



**SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)**

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Before the Director (Securities Market Division)

**In the matter of Show Cause Notice dated 28/07/2005
issued to Mr. Mohammad Hussain Adhi-Member KSE**

Date of Hearing

August 31, 2005

Present at the Hearing:

Representing **Mr. Mohammad Hussain Adhi**

Mr. Mohammad Ashraf Adhi, Authorized representative

ORDER

1. The matter arises out of a Show Cause Notice (hereinafter referred to as "the Notice") dated 28/07/2005 issued to Mr. Mohammad Hussain Adhi (hereinafter referred to as "the Respondent") Member-broker Karachi Stock Exchange (Guarantee) Limited (hereinafter referred to as "the KSE") by Securities and Exchange Commission of Pakistan (hereinafter referred to as "the Commission").
2. Brief facts of the case are that between 3^d March 2005 and 24th March 2005, the Respondent carried out 18 trades involving 21,900 shares, in the aggregate, of National Bank of Pakistan ("NBP"), Oil & Gas Development Company ("OGDC"), Pakistan Oilfields Limited ("POL"), Pakistan Petroleum Limited ("PPL"), Pakistan State Oil Limited ("PSO") and Pakistan Telecommunication Company Limited ("PTCL") through the Karachi Automated Trading System ("hereinafter referred to as "KATS") on behalf of two of his clients.
3. In the course of these trades, the Respondent purchased and sold 2,100 shares of NBP, 10,000 shares of OGDC, 2,900 shares of POL, 4,900 shares of PPL, 500 shares of PSO, and 1,500 shares of PTCL.



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Consequently, the trades cancelled each other out and there was no change in the beneficial ownership of the shares.

4. The trading activity carried out by the Respondent in the aforementioned manner apparently interfered with the fair and smooth functioning of the market by creating a false and misleading appearance of trading activity in the scrips mentioned hereinabove which is detrimental to the investor's interest.
5. The Commission obtained the following KATS data from the KSE regarding the 18 transactions executed by the Respondent in the month of March-2005 alone which revealed as follows:

Date	Client Code	Name of Share	No. of Shares	Purchase & Sale Rate	Time of Execution
07/03/2005	65	NBP-REG	1,100	144.35	1201500008
16/03/2005	72	NBP-REG	1,000	157.50	1400490016
04/03/2005	72	OGDC-REG	1,000	137.20	1023070092
09/03/2005	72	OGDC-REG	1,000	159.50	1307550029
11/03/2005	72	OGDC-REG	1,000	163.90	1004270061
11/03/2005	72	OGDC-REG	5,000	163.25	1508510019
21/03/2005	72	OGDC-REG	2,000	159.55	1000560017
03/03/2005	72	POL-REG	2,000	324.00	1101490007
09/03/2005	72	POL-REG	500	351.00	1007000095
16/03/2005	72	POL-REG	400	333.70	1250480011
07/03/2005	72	PPL-REG	1,000	263.50	1410460076
08/03/2005	72	PPL-REG	1,000	261.10	1107360046
08/03/2005	72	PPL-REG	1,000	264.10	1300150002
11/03/2005	72	PPL-REG	1,000	298.00	1446450012
14/03/2005	72	PPL-REG	900	307.25	1348290074
04/03/2005	72	PSO-REG	500	437.25	1009150070
09/03/2005	72	PTC-REG	500	90.60	1335360064
24/03/2005	72	PTC-REG	1,000	72.00	1248490007

6. After examining the aforesaid data, the Commission issued the Notice dated 28/07/2005 to the Respondent wherein details of the aforesaid trades executed at KATS were also provided and the Respondent was



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required to show cause as to why action should not be taken against him under section 17 of the Securities and Exchange Ordinance 1969 ("the Ordinance") and the Brokers and Agents Registration Rules, 2001 ("the Rules"). The Commission also enclosed with the Notice dated 28/07/2005 a summary of KATS data to afford the Respondent an opportunity to explain his position. In the Notice dated 28/07/2005, the Respondent was required to submit a written reply to the Notice dated 28/07/2005 within 7 days from the date of the Notice and hearing in the matter was fixed in Islamabad for 12/08/2005.

