



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)

Before the Director (Securities Market Division)

In the matter of Show Cause Notice issued to

Capital Vision Securities (Pvt.) Limited

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)2006/73 dated September 26, 2007
Date of Hearing	October 09, 2007
Present at the Hearing:	Mirza Mahmood Ahmed, Legal Counsel
Date of Order	January 23, 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)2006/73 dated September 26, 2007 (**"the SCN"**) issued to Capital Vision 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 KPMG Taseer Hadi & 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 a 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 the Commission from time to time:

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 May 14, 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 September 26, 2007, the Respondent was called upon to show cause in writing within seven days and appear before the undersigned on October 08, 2007 for a hearing, to be attended either in person and/or through an authorized representative, however, on the Respondent's request hearing was re-fixed for October 09, 2007.

6. The hearing was attended by Mirza Mahmood Ahmed, legal counsel of the Respondent, who argued the case. The Legal Counsel also submitted written replies on the behalf of the Respondent.

7. A summary of the contentions and objections that were raised by the Respondent in its written submissions and during the hearing and findings and conclusions of the Commission on the same are as follows:

8. Preliminary Objections

8.1 The objections raised by the Respondent, pertaining to the Enquiry, are given as under:-

- The Enquiry Officer did not conduct the Enquiry in a proper manner and halfway through the enquiry the Enquiry Officer left without providing an opportunity to the Respondent to furnish documentary evidence which could have cleared the objections raised in the Enquiry Report.
- There is a procedural requirement that in order to initiate an Enquiry the Commission must have a reason, like a complaint etc. However, in this case the Commission did not have any reason to conduct an Enquiry.



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- These Enquiries were a "fishing and roving exercise" and as per prior court decisions no Regulatory Authority is authorized to conduct frivolous enquiries. In support of its argument the legal counsel also provided copies of a number of such court orders. These are:
 - a) Order dated March 08, 1992 in the matter of Civil appeal Nos: 38-K to 40-K Assistant Director Intelligence and Investigation, Karachi v/s B.R. Herman and Others,
 - b) Order dated October 10, 2003 in the matter of Constitution Petition No. 1353 of 1998 and Constitution Petition No. 177 of 2002 - Karachi Administrative Employee cooperative Housing Society Ltd v/s Government of Sindh; and
 - c) Order dated September 20, 2004 in the matter of Customs Appeal No. K-779/04 - Muhammad Ateeq Paracha & Others v/s The State.
- The Commission has converted the Enquiry into an Audit.

8.2 I have considered the contentions and the preliminary objections raised by the Respondent and the issues raised therein and the same are addressed below:

- The Respondent's assertion that it was not provided an opportunity to furnish documentary evidence to clear different violations reported in the Enquiry Report is not correct. It may be noted that the Enquiry Officer forwarded draft Enquiry Report to the Respondent for a review and provision of any documents in order to clear violations reported therein. Further, before issuance of the SCN by the Commission, the Enquiry Report was forwarded to the Respondent in order to provide it with another opportunity to clear any violation reported in it. Based on the replies and documents provided by the Respondent a number of issues reported in the Enquiry Report were dropped and only those violations were taken up in the SCN where the Respondent could not provide sufficient evidences. Therefore, sufficient opportunity was provided to the Respondent to clear any violation reported in the Enquiry Report.
- The assertion of the Respondent that the Enquiry was conducted without any reason/compliant is false. It may be noted that the Review Period was a period of high volatility for Stock Market and in order to identify the reasons for such volatility the Commission conducted an initial Enquiry into the affairs of various members of LSE, including the Respondent. The findings of initial enquiry identified number of areas which needed further in-depth review for identification of possible violations of securities market rules, regulations. Therefore, it was deemed necessary to conduct enquiries in order to determine if there was any violation of applicable rules and regulations by the members. Further, it may be noted that Section 21 of the Ordinance allows the Commission to initiate an Enquiry on its own motion, when ever it deems necessary.
- The Respondent's contention that the Enquiry was a "fishing and roving exercise" is unfounded. As stated above the Enquiry was commenced based on the findings of the initial



enquiry conducted by the Commission that identified different areas which required further review/enquiry. The members were selected on the basis of trading volume in certain scrips during the review period. Further, the Enquiry Officer was given specific tasks that limited its scope to enquiry into and identifying any violation of the applicable rules, regulations. All the areas covered by the Enquiry Officer were critical and part of the scope of Enquiry assigned to it. It is further stated that the Commission is primarily responsible for regulating the capital markets and protection of investors under the Act and the Ordinance. Further, the Commission is not expected to take a reactionary approach and wait for complaints to be brought before it after the damage has already been caused. It is for this reason that the Commission has suo motu powers as stated above, to initiate an enquiry into the affairs and dealings in an Exchange or its members.

