



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)

Before the Director (Securities Market Division)

In the matter of Show Cause Notice issued to

S.Z 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 dated November 06, 2007

Date of Order

February 01, 2008

ORDER

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 S.Z 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 Fords 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 a 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 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 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 November 06, 2007, the Respondent was called upon to show cause in writing within seven days and appear before the undersigned on November 16, 2007 for a hearing, to be attended either in person and/or through an authorized representative. On the request of legal counsel the hearing date was re-fixed for November 27, 2007. However, legal counsel of the Respondent vide letter dated November 26, 2007 further requested that since the issues raised in the SCN are similar to the Show Cause Notices issued to Maan Securities (Pvt.) Limited, Amer Securities (Pvt.) Limited and Capital Vision (Pvt.) Limited, therefore, his arguments which were given during the hearings, held on October 9, 2007, may also be considered as arguments in this case as well.
6. The Legal Counsel also submitted written reply to the SCN vide letter dated December 04, 2007 on behalf of the Respondent.
7. A summary of the contentions and objections that were raised by the Respondent in its written submissions and findings and conclusions of the Commission on the same are as follows:

8. **Preliminary Objections**

- 8.1 The objections raised by the Respondent, pertaining to the Enquiry, are given as under:-

- The Enquiry Officer did not conduct the Enquiry in a proper manner and halfway through the enquiry the Enquiry Officer left without providing an opportunity to the Respondent to furnish documentary evidence which could have cleared the objections raised in the Enquiry Report.



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- There is a procedural requirement that in order to initiate an Enquiry the Commission must have a reason, like a complaint etc. However, in this case the Commission did not have any reason to conduct an Enquiry.
- These Enquiries were a "fishing and roving exercise" and as per prior court decisions no Regulatory Authority is authorized to conduct frivolous enquiries. In support of its argument the legal counsel provided copies of a number of such court orders. These are:
 - a) Order dated March 08, 1992 in the matter of Civil appeal Nos. 38-K to 40-K Assistant Director Intelligence and Investigation, Karachi v/s B.R. Herman and Others,
 - b) Order dated October 10, 2003 in the matter of Constitution Petition No. 1353 of 1998 and Constitution Petition No. 177 of 2002 – Karachi Administrative Employee cooperative Housing Society Ltd v/s Government of Sindh; and
 - c) Order dated September 20, 2004 in the matter of Customs Appeal No. K-779/04 – Muhammad Ateeq Paracha & Others v/s The State.
- The Commission has converted the Enquiry into an Audit.

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 it was not provided an opportunity to furnish documentary evidence to clear different violations reported in the Enquiry Report is not correct. It may be noted that the Enquiry Officer forwarded draft Enquiry Report to the Respondent for a review and provision of any documents to clear violations reported therein. Further, before issuance of the SCN by the Commission, the Enquiry Report was forwarded to the Respondent in order to provide it with another opportunity to clear any violation reported in it. Based on the replies and documents provided by the Respondent a number of issues reported in the Enquiry Report were dropped and only those violations were taken up in the SCN where the Respondent could not provide sufficient evidences. Therefore, sufficient opportunity was provided to the Respondent to clear any violation reported in the Enquiry Report.
- The assertion of the Respondent that the Enquiry was conducted without any reason/complaint is not true. It may be noted that the Review Period was a period of high volatility for Stock Market and in order to identify the reasons for such volatility the Commission conducted an initial Enquiry into the affairs of various members of LSE, including the Respondent. The findings of initial enquiry identified number of areas which needed further in-depth review for identification of possible violations of securities market rules, regulations. Therefore, it was deemed necessary to conduct enquiries in order to determine if there was any violation of applicable rules and regulations by the members.



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Further, it may be noted that Section 21 of the Ordinance allows the Commission to initiate an Enquiry on its own motion, when ever it deems necessary.

- The Respondent's contention that the Enquiry was a "fishing and roving exercise" is unfounded. As stated above the Enquiry was commenced based on the findings of the initial Enquiry conducted by the Commission that identified different areas which required further review/enquiry. The members were selected on the basis of trading volume in certain scrips during the review period. Further, the Enquiry Officer was given specific tasks that limited its scope to enquiry into and identifying any violation of the applicable rules and regulations. All the areas covered by the Enquiry Officer were critical and part of the scope of Enquiry assigned to it. It is further stated that the Commission is primarily responsible for regulating the capital markets and protection of investors under the Act and the Ordinance. Further, the Commission is not expected to take a reactionary approach and wait for complaints to be brought before it after the damage has already been caused. It is for this reason that the Commission has suo motu powers as stated above, to initiate an Enquiry into the affairs and dealings in an Exchange or its members.
- The Respondent's assertion that the Commission has converted the Enquiry into an Audit is not correct. It may be noted that the scope of the Enquiry was limited and covered only specific areas and did not cover the audit of the entire financials of the members. The Enquiry principally covered compliance of the Securities Market Laws

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 173 instances of Blank Sales during the Review Period.

9.3 The Respondent made the following submissions on the issue:

- The Respondent in its written reply dated December 04, 2007 stated that it has never been involved in Blank Selling and the Enquiry Officer has misconstrued the sales given in Annexure - A ("the Annexure") of the SCN as Blank Sales. The Respondent stated that its clients have given undertakings that they shall be responsible to provide delivery for the sale orders made by them and stated that these undertakings have already been submitted to


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the Commission vide letter dated October 11, 2007 and some undertakings were provided with the reply to the SCN.

