

Before the Director (Market Supervision & Registration Department)
Securities Market Division
Securities and Exchange Commission of Pakistan

**In the matter of Show Cause Notice Dated January 23, 2013 issued to
Shajar Capital Pakistan (Private) Limited, Broker Karachi Stock Exchange Limited**

Date of Hearing: March 13, 2013

Present at the Hearing:

1. Mr. Zulfiqar Haider Khan (Chief Operating Officer)
2. Mr. Kashif Syed Ehtesham (Chief Financial Officer)
3. Mr. Shahid Hussain (Consultant)

Representing SECP (SMD): Ms. Saima Shafi Rana (Deputy Director-MSRD)

ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice No. 4(BRK-229)SE/SMD/2010 dated January 23, 2013 (**the "SCN"**) under Section 22 of the Securities and Exchange Ordinance, 1969 (**the "Ordinance"**) issued to M/s. Shajar Capital Pakistan (Private) Limited (**the "Respondent"**), TREC Holder of the Karachi Stock Exchange Limited (**the "KSE"**) and a broker registered under the Brokers and Agents Registration Rules, 2001 (**the "Brokers Rules"**).
2. Brief facts of the case are that the Securities & Exchange Commission of Pakistan (**the Commission**) in exercise of its powers under Sub-section (1) of Section 6 of the Ordinance read with Rule 3 and Rule 4 of the Stock Exchange Members (Inspection of Books and Record) Rules, 2001 (**the "Inspection Rules"**) ordered an inspection of the books and records required to be maintained by the Respondent.
3. The report dated November 6, 2012 submitted by the Inspection Team disclosed that the Respondent was involved in imposing late payment charges to the clients. Moreover, irregularities in calculation of Net Capital Balance ('NCB') as on June 30, 2012 were also observed and it appeared that NCB was not in accordance with the Third Schedule of Securities and Exchange Rules, 1971 (**the "SE Rules"**). Thereafter, the Commission served a SCN to the Respondent, the contents of which are reproduced below:-

SUBJECT: SHOW CAUSE NOTICE UNDER SECTION 22 OF THE SECURITIES AND EXCHANGE ORDINANCE, 1969 READ WITH RULE 8 OF THE BROKERS AND AGENTS REGISTRATION RULES, 2001

WHEREAS, M/s. Shajar Capital Pakistan (Private) Limited ('SCPL') is a Trading Rights Entitlement Certificate (TREC) Holder of the Karachi Stock Exchange Limited and registered as a broker with the Securities and Exchange Commission of Pakistan ("Commission") under the Brokers and Agents Registration Rules, 2001 ("Brokers Rules").

2. *AND WHEREAS, the Commission in exercise of its powers under sub-section (1) of Section 6 of the Securities and Exchange Ordinance, 1969 ("Ordinance") read with Rule 3 and Rule 4 of the Stock Exchange Members (Inspection of Books and Record) Rules, 2001*


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("Inspection Rules") ordered an inspection vide order No. SMD/MS&CID-C&IW/10-1(144)/2012 dated September 4, 2012 of the books and record required to be maintained by SCPL. The Inspection Team submitted the inspection report to the Commission on November 6, 2012 which was forwarded to SCPL in accordance with Rule 7 of the Inspection Rules and response thereof was received on November 29, 2012.

3. **AND WHEREAS**, during the course of inspection, it was observed that SCPL has been imposing late payment charges to its clients, who have debit balances or do not clear their dues in time. Such practice is in contravention of Section 16 of the Ordinance, which is reproduced below for convenience.

"No member or associate shall, in contravention of any rules made under this Ordinance, directly or indirectly extend or maintain credit, or arrange for the extension or maintenance of credit, to or for any person for the purpose of purchasing or carrying any security."

4. **AND WHEREAS**, on review of the inspection report it has further come to the notice of the Commission that Net Capital Balance ("**NCB**") of SCPL as on June 30, 2012 is not in accordance with the Third Schedule of the Securities and Exchange Rules, 1971 ("**1971 Rules**") and has been overstated by an amount of Rs.27,692,776.

5. **AND WHEREAS**, prima facie, it appears that SCPL by submission of overstated "**NCB**" has given information which it had reasonable cause to believe to be false or incorrect in material particular in violation of Section 18 of the Ordinance, which reads as follows:-

"No person shall, in any document, paper, accounts, information or explanation which he is, by or under this Ordinance, required to furnish, or in any application made under this Ordinance, make any statement or give any information which he knows or has reasonable cause to believe to be false or incorrect in any material particular."

