



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
SECURITIES MARKET DIVISION

Before Executive Director (Securities Market Division)
In the matter of Show Cause Notices issued to

BMA Capital Management Limited

Under Section 22 of the Securities & Exchange Ordinance, 1969 and 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/02/07 dated January 26, 2007 SMD-SOUTH/SCN/07/07 dated March 15, 2007
Date of hearings	February 27, 2007 March 26, 2007
Present	Mr. Farrukh Khan - Chief Executive Officer Mr. Muhammad Amir Iqbal - Associate Director Mr. Arshad M. Tayebaly - Legal Counsel
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/02/07 dated January 26, 2007 and Supplementary Show Cause Notice SMD-SOUTH/SCN/07/07 dated March 15, 2007 issued to the BMA Capital Management 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 of the Forensic Report regarding the Exchange events of March 2005 by Diligence USA, LLC, 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 13 times, during the period from February 21, 2005 to March 18, 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 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/2/07 dated January 26, 2007 under Section 22(1) of the Securities & Exchange Ordinance, 1969 (Ordinance) for violation of Regulation 3(b) of the Regulations was issued to the Respondent, to explain in writing or in person before the Executive Director that why a penalty should not be imposed by the Commission in the matter. In this regard, the Respondent requested to give an opportunity of being heard and the hearing was fixed on February 27, 2007 at 11.00 a.m.
6. The hearing was held on Tuesday, February 27, 2007 at 11.00 a.m. for the first Show Cause Notice issued to the Respondent. The hearings was attended by Mr. Farrukh Khan Chief Executive, Mr. Muhammad Amir Iqbal - Associate Director and Mr. Arshad M. Tayebaly - Legal Counsel on behalf of the Respondent who presented their arguments before the Executive Director.
7. A summary of the contentions raised by the Respondent in its written submissions in response to the Commission's show cause notice No.SMD-SOUTH/SCN/2/07 dated January 26, 2007 are given hereunder:
 - Documentary evidence was required to be submitted, up to the satisfaction of the Exchange's management. In this regard, the Exchange followed a practice whereby the Exchange advises to furnish documentary evidence to members who take a sale position in particular scrip of more than Rs. 50 million. Although the Exchange's management was fully aware of such cases and collecting mark to market losses against exposure on a daily basis, there has not been a single instance where the Exchange requested for documentary evidence which reflects the satisfaction of the Exchange on such positions.
 - Regulation 3(b) of the Regulations 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 the Exchange's management. Since the Exchange had not asked for it, the requirement has been fully complied with.

- Section 22(1) of the Ordinance requires that the default to be “willful”. Non submission of documentary evidences under Regulation 3(b) of the Regulations cannot be termed as willful default on the part of brokerage house. As per Black’s Law Dictionary, the word “willful” has been defined as “Premeditated, malicious, done with evil intent or bad motive or purpose, or with indifference to the natural consequences unlawful; without legal justification.” There is nothing on record which shows that the violations were committed intentionally and deliberately.
- No unfair or illegal gain was or could have been made by the Respondent on account of not providing the documentary evidences and neither has any loss been caused to any third party, whomsoever.

8. Following arguments were made during the course of hearing against the Show Cause Notice No.SMD-SOUTH/SCN/2/07 dated February 27, 2007 are given hereunder:

- The Chief Executive initiated his arguments by emphasizing that the Respondent has always complied with the rules and regulations of the Exchange, Commission and other relevant statutes. He further asserted that the Respondent had never indulged in any kind of non-compliance or violations. As far as the compliance with R-3(b) is concerned, the Respondent has always submitted the documentary evidence whenever the Exchange had asked to furnish the documentary evidence.
- The Legal Counsel stated that the spirit of Regulation 3(b) is to prevent the brokers from indulging in short selling activity after the prescribed limit and in case the broker has crossed such limit either furnish shares or documentary evidence that the shares are lying in the (CDC) or with a bank or (DFI) to the Exchange.
- The Legal Counsel informed that the Respondent did not receive any notice from the Exchange advising that the net sale position in any scrip has been breached and either deposit the shares or provide documentary evidence against the shares sold beyond prescribed limit, during the period under review. Further, he also drew attention towards customary practice of the Exchange whereby notices were served to concerned brokers so as to satisfy the Exchange that the broker possesses the required number of shares against the over sale position. He further pointed out that no time line has been defined in the Regulation 3(b) of the Regulations for submission of the documentary evidence to the Exchange. He also raised a question to provide the documentary evidence up to the satisfaction of the Exchange’s management and wanted to know the ingredients of satisfaction criteria. Since the Exchange never

