



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN  
SECURITIES MARKET DIVISION

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

Arif Habib Securities 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/03/07 dated January 26, 2007 SMD-SOUTH/SCN/08/07 dated March 15, 2007
Date of hearing	April 3, 2007
Present	Mr. Iqbal L. Bawaney - Legal Counsel Mr. Arif Habib - Chief Executive Mr. Tahir Iqbal - CFO
Date of Order	April 5, 2007

**ORDER**

1. I have before me 64 cases involving broadly the same issues in relation to the 64 Show Cause Notices, issued by the Commission to 64 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 64 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 64 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/03/07 dated January 26, 2007 and Supplementary Show Cause Notice SMD-SOUTH/SCN/08/07 dated March 15, 2007 issued to Arif Habib Securities 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 180 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 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/03/07 dated January 26, 2007 was issued under Section 22(1) of the Securities & Exchange Ordinance, 1969 (Ordinance) for violation of Regulation 3(b) of the Regulations to the Respondent, to explain in writing or in person before the Executive Director within fourteen days from the date of the notice that why a penalty should not be imposed by the Commission in the matter.
6. 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/03/07 dated January 26, 2007 are given hereunder:
  - The Respondent is of the view that it has been providing the requisite information and related evidences for the shares lying in CDC or with a bank or DFI as required under Regulation 3(b). As no dissatisfaction was ever expressed by the Commission and therefore the matter apparently stood satisfactorily resolved.
  - It was argued that the Exchange had a practice whereby net sale positions of brokerage houses under Regulation 3(b) were determined through computerized system and concerned brokerage houses were advised to deposit shares or submit documentary evidence in respect of shares sold beyond Rs. 50 million. During that period, the Exchange did not show dissatisfaction. On the contrary, whenever KSE had itself advised to submit the evidence, the brokerage house always abided and did the needful..
  - It was asserted that Section 22(1)(c) of the Ordinance, was amended vide Finance Act, 2006 whereas alleged violations pertains to the period between February 21, 2005 to March 25, 2005. Therefore, the Commission cannot implement any penal provision retrospectively.
  - It was further stated that the Commission cannot invoke Section 22(1)(c) of the Ordinance based on the amendment effectuated in July 2006, otherwise it will be violation of Article 12 of the Constitution of Pakistan.
  - It was contended that the Exchange had adopted a mechanism of submitting the evidence relating to Regulation 3(b) of the Regulations which was followed by the

Respondent as it relied upon the Exchange's representations and therefore if at all there has been any violation, the Exchange alone would be responsible for such act.

7. Subsequently, a supplementary Show Cause Notice No.SMD-SOUTH/SCN/08/07 dated March 15, 2007 was issued 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 March 22, 2007 at 11:30 a.m. in the office of the Executive Director for a personal hearing, to be attended either in person and/or through its authorized representative/advocate. Subsequently, on the request of the Respondent the date of the hearing was extended and rescheduled on April 3, 2007 at 4:00 p.m.
8. The hearing was held on Tuesday, April 3, 2007 at 4:00 p.m. which was attended by Mr. Iqbal L. Bawaney - Legal Counsel, Mr. Arif Habib - Chief Executive and Mr. Tahir Iqbal - CFO ("the representatives") and on behalf of the Respondent who submitted a written reply and argued the case.
9. Submissions made by the Respondent in its written reply to the Commission's supplementary Show Cause Notice No.SMD-SOUTH/SCN/08/07 dated March 15, 2007 are given hereunder:
  - It was stated that the Respondent has not committed any violation. The Respondent has reiterated the contentions raised in the earlier reply.
  - It was contended that since the initial Show Cause Notice was per se not maintainable in law, the supplementary show cause notice being in conjunction with the initial Show Cause Notice also has no sanctity in law.
  - It was argued that the supplementary Show Cause Notice has been issued under totally new law i.e. the Brokers Rules, which suggest that the Commission has previously erred in law and as such any action would eventually be challengeable at a higher forum.

