



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)
Market Supervision and Capital Issue Department

Before The Director / HOD (MSCID)

In the matter of Show Cause Notice issued to

Pearl Capital Management (Pvt.) Limited

Date of Hearing:

November 17, 2011

Present at the Hearing:

Representing the Pearl Capital Management (Pvt.) Limited

Mr. Muhammad Jaffar

Chief Operating Officer

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/2011 dated November 04, 2011 ("SCN") issued to Pearl Capital Management (Pvt.) Limited ("Respondent"), corporate member of the Karachi Stock Exchange (Guarantee) Limited ("KSE") by the Securities and Exchange Commission of Pakistan ("Commission") under Section 22 of the Securities and Exchange Ordinance, 1969 ("Ordinance") and Rule 8 of the Brokers and Agents Registration Rules, 2001 ("Brokers Rules").
2. The brief facts of the case are that the Respondent is registered with the Commission under the Brokers Rules. On perusal of the trading data of Karachi Automated Trading System ("KATS") of the KSE for the month of June 2011, July 2011 and August 2011, it was observed that the Respondent had been engaged in selling and then squaring up the positions in different scrips in its proprietary account.
3. During the month of June 2011, the Respondent in its proprietary account sold 305,355 shares of The Bank of Punjab Limited ("BOP"), 201,876 shares of Byco Petroleum Limited ("BYCO"), 161,500 shares of NIB Bank Limited ("NIB"), 55,000 shares of D.G. Khan Cement



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Company Limited ("DGKC") and 50,000 shares of TRG Pakistan Limited ("TRG") and then squared up its positions by purchasing the same shares.

4. During the month of July 2011, the Respondent in its proprietary account sold 213,362 shares of Azgard Nine Limited ("ANL"), 205,350 shares of Bank Al-Falah Limited ("BAFL"), 144,565 shares of BYCO, 100,200 shares of BOP and 53,000 shares of DGKC, and then squared up its positions by purchasing the same shares.
5. During the month of August 2011, the Respondent in its proprietary account sold 167,343 shares of BAFL, 97,846 shares of Pakistan International Airline Corporation Limited ("PIA"), 88,232 shares of Arif Habib Corporation Limited ("AHCL"), 87,728 shares of Lucky Cement Limited ("LUCK"), 62,709 shares of Silk Bank Limited ("SILK"), 35,762 shares of Lotte Pakistan PTA Limited ("LOTPTA") and 17,862 shares of BOP and then squared up its positions by purchasing the same shares.
6. The Commission vide letters dated August 26, 2011 and October 04, 2011 sought clarification regarding the above mentioned sales executed by the Respondent. In response the Respondent vide letters dated September 19, 2011 and October 14, 2011 provided various undertaking of loan of shares from four brokerage houses for the sales executed in its proprietary account.
7. The aforementioned response of the Respondent was not considered satisfactory as it did not contain any evidence and justification regarding the execution of sales in its proprietary account. Consequently, SCN dated November 04, 2011 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 through this SCN was asked to explain its position through written reply within seven (7) days of issuance of SCN and also appear in person or through an authorized representative before the undersigned at Commission's Head Office, Islamabad on November 17, 2011 at 11:00 a.m. for hearing.
8. On the date of hearing Mr. Muhammad Jaffer, Chief Operating Officer ("**Representative**") appeared on behalf of the Respondent. At the time of hearing the Representative also submitted the written reply to the SCN. The key assertions made by the Respondent in its reply are reproduced below:-



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- i) *We have gone through your letter minutely pertaining to the sale of shares being done by us in the month of June 2011, July 2011 and August 2011 and appreciated you that you had taken good care in recording the sale of shares of each and every item properly. It seems that you are giving your exclusive efforts while maintaining the record of sales of shares for each and every transactions executed at Exchange, for which, we have no option but to praise your efforts being done by you in this regard.*
- ii) *We had already provided pre-existing interest for all your mentioned sale but as per the usage of F8 key the short – sale is considered, we could not able to use F8 for all our short sales mistakenly, for which, we are very regretting and condemn in this respect.*
- iii) *Despite all these claims raised by you in this regard we assure that in future we will take proper care while doing short-sales and follow proper guidelines of executing short-sale in future. We anticipate that you will condemn and forgive our mistake this time only, for which, we shall ever remain grateful to you. We once again assure you that from today you will not find any short - sale from our end without proper documentation.*
9. During the course of hearing, the Representative made the following submissions:
- a) The Representative contended that the Respondent had provided documents to this office evidencing pre-existing interest in the shares alleged to have been subject matter of Blank Sales. At this juncture, the Representative was confronted with the documents submitted by the Respondent that has been referred to as the undertaking of loan of shares provided by Progressive Securities (Pvt.) Limited, Value Stock Securities (Pvt.) Limited, Sherman Securities (Pvt.) Limited and Rafi Securities (Pvt.) Limited. After the introduction of Securities Lending and Borrowing (“SLB”) mechanism, this undertaking by no means can be taken as a valid contract between two parties in context of pre-existing interest. However, the Representative had no explanation to the satisfaction of this forum.
10. Considering the arguments made by the Respondent through a written reply and the submissions made by the Representative of the Respondent during the course of hearing, it



