



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

Ismail Iqbal Securities (Private) Limited

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/120/07 dated August 31, 2007
Date of hearing	October 11, 2007
Present	Mr. Asad Iqbal and Mr. Junaid Haroon
Date of Order	December 26, 2007

ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice SMD-SOUTH/SCN/120/07 dated August 31, 2007 ("**Show Cause Notice**") issued to **Ismail Iqbal Securities (Private) Limited** (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 / KSE**") 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 and 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 9, 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, the Show Cause Notice was issued to the Respondent under Rule 8 of the Brokers Rules stating that the Respondent has prima facie contravened *inter alia* 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 this 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 October 11, 2007 for a hearing, to be attended either in person and/or through an authorized representative.

6. The hearing was held on October 11, 2007 which was attended by Mr. Asad Iqbal and Mr. Junaid Haroon, the Representative 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 submission / during the hearing and findings / conclusion 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 2,387 instances of blank sales during the Review Period.

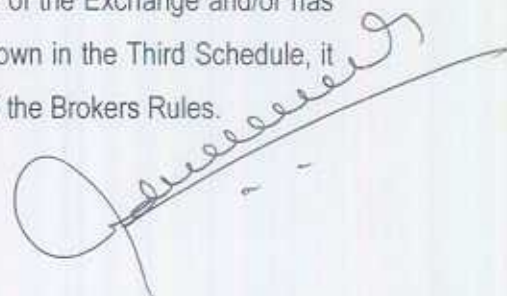
8.2 The Respondent made the following submissions on this Issue ("Issue No. 1"):

- The Respondent contended that the instances reported by the Enquiry Officer were not blank sales. The Respondent claimed that some of the instances pertained to clients which had pre-existing interest in the form of holdings in their respective CDC Investor accounts.
- The Respondent further contended that in some instances, the transactions were executed through wrong KATS ID due to mistake.
- The Respondent further contended that some instances represented intra-day trading and the respective clients had purchased the relevant scrip before selling the same.
- The Respondent admitted that some instances were a result of error on the part of its clients, however, the same were not material.

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

- Perusal of the documents submitted by the Respondent revealed that 1,027 out of 2,387 instances were not blank sales and the respective clients had pre-existing interest at the time of trade.
- In respect of remaining 1,360 instances the evidences submitted by the Respondent were not found satisfactory and as far as its contention that the instances were not material is concerned, the number of instances identified as blank sales cannot be considered immaterial.

8.4 Considering the above facts and the contentions of the Respondent, it is established that on 1,360 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.



opening forms with supporting documents and that the Respondent should clearly direct all of its existing clients to submit duly filled account opening forms.

10. Customers' securities held in House account for pledge purpose

10.1 In terms of CDC Regulation 2.11.1, the term "House Account" is defined as:

"An account maintained on the CDS by an account holder for recording book entry securities beneficially owned by the account holder".

10.2 Findings of the Enquiry Officer revealed that in case of certain customers no CDC sub-accounts were opened and in the absence of these accounts, the related movements of securities against the transactions undertaken by such customers were affected through the House Account. ("**Issue No. 3**"):

10.3 Findings of the Enquiry Officer revealed that KATS ID "IIS" was used to perform trading on behalf of multiple customers. No CDC sub-accounts were opened for these customers and in the absence of these accounts; the related movements of securities against the transactions undertaken by such customers were affected through the House Account. ("**Issue No. 4**")

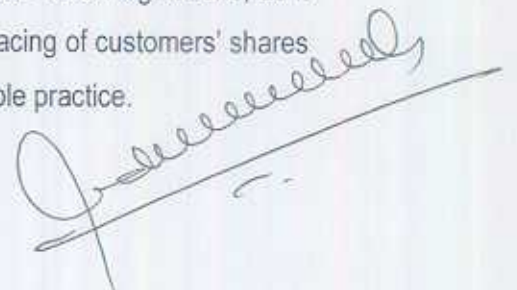
10.4 The Respondent made the following submission on the **Issue No. 3**:

- The Respondent submitted that it has a practice of holding certain customers' shares in the CDC House account of the Respondent since the financing against these shares have been provided by the Respondent through margin financing or In-house badla financing.

10.5 The Respondent made the following submission on the **Issue No. 4**:

- The Respondent submitted that this represented trading conducted by the family members of the directors and therefore the trading of these persons was affected through the CDC House account. The Respondent further submitted that the practice has now been discontinued.

10.6 I have considered the contentions of the Respondent and am of the view CDC accounts are opened to establish the title and beneficial ownership of the shares and keeping the shares of clients in the House account is a serious violation of the CDC Regulations, as it results in a change in the beneficial ownership of the shares. Placing of customers' shares in the CDC House account of the Respondent is not an acceptable practice.



10.7 Considering the above mentioned facts, it is established that the Respondent has violated Regulation 2.11.1 of the CDC Regulation. 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. Therefore, I am of the view that a penalty of Rs.25,000 (Rupees Twenty Five Thousand) be imposed on the Respondent.

11. Order Register

11.1 In terms of Rule 4(1) of the Securities and Exchange Rules 1971 ("**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, 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."

