



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN  
(Securities Market Division)

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Before The Director (Securities Market Division)

In the matter of Show Cause Notice issued to

ACE Securities (Pvt.) Limited

Date of Hearing:

(i) July 22, 2009

(ii) August 07, 2009

Present at the Hearing:

Representing the ACE Securities (Pvt.) Limited

Mr. Haider Waheed

Legal Council of the Respondent

Assisting the Director (SMD)

Mr. Muhammad Ali

Deputy Director

**ORDER**

1. This order shall dispose of the proceedings initiated through Show Cause Notice bearing No. 1(07) BS/KSE/MSW/SMD/2009/18 dated July 08, 2009 ("the SCN") issued to ACE Securities (Pvt.) Limited ("the Respondent"), Member of the Karachi Stock Exchange (Guarantee) Limited ("KSE") by the Securities and Exchange Commission of Pakistan ("the Commission") under Section 22 of the Securities and Exchange Ordinance, 1969 ("the Ordinance") and Rule 8 of the Brokers and Agents Registration Rules, 2001, ("the Brokers Rules").
2. The brief facts of the case are that the Respondent is a member of KSE and is registered with the Commission under the Brokers Rules. On perusal of the trading data of the KSE for the month of May 2009 it was noted that the client of the Respondent namely Muhammad Imran ("MI") first sold and then squared his position in the scrips of Pervez Ahmed Securities ("PASL") to the tune of 200,000 shares, D.G. Khan Cement Company Limited ("DGKC") to the tune of 140,000 shares, Arif Habib Securities Limited ("AHSL") to the tune of 100,000 shares, Jahangir Siddiqui & Company Limited ("JSCL") to the tune



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of 85,000 shares, Oil and Gas Development Company Limited ("OGDC") to the tune of 50,000 shares, Nishat Mills Limited ("NML") to the tune of 50,000 shares, D.S. Industries Limited ("DSIL") to the tune of 50,000 shares, Fauji Fertilizer Bin Qasim Limited ("FFBL") to the tune of 41,000 shares, Pakistan Petroleum Limited ("PPL") to the tune of 30,000 shares and Attock Refinery Limited ("ATRL") to the tune of 20,000 shares.

3. On further perusal of the trading data of the KSE for the month of May and June it was noted that another client of the Respondent namely Mr. Abdul Waheed ("AW") first sold and then squared his position in the scrips of AHSL to the tune of 100,000 shares and 75,000 shares, JSCL to the tune of 152,000 shares, DGKC to tune of 100,000 shares, NML to the tune of 35,000 shares, OGDC to the tune of 35,000 shares, PPL to the tune of 30,000 shares, Pakistan Oil Field Limited ("POL") to the tune of 30,000 shares and Lucky Cement Limited ("LUCK") to the tune of 25,000 shares.
4. The Commission vide its letters dated May 21, 2009, June 02, 2009 and June 16, 2009 sought clarification regarding the Blank Sales by the Respondent on behalf of its clients. The Respondent in its replies vide letters dated May 30, 2009, June 15, 2009 and June 22, 2009 provided the letters from different clients allowing MI and AW to sell their shares in ready market and then settling the sale position from their Central Depository Company ("CDC") holdings. The replies of the Respondent were not considered satisfactory and contained no evidence to establish that MI and AW had any pre-existing interest in the scrips mentioned above.
5. After perusal of the Respondent's replies to the above mentioned letters, which clearly showed that the Respondent had executed the said trades without having pre-existing interest the SCN was issued to the Respondent under Section 22 of the Ordinance and the Brokers Rules stating that the Respondent has prima facie contravened Clause A (2) and A (5) of the Code of Conduct set forth under the third schedule of the Brokers Rules. The Respondent was required to appear in person or through an authorized representative before the undersigned at the Commission's Islamabad Office on July 16, 2009 for a hearing. However, the date and venue of hearing was changed on the Respondent's request. Subsequently, hearing was held at the Commission's Karachi Office on July 22, 2009, which was attended by Mr. Haider Waheed ("the Legal Council of the Respondent") on behalf of the Respondent. In the hearing the Legal Council of the Respondent requested that the Legal Council engaged to argue the case instant has been



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unwell and the hearing be adjourn to some suitable date in future. Later, the next hearing was conducted at Commission's Islamabad office on August 07, 2009 and the Legal Council of the Respondent attended the hearing on the Respondent's behalf.