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is established that the Respondent sold shares without having pre-existing interest and without following the pre-requisites of the Regulations for the Short Selling under Ready Market, 2002 ("**Regulations**"). Following are the omissions which were observed on part of the Respondent while executing the Short-Sale transactions:

- (i) The copies of agreements provided by the Respondent also contradict with the definition of short sale as defined in clause 2 (J) of the Regulations that *"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 SLB contract executed through SLB Market at Clearing Company in accordance with its Regulations / Procedure to meet delivery requirements on the settlement date"*. The pre-existing interest submitted by the Respondent simply in form of letter signed by other Brokerage House can't be accepted as legal document between the two parties in context of pre-existing interest. It is pertinent to mention here, that a Clearing Member of KSE is eligible to apply the National Clearing Company of Pakistan ("**NCCPL**") for admission as Lender/Borrower if such Clearing Member fulfills the criteria as laid down under the Rules and Regulations of NCCPL. After the introduction of SLB through SLB Market, the Borrower can Borrow the SLB Eligible Securities from Lender through the bid and offer mechanism on the SLB Portal provided by NCCPL.
- (ii) As clearly mentioned in clause 5 (b) of the Regulations that *"the trade would be declared as a Short Sale at the time of placement of order through KATS in a special window designated in the system"*, whereas the Respondent clearly violated the same and argued that all the trades in question were not executed through facility of F8 window mistakenly. The mere acknowledgment of mistake can not absolve the Respondent from its duty to follow the laid down Regulations.
- (iii) The clause 8 (i) of the Regulations states that the Short Sale are only allowed in the securities which are prescribed by the Exchange with prior approval of the Commission. The Respondent did not comply with the KSE notice no. KSE/N-762 dated February 18, 2011 by executing the Short Sale



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transactions in the scrips of BOP, PIA, SILK, ANL, BYCO, NIB and TRG which were not eligible for Short Selling.

11. After a detailed and thorough perusal of the facts, information and evidence available on record, contentions and averments made by the Representative during the course of the hearing, it is established that the Respondent placed the sale orders in its proprietary account without having pre-existing interest and without fulfilling the prerequisites of the Regulations. The Clause-2 (a) of the Regulations says "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 delivery requirements*". Hence, the sale by the Respondent without pre-existing interest falls within the ambit of Blank Sales which is prohibited in the Regulations. By indulging into the Blank Sales, the Respondent has failed to exercise due care, skill and diligence in conduct of its business and has also failed to abide by the provisions of the Rules & Regulations issued by the Commission and KSE from time to time, thus violated the Clause A(2) and A(5) of the Code of Conduct set forth under the third schedule of the Brokers Rules and also violated Regulation 4 of the Regulations which in turn is violation of Rule 12 of the Brokers Rules read with Rule 8 of the Brokers Rules.
12. It is pertinent to mention here that the Commission had earlier passed order dated May 26, 2011 against the Respondent under Section 22 of the Ordinance for violation of Code of Conduct set forth under the third schedule of the Brokers Rules. The Commission vide this order had directed the Respondent to ensure that full compliance be made of all Rules Regulations and directives of the Commission and the stock exchanges in future for avoiding any punitive action under the law. The Respondent was also reprimanded through letters dated December 30, 2010, January 25, 2011 and July 11, 2011 to conduct its business with due diligence care and skill failing which appropriate action can be taken against it. It is regrettable to note that despite of the earlier direction and warnings of the Commission, the Respondent continuously indulged in trading activities that are not permitted in the law. It clearly shows relaxed and casual attitude of the Respondent towards compliance and its conformity with the applicable rules and regulations. The Commission has taken a very serious note of such conduct of the Respondent.
13. It is the responsibility of each and every market participant to play its due role to ensure that market is fair, efficient and transparent for the protection of investors and to reduce the



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systematic risk of the market. If any market participant does not act accordingly then it should be held accountable for that. The above-mentioned trading activities of the Respondent interfered with the fair and smooth functioning of the market and also damaged the interest of other investors who were trading in the stock market. The violation of the Rules and Regulations is a serious matter which entitles the Commission to 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. 300,000 (Rupees Three Hundred Thousand only). Additionally, I strongly advise the Respondent to take immediate measures and put in place proper system and checks to eliminate the occurrence of such instances in future. I again 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.

14. 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.
15. This Order is issued without prejudice to any other action that the Commission may initiate against the Respondent in accordance with law on matters subsequently investigated or otherwise brought to the knowledge of the Commission.

Imran Inayat Butt
Director / HOD (MSCI)

Announced on November 30, 2011
Islamabad.