



Before the Executive Director (Securities Market Division)

In the matter of Show Cause Notice issued to

Siddiq Moti

Under Rule 8 read with Rule 12 of the Brokers and Agents Registration Rules, 2001 ("the Brokers Rules") and Section 28 of the Central Depositories Act, 1997 ("the CDC Act")

Number and date of Notice	SMD-SOUTH/SCN/122/07 dated October 10, 2007
Date of hearing	November 15, 2007
Present	Mr. Usman Shaikh and Mr. Javed Ibrahim
Date of Order	January 22, 2008

ORDER

1. This order shall dispose of the proceedings initiated through Show Cause Notice SMD-SOUTH/SCN/122/07 dated October 10, 2007 ("**Show Cause Notice**") issued to Mr. Siddiq Moti (the "**Respondent**") by the Securities and Exchange Commission of Pakistan (the "**Commission**") under Rule 8 of 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 to the Brokers Rules and under section 28 of the CDC Act.
2. Brief facts of the case are that the Respondent is a member of the Karachi Stock Exchange (Guarantee) Limited (the "**Exchange**") 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 ("**1969 Ordinance**") and KPMG Taseer Hadi & Co. ("**the Enquiry Officer**") was appointed as the Enquiry Officer under the above mentioned section inter alia:
 - a) to enquire into the dealings, business or any transaction by the Respondent during the period from April 1, 2006 to June 15, 2006 ("**the Review Period**");
 - b) to identify any and all the acts or omissions constituting the violation of the 1969 Ordinance and the Rules made thereunder; and
 - 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 ("**2002**");

Regulations") and The Central Depository Company of Pakistan Limited Regulations ("**CDC Regulations**") read with the CDC Act.

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 under cover of a letter dated May 18, 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, a Show Cause Notice was issued to the Respondent under Rule 8 of the Brokers Rules and under section 28 of the CDC Act, 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 and requirements of the CDC Act and CDC Regulations. Rule 12 of the Brokers Rule and clause A5 of the code of conduct 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. The Respondent was called upon to show cause in writing within seven days and appear before the Executive Director (SMD-South) on November 15, 2007 for a hearing, to be attended either in person and/or through an authorized representative.
6. The hearing was held on November 15, 2007 which was attended by Mr. Usman Shaikh and Mr. Javed Ibrahim, the Representatives of the Respondent, who submitted a written reply and argued the case.
7. A summary of the contentions that were raised by the Respondent in the written reply / during the hearing and findings / conclusions of the Commission on the same are as follows:



8. Blank Sales

8.1 In terms of Regulation 4 of the 2002 Regulations, blank sales are not permissible. The findings of the Enquiry Officer revealed 4,584 instances of blank sales during the Review Period.

8.2 The Respondent made the following submissions on this Issue ("**Issue No. 1**"):

- The Respondent contended that the instances reported by the Enquiry Officer were not blank sales since all these transactions represent day trades wherein the respective customers cleared their position before the end of day. The Respondent also claimed that in certain cases a customer instructs execution of a sale order and undertakes to deliver securities to the broker. Later, the said customer purchases back the shares thus squaring his position. According to the Respondent, it is not possible to stop these transactions.

8.3 I have considered the contentions of the Respondent and the same are addressed by me below:

- The 2002 Regulations make it absolutely clear that blank sale is a sale which is made without owning shares, without pre-existing interest or without entering into a contractual borrowing arrangement to meet delivery of shares. Hence, merely the fact that the respective customers have purchased the shares sold on the same day, thus squaring their positions, will not establish that these sales were not blank sales if at the time of making the sale, the pre-requisites mentioned above were not met.
- The Respondent has also claimed that a customer undertakes to deliver securities at the time of sale and later squares his position. In this regard, it is the obligation of a brokerage house to ensure compliance with all applicable rules and regulations and appropriate internal control procedures need to be in place to prevent a customer from making a sale without holding pre-existing interest.
- Perusal of documents provided by the Respondent show that for some instances, it is claimed that the respective clients had pre-existing interest in the form of COT or have met delivery of shares. However, appropriate supporting documents were not submitted in favor of this claim.

8.4 Considering the above facts and the contentions of the Respondent, it is established that on 4,584 occasions blank sales have been made in violation of Regulation 4 of the 2002 Regulations. In terms of Rule 8 of the Brokers Rules, more particularly sub rule (ii), sub rule (iii) and sub rule (iv) thereof, where the Commission is of the opinion that a broker has inter alia failed to comply with any requirements of the Securities & Exchange Commission



of Pakistan Act, 1997 or the 1969 Ordinance or of any rules or direction made or given thereunder 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.

8.5 In light of the above i.e. the fact that the Respondent made blank sales, the Respondent has violated the 2002 Regulations thereby attracting sub rule (iii) 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 Brokers Rule. Accordingly, a penalty of Rs.100,000 (Rupees One Hundred Thousand) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.

9. Book entry securities of different customers held in a single CDC-sub account

9.1 In terms of Section 2(27) of CDC Act 1997, the term "sub-account" has been defined as:

"sub-account " means a sub-account maintained, as part of the account of a participant, in accordance with the regulations by a central depository in the name of a sub-account holder so as to record the title of the sub-account holder to any book-entry securities entered in such sub-account."

9.2 Findings of the Enquiry Officer revealed that in case of certain customers, sub-accounts were not opened and in the absence of these sub-accounts, the shares beneficially owned by these customers were affected through a separate CDC sub-account.

