



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

Pearl Capital Management (Pvt.) Limited

*Date of Hearing:*

*April 12, 2011*

*Present at the Hearing:*

*Representing the Pearl Capital Management (Pvt.) Limited*

*(i) Mr. Muhammad Jawad*

*Head of Settlement*

*(ii) Mr. Tauseef M. Iqbal*

*IT Consultant*

*Assisting the Director (SMD)*

*(i) Ms. Shazia Baig*

*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/ dated March 31, 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 December 2010, January 2011 and February 2011, it was observed that the Respondent in its proprietary account and in the accounts of its clients namely Nausheen Azfar ("NA"), Abdul Wahab ("AW") and Anwar Siddique ("AS") had been engaged in selling and then squaring up the positions in different scrips.



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3. During the month of December 2010, the Respondent in its proprietary account sold 145,000 shares of TRG Pakistan Limited ("TRG") and 82,025 shares of Arif Habib Corporation Limited ("AHCL") and then squared up the position to the tune of 125,000 shares and 47,900 shares respectively. NA sold 150,000 shares of NIB Bank Limited ("NIB") and then squared up her position to the tune of 60,000 shares. AW sold 60,000 shares of Azgard Nine Limited ("ANL") and then squared up his position by purchasing the same shares. AS sold 75,000 shares of ANL and 50,000 shares of Bank of Punjab Limited ("BOP") and then squared up his position by purchasing the same shares.
4. During the month of January 2011, the Respondent in its proprietary account sold 59,000 shares of AHCL and squared up its position to the tune of 55,000 shares, sold 102,000 shares of Lafarge Pakistan Cement Limited ("LPCL") and squared up its position to the tune of 100,000 shares, sold 100,000 shares of TRG and 100,000 shares of Bank Al-Falah Limited ("BAFL") and squared up its position by purchasing the same shares.
5. During the month of February 2011, the Respondent in its proprietary account sold 95,525 shares of Silk Bank Limited ("SILK") and squared up its position to the tune of 94,000 shares, sold 139,999 shares of LPCL and squared up its position to the tune of 119,000 shares and sold 70,000 shares of Karachi Electric Supply Company Limited ("KESC") and squared up its position to the tune of 50,000 shares.
6. The Commission vide letters dated February 01, 2011, March 02, 2011 and March 17, 2011 sought clarification regarding the above mentioned sales executed by the Respondent. In response the Respondent vide letters dated February 03, 2011 and March 03, 2011 provided the under takings of loan of shares for the sales executed in its proprietary account and its different clients accounts. Further, the Respondent in its replies stated that its clients were using online trading terminals for executing trades and functionality of F8 window is not updated at online trading system. The Software vendor will implement this functionality in online trading system as soon as possible.
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 accounts as well as in its clients accounts. Consequently, SCN dated March 31, 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



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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 Karachi Office on April 12, 2011 at 11.30 a.m. for hearing.

8. The Respondent's written reply to the SCN dated April 06, 2011 received in the Commission on April 11, 2011. The key assertions made by the Respondent in its written reply are reproduced below:

i) *We had already clarified to you in our previous communications that most of our transactions are executed through our on line Gateway Terminal instead of KATS but the functionality of F8 is currently not available at our Online Trading System. In this respect, we would like to assure you that the functionality of F8 will be updated at our Online Trading Terminal by the end of the of April 2011.*

ii) *We agree that as per rules and regulations of KSE, Blank - Sales are not permissible but we would like to draw your kind attention that we had not executed any Blank Sales as we had provided proper pre-existing interest for each sale inquired by you. So, please be treated these sales as Short-Sales instead of Blank - Sales. We hereby affirm that we have to follow all rules and regulations of Short-Sale and had provided you all the pre-existing interest letters for each sale inquired by you but as the usage of F8 key is concerned please be noted that at this time our Online system is not supporting F8 key and we are in the process of implementing this F8 key in our Online Trading System. Therefore, we assure that the said functionality will be available in our online Trading System by the end of April 2011.*

iii) *We would like to inform you that we have been sending these scrips pre-existing interest letters to KSE since 6 months. But we have not received any intimation or any reply from KSE that they are not accepting these scrips pre-existing letters as these scrips are not eligible for Short - Sale. If the Exchange had intimated / restricted to us initially then we may not allowed our clients to execute Short - Sale in these scrips. However, as you had notified to us about these scrips, which are not eligible for short-sale, we hereby assure you that from onwards we*



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*will take-care and not allowed to any of our clients to execute Short-Sale in those scrips, which you have notified to us.*