issued any notice to the Respondent in respect of alleged violations, this proves that the Exchange was satisfied that the Respondent possesses the requisite shares in its CDC or a bank/DFI.

- The Chief Executive asserted that the Respondent did not derive any profit/gain by not tendering documentary evidence to the Exchange.
 - The Legal Counsel emphasized on the word “willful” and stated that non submission of documentary evidence under Regulation 3(b) cannot be termed as willful default on the part of the Respondent. In this regard, the Legal Counsel presented copies of some cases enacted in our courts.
 - The Legal Counsel categorically insisted that there was no violation on the part of the Respondent as default was not on account of a willful default.
 - Since the Commission has examined the records of the Respondent and has verified that required holdings were available with the Respondent, the Legal Counsel requested to withdraw the above referred show cause notice and do not impose any penalty on the Respondent.
 - The Chief Executive showed his concerns over issuance of this show cause notice which has distorted the reputation of the Respondent. In fact, all major newspaper published this news on their front page and its foreign clients are inquiring whether any criminal investigations are underway.
9. Subsequently, a supplementary show cause notice No.SMD-SOUTH/SCN/07/07 dated March 15, 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 Executive Director on March 22, 2007 at 12:00 p.m. the office of the Executive Director for a personal hearing, either in person and/or through its authorized representative/advocate.
10. The hearing was held on Thursday, March 29, 2007 at 12.00 p.m. for supplementary Show Cause Notice issued to the Respondent. The hearing was attended by Mr. Farrukh Khan Chief Executive, Mr. Muhammad Amir Iqbal - Associate Director and Mr. Arshad M. Tayebaly - Legal Counsel on behalf of the Respondent who presented their arguments before the Executive Director.

11. Submissions made by the Respondent in its written reply to the Commission's supplementary show cause notice No.SMD-SOUTH/SCN/07/07 dated March 15, 2007 are given hereunder:

- It has been challenged the issuance of Supplementary Show Cause Notice as the same is unwarranted and ill-founded on the ground that after sending the initial Show Cause Notice and commencing full hearing, the Commission was required to pass an order and first come to a conclusion as to whether the Respondent has committed any breach or violation of Regulation 3(b) of the Regulations. It has been also submitted that unless an order was passed on the initial Show Cause Notice, the Supplementary Show Cause Notice should not have been issued as the same is an after-thought and without justification.
- The Supplementary Show Cause Notice has alleged that the Rule 8 of the Brokers Rules more particularly, sub rule (iv) read with rule (iii) has been violated, therefore, the Respondent has contravened the rules and regulations of the Exchange and failed to follow any requirement of the code of conduct laid down in the Third Schedule. In this regard, it has been submitted that for the reasons stated in the reply in response to initial Show Cause Notice and hearing held on February 27, 2007, it has been reiterated that the Respondent has not committed any violation or breach of Regulation 3(b) of the Regulations. The content of the reply may and more particularly, its paras 4, 5, 6, 7, 8, and 9 may be read as reply to the Supplementary Show Cause Notice.
- It has been submitted that without prejudice to the contentions of the Respondent 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 Legal 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 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 Respondent to explain its position.

- Without prejudice to the above, even otherwise if it has been 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 Respondent. It has been submitted 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 has been 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 Respondent that the regulatory body would do justice in the circumstances.
- It has been stated that the Respondent 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 has been 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 Respondent complaining of any violation of Regulation 3(b) and in fact, all correspondence done by the Exchange reinforces the reporting practice

followed by the Respondent under Regulation 3(b), and, therefore, for the reasons stated above, it is clear that the Respondent 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 Respondent is one of the 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 Respondent. The Respondent continues to be adversely affected by these proceedings and in this regard, reserves its right to take appropriate action for redressal of its grievance as may be advised.