9.3 The Respondent made the following submission on this Issue ("**Issue No. 2**"):

- The Respondent submitted all the customers whose shares were held in the sub-account had given authority letters for this practice and these customers were not interested in opening individual CDC sub accounts.

9.4 I have considered the contention of the Respondent and am of the view that CDC accounts are opened to establish the title and beneficial ownership of the shares and keeping the shares of clients in a CDC sub account opened in the name of another customer is a serious violation of the CDC Act, as it results in the change in the beneficial ownership of the shares. Furthermore, authority from a customer cannot be circumvent a mandatory provision of the law.

9.5 In terms of Section 28 read with Section 3 of the CDC Act, it is provided that the Commission can impose a penalty for contravention or an attempt to contravene any

provision of the CDC Act or CDC Regulations. Since by keeping the book entry securities of different clients in a single CDC sub account opened in the name of another client, the Respondent has violated Section 2(27) of CDC Act 1997, I am of the view that a penalty of Rs.25,000 (Rupees Twenty Five Thousand) be imposed on the Respondent.

10. Maintenance of proper books of accounts

10.1 In terms of Rule 8 1(a) and (c) of the Securities and Exchange Rules, 1971 ("**1971 Rules**"), it is provided that:

"Every member shall prepare and maintain, as required by sub-section (1) of section 6, the following books of account and other documents in a manner that will disclose a true, accurate and up-to-date position of his business, namely:-

- a. journal (or other comparable record), cash book and any other books of original entry, forming the basis of entries into any ledger, the books of original entry being such as contain a daily record of all orders for purchase or sale of securities, all purchases and sales of securities, all receipts and deliveries of securities and all other debits and credits;....
- c. ledgers (or other comparable records) reflecting securities in transfer, securities borrowed and securities loaned and securities bought or sold, of which the delivery is delayed".

10.2 Findings of the Enquiry Officer revealed that the Respondent did not maintain separate records of shares of customers and shares arranged for pledge against the running finance facility ("**Issue No.3**").


10.3 Findings of the Enquiry Officer revealed instances where the release of CFS was recorded in a different account from the one in which the CFS was entered ("**Issue No. 4**").

10.4 Findings of the Enquiry Officer revealed differences between the holdings of book entry securities by client as per the back office record and as per the CDC Balance statements ("**Issue No. 5**").

10.5 The Respondent made the following submissions on **Issue No. 3**:

- The Respondent contended that it maintains proper records for shares pledged in electronic form. Further, the shares were pledged with the authority of the customers.



- 10.6 I have considered the contention of the Respondent and am of the view that the pledging of customers' shares with financial institutions for obtaining finance is not an acceptable practice and in order to provide financing to the customers, CFS and margin financing could be utilized. Further, authority from a customer cannot circumvent a mandatory provision of the law. Nevertheless, considering the above mentioned facts 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.
- 10.7 The Respondent made the following submission on **Issue No. 4:**
- The Respondent contended that during the material time, the COT was short from the market due to which this practice was adopted and the COT so availed was divided among the respective customers through computer generation. The Respondent also claimed that this was the market practice at that time.
- 10.8 I have considered the contention of the Respondent and am of the view that the practice described by the Respondent is not acceptable. However, keeping in view that during the Review Period, In-house badla was allowed, 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
- 10.9 The Respondent made the following submission on **Issue No. 5:**
- The Respondent submitted that the alleged difference in time is mainly due to the period of settlement. The Respondent submitted CDC reports in support of its claim.
- 10.10 Considering the above mentioned facts 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.
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11. Fairness, due care and diligence

11.1 In terms of Clause A 1 and A2 of the code of conduct contained in the Third Schedule read with Rule 12 of the Brokers Rules, it is provided that:

A1-"A broker shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business"

A2-"A broker shall act with due skill, care and diligence in the conduct of all his business."

11.2 Findings of the Enquiry Officer revealed an account which was opened in the name of a minor ("**Issue No. 6**").

11.3 Findings of the Enquiry Officer revealed an account which was opened in the name of an employee of the Respondent but in which trading was carried out by another person. Profits made during the Review Period on this account were transferred to other accounts ("**Issue No. 7**").

11.4 The Respondent made the following submission on **Issue No. 6**:

- The Respondent contended that the title of the account is now changed to the name of the mother of that minor. The Respondent agreed that opening the name of an account in the name of a minor was an irregularity which has now been corrected.

11.5 Considering the above mentioned facts 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.

11.6 The Respondent made the following submissions on (**Issue No. 7**):

- The Respondent contended that it has not opened any account in the name of an employee. The account referred to in the Enquiry Officer's report pertains to a client of the Respondent and balances were transferred out of his account upon his written instruction. The Respondent, upon direction of the Commission, submitted supporting documents.



- 11.7 Considering the above mentioned facts 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.
12. In view of what has been discussed above, I am of the considered view that no punitive action is necessary in relation to Issues No. 3,4,5,6 and 7 and a simple caution will suffice. As regards Issues Nos. 1 and 2, as stated above, penalties of Rs.100,000 (Rupees One Hundred Thousand) and Rs.25,000 (Rupees Twenty Five Thousand) are respectively imposed, which should be deposited with the Commission not later than fifteen (15) days from the date of receipt of this Order.



Zafar Abdullah

*Executive Director
Securities Market Division*