



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)

Before The Director (Securities Market Division)

In the matter of Show Cause Notice issued to

Zafar Moti Capital Securities (Pvt.) Limited

Date of Hearing:

July 22, 2009

Present at the Hearing:

Representing the Zafar Moti Capital Securities (Pvt.) Limited

(i) Mr. Javed Ibrahim

Chief Operating Officer

(ii) Mr. Usman Sheikh

Legal Council of the Respondent

Assisting the Director (SMD)

(i) Mr. Muhammad Ali

Deputy Director

(ii) Mr. Adnan Ahmed

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 Zafar Moti Capital 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 the perusal of trading data of Karachi Automated Trading System ("KATS") of KSE for the month of May, 2009 it was noted that the clients of the Respondent namely Mr. Muhammad Hussain ("MH") bearing code "8317" and Mr. Abdullah ("AB") bearing code "8305" had been engaged in first selling and



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then squaring up their positions in the scrip of National Bank of Pakistan ("NBP") and Oil & Gas Development Company Limited ("OGDC") respectively. It was observed that on May 04, 2009 MH first sold 77,000 shares of NBP between 12:31:58 p.m. to 15:04:50 p.m. and subsequently squared his position by purchasing 55,000 shares between 15:07:24 p.m. to 15:29:04 p.m. and 22,000 shares were squared on May 05, 2009 between 9:31:49 a.m. to 9:32:58 a.m. It was further observed that on May 26, 2009 AB first sold 60,000 shares of OGDC between 12:39:57 p.m. to 12:42:07 p.m. and subsequently squared his position by purchasing these shares between 12:56:09 p.m. to 15:22:20 p.m. The available record did not show that the said clients had pre-existing interest in the shares before above mentioned sales.

3. The Commission vide letter dated June 16, 2009 sought clarification from the Respondent regarding the above mentioned sales by it on behalf of MH and AB. The Respondent in its reply vide letter dated June 19, 2009 provided the CDC Account Balance Report and two authority documents of its another client Mr. Sajjad Mehdi (SM) as a proof of pre-existing interest of MH and AB against the abovementioned sales. In its first authority document SM allowed MH to sell and move 105,000 shares of NBP from his CDC Sub Account. In its second authority document SM allowed AB to sell and move 44,100 shares of OGDC from his CDC Sub Account. The aforementioned reply of the Respondent along with authority document was examined and was not considered satisfactory as same did not contain any evidence to prove pre-existing interest in the shares before sale nor did it provide any reasonable justification for execution of sale by the Respondent on behalf of its clients.
4. After perusal of the Respondent's replies to the above mentioned letter, 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 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 Commission's Islamabad Office on July 21, 2009, for a hearing. However, the date and venue of hearing was changed on the Respondent's request. Subsequently, the hearing was held at Commission's Karachi Office on July 22, 2009, which was attended by Mr. Javed Ibrahim, Chief Operating Officer of the Respondent and Mr. Usman Sheikh, Legal Council of the Respondent ("the Representatives of the Respondent") on behalf of the Respondent.



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5. The Legal Council of the Respondent vide its written reply dated July 13, 2009 and the Representatives of the Respondent during the course of hearing made the following submissions:-

- (a) The Legal Council of the Respondent in its written reply submitted that the Respondent's client SM owned 609,400 shares of NBP in its CDC Sub Account and SM through authority document has authorized MH to sell and even to move 105,000 shares of NBP from his CDC Sub Account as there is no restrictions to enter into this kind of agreement in the capital market. The Representatives of the Respondent stated that MH squared his selling position by purchasing 55,000 shares of NBP on same day and 22,000 shares were purchased on next day. They further added that the genuineness of this transaction and authority document can be verified from a simple fact that in term of the affidavit SM has made available delivery of 22,000 shares of NBP for clearing purposes to the Respondent for the account of MH as per commitment.
- (b) The Legal Council of the Respondent further stated that in the other case SM through its authority document has given authorization to AB to sell and move 44,100 shares of OGDC from his CDC Sub Account but due to inadvertence and error AB sold 60,000 shares instead of 44,100 shares and the said position was immediately brought into the notice of AB who bought 19,000 shares within 15 minutes and squared his over sold position with a loss of Rs. 0.25 per share which clearly shows that no gain or profit was involved in squaring up the oversold position.
- (c) The Legal Council of the Respondent in its written reply further stated that whatever relation-ship exist between SM, MH and AB in their independent capacity the Respondent cannot ask question about the relationship between them even otherwise as per Sharia and Quran, it is a settlement law that a Muslim can Hiba (gift) its property to any one even to stranger and the only requirement through Law is offer, which was made through the affidavit, duly sworn before the notary public.
- (d) The Representatives of the Respondent during the course of hearing emphasized that these transactions were considered regular sales not blank sales because at the time of selling of shares both clients i.e. MH and AB had provided copies of authority documents along with CDC Balance Report of SM to the Respondent as a



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proof of pre-existing interest in the shares of NBP and OGDC before selling. They further added that after confirming the holding position of SM from its CDC Sub Account the Respondent sold shares in the accounts of MH and AB because both are reputed clients of the Respondent. The Representative of the Respondent admitted that they oversold 15,900 shares of OGDC in AB account due to error but the same were bought back immediately to rectify the error.

