



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)

Before the Joint Director (Securities Market Division)

In the matter of Show Cause Notice dated 27.07.2005
Issued to First National Equities Limited

Date of Hearing

15th August 2005

Present at the Hearing:

Representing First National Equities Limited:

Mr. Saeed. A. Bajwa. CEO

ORDER

1. The present matter arises out of a Show Cause Notice bearing No. SMD/SCN/6/2005 dated 27.07.2005 issued to First National Equities Ltd., a Corporate Member of the Karachi Stock Exchange (G) Ltd. (“the Respondent”).
2. Brief facts of this case are that between 01.03.2005 and 31.03.2005, the Respondent carried out 33 trades involving total 71,200 shares of Oil & Gas Development Company (OGDC), Pakistan Oil Field Limited (POL), Pakistan State Oil Limited (PSO), Pakistan Telecommunications Company Limited (PTC), Pakistan Petroleum Limited (PPL) and National Bank of Pakistan (NBP) through the Karachi Automated Trading System (KATS) on behalf of 4 of its clients.
3. In the course of these trades, the Respondent purchased and sold, on behalf of the said 4 clients, 26,300 shares of OGDC, 5,400 shares of POL, 2,000 shares of PSO, 11,000 shares of PTC, 19,000 shares of PPL and 7,500 shares of NBP. Each of these trades cancelled each other out with the effect that there was no change in the beneficial ownership of the shares.
4. The Securities and Exchange Commission of Pakistan (the Commission) obtained the KATS data from the Karachi Stock Exchange (G) Ltd. (KSE) for the relevant period, which revealed that during the month of March 2005 the Respondent had executed the following trades which cancelled each other out and did not result in change of beneficial ownership:

DATE	CLIENT CODE	NAME OF SHARE	NUMBER OF SHARES	PURCHASE AND SALE RATE	TIME OF EXECUTION
18/03/2005	I	NBP-REG	7,500	147	1507350058
2/03/2005	I	OGDC-REG	10,000	124.75	1036350002
8/03/2005	G	OGDC-REG	1,000	148.25	1343100033
9/03/2005	G	OGDC-REG	1,000	159.5	1259270040
9/03/2005	G	OGDC-REG	1,000	159.5	1301480075
14/03/2005	I	OGDC-REG	300	167.5	1037090046
14/03/2005	I	OGDC-REG	7,000	174	1408280102



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14/03/2005	G	OGDC-REG	5,000	176.55	1414250065
21/03/2005	G	OGDC-REG	500	159.55	1026490026
21/03/2005	G	OGDC-REG	500	159.55	1027050054
3/03/2005	G	POL-REG	500	337.5	1402210010
9/03/2005	J	POL-REG	500	352	958560107
9/03/2005	G	POL-REG	1,000	358	1110440025
9/03/2005	G	POL-REG	1,000	359	1126430060
11/03/2005	G	POL-REG	1,000	353.6	942000100
11/03/2005	G	POL-REG	500	346.5	1458380023
24/03/2005	G	POL-REG	200	266.7	949370005
25/03/2005	G	POL-REG	100	253.4	937200333
25/03/2005	G	POL-REG	100	253.4	937200336
31/03/2005	J	POL-REG	500	269	1036340052
1/03/2005	G	PPL-REG	1,000	259	1355390006
7/03/2005	G	PPL-REG	500	265	1200480021
10/03/2005	119	PPL-REG	15,500	293	1328030018
14/03/2005	G	PPL-REG	1,000	317	945180075
30/03/2005	G	PPL-REG	1,000	229	1109210019
1/03/2005	G	PSO-REG	500	435	1255210023
7/03/2005	G	PSO-REG	500	441.5	1408190054
8/03/2005	G	PSO-REG	1,000	473	1148480055
2/03/2005	G	PTC-REG	2,000	70.6	1249170030
3/03/2005	G	PTC-REG	5,000	70	1105010072
3/03/2005	G	PTC-REG	1,000	70	1105010074
3/03/2005	J	PTC-REG	2,000	70.25	1243520092
3/03/2005	J	PTC-REG	1,000	70.25	1243520093

5. In view of the preceding a Show Cause Notice dated 27.07.2005 was issued to the Respondent, detailing the aforesaid facts and asking it as to why action should not be initiated against it under Section 17 of the Securities and Exchange Ordinance 1969 (the Ordinance) and the Brokers and Agents Registration Rules, 2001 (the Rules). A copy of the KATS data was also sent to the Respondent in order to allow it an opportunity of answering the same. The Respondent was asked to submit a written reply with in 7 days from the date of the Show Cause Notice and the hearing in the matter was fixed for 15.08.2005.
6. The Respondent submitted a written reply to the Show Cause Notice on 02.08.2005 and also appeared in person through its authorized representative Mr. Saeed A. Bajwa on 15.08.2005. The main points raised by the Respondent in its written reply and in the course of hearing were as follows:
 - (a) The Show Cause Notice is misconceived and based on mere assumptions. It is apparent from the Show Cause Notice that the Commission has only picked certain isolated transactions from the entire record of the Respondent's trading account and the scrutiny of its trading record has not been done on the basis of any specific criteria.
 - (b) The trades in question were executed by the Respondent on behalf of its following four clients:



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S/ No	Client Code	Name of Client	Category
1.	I	Invest Forum (Pvt.) Ltd.	C-543-Member ISE
2.	G	General Investment & Securities (Pvt.) Ltd.	C-542-Member ISE
3.	J	GR Securities SMC (Pvt.) Ltd.	C-562-Member ISE
4.	119	Saeed Ahmad	Individual

The transactions annexed with the Show Cause were executed by the Respondent on behalf of the aforesaid clients. Thus there is absolutely no question of Respondent's involvement in creation of a false and misleading appearance of trading activity. Further the above mentioned accounts are not proprietary accounts of the Respondent and except for one client bearing Code No. 119 and rest of the accounts are of members of Islamabad Stock Exchange (G) Ltd. (ISE) which were trading on behalf of their clients in their own names.

- (c) The Client's accounts in question are trading or arbitrage accounts and these clients traded both in 'ready' and 'futures' markets. In such accounts the investor takes split second decisions for buying and selling of various scrips. Moreover, these accounts were not delivery accounts, in that case the use of these two modes of trading is most likely to result in squaring of a client's position in certain scrips. However, it does not involve any illegality.
- (d) The Respondent further pleaded that record of aforesaid accounts show massive trading on each particular day. The trades in question form far less than even 1% of the daily trading in the said accounts. Therefore it is highly improbable that the Respondent or its client could gain any huge advantage in such a minimal number of transactions.
- (e) Moreover the Respondent also stated that the market cannot be manipulated with such a low trade volume, particularly in the case of shares in question as these shares were already being traded heavily during the month of March, 2005.
- (f) That the record annexed with the Show Cause Notice itself shows that the Respondent purchased and sold above mentioned shares, on behalf of its clients, on various dates and on different rates. This clearly shows that the sole objective of Respondent's clients was to earn little profit on each of the many transactions they carried out. This trend of the transactions showed that there was no intention on the Respondent's part or its clients or their clients to keep beneficial ownership of the above mentioned scrips.
- (g) That in the trading accounts in questions, it is highly probable that a client would sell certain number of shares of particular scrip and after some time the same investor would purchase a huge lot of same scrip. In such a case buying and selling of few shares could definitely cancel each other out, but it would be absolutely co-incidental and would not involve any *mala fide* intention on the part of investor or client.
- (h) That Section 17 read with Section 22 of the Ordinance entails penal actions. Therefore under the general principal of law the two Sections read together only come into play when the acts prohibited under Section 17 are done by a person with *mala fide* intention to commit fraud. The explanations given through written



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reply and during the hearing clearly shows that these transactions were not executed intentionally or with *mala fide* intentions.

- (i) That the above contentions make it clear that the Respondent have not violated, much less with *mala fide* intention, any of the provisions of the Ordinance, or any other relevant law or rules applicable to the securities markets. The Respondent also requested the withdrawal of the Show Cause Notice.

7. I have heard the Respondent at length after carefully examining the record, I find that the following issues arise out of this matter:

- (a) Whether the acts of commission and omission as alleged against the Respondent constitutes a breach of Rules? If so, up to what extent?
- (b) What should the order be?

Each of these issues has been examined seriatim:

(a) Whether the acts of commission and omission as alleged against the Respondent constitute a breach of Rules? If so, up to what extent?

8. In the course of its written as well as oral contentions, the Respondent has acknowledged the fact of carrying out all 33 trades detailed in the Show Cause Notice. The plea of the Respondent that the trades in question annexed to the Show Cause Notice have been selected by the Commission without any criteria is not correct. The said trades have been selected on the criterion that the buyer and the seller is the same and the transactions have cancelled each other out without any change of beneficial ownership of the shares. This fact was clearly mentioned in the Show Cause Notice as well.

9. Further, the contention of the Respondent that trades in question were executed on behalf of its above mentioned clients therefore there was no involvement of the Respondent is not acceptable. The trades in question were executed by the Respondent on behalf of its clients and the Code of Conduct prescribed for Brokers under the Rules requires the brokers to operate their business with due skill, fairness and diligence. Hence, had the Respondent exercised due skill and care the trades in question would have not occurred. The Respondent should have monitored the trades of the client and abstained from entering the buying and selling orders of the same client at the same price. Moreover, such trading activity interferes with the fair and smooth functioning of the market by giving the impression of active trading of shares in the market, however in fact throughout the trades the shares remain in the possession of the same person.