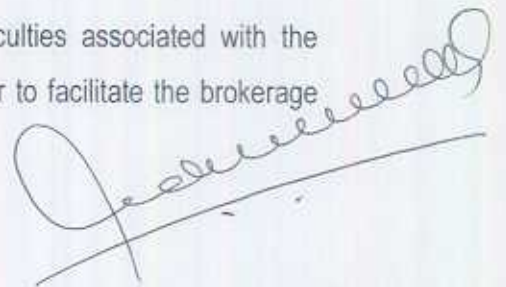
11.2 Findings of the Enquiry Officer revealed that the register as mentioned above was not maintained by the Respondent during the Review Period.

11.3 The Respondent made the following submission on this Issue ("**Issue No. 5**"):

- The Respondent contended that it is maintaining an order log which fulfills the requirements of the above mentioned rule. The Respondent also informed that a phone recording system is also in place.

11.4 I have considered the contention of the Respondent and am of the view that the order 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, since the order log only records those orders that are placed by the brokerage house into KATS and not the orders received from the clients. Same holds true for the computerized system at KSE and in absence of Order Register, several requirements of the Regulations for Proprietary Trading, 2004 also cannot be complied with. Hence, it is absolutely incorrect to assume that the Order Register has become obsolete.

11.5 The Commission is however cognizant of the practical difficulties associated with the maintenance of such an Order Register manually and in order to facilitate the brokerage



houses in meeting the requirements of the said rule, the KSE is developing a system which will be provided in due course. However, it is noted with disappointment that the brokerage houses and exchanges 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 requirements of the Rule 4(1) of the 1971 Rules.

- 11.6 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. CDC Balance statements

- 12.1 In terms of Regulation 6.2A.1 of the CDC Regulations, it is provided that:

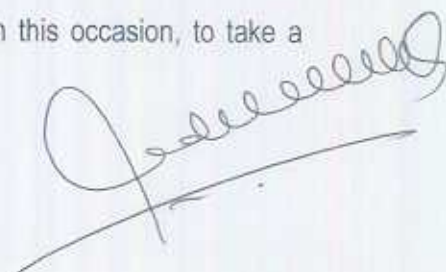
"Every Participant shall send by the 10th day of every month to all Sub- Account Holders maintaining Sub-Accounts under the control of such Participant Holding Balance statements showing the number of every Book-entry Security entered in every such Sub-Account as of the end of the preceding month. Such Holding Balance statements shall be generated from the CDS and shall be sent to the Sub-Account Holders in the manner set out in Regulation 2.6.4."

- 12.2 Findings of the Enquiry Officer revealed that the Respondent did not have a practice to send the CDC Balance statements to all of its customers by the 10th of each month as required under the CDC Regulations and where the CDC Balance statements were sent, the same were not generated from the CDS, instead the statement was sent on the Respondent's own format.

- 12.3 The Respondent made the following submission on this Issue ("**Issue No. 6**"):

- The Respondent contended that it has a practice of balance reports to its clients on daily basis through e-mail and has also started the practice of sending the CDC Balance statements through courier.

- 12.4 Considering above mentioned fact, the corrective measures taken by the Respondent and the practical difficulties in sending the CDC balance statements to all of the clients of the Respondent, including the dormant accounts, I am inclined, on this occasion, to take a



lenient view in the matter and will not take any punitive action under section 28 of the CDC Act. I would further direct the Respondent to ensure that full compliance is made of all the rules and regulations in future for avoiding any punitive action under the law.

13. Difference in the Back Office record and CDC Statements

13.1 In terms of Rule 8 (1)(a) and (c) of the 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".

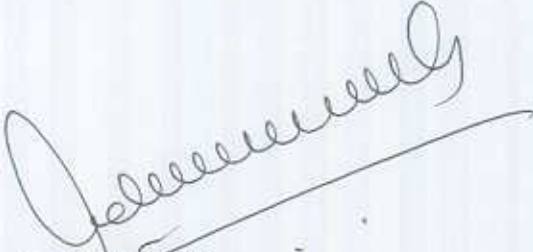
13.2 Findings of the Enquiry Officer revealed differences between the holdings of book entry securities by client as per the back office record and as per the CDC Balance statements.

13.3 The Respondent made the following submission on this Issue ("**Issue No.7**"):

- The Respondent contended that its back office records clearly reflect the movement of all securities in the accounts. The Respondent contended that the differences were temporary in nature and occurred only due to constraints of time. The Respondent further submitted that it has taken measures to ensure that the same does not occur in future.

13.4 Considering the above mentioned facts and the corrective measures taken by the Respondent, 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. I would further direct the Respondent to design and implement a sound system of internal controls in order to ensure that full compliance is made of all the rules and regulations in future for avoiding any punitive action under the law

14. 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. 2, 5, 6 and 7 and a simple caution will suffice in case of Issues No. 2 and 5. As regards Issues No. 1, as stated above, a penalty of Rs.100,000/- (Rupees One Hundred Thousand) is imposed, whereas with respect to Issues No. 3 and 4, a penalty of Rs.25,000 (Rupees Twenty Five Thousand) is imposed. These penalties 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