6. The Legal Council of the Respondent vide its written reply and during the course of hearing made the following arguments:
- (a) The Legal Council in its written reply denied the allegation of blank sales levied on the Respondent through SCN. The Legal Council of the Respondent stated that perusal of the letters of various clients shows that the interest was transferred in favor of MI and AW to trade in subject securities and express authority was given to the Respondent to move the subject shares to meet any delivery requirements. Therefore, the allegation of allowing blank sales is without any substance. Further, all trades/transactions in question were executed and allowed to take place only after the express authority obtained from MI and AW.
  - (b) The Legal Council of the Respondent in its written reply stated that respective clients had transferred their interest in the subject securities by allowing the Respondent to transfer the securities from their CDC accounts as and when required. CDC Account sheets clearly show that all material times, the subject securities were available in the CDC Sub-Accounts of the clients who authorized the Respondent to move the shares for settlement purposes. The Legal Council of the Respondent insisted that this is a simple case of joint trading by individuals with mutual understanding and common interest.
  - (c) The Legal council of the Respondent in its written reply and at the time of hearing argued that unlike a blank sale, a short sale is acceptable in principle and short selling subject to a number of restrictions only to avoid potential market abuse in certain circumstances. In the said case the potential risk of short sale were well covered as the Respondent had been expressly authorized by respective clients to transfer their shares before settlement date in order to meet possible delivery of shares sold. The Respondent has substantially followed the law in its spirit and the subject transactions had no adverse effect on market.
  - (d) The Legal Council of the Respondent emphasized that Rule 8 of the Brokers Rules, only allows the Commission to impose fine or suspends registration of the broker, if it is in the public interest to do so. Furthermore, the penalty under Section 22 (c)



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of the Ordinance can only be imposed if it is the case of willful violation of the rules and regulation. He further added that there has been no willful violation of any rules and regulations in the instant case as the Respondent has only followed the instructions of the clients in bonafide matter believing that it was acting within the spirit of the relevant laws. The Legal Council of the Respondent further stated that the Section 22 of the Ordinance is not attracted in this case as the said section relates to imposition of substantial penalty for willful violation which is not the case. Further the subject trades/transactions have no adverse effect on the market, therefore, penalizing the Respondent with fine or suspension would be highly disproportionate and would not advance public interest in any manner. The Legal Council of the Respondent assured that in future, the Respondent will be more careful in ensuring that all laws and regulations are followed in letter and spirit and prayed that a lenient view was taken in this case and SCN may be withdrawn.

7. I have considered the contentions of the Respondent and the issued raised therein and the same are addressed as under:-

(a) The Legal Council of the Respondent in his written reply as well as oral contentions made during the course of hearing, emphasized that above mentioned sales were regular sales because shares sold by MI and AW were available in CDC Sub Accounts of different clients of the Respondent who authorized the Respondent through authority letters to sell and move shares from their CDC Sub Accounts. In this regard it is pertinent to mention here that a sale transaction of shares is said to be regular when a client has pre-existing interest in the shares before sale. Hence, it is utmost necessary to ascertain whether the Respondent's clients MI and AW had pre-existing interest in the shares to the extent of their sale. According to Clause-2(g) of the Regulations for Short Selling under Ready Market, 2002 ("the Regulations") Sale with pre-existing interest means:-

- i. *The Squaring up of an earlier purchase on the same exchange in the same settlement.*
- ii. *The Squaring up of an earlier purchase on the same exchange in a different settlement which will settle prior to the settlement of the sale.*
- iii. *The Squaring up of an earlier purchase on another exchange in a different settlement which will settle prior to the settlement of the sale.*
- iv. *The squaring up of an earlier purchase on another exchange in the same settlement.*



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However, the record provided by the Respondent did not substantiate that MI and AW had any earlier purchase on any exchange before the sale in the regular market. CDC Account Balance Reports of the MI and AW obtained from CDC have also confirmed that they had no buying position in the scrips before the sale.