- The Respondent's assertion that the Commission has converted the Enquiry into an Audit is not correct. It may be noted that the scope of the Enquiry was limited and covered only specific areas and did not cover the audit of the entire financials of the members. The Enquiry principally covered compliance of the Securities Market Laws.

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

9.1 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"

9.2 The findings of the Enquiry Officer revealed 12,362 instances of Blank Sales during the Review Period.

9.3 The Respondent made the following submissions on the Issue

- The Respondent in its written reply dated October 04, 2007 to the SCN denied execution of Blank Sales and stated that in some of the cases its clients instruct execution of sales orders and undertake to deliver securities to the Respondent. Later on if the client fails to deliver the said securities the sale entry may stand without delivery of shares. However, this is not due to any fault, incompetency or illegality on the part of the Respondent. All such transactions are later on squared up by the clients and it is possible that many transactions mentioned in the Annexure - A (the Annexure) of the SCN were of this nature.
- During the hearing, the Respondent again denied that the sales mentioned in the Annexure are Blank Sales and agreed to provide documentary evidence of pre-existing interest of the clients.



in this regard. However, vide letter dated November 20, 2007, the Respondent provided printouts of statements vide which it tried to show that the clients first bought and then sold the shares mentioned in the Annexure.

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

- The Respondent's assertion that it executed its clients' order on their undertaking that they will provide deliveries to the Respondent when required can not be taken as evidence that the clients had pre-existing interest in the shares being sold by them. It may be noted that the Respondent is responsible for each and every order executed through its house, therefore, the Respondent should have obtained documentary evidence of pre-existing interest in the shares being sold by its clients. Mere undertakings by the clients do not prove the pre-existing interest of the clients in the shares being sold and it does not absolve the Respondent from its obligation to ensure compliance of Short Selling Regulation.
- With regard to the statements provided vide letter dated November 20, 2007, review of the same do not show that the clients had pre-existing interest in the shares before sales mentioned in the Annexure. The statements made incorrect calculations in order to show that the clients had buy positions before sale. In some of the statements the Respondent only moved the buy trades above the sale trades, however, the time of these trades showed that buying were always made after sales. Further, in most of the cases the Respondent treated the buying trades, that were made to square up earlier sales, as buy positions against the subsequent sales which is not a correct method of calculation, as net positions of the clients at any point of time should be considered. It may be noted that the sales mentioned in the Annexure only includes those sales which were made when the clients had zero or net negative position and the Enquiry Officer did take into account the purchase of shares. Therefore, in absence of any further documentary evidence it is clear that the sales mentioned in the Annexure are Blank Sales.

9.5 Considering the above facts and the contentions of the Respondent, it is clear that 12,362 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.



9.6 In light of the above i.e. the facts 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. 75,000 (Rupees Seventy Five Thousand only) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.

10. Account Opening Forms ("Issue No. 2")

10.1 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:

- i) List of Transaction fee, Commission to be charged by the Broker and other CDC charges to be levied should be attached with the AOFs.
- ii) Attested copy of CNIC of the clients should be attached with the AOF.
- iii) AOFs should be duly signed by the witnesses.
- iv) Margins to be maintained by the clients should be mentioned on AOFs.

10.2 Findings of the Enquiry Officer revealed that;

- i) List of Transaction fee, Commission to be charged by the Respondent and other CDC charges to be levied were not attached with the AOFs.
- ii) CNIC's of the clients enclosed with AOFs were not attested.
- iii) AOFs were not signed by the witnesses.
- iv) Margins to be maintained by the clients were not mentioned on AOFs.

10.3 The Respondent made the following submission on these issues:

- With reference to violation of not attaching list of charges with the AOFs the Respondent asserted that Commission slabs and Transaction Charges are given by the Respondent to its clients through Trade Confirmations which are sent daily and through Ledger/Account Statement which is sent weekly. The Respondent further stated that it is in process of rectifying this error.
- With reference to violation of unattested copies of client's CNICs the Respondent asserted that it is running its house since 2001 when SAOF was not prescribed by the Commission nor it was required that CNICs may be annexed with the AOFs. However, it is currently rectifying the error and has requested its clients to provide attested copies of CNICs.



