



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)

Before The Director (Securities Market Division)

In the matter of Show Cause Notice issued to

Foundation Securities (Pvt.) Limited

Date of Hearing:

July 2, 2009

Present at the Hearing:

Representing the Foundation Securities (Pvt.) Limited

- | | |
|-------------------------------|------------------------------|
| (i) Syed Ahmed Zaidi | General Manager - Operations |
| (ii) Mr. Mohammad Ali Lashari | Advocate High Court |

Assisting the Director (SMD)

- | | |
|------------------------------|--------------------|
| (i) Mr. Muhammad Atif Hameed | Deputy Director |
| (ii) Ms. Tayyaba Nisar | Assistant Director |

ORDER

1. This order shall dispose of the proceedings initiated through Show Cause Notice bearing No. 1(06) PM/KSE/MSW/SMD/2009 - 11 dated June 19, 2009 ("the SCN") issued to Foundation 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 Broker 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 Broker Rules. On the perusal of KSE trading data from April 22, 2009 to May 07, 2009, it was observed that Respondent's clients, Muhammad Sarfraz ("MS") and Sheikh Noor Elahi ("SNE") bearing client



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codes ("1334") and ("1398") respectively, had been engaged in extensive buying and selling in the scrip of Ravi Textile Mills Limited ("RAVT"). During this period, the share price of RAVT increased from Rs. 2.55 to Rs 10.94. It was observed that on April 27, 2009 and April 29, 2009 buy and sell orders were placed through the accounts of MS and SNE in such a way that buy orders of one client matched with the sell orders of the other client. Subsequently, the said trades were reversed on the same day and hence the trades in question did not ultimately result in change in beneficial ownership of the shares. Moreover, the abovementioned trading between the two clients cumulatively contributed 98.86% and 52.36% of the total volume in the scrip of RAVT on April 27, 2009 and April 29, 2009 respectively. The impact of trades executed by MS and SNE, individually, on share price and market volume of RAVT is given in the tables below:

Table - A

Ravi Textile Mills Limited Muhammad Sarfraz								
Date	Bought Quantity	Average Buy Price	Sold Quantity	Average Sell Price	Closing Price	Market Volume	% to Market Volume (Buy)	% to Market Volume (Sell)
23-Apr-09	-	-	500	3.55	3.49	40,500	-	1.23%
24-Apr-09	-	-	50,000	4.49	4.49	62,000	-	80.65%
27-Apr-09	518,000	5.47	555,000	5.24	5.04	1,101,500	47.03%	50.39%
28-Apr-09	27,500	6.00	500	6.04	6.04	51,500	53.40%	0.97%
29-Apr-09	364,500	7.02	360,000	6.78	6.97	764,000	47.71%	47.12%
30-Apr-09	91,500	7.68	-	-	6.94	111,000	82.43%	-
7-May-09	137,000	10.77	-	-	9.99	412,000	33.25%	-

Table - B

Ravi Textile Mills Limited Sheikh Noor Elahi								
Date	Bought Quantity	Average Buy Price	Sold Quantity	Average Sell Price	Closing Price	Market Volume	% to Market Volume (Buy)	% to Market Volume (Sell)
27-Apr-09	500,000	5.43	500,000	5.49	5.04	1,101,500	45.39%	45.39%
29-Apr-09	200,000	6.99	200,000	7.04	6.97	764,000	26.18%	26.18%
4-May-09	20,000	7.88	-	-	7.94	86,000	23.26%	-



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3. It was further noted that MS and SNE had been engaged in extensive buying and selling in the scrip of Colony Mills Limited ("CML"). It was observed that on April 24, 2009 and April 27, 2009 buy and sell orders were placed in the scrip of CML through the accounts of the MS and SNE in such a way that buy orders of one client matched with the sell orders of the other client. Subsequently, the said trades were reversed on the same day and hence the trades in question did not ultimately result in change in beneficial ownership of the shares. Moreover, the abovementioned trading between the two clients cumulatively comprised 82.47% and 86.43% of the total volume in the scrip of CML on April 24, 2009 and April 27, 2009 respectively and were executed at days' highest prices. The impact of trades executed by MS and SNE, individually, on share price and market volume of CML is given in tables below:

