enquiry Officer, 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.
14. 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. 5 and 6 and a simple caution will suffice in case of Issue No.5. As regards Issue No. 1, 2, 3 and 4, as stated above, penalties of Rs. 10,000 (Rupees Ten Thousand), Rs. 10,000 (Rupees Ten Thousand), Rs.25,000 (Rupees twenty five thousand) and Rs. 1,000 (Rupees One Thousand) are respectively imposed, which should be deposited with the Commission not later than fifteen (15) days from the date of receipt of this Order.



Zafar Abdullah
Executive Director
Securities Market Division