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- With reference to the violation of missing signatures of witnesses on the AOFs, the Respondent stated that it started the brokerage house in 2001 and at that time signatures of witnesses on AOFs were not mandatory. Therefore, in some of the cases signatures of witnesses are missing on AOFs, however, currently it is in process of getting new AOFs executed from its clients and said omissions will be rectified soon.
- With regard to not mentioning of amount/ percentage of margin to be maintained by the clients the Respondent stated that it is a matter between client and the Respondent as it treats all its clients based on their credentials. Because of this the margin amount/percentage varies from client to client, therefore, same is not mentioned on AOFs. However, clients are informed about the percentage of margin deposit and they are also issued margin calls notices as and when their margin amount is insufficient.

10.4 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 statements/trade confirmations suffices the requirement of attaching the list of charges with the AOFs. Therefore, by not attaching the said list with the AOFs the Respondent has failed to comply with the directives of the Commission. 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 his clients. In case of any dispute arises between them all the matters are resolved on the basis of clauses of the AOF.
- With regard to Respondent's assertion on violation of un-attested copies of client's CNICs, it is clear that the Respondent failed to comply with the abovementioned directives of the Commission. The Respondent assertion regarding unattested copies of CNICs of old clients does not hold grounds on the basis that SAOF was prescribed by the Commission in November, 2003 and since then a long time has passed, however, the Respondent has still not complied with the requirements of AOFs.
- With regard to violations of missing signatures of witnesses on AOFs it may be noted that it is the requirement of the SAOF prescribed by the Commission that AOFs should be signed by the witnesses and Respondent's assertion clearly shows that it has failed to comply with the said requirement of SAOF.
- With regard to the Respondent's assertion regarding not mentioning of percentage of margin deposit on AOFs, it may be noted that it is the requirement of SAOF that the same should be mentioned on AOFs. Verbally informing the client about the percentage of margin deposit does



not suffice the said requirement of the SAOFs. In this connection it may further be noted that writing percentage of margin deposit on AOFs makes it a part of AOF. Therefore, mentioning of percentage of margin deposit on AOFs also safeguards the interests of the clients and the broker.

- 10.5 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 requirements of 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, to take action under Rule 8(a) or (b) of the Brokers Rules.
- 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 Respondent's statement that it has already taken corrective actions 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 these instances 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. **Order Register ("Issue No. 3")**
- 11.1 In terms of Rule 4(1) of the 1971 Rules it is provided that:
- "All orders to buy or sell securities which a member may receive shall be entered, in the chronological order, in a register to be maintained by him in a form which shows the name and address of the person who placed the order, the name and number of the securities to be bought or sold, the nature of transaction and the limitation, if any, as to the price of the securities or the period for which the order is to be valid."
- 11.2 The findings of the Enquiry Officer revealed that the register as mentioned above was not maintained by the Respondent during the Review Period.
- 11.3 The Respondent made the following submission on the aforementioned issue:
- The Respondent in its written reply asserted that electronic ledger as maintained today fulfills the requirement of abovementioned Rule. The Respondent further asserted that the said Rule was introduced when manual trading was prevalent in the stock market.
 - During the hearing the Respondent stated that now-a-days due to high volume and velocity of trading it is practically impossible to maintain manual order register.



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- 11.4 I have considered the contentions of the Respondent and I am of the view that electronic ledgers or the Daily Activity Log, as mentioned by the Respondent is not a substitute for the Order Register as required under the Rule 4(1) of the 1971 Rules. The aforementioned Logs only record those orders that are placed by the Respondent into LOTS and not all the orders which were received from the clients and not entered into LOTS. Further, the said Log only records the time of placement of orders into the system and not the time of receipt of orders.
- 11.5 The Commission is also cognizant of the practical difficulties associated with the maintenance of such an Order Register manually. However, it is noted with disappointment that the brokerage house and LSE were not able to keep pace with evolution in technology and significant increase in trading activities whereby a system should have been developed to enable simultaneous recording of orders received from clients and their incorporation in a database to generate the Order Register as required under the Rule 4(1) of the 1971 Rules.
- 11.6 Considering the above mentioned fact 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 that 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 the laws, regulations and directives of the Commission in future for avoiding any punitive action under the law.
12. As stated above, the Respondent is penalized as follows:
- As regards Issue No1, as stated above, a penalty of Rs. 75,000/- (Rupees Seventy Five Thousand only) is imposed.
 - No punitive action is taken in relation to Issue No. 2 and 3 and a simple caution will suffice.
- 12.1 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 (SM)
Securities Market Division