- (e) The Representatives of the Respondent prayed that the Commission may drop the proceedings together with the show cause notice so the Respondent may continue its business smoothly, effectively and efficaciously to the entire satisfaction of their valuable clients as per law.

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

- (a) The Respondent in its written reply as well as oral contentions made by the Representatives of the Respondent during the course of hearing, emphasized that above mentioned sales were regular sales because shares sold by MH and AB were available in CDC Sub Account of the SM who authorized MH and AB through authority document to sell and move shares from his CDC Sub Account. 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 had pre-existing interest in the shares of NBP and OGDC to the extent of 77,000 shares and 60,000 shares respectively or not. 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.*

However, the record provided by the Respondent did not substantiate that MH and AB had any earlier purchase on any exchange before the sale. CDC Account Activity Report of the MH and AB obtained from Central Depository Company



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("CDC") in the shares of NBP and OGDC has also confirmed that they had no buying position in the said scrips before the sale.

- (b) 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. Short Sale Prerequisites in clause 5 of the Regulations stated that no Member on his Proprietary Account or Client's Account shall make a Short Sale unless:

- (i) The sale is made at an Uptick or Zero-Plus Tick; and
- (ii) The trade is declared as a short sale at the time of placement of order through KATS in a special Short Sale Order Window designated in the system for the purpose.

However, the subject short sale transactions were executed through Regular Sale Order Window without using the special Short Sale Order Window. Hence, the short sale by the Respondent in its client's accounts without full filling the short sale prerequisites is clear violation of the Regulations.

- (c) The assertion of the Legal Council of the Respondent that "there exist a independent relationship between SM, MH and AB and as per Sharia and Quran, it is a settlement law that a Muslim can Hiba (gift) its property to any one even to stranger and the only requirement through Law is offer" is not true. It is pertinent to mention here that the term "Gift" is defined in Section 122 of the Transfer of Property Act, 1882 ("TPA") as the transfer of existing moveable or immovable property made voluntarily by the donor to the donee without any consideration. All the following ingredients have to be satisfied for a gift to be considered valid. Lacking of any one of them will not constitute a valid gift:

- (i) Declaration by donor of property;
- (ii) Acceptance by donee; and



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(iii) *Delivery of possession or entitlement*

CDC Account Statement of SM and the authority documents clearly show that securities were not transferred in favor of any of the authorized persons. They were only traded on behalf of the owners. Hence lacking the main ingredient of transfer of entitlement or possession, the authority documents cannot be considered and treated as a valid gift.

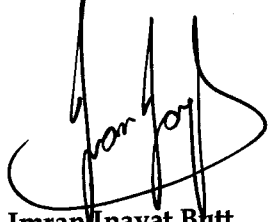
7. It is pertinent to mention here that the Representatives of the Respondent at the time of hearing informed that SM is authorized agent of the Respondent. During the course of hearing the Representatives of the Respondent were also asked to provide the Account Opening Forms of MH, AB and SM. The requisite documents were provided by the Respondent. The scrutiny of account opening forms of MH and AB revealed that both the clients have authorized Mr. Salman, a dealer of the Respondent, to operate their trading accounts and also collect shares, proceeds, bills, cheques on their behalf. Considering the above facts it appears that MH and AB may have close links with the Respondent's dealer and being a agent of the Respondent, SM has facilitated the MH and AB by providing them authority to sell shares on his behalf in the ready market without having pre-existing interest and without following prerequisites of the Regulations.
8. Considering the facts and thoroughly evaluating the evidence/information available on record and after perusal of assertions made by the Representatives of the Respondent it is established that the Respondent has placed the sale orders in its client's accounts without having pre-existing interest and without fulfilling the prerequisites of the Regulations. The Respondent's client MH by executing the sale of 77,000 shares of NBP in its trading account on May 04, 2009 and then squaring up 55,000 shares on same day and 22,000 shares on May 05, 2009 earned profit of approximately Rupees 200,000.
9. 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 Short Sales on its clients behalf without fulfilling the prerequisites in its clients accounts has violated the 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 following prerequisites of the Regulations clearly shows that



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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.

10. 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. 400,000 (Rupees Four Hundred Thousand only). I strongly advise 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.
11. 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 October 16, 2009
Islamabad.



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