7. The hearing fixed for 12/08/2005 was adjourned and was re-fixed for 31/08/2005. The Respondent submitted a written reply to the Notice dated 28/07/2005 vide his letter dated 04/08/2005. The Respondent in its written reply stated that he has executed trades on the instructions of two of his clients in the normal business manner and provided details of its clients as under:-

- (i) Client Code 65 is Kawaja Sami Rashid-Member-broker Lahore Stock Exchange (Guarantee) Limited ("the LSE").
- (ii) Client Code 72 is Millennium Securities & Investment (Pvt.) Limited, Corporate Member-broker Islamabad Stock Exchange (Guarantee) Limited ("the ISE").

8. The Commission vide fax letter dated 30/08/2005 advised the Respondent to bring with him at the time of hearing complete details of the trades executed by his two clients. On the date of hearing, Mr. Ashraf Hussain Adhi appeared before me representing the Respondent. The representative of the Respondent stated that the Respondent executed all the trades contained in the Notice dated 28/07/2005 on behalf of two members of LSE and ISE. On a query, the representative of Respondent confirmed that the trades in question were not the proprietary trades of



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the said members. The representative also stated that these were the orders of the clients of said members which had been executed through the Respondent at KSE. The representative of the Respondent was asked to present the details of the clients on whose behalf the said members have placed the orders, to which he averred that he does not have any information about the Clients of both members. Despite the clear instructions of the Commission vide letter dated 30/08/2005, the Respondent failed to produce any details which could prove that there was change of beneficial ownership in respect of the trades executed by the Respondent. During the course of hearing, in addition to what is stated above, the contentions of the representative of the Respondent are summarized as the under:

- a. That both the members give orders of their Clients from Lahore and Islamabad having large volume and any positions pending / outstanding are squared at the day end.
- b. That sometimes due to high volatility in the KSE, KATS Operators of the Respondent instead of cancellation of pending/unexecuted buy/sell orders of the Clients put contra entry in the KATS by way of putting large orders in opposite directions.
- c. That in some cases the trades may cancel each other out as result of error on the part of the KATS operator while punching the bids and offers or such trades may occur due to overlapping of limit orders given by the said members.
- d. That the Respondent charges commission, Laga charges etc. on such trades which cancel each other out and there is no change in beneficial ownership and the Clients do not object to it due to expected gain from the prompt orders execution in opposite direction.



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- e. That the Respondent is not in practice of intimating to KSE about the transactions which canceled out each other whereas such trades become part of turnover of shares at the KSE.
 - f. That the trades were not executed to mislead or manipulate the market price of the shares because these constituted a very small part of the total trades executed on those dates. However, the representative of the Respondent admitted that the cumulative impact of all such trades carried out on the exchange may influence the investors.
9. In order to afford the Respondent another opportunity to defend his position, after the hearing on 31/08/2005, the representative of the Respondent was handed over a letter asking him to furnish the following information by September 01, 2005:-
- (i) Copies of account opening forms of the two Clients.
 - (ii) Details/proof from the aforesaid Clients that beneficial ownership of the shares did take place in the trades annexed with the Notice dated 28/07/2005.

It is also pertinent to mention here the Respondent, on the date of hearing, faxed the first pages of the Account Opening Forms of the said members. However, neither the complete copies of the Account Opening Forms of said members of LSE and ISE nor any information relating to details from the aforesaid Clients/members have yet been furnished that beneficial ownership of the shares did take place in the trades annexed with the Notice dated 28/07/2005. The representative of the Respondent was categorically instructed to intimate to the undersigned on telephone that the requisite information has been furnished. Till the passing of this order, nor the information has been furnished neither any request for extension for



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submission of the requisite information has been received. Since the information has not yet been received by the undersigned despite lapse of a couple of days after the expiry of the deadline, I have noted such behavior of the Respondent with concern and it causes me to believe that beneficial ownership of the shares did not take place in the trades annexed with the Notice dated 28/07/2005 and, therefore, I am constrained to pass the instant order.

10. After care full perusal of the record on file and taking into consideration verbal and written submissions made before me and the conduct of the Respondent stated in para 9 above, I am of the view that the Commission must address the following questions:

- (a) Did the acts or omissions as alleged against the Respondent breach the Rules and do such acts or omissions warrant action against the Respondent?
- (b) If the Respondent is found in breach of the provisions of the Ordinance and the Rules, what should be the penalty imposed on the Respondent?