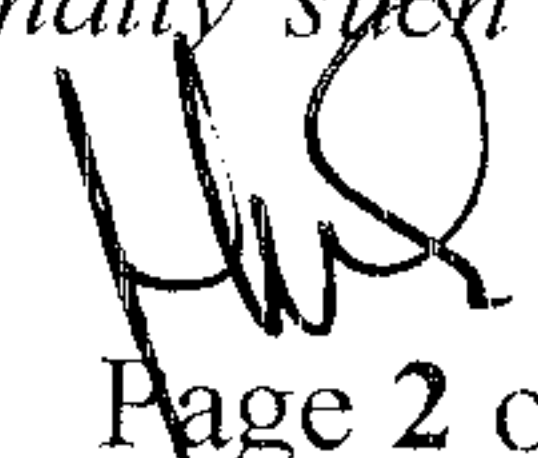
6. **AND WHEREAS**, in light of the facts mentioned above, prima facie it appears that SCPL is in contravention of Section 16 of the Ordinance, Third Schedule of the 1971 Rules read with Section 18 of the Ordinance, the contravention of which invokes penalty under Section 22 of the Ordinance and Rule 8 of the Brokers Rules.

7. **AND WHEREAS Rule 8 of Brokers Rules provides that;**

"...Where the Commission is of the opinion that a broker has furnished wrong or false information, the Commission may, if it considers necessary in the public interest so to do, by order in writing suspend the registration of a broker for such period as may be specified in the order or impose on a broker a fine not exceeding one hundred thousand rupees."

8. **AND WHEREAS**, sub-section (1) of section 22 of the Ordinance provides that:

" If any person refuses or fails to furnish any document, paper or information which he is required to furnish by or under this Ordinance; or refuses or fails to comply with any order or direction of the Commission made or issued under this Ordinance; or contravenes or otherwise fails to comply with the provisions of this Ordinance or any rules or regulations made thereunder, the Commission may if it is satisfied after giving the person an opportunity of being heard that the refusal, failure or contravention was willful, by order direct that such person shall pay to the Commission by way of penalty such



sum not exceeding fifty million rupees as may be specified in the order and in the case of continuing default, a further sum calculated at the rate of two hundred thousand rupees for every day after the issue of such order during which the refusal, failure or contravention continues.”

9. **NOW THEREFORE**, you are hereby called upon to show cause in writing by February 1, 2013 as to why action as provided under Section 22 of the Ordinance and/or Rule 8 of the Brokers Rules may not be initiated against SCPL for violation as indicated above. You are further directed to appear in person or through an authorized representative (with documentary proof of such authorization), on **February 4, 2013** at 11:00 a.m. at the SECP Headquarters – Islamabad. You are advised to bring all relevant record in original, which you may consider necessary for clarification/or in your defense. This notice sufficiently discharges the Commission’s obligation to afford SCPL an opportunity of hearing in terms of Section 22 of the Ordinance and Rule 8 of the Brokers Rules. In case of your failure to appear on the stated date of hearing it will be deemed that SCPL has nothing to say in its defense and the matter will be decided ex-parte on the basis of available record.

10. Please note that this show cause is being issued without prejudice to any action, which may be taken or warranted for the above said or any other default under the above referred or any other provisions of law. Kindly acknowledge receipt of this show cause notice through return fax or courier at your earliest.

Sd/-
Hasnat Ahmad
Director

4. Thereafter, the hearing fixed for February 4, 2013 was adjourned once on the request of the Respondent. The Respondent submitted a written response to the SCN dated February 7, 2013. The following arguments were put forward by the Respondent in its written response and during the hearing held on March 13, 2013:

(a) **Overstatement of Net Capital Balance:** In this connection, the Respondent in its written response stated as follows:

“The focal point to be noted here is that the Inspection Team has accepted and included items classified as 'Other Assets' aggregating to Rs 8'864'211, despite the fact that the Third Schedule to the Rules did not categorically specify these items. However, 'Other Assets' of Rs 27,692,776 were not taken into account. The Third Schedule to the Rules does not categorically specify 'Other Assets' despite the fact that these are 'current' in nature according to Generally Acceptable Accounting Principles and are in the ordinary course of business. However, this is the industry practice and keeping in view the fact that these items are of 'current nature', the Brokerage houses incorporate 'Other Assets' while calculating their NCB which is being accepted by their auditors and stock exchanges as well....