10. The Respondent contended that 3 out of 4 accounts of its Clients bearing Code I, G and J are not its proprietary accounts and in fact are members of ISE. It was further contended by the Respondent that the said 3 Clients traded on behalf of their clients in their own names and a change in the beneficial ownership of the shares did take place. During the hearing and further vide SECP letter No.SMD/SCN/6/2005 dated 15.08.2005 the Respondent was specifically asked to substantiate its plea with documentary evidence that the aforesaid three Clients were trading on behalf of their clients in their own names and the beneficial ownership of the shares was changed. However, the Respondent failed to provide any documentary evidence in support of his aforementioned plea. Therefore, this plea of the Respondent is rejected.

11. The contention of the Respondent that the trading in both “Ready” and “Futures” markets is most likely to result in squaring of a client’s position in certain scrips does not hold ground as both the markets are separate and a trade in “Futures” market cannot be cancelled out with another trade in “Ready” market and vice versa. The trades in both the markets are independent from each other. Hence this plea of the Respondent is rejected.
12. Further the assertion by the Respondent that the trades given in the Show Cause Notice constitute a nominal percentage of the total traded volume in particular scrips on a particular day and therefore cannot in any way affect the market price of shares is not accepted. Although the minimal percentage of trades in question might have not affected the price of a share in the instant matter however this fact cannot be ignored that these trades did become the part of over all trading volume and such trades gave a false impression of active trading in these scrips at the time of execution.
13. The assertions of the Respondent that the record annexed with the Show Cause Notice itself shows that the Respondent purchased and sold above mentioned shares on various dates and on different rates is not correct. The trades mentioned in the record annexed to the Show Cause Notice were executed on different dates, however, the buying and selling in each trade was executed simultaneously and on the same price. The contention of the Respondent that the sole objective of its clients was to earn little profit on each of the many transactions they carried out is not borne out by facts. The fact of the matter is that profit cannot be derived from the trades where a client simultaneously bought and sold shares on the same price and such transactions did not result into change of beneficial ownership of the shares involved therein. Moreover, it is also evident from the KATS data annexed to the Show Cause Notice that the beneficial ownership of the shares involved in the trades in question remained unchanged. Therefore, the above assertions of the Respondent are rejected.
14. Further the plea of the Respondent that it is possible in some cases that a particular order may be squared up with another order previously placed in the ready market, by the same client on the same day also does not hold ground. If the trades in question had occurred due to the aforesaid reason then it clearly shows that the Respondent did not at all times carry out its business with due skill, fairness, promptitude and diligence. The Respondent should have informed its clients about their unexecuted orders in order to avoid the possibility of canceling out their previously placed orders with the new orders. Moreover, the occurrence of series of transactions which cancelled each other out is not a mere coincidence, instead it is an act of sheer negligence on part of the Respondent.
15. The Respondent by executing and permitting to execute trades which cancelled each other out and did not result in the transfer of beneficial ownership has indulged in acts which have interfered with the fair and smooth functioning of the market to the detriment of the interest of investors and has failed to follow the requirements of the Code of Conduct prescribed for brokers in the Rules.
16. In failing to ensure that a proper system was in place to avoid repeated occurrence of these trades where buy and sell orders by the same client cancel out each other, the Respondent has failed to act with due skill, care and diligence in the conduct of its business. Consequently, the Respondent has failed in its duty to maintain high standards of integrity, promptitude and fairness in the conduct of all its business and has in fact indulged in dishonorable, disgraceful and improper conduct on the Stock Exchange and has therefore acted in gross and blatant violation of Rule 8(iv) read with Rule 12 of the Rules.



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(b) *What should the order be?*

17. The Respondent has acted contrary to provisions 1, 2, 4 and 5 of the Code of Conduct prescribed for the broker in the Rules in violation of Rule 8(iv) read with Rule 12 of the Rules. The violation of the Rules is a serious matter which entitles the Commission to suspend the Respondent's license; however, I have elected not to exercise this power at present. Therefore in exercise of the powers under Rule 8(b) of the Rules, I hereby impose on the Respondent, the penalty of Rs.50,000.00 (Rupees Fifty thousand). This sum of Rs. 50,000.00 should be deposited in the account of the Commission maintained in the designated branches of Habib Bank Ltd., no later than thirty (30) days from the date of this Order. A copy of the Challan form evidencing the deposit of penalty amount must be sent to the Commission.
18. In addition to the aforesaid, I hereby direct the Respondent to abstain from buying and selling of shares in a manner that does not result in a change in the beneficial ownership of the shares failing which action will be taken against him in accordance with law.
19. 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.

Ikram Ul Haque

Joint Director (SM)

Date of Order: 26.08.2005