BEFORE THE APPELLATE BENCH

In the matter of

Appeal No. 54 of 2019

M/s. Din Capital Limited

...Appellant

Versus

Commissioner (Securities Market Division),
Securities and Exchange Commission of Pakistan

...Respondent

Date of Hearing: 02/01/2020

Present:

For the Appellant:

i. Mr. Ali Nanji, CEO, Din Capital Limited
ii. Mr. Muhammad Ghayasuddin, Director, Din Capital Limited

For the Respondent:

i. Mr. Osman Syed, Joint Director (Adjudication-1)
ii. Mr. Muhammad Faisal, Management Executive (Adjudication- I)
iii. Ms. Mehwish Naveed, Management Executive (Adjudication-III)

ORDER

1. This Order is passed in the matter of Appeal No. 54 of 2019 filed under section 33 of the Securities and Exchange Commission of Pakistan Commission Act, 1997 against

the Order dated 18/06/19 (the Impugned Order) passed by Commissioner, Securities Market Division (the Respondent).

2. The brief facts of the case are that Din Capital Limited (the Appellant) is a Trading Rights Entitlement Certificate holder of the Pakistan Stock Exchange Limited (the PSX) and licensed as a securities broker under the Securities Act, 2015 (the Securities Act). While analyzing the trading data of PSX for the period from 01/01/15 to 30/09/16, it was observed that trades of the Appellant substantially matched with Askari Investment Management Limited (the AIML) funds. Accordingly, an investigation under section 139 of the Securities Act was carried out that revealed the following:

   i. The accounts of three clients of the Appellant namely; Mr. Adnan Abid, Mr. Sarmand Shahbaz Bughio and Ms. Amna Haseeb Khan (referred to as "Client 1", "Client 2" and Client 3") were used for front running the orders of three funds of Askari Investment Management Limited (AIML) during the period from January 2015 to October 2015. Mr. Mustafa Iqbal Khan, Chief Investment Officer/Equity Fund Manager of AIML passed inside information regarding orders of AIML to Mr. Shahzad, KATS operator/employee of the Appellant. Mr. Shahzad, using that inside information, matched the orders through the accounts of the above-mentioned clients. The said clients had not given authority to Mr. Shahzad to trade on their behalf and as a result of the transactions where orders of AIML matched with those of the clients, unlawful gain of Rs 8,314,618 was made.

   ii. The Appellant had extended funds to the said client accounts during the said period. A summary of debit balances in the said client accounts is as under:

(Rs. In million)

Client	Period	Highest debit balance
1.	May 21, 2015 to June 29, 2015	31.5
	August 7, 2015 to October 5, 2015	28.7

2.	July 14, 2015 to November 16, 2015 November 23, 2015 to March 28, 2016	32.5 7.8
3.	August 21, 2014 to January 9, 2015 January 22, 2015 to February 27, 2015	48.7 40.7

3. It appeared from the foregoing that the Appellant prima facie acted in violation of:
   a) Rule 12 of the Broker and Agents Registration Rules 2001 (the Broker Rules) which requires a securities broker to abide by the Code of Conduct specified in the Third Schedule to the Brokers Rules (the Code of Conduct). The Appellant in violation of the Code of Conduct failed to maintain high standards of integrity, fairness and exercise due skill and care in the conduct of its business.
   b) Rule 34 of Securities (Leveraged Markets and Pledging) Rules, 2011 (the Securities Rules) which prohibits a securities broker from providing financing except in accordance with and to the extent permitted by the Rules. The Appellant provided financing to three clients for long durations.
   c) Section 74 and Section 150 of the Securities Act which requires a securities broker to observe high standards of integrity and fair dealing, act with due care, skill and diligence, observe high standard of market conduct and put in place an adequate system of internal controls and internal audit for ensuring compliance with the relevant laws for the time being in force.

4. A Show Cause Notice dated 21/01/19 (the SCN) was served on the Appellant. The Appellant submitted its reply vide letter dated 29/02/19. Hearing in the matter was held on 20/02/19 and Mr. Ali Asghar Nanji, Chief Executive Officer and Mr. Muhammad Ghayasuddin, Director (the Authorised Representatives) appeared on behalf of the Appellant and made their submissions.

5. The Respondent dissatisfied with the response of the Appellant held that violations of the regulatory framework committed by the Appellant were established. The Respondent held that unlawful extension of financing to customers and maintenance of ineffective internal controls posed considerable risk to customers of a securities broker, integrity of the entire brokerage industry and the capital market as a whole. Therefore, a penalty of Rs 500,000 was imposed on the Appellant by the Respondent in exercise of powers conferred under section 150 of the Securities Act. The Appellant was also strictly advised by the Respondent to ensure compliance with the applicable laws in letter and spirit.

