



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)

Before the Director (Securities Market Division)

In the matter of Show Cause Notice issued to

Muhammad Ayub Chaudhary

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)2006/76 dated August 28, 2007
Date of Hearing	September 06, 2007
Present at the Hearing:	Mr. Muhammad Ayub Chaudhry Mr. Muhammad Asif Imran
Date of Order	December 27, 2007

ORDER

1. This order shall dispose of the proceedings initiated through Show Cause Notice bearing No. MSW/SMD/LSE/1(5)2006/76 dated August 28, 2007 (**"the SCN"**) issued to Muhammad Ayub Chaudhary (**"the Respondent"**), Member of the Lahore Stock Exchange (Guarantee) Ltd. (**"the 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 Ford 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 the 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 Lahore Stock Exchange (Guarantee) Limited, 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 Enquiry Officer's report was sent to the Respondent under cover of a letter dated May 22, 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 reply to the above mentioned letter, which did not adequately explain the position, the SCN was issued to the Respondent under Rules 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 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 Act and the rules, regulations issued by the Commission and the stock exchange from time to time as may be applicable to them".

5. On August 28, 2007 the Respondent was called upon to show cause in writing within seven days and appear before the undersigned on September 06, 2007 for a hearing, to be attended either in person and/or through an authorized representative.

6. The hearing was held on September 06, 2007 which was attended by Mr. Muhammad Ayub Chaudhary, Member LSE, and Muhammad Asif Imran, Manager of Respondent, who argued the case and also submitted written reply dated September 3, 2007 vide which Respondent requested to refer to his earlier replies dated June 01, 2007 and June 13, 2007.

7. A summary of contentions raised by the Respondent in its written submissions and during the hearing and findings and conclusion of the Commission on the same is as follows:

8. **Blank Sales ("Issue No. 1")**

8.1 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"

8.2 The findings of the Enquiry Officer's report revealed 55 instances of Blank Sales during the Review Period.

8.3 The Respondent made the following submissions on the issue:



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- The Respondent stated that Blank Sales mentioned at serial number 22, 23 and 24 of the Annexure – A ("the Annexure") of the SCN were executed by his employee Mr. Munawar Iqbal who had committed a fraud of Rs. 6.2 million because of which he was removed from his job.
- Whereas with respect to the rest of the instances of Blank Sales the Respondent stated that his house was not using Client's Trade Risk Filter ("the CTRF") during the Review Period because of which his house could not keep track of exact shareholding position of the clients due to which Blank Sales as mentioned in the Annexure of SCN were executed. However, Respondent informed that after detection of Blank Sales he has implemented appropriate system from April 04, 2007.

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

- The Respondent has acknowledged vide his written reply and during the hearing that the Blank Sales mentioned in the Annexure was executed by his house because he could not keep track of exact shares holding positions of the clients. However, with regard to Blank Sales mentioned at serial number 22, 23 and 24 of the Annexure the Respondent stated that same were executed by his above mentioned employee. The said explanations given by the Respondent clearly shows that he failed to run the brokerage house with due care, skill and diligence and also failed to put in place proper system and controls.

8.5 Considering the above facts and the contentions of the Respondent, it is an established fact that on 55 occasions 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, in terms of and 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.

8.6 In light of the above i.e. the fact 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. 25,000 (Rupees Twenty Five Thousand only) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.

9 Account Opening Form ("Issue No. 2")

9.1 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



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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:

- Attested copies of clients' CNICs must be attached with the AOFs;
- List of Transaction fee, Commission to be charged by the Broker and other CDC charges to be levied should be attached with the AOFs;

9.2 Findings of the Enquiry Officer revealed that:

- Copies of clients' CNICs attached with AOF were not attested.
- List of Transaction fee, Commission to be charged by the Broker and other CDC charges to be levied were not attached with the AOFs.

9.3 The Respondent made the following submission on this issue:

- With regard to violation of non attestation of the CNICs of the clients the Respondent stated that normally all CNICs are attested at the time of opening account but due to error some attested copies of CNICs could not be obtained; however, now the said error has been rectified.
- With regard to violation regarding not attaching, with AOF, list of transaction fee, commission to be charged by the Respondent and other CDC charges to be levied the Respondent stated that he was not aware of this requirement, however, after the Enquiry the same has been attached with all the AOFs.

9.4 I have considered the assertion of the Respondent and it is clear to me that the Respondent has acknowledged above-mentioned violations. However, the Respondent can not be absolved from his obligation of complying with the aforementioned directive of the Commission based on his claim that he was not aware of the aforementioned requirements of SAOF. It may be noted that all the directives of the Commission are sent to the exchange for circulating the same to all members. The said directives are also placed on the web site of the exchange.

9.5 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) and sub rule (v) therefore, where the Commission is of the opinion that a broker has inter alia failed to comply with any requirements of the 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 take action under Rule 8(a) or (b) of the Brokers Rules.



9.6 In light of the above i.e. the fact the Respondent failed to comply with Commission's directives thereby attracting sub rule (v) of the Rule 8 of the Brokers Rule. However, based on the Respondents statement that he has already taken corrective action and assurance to the Commission that such violations will not occur in future 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 rules, regulations and directives of the Commission in the future for avoiding any punitive action under the law.

10. **Separate Bank Account for Clients Funds ('Issue No. 3')**

10.1 In terms 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."

10.2 The findings of the Enquiry Officer revealed that the Respondent was not maintaining a separate bank account for clients' funds.

10.3 The Respondent made the following submission on the aforementioned issue:

- With regard to the violation of not maintaining a separate bank account for clients' funds the Respondent stated that he was not aware of this requirement and neither the Auditors pointed out such requirement during System Audit. However, after this matter was pointed out by the Enquiry Officer he has opened a separate a bank account and clients' funds have been transferred into this account.

10.4 I have considered the assertions of the Respondent and it is clear to me that the Respondent has failed to comply with the above mentioned directive of the Commission. The Respondents statement that he was not aware of the Commissions' direction on maintenance of separate bank account for clients' funds does not absolve him from his obligation of complying with Commission's directive and therefore, can not be taken as sufficient explanation/excuse.

10.5 Considering the above facts and the contentions of the Respondent, it is established that Respondent has failed to comply with Commission's directive. In terms of Rule 8 of the Brokers Rules, more particularly sub rule (v) therefore, where the Commission is of the opinion that a broker has inter alia failed to comply with any requirements of the directions of the Commission it may in the public interest, 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, based on the Respondents statement that he has already taken corrective action and assured that that such violations will not occur in future 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 rules, regulations and directives of the Commission in the future for avoiding any punitive action under the law.
11. As stated above, the Respondent is penalized as follows:
- As regards Issue No. 1, as stated above, a penalty of Rs. 25,000/- (Rupees Twenty Five Thousand only) is imposed.
 - No punitive action is taken in relation to Issue No. 2 and 3 and a simple caution will suffice.
12. The matter is disposed of in the above matter 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