*iv) We had conducted our Short-Sale so far with due skill, care and diligence, which is must for us in order to conduct and require for our business to run smoothly. We had not violated any provision of the act, rules and regulation of the SECP and KSE as applicable to us.*

*v) We hereby undertake and assure you that we have not offended with any of the requirements of the Act/Ordinance, rules or directives of SECP as well as KSE. In this connection, we would be pleased to mention that we had already followed the third schedule of Ordinance of SECP entirely and properly.*

*vi) Since we had explained the matter in detail and we had abided by all the rules and regulations of KSE and SECP, please be kept in mind that we had not violated any Rules and Regulations of SECP and KSE since the above mentioned sales are not the Blank Sales but the Short Sales, for which , we had already submitted the documentary evidences and the pre-existing interest of shares received from concerned clients.*

9. Further, the Respondent through its reply of SCN also provided the under takings of loan of shares along with the CDC Balance Reports of different clients and a KSE member as evidence of its pre-existing interest in the shares sold.
10. On the date of hearing Mr. Muhammad Jaffer, Chief Operating Officer ("COO") appeared on behalf of the Chief Executive Officer ("CEO") of the Respondent as he was abroad. This forum was appraised by the COO that he was not conversant with the facts of the matter and that the CEO had nominated two other officials of the Respondent to appear in this hearing but one of them couldn't come due to personal engagement.
11. The absence of the authorized officers was noted with concern as the hearing was specially scheduled at Karachi Office to facilitate the Respondent. The COO requested the undersigned to extend the time of hearing so that the authorized officers could attend the scheduled hearing in Karachi. Therefore, the hearing was rescheduled at 2:30 p.m on the same day.



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12. Subsequently, the representatives of the Respondent Mr. Muhammad Jawad, Head of Settlement and Mr. Tauseef M. Iqbal, IT Consultant (“**Representatives**”) appeared before me and made the following submissions:

- a) The 80% trades of the Respondent took place through on-line trading and since the facility of using F-8 window was not operational for some time, therefore, all the Short-Sale transactions were made without using F-8 window.
- b) The Representatives 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, therefore, the Respondent should not be penalized for any alleged violation of law. At this juncture, the Representatives were confronted with the documents submitted by the Respondent that has been referred to as the undertaking of loans. The documents are a simple letters purporting to be an undertaking of loan. This by no means can be considered as a valid contract between two parties that would give the Respondent a pre-existing interest in the shares mentioned in transactions stated in the preceding paragraphs. However, the Representatives had no explanation to the satisfaction of this forum.
- c) The Representatives stated that the Respondent has always complied with all the directives issued by the Commission and Stock Exchange from time to time but when the Representatives were informed that their trading in various in-eligible scrips of Short Selling was also a contravention of KSE notice # KSE/N-4272 dated August 16, 2010. In response to this query, the Representatives reiterated the same stance as written in the Respondents reply of the SCN. They argued that the pre-existing interest of the same scrips have been provided to KSE since last six months but KSE has raised no object on the scrips and pre-existing interest.

13. Considering the arguments made by the Respondent through a written reply and the submissions made by the Representatives during the course of hearing, it 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,



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2002 ("Regulations"). Following are the omissions which were observed on part of the Respondent while executing the Short-Sale transactions:

- (i) 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 they didn't have the facility of F8 window at the time of executing the Short Sales through their online system. The mere argument of system mal-function can not absolve the Respondent from its duty to follow the laid down Regulations.
- (ii) 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 # KSE/N-4272 dated August 16, 2010 by executing the Short Sale transactions in those scrips which were not eligible scrips for Short Selling. The Respondent argument that KSE never raised objection for submitting the pre-existing interest in in-eligible scrips didn't exonerate it to fulfill the obligations as member of KSE and it has to follow all the directives and notices issued time to time to all the members of the KSE.
- (iii) The evidence of pre-existing interest provided by the Respondent also lacks the requirements of contractual borrowings. A contract is supposed to be a legal document/contract made on an affidavit and signed between two parties to lend/borrow the shares. Otherwise SLB Contract (Securities Lending Borrowing Contract) should be used for such contracts. 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.

14. After a detailed and thorough perusal of the facts, information and evidence available on record, contentions and averments made by the Representatives of the Respondent during the course of the hearing, it is established that the Respondent placed the sale orders in its proprietary account and its clients accounts 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-*



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*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.*

15. 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. 100,000 (Rupees One 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.
16. 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.
17. 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 (SM)

Announced on  
Islamabad.

May 26, 2011