- (b) The assertion of the Legal Council of the Respondent that "*these are the simple cases of joint trading and all the subject securities were available in other clients CDC Sub Accounts at the time of selling of shares*" is not true. During the course of hearing the Legal Council of the Respondent was also asked to provide the Account Opening Forms of MI, AW and all the other clients who have given authority to use their shares. The requisite documents were provided by the Respondent vide letter dated August 18, 2009. The scrutiny of account opening forms revealed that MI and AW have no joint trading account with any other client of the Respondent and MI and AW traded shares in their individual capacity. The Respondent has provided simple authority letters as proof of pre-existing interest against the shares sold. However, merely providing a simple authority letter of other clients of the Respondent can not be considered as pre-existing interest of the Respondent's clients as required in the Regulations.
- (c) The Respondent through its written replies provided the letters of its different clients allowing MI, AW to sell shares at Ready Market and settle the trade through the Respondent in case short sale are not covered on the same day. While reviewing the contents of the authority letters, it transpired that details of the contractual arrangements have not been specified in the authority letters. Further, authenticity and language used in the letters is vague. It is a known fact that if the terms of the agreement are uncertain or ambiguous, the agreement is void and unenforceable. Moreover, for the sake of arguments, if it is assumed that the agreements allow MI and AW to meet delivery requirements by using the securities the sale transactions cannot be classified as a short sale till the sale transaction is formally declared as short sale transaction at the time of placing the order on the KATS trading system and fulfill the Short Sale Prerequisites define in Clause 5 of the Regulations. The detailed scrutiny of authority letters revealed that nine authority letters provided by the Respondent were not signed by the persons giving the authority to MI and AW.



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(d) The assertion of the Legal Council of the Respondent that "the Respondent has substantially followed the law in its spirit and the subject transactions had no adverse effect on market" is not true. The clause 2 (h) of the Regulations says "Short Sale" means "a sale by a Member, on his Proprietary account or on Client's Account, not owning securities at the time of sale or the sale without constituting a Pre-existing Interest but is a sale on Proprietary Account or Client's Account entered into on the basis of Prior Contractual Borrowing Arrangement to meet delivery requirements on the settlement days". Moreover the Clause-2(f) of the Regulations clearly defines the ambit of its applicability wherein it is clearly mentioned that prior contractual borrowing arrangements are applicable only in respect of execution of short sale trades, whereas these arrangements can not be made valid for regular market sale. According to Clause-2(a) of the Regulations, "Blank Sales" means "a sale by a party that does not own shares or the sale does not constitute a sale with pre-existing interest or is a sale by a party that has not entered into a contractual borrowing arrangement to meet the delivery requirements". Hence, the sale by the Respondent's Client without pre-existing interest and Contractual Borrowing Arrangement falls within the ambit of Blank Sale which is prohibited in terms of the Regulations.

(e) With regard to the Respondents contention that section 22 of the Ordinance is not invoked in this case as the section uses the word "willful" it may be noted that the execution of the trades in question clearly shows the intention of the Respondent. In this connection it may be noted that the word "willful" in common sense means voluntary or intentional. Willful breach or violation of any provision of law or rules or regulations is the breach or violation which is done or committed intentionally. Intention is, therefore, the basic ingredient of willfulness however, it is not necessary for the Commission to prove that the said breach or violation is mala fide. Further, attention is also invited towards the case titled City Equitable Fire Insurance Co Ltd Re, 1925 Ch 407 referred to in 2005 CLS 333:

*"a default, in case of breach of duty, will be considered "willful" even if it arises out of being recklessly careless, even though there may not be knowledge or intent".*

8. Further, placement of the sale orders without having pre-existing interest interfere in the fair and smooth functioning of the market and created misleading impression for the other investors. The Respondent by executing Blank Sales on its clients behalf has violated the



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Regulations which in turn is violation of Code of Conduct set fourth under the third schedule of Brokers Rules ("Code of Conduct") that makes it mandatory on the Respondent to execute its business with due care and skill and to put in place proper systems and controls to ensure that its business is conducted according to the applicable Rules and Regulations. The placing of sale orders and then squaring it without having pre-existing interest clearly shows that the Respondent has failed to conduct its business with due diligence, care and has interfered in smooth and fair functioning of the market. Therefore, keeping in view the aforementioned, it is evident to me that the Respondent has violated Clause A2 and A5 of the Code of Conduct of the Brokers Rules which in turn is a violation of Brokers Rules.

9. The violation of the Rules and Regulations is a serious matter which entitles the Commission to even suspend the Respondent's membership but I have elected not to exercise this power at present. However, in exercise of the powers under Section 22 of the Ordinance, I hereby impose on the Respondent a penalty of Rs. 600,000 (Rupees Six Hundred Thousand only). I strongly advice the Respondent to take immediate measures and put in place proper checks and procedures to eliminate the occurrence of such instances in future. I also direct the Respondent to ensure that full compliance be made of all rules, regulations and directives of the Commission in the future for avoiding any punitive action under the law.
10. The matter is disposed of in the above manner and the Respondent is directed to deposit the fine 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 the copy of the deposit challan to the undersigned.

Imran Inayat Butt  
Director (SM)

Announced on November 05, 2009  
Islamabad.