



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
SECURITIES MARKET DIVISION

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

Noman Abid & Company Limited

Under 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/38/07 dated March 16, 2007
Date of hearing	April 3, 2007
Present	Mr. Iqbal L. Bawaney - Legal Counsel Mr. Hammad Tahir - Head of Equity Sales
Date of Order	April 05, 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 SMD-SOUTH/SCN/38/07 dated March 16, 2007 issued to Noman Abid & Company 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 56 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/38/07 dated March 16, 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 Executive Director (SMD-South) on Thursday, March 28, 2007 at 09:30 a.m. for a hearing, to be attended

either in person and/or through an authorized representative. Subsequently, on the request of the Respondent the date of the hearing was extended and rescheduled on Tuesday, April 3, 2007 at 4:00 p.m.

6. The hearing was held on Tuesday, April 3, 2007 at 4:00 p.m. which was attended by Mr. Mr. Iqbal L. Bawaney - Legal Counsel and Mr. Hammad Tahir - Head of Equity Sales as the Representatives of the Respondent ("the Representative"), who submitted a written reply and argued the case.
7. A summary of the contentions raised by the Respondent in the written submissions are as follows:
 - According to the Respondent's interpretation the purpose and spirit of Regulation 3(b) of the Regulations is to establish a limit upon a broker exercising a short sell position beyond Rs. 50 million as it allows adjustments for purchases in other counters.
 - As per Regulation 3(b) of the Regulations a broker is only liable to undertake reporting when the limit of Rs. 50 million is breached after netting off the purchases. Without breaching the limit of Rs. 50 million, the said reporting requirement does not apply.
 - On the other hand, the Exchange asks the broker to provide evidence as it is unaware of a broker's position of his or his client's previous bought position. Therefore, the KSE asks the broker randomly or on each occasion so as to provide evidence that such selling is not breaching the Rs. 50 million net sale limit, and only does the Exchange get satisfied or will get satisfied once it sees that the said sale is not beyond Rs. 50 million after allowing adjustments which are seen in the form of deliveries held in CDC, which mean previously purchased securities.
 - The Exchange may further verify that these CDC balances are not of CFS/COT financed securities. A broker is only required to report in case where he is in breach of the aforesaid limit. Why would anybody breach the limit and then also be able to report and prove that he has not breached the limit?

- The Respondent has asked that on examination of their record it has been found that largely all sales were backed by simultaneous purchases in other counter on the same time and same date. If the data is examined in the light of excluding previously held deliveries (that is purchase bought before the March Counter i.e. before 21st Feb 2005) it shows the net cumulative amount of the sale does not exceed Rs.50,million. Therefore the Regulation 3(b) of the Regulations does not apply.
- It was further clarified that the Respondent never had any net sell/short sell/blank sell during the period under review. Always all their sale positions were backed by simultaneous T+3 purchases or simultaneous buy in the previous month's Future Counter if both counters are operational i.e. 21st to 25th February 2005. Some of their sales may also be against deliveries of previously bought securities but those too if accumulated and if it is thought that previously bought securities or previously held deliveries (purchase before 21st Feb 2005) cannot be net off from the Future Market sales, even then their net sales do not exceed the prescribed limit.
- The Respondent also pointed out that large quantities were pledged with the Exchange for the purpose of exposure and they enclosed an updated position of annexure A of the Show Cause Notice.
- As per the customary market practice whenever a member sold beyond Rs. 50 million the brokers were asked by the Exchange (whenever they wished to ask) to provide the evidence to the satisfaction of the Exchange and never was there a practice to inform Exchange unless asked for. Neither does Regulation 3(b) of the Regulations prescribe any method or timing as to when the broker is to self submit the evidence.
- It was further informed that the Respondent was holding sufficient balances in the CDC and had not conducted any short sales and requested the Commission to take a lenient view with reference to the circumstances and interpretations explained.

8. The Following arguments were made by the Representative during the course of hearing:

- 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.

- 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 with out 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.
9. 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 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.

- 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.

11. 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