- It was argued that since no violation of Regulation 3(b) of the Regulations has taken place, the question of contravention of Clause A5 of the Third Schedule to the Brokers Rules does not arise. Hence the action under Rule 8 of the Brokers Rules is not warranted in law.
- It was further argued that if there was any contravention of any internal Rules and Regulations of the Exchange, there ought to have been a formal complaint lodged by the Exchange with the Commission. Since no complaint has been lodged by the Exchange with regard to the alleged contravention, the initial Show Cause Notice as well as supplementary Show Cause Notice is not sustainable.
- It was argued that the above referred practice was adopted by the Exchange to ensure the compliance with Regulation 3(b) of the Regulations for which the Exchange was liable alone and the Exchange is also a necessary party to the proceedings. Further the Respondent has also requested the Exchange to appear in the hearing and present their point of view with complete evidence. The Respondent has mentioned that they reserve the right to cross examine the Exchange's concerned officers.

10. The following arguments were made during the course of hearing:

- The representative of the Respondent discussed the implication of the Commission's decision, on the Respondent's business and the over all market. He emphasized that there are some factors which will manipulate the situation and will distort a general perception about the brokers and their business practices though the Commission's action will remain as lenient as "warning",
- The Representatives further argued that Regulation 3(b) of the Regulations is a "Secondary legislation" and is primarily made for the purpose of internal control of the Exchange. The Exchange in its own capacity has discretionary powers of using and implementing its Regulations. In view of this discretion it was a customary practice of the Exchange to ask for necessary information required under Regulation 3(b) of the Regulations. As per this practice brokers were never supposed to initiate the

compliance requirements, as being interpreted by the Commission. In order to discuss the term "Regulation" the Representatives quoted the case of Haji Ghulam Zamin vs A.B. Khondkar, PLD 1965 Dacca 156, page no 187.

- Further, the Representatives discussed the letter provided by the Exchange as evidence of acceptance that the Exchange used to collect the required information from the brokers by issuing them letters and also providing them flexibility of time so that the required evidence could easily be collected from their respective clients.
- The Representative further argued that as per the spirit of the law, the system adopted by the Regulator is perceived as a rule and in this particular scenario, the Exchange being the front line regulator had a well established practice.
- The Representative placed emphasis on the word "advice" used in the Exchange's letter and it was argued that as stated earlier the Regulations were meant for the internal control of the Exchange, therefore, the Exchange used the word "advice" and not "call upon" showing the confidence it placed in its brokers. It was further added that if there would have been any violation of law by the brokers for not submitting the evidences even in the usual practice, the Exchange should have used the word "failed" which has not been used by them in their correspondence..
- It was asserted that Regulation 3(b) of the Regulations does not specify any time limit for the brokers to deposit the required evidence with the Exchange. In addition it is not practically possible for a broker to deposit such evidence in advance to the Exchange. It was concluded that since the Exchange was satisfied with its members, therefore, there is no violation of law has been committed by his clients.
- He then argued the applicability of the law under which all his clients were issued show cause notices. He started with Arif Habib Securities and argued that in the First Show Cause notice issued to the said client under Section 22, which has been offset by the Legal Counsel on the grounds of subsequent modification in the said law and which can not be applicable to the his client retrospectively. So that the Commission issued him a supplementary Show Cause Notice under the Brokers Rule, which reveals the mind of the Commission that they have already decided to penalize the brokers under whatsoever rules.

- It was further contended that it is the practice of law that if the Regulator identified any breach of law, a Show Cause Notice is issued to the alleged party for necessary explanation in writing. In case the written reply does not satisfy the Regulator then an opportunity of hearing is provided to the party. But in this case the Commission has already fixed the hearings without considering or concluding on the written submissions of the Respondent which is again substantiating the argument that the Commission has already made up its mind for penalizing the brokers under the alleged violation. It was added that the practice of "natural justice" demands that the opportunity of the written explanation should be given to the alleged party before calling the hearing.
- The Representatives asserted that the Show Cause Notice issued to the Respondent is lacking its legal sanctity because the allegations written in these Show Cause Notice are mainly derived from the Forensic Report of Diligence, which itself is lacking in the authenticity in his view point. It was argued that the Diligence was not aware of the local practices of the market and there are many loopholes in their investigation so that the Show Cause Notice can not be issued, based on the findings of the Forensic Report.
- The Representatives finally argued on the role of the Exchange's management. They stated that the management of the Exchange is a party in this case and they should be called upon to cross examine their intention for not asking the evidence during March 2005.

11. 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.

12. 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.

13. 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*