....the Third Schedule to the Rules is silent as to inclusion or exclusion of these items in the calculation of NCB and yet there is no bar to such inclusion. Further, no guidance in this regard is available from other sources...SCPL while calculating its NCB, considered in good faith these balances based on the understanding that these amounts are in current nature (the Inspection Team of

the Commission has adopted the same view while adding Rs. 8,864,211 in their calculation of NCB)....

..Another important aspect that needs to be considered here is that NCB calculated to determine the maximum exposure limit of the Brokerage houses in ready market. Further, if a Brokerage house intentionally overstates its NCB, it definitely means that the Brokerage house intends to enjoy higher exposure limits than its entitlements to enhance its revenues. However, SCPL has not utilized its NCB in full capacity. The highest trade during aforementioned period was only Rs. 164.2 million which is 16.31 times the Commission adjusted NCB (i.e. 14,064,631 as disclosed in Inspection Report). This is an abundant proof that neither there was a need, nor any intention to overstate NCB, for the purposes of misusing the so called enhanced exposure limit.”

The Respondent emphasized that the overstatement is not willful rather just interpretation issue. The Respondent said that it has included certain items in Other Assets and the Inspection Team has included only few items as “Other Assets”. Both categories are not defined. The difference is of understanding. The Respondent requested that Commission may issue a guideline regarding Net Capital Balance which clearly states which heads should be included in calculating Net Capital Balance.

(b) **Late Payment Charges:** *Regarding this, the Respondent in its written statement stated as under:*

“..at times clients purchase securities through us, but are unable to make the payments, on account of which we hold the securities. Late payment charges are applied to such client to cover SCPL's financial costs and losses due to blockage of funds. This charge can by no means be considered as financing or extending or maintaining of credit to any client for purchase of securities. In fact, the clients place orders and there is no financing or credit arrangements with such clients. It is only after the securities are purchased that we realize that the payment is not forthcoming and SCPL remains out of money, but SCPL remains bound to pay for such purchases out of its own resources on the settlement dates. If SCPL does not recover late payment charges, there will be a serious impact on its Financials. This tendency is quite common with clients of most of the brokerage houses...”

The Respondent accepted that it was imposing late payment charges/liquation damages to cover its cost.

5. The arguments raised by the Respondent are discussed and appraised hereunder in seriatim:

(a) **Overstatement of Net Capital Balance**

The inspection Team has accepted few items under the head “Other Assets”, however after evaluating the written and oral submission made by the Respondent and observations of the Inspection Team, I am of the considered opinion that the Third Schedule of SE Rules does not allow items under the head “Other Assets” and therefore

the amount of Rs. 8.87 million should not have been included in the NCB. As a result, NCB was overstated by an amount of Rs. 36.56 million (*Rs. 27.693+ Rs. 8.87*).

(b) Late Payment Charges

During the hearing the Respondent accepted that it charged liquidation damages/financial charges to cover the cost. It is apparent that such late payment charges are identical to in-house financing/badla financing and are violation of Section 16 of the Ordinance.

6. I have examined the facts, evidences and documents on record, in addition to the written and verbal submissions made on behalf of the Respondent. It is observed that the Respondent was fully aware that "Other Assets" are not to be included in calculation of NCB. It is evident that the NCB is overstated by an amount of Rs. 36.56 million. It is further evident that the Respondent by submission of overstated NCB has submitted a statement and given information which it had reasonable cause to believe to be false or incorrect in material particular in violation of Section 18 of the Ordinance. Moreover, it is established that the Respondent was charging liquidation damages/financial charges in violation of Section 16 of the Ordinance.

7. The violation of the Ordinance, rules and regulations is a serious matter. However, taking a lenient view and in view of the regulatory violations as discussed above, through this Order, the Respondent is directed to deposit a sum of Rs. 100,000 (Rupees One Hundred Thousand Only) under Section 22 of the Ordinance to the Commission by way of penalty. The Respondent is further directed to ensure full compliance with the Ordinance, rules, regulations and directives of the Commission in future.

8. The matter is disposed of in the above manner and the Respondent is directed to deposit the penalty in the account of the Commission being maintained in the designated branches of MCB Bank Limited not later than thirty (30) days from the date of this Order and furnish copy of the deposit challan to the undersigned.

9. This Order is issued without prejudice to any other action that the Commission may initiate against the Respondent in accordance with the law on matters subsequently investigated or otherwise brought to the knowledge of the Commission.


Hasnat Ahmad
Director (MSRD)

**Announced on April 11, 2013
Islamabad.**