12. Following arguments were made during the course of hearing against the Supplementary Show Cause Notice No.SMD-SOUTH/SCN/07/07 dated March 15, 2007 are given hereunder:

- The Chief Executive showed his concern regarding the issuance of supplementary show cause notice. He argued that the Commission is trying to analyze the alleged violations in the light of various rules and regulations and finding different angles to penalize the Respondent without deciding whether the Respondent has committed any violation of law or not.
- The Legal Counsel stated that the Commission performed a year long exercise to investigate the matter and found mere non-compliance of Regulation 3(b) of the Regulations and created charge against the Respondent under Section 22 of the Ordinance. Later on, appropriate justifications along with the written submissions were provided in the first hearing regarding the applicability of Section 22 of the Ordinance. He further contended that the Commission issued them a supplementary show cause notice under another Law i.e. Brokers Rules, without concluding on the submissions of the first notice. He emphasized that if there was any other law, it should have been covered in the first show cause notice. He pointed out that the Commission should have issued an order on the first hearing rather issuing them a supplementary show cause notice.

- He further added that the issuance of supplementary show cause notice reflects that there is some malafide intention on the part of the Commission and this exercise is only being carried out to create a charge under any relevant statute against of the Respondent. He also mentioned that they reserve a right to challenge any penal action taken against broker in the court of law.
- He contended that the Regulations do not come under the purview of Rule 8(iii), he further discussed the contravention of Clause A5 of the code of conduct in the Third Schedule to the Brokers Rules. He discussed this clause in context of 3(b) violation and explained that since no time period or way of documentary submission of evidence is defined in the Regulation 3(b) and further KSE did not show any dissatisfaction on the issue, therefore the omission of this act on the part of the Respondent is not violation and so does the clause A5 of Brokers code of conduct. He emphasized that satisfaction of KSE was the main concern.
- He then argued the term "Public Interest" used in the supplementary show cause notice and discussed in context of some Supreme Court decision. He asserted that non-submission of documentary evidence can not affect the "public interest", in whatsoever manner. He pointed out that neither the Exchange nor any investor has lodged the complaint with the Commission regarding such non-compliance. He also commented that it's the prime responsibility of the Commission to decide that if they impose any penal action against the brokers, will it in any way be in "public interest"?
- The Legal Counsel argued that neither the Respondent received any complaint from the Exchange nor even the Exchange asked for documentary evidences which they normally asked in various other cases, which implied the satisfaction of the Exchange. He further added that if front line regulator was satisfied with the situation, being fully aware what's actually going on and did not show any concern, the "Natural Justice" demands that the Respondent should not be penalized. He further said that even if it is conceivable that the broker has done any violation of Law or Willful violation of law, of not presenting the documentary evidences to KSE, should its license be cancelled on this ground, taking the cushion of "public interest"?
- The Counsel concluded his submissions by making this point that repercussion of any kind of penalty will have serious impact on the business of the Respondent as general investor will take it as malafide act of the Respondent, with out considering the factual

details of Regulation 3(b). He once again informed the Commission that the Respondent reserve a right to go in court of law to claim any damages, caused by the Commission actions.

13. 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 Respondent's contention that Section 22 of the Ordinance is not attracted, as it was not applicable at the material time and cannot be applied retrospectively, there is no denying that if there was any non-compliance of Regulation 3(b) of the Regulations, the Commission also has the power under Rule 8 of the Brokers Rules to take punitive action. Accordingly, upon consideration of the Respondent's contentions, and to meet the ends of justice, the Commission issued a Supplementary Show Cause Notice under Rule 8 of the Brokers Rules to which the Respondent not only submitted its written response but also attended the hearing and made submissions thereon, which were duly considered by the Commission. In relation to same, it is pertinent to note that the Commission's power to independently proceed under Rule 8 of the Brokers Rules was not challenged by the Respondent. Moreover, due process was followed by the Commission with the 'rules of natural justice' being fully met. As such, the Respondent's contentions in this context are misconceived.
- 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.

14. 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.
15. 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