6. The Appellant preferred the instant appeal on the grounds that all transactions that were carried out in the three client accounts in question, were followed by an SMS to the client and emails of trade confirmations and periodic statements were also punctually sent. Furthermore, the Appellant argued that they were under a legal obligation to execute lawful trades as per the instructions of their clients and at no time did the customer ever dispute the veracity of the transactions conducted in their account. The Appellant further argued that as far as front running is concerned all the referred transactions were executed on the express instructions of the clients and there was nothing on record to show that such transactions were taking place in violation of the law. Furthermore, the Respondent argued there was no procedure or mechanism that can make a broker know in advance that any transaction is taking place as a consequence of front running. Furthermore, they stated that in respect of debit balances, prior to Circular 20 of 2017 (the Circular 20), it was a general practice by brokerage houses to facilitate clients for trading purposes and the facilitation was done with the exposure margins of the particular client. The Appellant further argued that they always ensured risk management and it was done purely to assist and encourage the clients to generate trading activity. They contended that after 2017 when the Securities and Exchange Commission of Pakistan (the Commission) took action to prevent brokerage houses from lending to a client base and gave warning to members to discontinue the practice, the Appellant also followed the Commission's instructions and converted the client deliveries into leveraged products i.e. Margin Financing (MF),

Margin Financing System (the MFS) and Futures, thereby, reducing the debit balances of the client accounts. Furthermore, the Appellant argued that any violations were unintentional on their part and should be condoned as they are already in the process of surrendering their license.

7. The Respondent rebutted the arguments of the Appellant on the grounds that the Appellant was penalized for non-compliance of the Code of Conduct. Furthermore, the Respondent argued that examination of clients' ledgers obtained during the investigation revealed presence of significant debit balances during most of the review period and the Appellant has not disputed the extension of financing to such clients. Furthermore, the Appellant by taking the plea that they were doing so to encourage clients to generate trading activity violated the Code of Conduct which prohibits the Appellant from encouraging transaction of securities with the sole object of generating brokerage or commission. Furthermore, the Respondent stated that significant debit balances corroborate the fact that the Appellant was involved in extending its funds to the said clients' accounts in violation of Rule 34 of Securities Rules. The Respondent further argued that Circular 20 was only issued to warn brokers from further unauthorized deposit taking activity in one form or another which was in contravention of both the Companies Act 2017 (the Companies Act) and the Securities Act. Furthermore, the Respondent argued that front running was not just observed in a single instance but there were multiple instances of front running that had taken place in shares of sixteen different companies. Therefore, the Respondent argued, that if the Appellant's internal control systems had been adequate and effective, it would have attracted the Appellant's attention to the trading activity in these accounts.

8. We have heard the parties i.e. the Appellant and the Respondent. We are of the view that front running is akin to insider trading and a criminal offence. We have perused the investigation report dated 11/10/17 and observed that there is no evidence to suggest that front running was taking place through the Appellant. We have also noted, however, that

the KATS operator namely Mr. Shahzad was an employee of the Appellant and they should have ensured that proper checks were in place to prevent front running from taking place with their clients' accounts. The Appellant, therefore, in violation of the Code of Conduct failed to exercise due skill and care in the conduct of its business. Furthermore, we are of the view that the Appellant has violated the Securities Rules by extending unlawful financing to clients. The Appellant's argument that prior to 2017 it was a standard practice of brokers to lend to a client base to facilitate them for trading purposes does not hold merit. We concur with the Respondent that the law was already in place which prohibited unlawful deposit taking, in one form or another, and Circular 20 was only issued to warn brokers who were involved in unlawful deposit taking to refrain from such activities which was in contravention of both the Companies Act and Securities Act. Having said that, we also agree with the Appellant that prior to 2017, most brokers were given a warning and not penalized for unlawful financing in respect of debit balances. Moreover, the Appellant has stated on record that any violations on their part were unintentional and that they are already in the process of surrendering their license.

9. In view of the foregoing, the penalty imposed on the Appellant is reduced to Rs 250,000 and the Appellant is directed to ensure full compliance of the provisions of the law in future. The Appeal is disposed of accordingly.

Shaukat Hussain
Commissioner (CCD, Insurance)

Farrukh H. Sabzwari
Commissioner (SCD, AML)

Announced on: 07 FEB 2020