- The Respondent in its abovementioned written reply also asserted that in some cases Enquiry Officer has added up the sales transactions and has ignored corresponding purchase transactions. The Respondent further stated that it is common that sometimes a client places sale order and after a while due to sudden depression in the price, the client square up his position during the same day. As a result such transaction would not reach clearing stage and such transactions have also been misconstrued by the Enquiry Office as Blank Sale. The Respondent further stated that in some cases orders were entered into the system by mistake which were later on corrected and consequently gave false impression of Blank Sales.

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

- The Respondent in its written replies dated October 11, 2007 and December 04, 2007 provided a number of undertakings which do not suffice the requirement of the Short Selling Regulations and can not be taken as proof of pre-existing interest. It may be noted that the Respondent is responsible for each and every order placed through its brokerage house and it is its duty to put in place proper systems and control to ensure that all order placed by it on the system are in conformity with the requirement of applicable rules and regulation. The Respondent should have obtained sufficient documentary evidence of pre-existing interest before placing clients' sale orders in the system. Further, after a review of the undertakings provided by the Respondent vide letter dated December 04, 2007, it was observed that these were authorizations from Darson Securities (Pvt.) Limited to the Respondent to sell certain number of shares on its behalf. Whereas Blank Sales given in the Annexure pertain to the clients of the Respondent. Further, a review of the undertakings provided vide letter dated October 11, 2007 indicated that the same are authority letters from one client to another to sell his shares on his behalf. Therefore, the said undertakings/authorization letters cannot be treated as valid borrowing agreements nor it can be taken as pre-existing interest of the clients against the blank sales mentioned in the Annexure. Therefore, in the absence of any documentary evidence of pre-existing interest, it is clear that the sales mentioned in the Annexure are Blank Sales.
- The Respondent's assertion that Enquiry Officer has only added up sale transactions and ignored purchase transaction is not correct. In this regard, it may be noted that Enquiry Officer has taken in to account purchase trades while calculating Blank Sales and same was also confirmed through the record available with the Commission. The Enquiry Officer has



only mentioned those sales in the Annexure which were made when the client had zero or negative position i.e. oversold position in a scrip. With regard to the Respondent's assertion that some times the clients first sell their shares and after a while square their position, it may be noted that the said transactions would not be violation of Short Selling Regulations if the client had pre-existing interest before sale. However, any sale made without pre-existing interest in the shares being sold is Blank Sales as defined under Short Selling Regulations and trades mentioned in the annexure are ones where the Enquiry Officer did not find any evidence of pre-existing interest. Further, with regard to the Respondent's statement that some times sales orders are placed by mistake into the system, it may be noted that the Respondent is responsible to put in place proper system and controls to ensure that all the orders placed by it into the system are in conformity with applicable rules and regulations. The Respondent's mere statement of execution of orders by mistake does not absolve it from its obligation to comply with applicable rules and regulations.

- 9.5 Considering the above facts and the contentions of the Respondent, it is clear that 173 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 facts that 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.
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) AOFs of all clients should be maintained by the brokers.



- ii) Copies of client's CNICs should be attached with the AOFs.

10.2 Findings of the Enquiry Officer revealed that:

- i) AOFs of 12 clients were not provided to the Enquiry Officer.
ii) Copies of CNICs of two clients were not attached with the AOFs.

10.3 The Respondent made the following submission on these issues:

- With regard to missing AOFs, the Respondent vide its letter dated December 04, 2007 provided copies of some of the AOFs and for the rest of the missing AOFs the Respondent asserted that same belong to clients who are not in contact with the Respondent and their accounts are effectively defunct since long.
- With regard to the missing copies of CNICs of the clients, the Respondent vide letter dated December 04, 2007 provided copies of the same and stated that they were also shown to the Enquiry Officer.

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 violation of missing AOFs the Respondent vide its reply dated December 04, 2007 has provided copies of 6 out of 12 missing AOFs, whereas for the rest of the cases, mentioned at serial nos. 1, 2, 7, 8, 10 and 11 of the Appendix – A ("the Appendix") of the Enquiry Report, the Respondent stated that these belong to its clients which do not deal with the Respondent anymore. However, vide its letter dated October 11, 2007 the Respondent had stated that all the AOFs were shown to Enquiry officer except for the clients mentioned at serial nos. 7-9 of the Appendix which belonged to those clients who are not in contact with the Respondent. Keeping in view the above, it is clear that the Respondent is not maintaining AOFs of all the clients which is a violation of above mentioned directives of the Commission.
- With regard to the missing CNICs of the clients, the Respondent has cleared the Enquiry Officers observation by providing the copies of missing CNICs.

10.5 Considering the above facts and the contentions of the Respondent, it is established that the 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), (vi) and sub rule (v) therefore, where the Commission is of the opinion that a broker has inter alia failed to comply with requirements of 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.



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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, 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 by the Lahore Stock System ("the LSS") fulfills the requirement of abovementioned Rule.
- 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.



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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 be 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 of 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."

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 in its written reply dated December 04, 2007 stated that it is now maintaining a separate bank account for clients' funds.

12.4 I have considered the contentions of the Respondent and I am of the view that the Respondent has complied with the Commission's directive No. SMD/SE 2(20)/2002 dated March 4, 2005. Therefore, no punitive action will be taken against the issue no. 4.

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

- a) As regards Issue No. 1, 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 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