



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN  
(Securities Market Division)

1998

Before The Director (Securities Market Division)

In The Matter Of Show Cause Notice Issued To

**MGM Securities (Pvt.) Limited**

**Under Rule 8 read With Rule 12 of The Brokers and Agents Registration Rules, 2001**

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Number and Date of Notice	No. MSW/SMD/LSE/1(5)2006 dated November 06, 2007
Date of Hearing	November 16, 2007
Present at the Hearing:	Syed Hassan Iqbal
Date of Order	January 11, 2008

**ORDER**

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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 MGM 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 Ford Rhodes Sidhat 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 broker 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 LSE, Securities and Exchange Rules 1971 ("**the 1971 Rules**") and directives issued by 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 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 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.

6. The hearing was attended by Syed Hassan Iqbal, director of the Respondent who argued the case. The Respondent vide its letter dated November 08, 2007 requested that its reply dated October 11, 2007 may be treated as reply to the SCN.

7. A summary of contentions and objections that were 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 revealed 52 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, in its reply dated October 11, 2007, asserted that its clients had opening positions against sales mentioned in the Annexure – A ("the Annexure") of the SCN and in some cases the sales were made over and above the opening positions by mistake. Whereas against sales mentioned at serial nos. 49-51 the Respondent provided borrowing agreement.
- The Respondent during the hearing stated that it has not allowed any of its clients to Short Sell in the market, except a few clients who had positions in their Investor Accounts or with other houses. However, after the Enquiry it has totally disallowed the clients from Short Selling.
- The Respondent further requested that a lenient view may be taken as it has already taken corrective actions after detection of the mistakes.

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

- The Respondents assertion that the clients had prior positions against the sales mentioned in the Annexure is not correct. Scrutiny of the trading data shows that the said sales were made over and above the opening balances of the clients. Therefore, the clients did not have adequate positions against the sales mentioned in the Annexure. Further, the Respondent assertion that some of the Blank Sales given in the Annexure are result of typographical errors does not absolve it from its obligation to comply with the Short Selling Regulations. It may be noted that Respondent is responsible for each and every order which is placed through its terminals and further, the Code of Conduct set forth under the Brokers Rules requires every member to exercise due care, skill and diligence in the conduct of his business. Further, it is the responsibility of the Respondent to put in place proper systems and controls to ensure that each order executed through his house fulfills the requirements of law. However, the execution of blanks sales as given in the Annexure shows that the Respondent has violated Short Selling Regulations and the Respondents house lacks proper systems and controls in place to prevent execution of such trades.
- Further, in respect of the sales mentioned at the serial nos. 49-51 it may be noted that Short Selling Regulations require that Short Sales can only be executed after fulfilling pre-requisites given in Regulation 5 of Short Selling Regulations. The Regulation 5 states that Short Sales should be identified as Short Sales at the time of placement of order and for this purpose the LSE trading system has provided a separate window for placement of short sales. Since the Respondent did not identify the said trades as Short Sales at the time of placement of orders, the trades in question can not be treated as Short Sales.
- Further, the Respondents assertion that it only allowed some of its clients to execute Short Sales, merely on the basis that they usually had positions in their CDC Investor Accounts or with other houses, does not prove that the clients had pre-existing interest before sales. The Respondent should



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have obtained sufficient documentary evidence, from its clients, for their pre-existing interest before placement of order in the system, to ensure that applicable rules and regulations are not violated.

- 8.5 Considering the above facts and the contentions of the Respondent, it is established that 52 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.
- 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 Forms ("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 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

- List of Transaction fee, commission to be charged by the broker and other CDC charges to be levied should be enclosed with the AOFs.
- AOFs should be signed by the witnesses.

9.2 The findings of the Enquiry Officer revealed that:

- List of Transaction fee, commission to be charged by the broker and other CDC charges to be levied was not enclosed with the AOFs.
- AOFs were not signed by the witnesses.

9.3 The Respondent made the following submission on these issues:

- With regard to not attaching the list of transaction fee with the AOFs, the Respondent stated that trade confirmation/account statement contains the amount and rate of Commission being charged.



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- With regard to missing signatures of witnesses on the AOFs, the Respondent asserted that it was not aware of any such requirement and further this violation was not pointed by the auditors during previous System Audits.
- 9.4 I have considered the contentions of the Respondent and the issues raised therein and the same are addressed by me below:
- I have considered the contentions of the Respondent regarding missing list of charges with AOFs and do not agree with the Respondent that giving commission rates on the account statement/trade confirmation suffices the requirement of attaching the list of charges with the AOF. It may be noted that enclosing the list of charges with the AOF makes it part of the AOF which is the basic agreement between the broker and its clients. In case any dispute arises between them all the matters are resolved on the basis of clauses of the AOF. Therefore, by not attaching the said list with the AOF the Respondent has failed to comply with the directives of the Commission.
  - With regard to the Respondent's assertion regarding missing signatures of witnesses on the AOFs it was pointed out to the Respondent during the hearing that it is the requirement of the SAOF that each AOF should be signed by the witnesses. Further, failure to highlight such violations during the System Audit, conducted under Regulations Governing System Audit of the Brokers of the Exchanges, 2004, does not absolve the Respondent from its obligation to comply with the requirements of the Commission's directives. The Respondent should have been vigilant and should have put in place proper systems and controls to ensure compliance with applicable rules and regulations.
- 9.5 Considering the above facts and the contentions of the Respondent, it is established that 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), (iv) and sub rule (v) therefore, where the Commission is of the opinion that a broker has inter alia failed to comply with 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 directive thereby attracting sub rule (v) of the Rule 8 of the Brokers Rule. However, based on the Respondent's statement that he has already taken corrective actions and assured 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 be made of all rules, regulations and directives of the Commission in the future for avoiding any punitive action under the law.
10. As stated above, the Respondent is penalized as follows:



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- a) As regards Issue No1, as stated above, a penalty of Rs. 25,000/- (Rupees Twenty Five Thousand only) is imposed.
- b) No punitive action is taken in relation to Issue No. 2 and a simple caution will suffice.

10.1 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  
Securities Market Division