11. Having examined all the relevant issues pertaining to this case in depth, my findings are as follows:

- a. In the course of the Respondent's written as well as oral response to the Notice dated 28/07/2005, the Respondent has admitted that he carried out all 18 trades detailed in the Notice. The practice of cancellation of pending/un-executed orders through contra entry shows that KATS operators are insufficiently trained and/or are inexperienced for their job. I am not aware whether or not any action was taken against the KATS operators who had made the said thing as practice. Further this may be a way of



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earning more commission as the Respondent admitted of charging commission on the trades which cancel each other out. The Respondent, by ignoring the negligent and erroneous practices of the KATS operator, who is an employee of the Respondent has in fact encouraged his employee to conduct his business in a manner contrary to the Rules and has failed to exercise due skill, care and diligence in the conduct of business.

- b. Further the Respondent's assertion that sometimes due to high volatility in the KSE, KATS Operators of the Respondent instead of cancellation of pending/unexecuted buy/sell orders of the Clients put contra entry in the KATS by way of putting large orders in opposite directions is not acceptable. This clearly tantamount to negligence on part of the Respondent as it is also a violation of the brokers' code of conduct under which a broker is required to have in place adequate arrangement for proper conduct of his business, irrespective of the volume of such business. According to the broker's code of conduct laid down in the Third Schedule of the Rules, the Respondent is obliged to have adequately trained staff and arrangements to render fair, prompt and competent services to his clients. Engaging in and allowing trading activity in the market merely for the purpose of canceling an order previously entered in KATS creates a false impression of trading activity in that particular scrip and is not only contrary to high standards expected of a broker but is also improper, dishonorable, disgraceful and against the law.
- c. The practice of brokers operating through other brokers whether of the same exchange or of other exchange(s) is an unhealthy practice detrimental to the interest of investors. I am not aware whether or not the investors investing through Khawaja Sami



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Rashid Member LSE or Millennium Securities & Investment (Pvt.) Limited, Member ISE know the fact that their securities are being traded through the Respondent in the name of the said members. The investors who have invested through Khawaja Sami Rashid or Millennium Securities & Investment (Pvt.) Limited, do not have any contract with the Respondent and in case any dispute arises, they stand at a weak legal position, as their transactions are being carried out and recorded in the name of above members. This practice of broker appointing a sub-broker not only hampers the functioning of stock exchange and the Commission while undertaking monitoring and surveillance of trading activity but also compromises on transparency of the market. The aforesaid practice is also contrary to international best practices undertaken by brokerage houses. The Respondent has thus acted against the interest of the investors and has failed to act with due skill, care and diligence in conduct of his business by allowing his clients, Khawaja Sami Rashid and Millennium Securities & Investment (Pvt.) Limited, to act on behalf of other clients under one account.

- d. The relevant KATS data independently obtained by the Commission from the KSE (which was made available to the Respondent and has not been disputed by it) establishes that the aforesaid trades had the effect of canceling each other out and did not result in any change in the beneficial ownership of these shares. Such trading activity interferes with the fair and smooth functioning of the market and undermines market integrity by creating an impression of shares being traded in the market when in fact the trades have been cancelled out by the same person. The interests of the investor are compromised due to the fact that they receive a false impression of trading in the market which is more



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than likely to influence the decision of any reasonable investor to invest or trade in the market.

- e. The Respondent could not justify or explain the technical problems as the reason for entering a contra entry. In failing to ensure that the order was cancelled in a timely manner and instead revising the previous order entered in KATS by the KATS operators, the Respondent has acted improperly and negligently in breach of his duty to act with due skill, care and diligence in the conduct of his business. Consequently, the Respondent has failed in his duty to maintain high standards of integrity, promptitude and fairness in the conduct of his business.
12. It is clear from the facts detailed above that the Respondent has failed to follow the requirements of the Code of Conduct prescribed for brokers. By executing and permitting the execution of trades which cancelled each other out and did not result in the transfer of beneficial ownership the Respondent has indulged in acts which have interfered with the fair and smooth functioning of the market to the detriment of the interests of investors. The Respondent has failed to maintain high standards of integrity, due skill and care in the conduct of his business. He has indulged in manipulative, fraudulent and deceptive practices, has engaged in malpractices and has not complied with statutory requirements, and has therefore acted in violation of Rule 8(iv) of the Rules.
13. The violation of the Rules is a serious matter that entitles the Commission to suspend the license of the Respondent but I have elected not to exercise this power at present. However, in exercise of the powers under Rule 8(b) of the Rules, I hereby impose on the Respondent, a penalty of Rs. 50,000 - (Rupees fifty thousand only) which should be



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deposited with the Commission no later than thirty (30) days from the date of this Order.

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

(Imtiaz Haider)
Director (SM)

Date of the Order: 06/09/2005