Table - C

Colony Mills Limited Muhammad Sarfraz								
Date	Bought Quantity	Average Buy Price	Sold Quantity	Average Sell Price	Closing Price	Market Volume	% to Market Volume (Buy)	% to Market Volume (Sell)
24-Apr-09	545,500	7.70	545,500	7.61	7.65	1,212,500	44.99%	44.99%
27-Apr-09	595,000	8.02	500,000	7.99	7.85	1,153,000	51.60%	43.37%
30-Apr-09	5,000	6.80	5,000	6.66	7.11	1,079,000	0.46%	0.46%

Table - D

Colony Mills Limited Sheikh Noor Elahi								
Date	Bought Quantity	Average Buy Price	Sold Quantity	Average Sell Price	Closing Price	Market Volume	% to Market Volume (Buy)	% to Market Volume (Sell)
24-Apr-09	500,000	7.60	500,000	7.70	7.65	1,212,500	41.24%	41.24%
27-Apr-09	500,000	7.98	500,000	8.05	7.85	1,153,000	43.37%	43.37%

4. The Respondent was requested, vide the Commission's letter dated May 07, 2009 to explain its position on the matter, as the above mentioned trades created false market, resulted in no change in beneficial ownership and interfered with fair and



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smooth functioning of the market. The Respondent vide its letter dated May 08, 2009 replied that the said transactions were executed through its Lahore Branch Office and it had taken notice of the issue and the matter had been forwarded to its Risk Management Department. Furthermore, the Respondent informed that the accounts of MS and SNE had been suspended immediately and their account balances have been freezed. The Respondent also requested for time of seven days in order to investigate the matter in detail.

5. The Respondent vide its subsequent letter dated May 15, 2009 stated that both the clients had been executing trades in independent accounts resulting in change of beneficial ownership, therefore no illegal activity had taken place. Moreover, the Respondent apprised that in order to cater with any violation committed by the clients which was not in knowledge of the Respondent or any of its employees, it had issued account closure notices to MS and SNE and also demanded resignation of the concerned trader. The Respondent further requested the Commission for assistance in the matter of releasing the account balances of the accounts of MS and SNE, as the said clients had been pressurizing it for release of their account balances.
6. The Commission vide its letter dated June 02, 2009 directed the Respondent to ensure that the account balances of MS and SNE were not released until further instructions. Moreover, the Commission also requested for copies of Account Opening Forms ("AOF"), copies of CNIC and Receipt and Payment Statement from April 10, 2009 to May 10, 2009 relating to MS and SNE accounts.
7. The Respondent vide its letter dated June 03, 2009 provided requisite information to the Commission. On perusal of AOFs of MS and SNE, it was observed that MS and SNE had authorized Qasim Ali Sarwar and Muhmmad Asim Sheikh to operate and settle their accounts. It was also observed that Qasim Ali Sarwar is employed as an equity trader in Universal Equities (Pvt.) Limited ("UEL"), Member of the Lahore Stock Exchange (Guarantee) Limited ("LSE") and MS is the Chief Executive of UEL. Moreover, Muhammad Asim Sheikh is son of SNE and also nominee of SNE for his account. He is also director of UEL. The aforementioned clearly shows



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that accounts of both SNE and MS were not being operated independently by two different persons and both had prior links.

8. Keeping in view the aforesaid, on June 19, 2009 the Respondent was called upon to show cause in writing and appear before the undersigned at Commission's Islamabad office for a hearing on July 02, 2009. The Respondent appointed Minto & Mirza as Legal Counsel for the said matter, which submitted reply to the SCN, vide its letter dated June 25, 2009 on behalf of Respondent.
9. On the date of hearing, Syed Ahmed Zaidi and Mr. Mohammad Ali Lashari ("The Representatives") appeared on behalf of the Respondent. The arguments made by the Representatives during the hearing and in written reply to the SCN are presented below:
 - i) *In its reply, the Legal Counsel re-iterated the earlier submissions of the Respondent and quoted that the said trades were executed in the accounts of two independent clients, therefore, there was an apparent change of beneficial ownership. Moreover, it emphasized that the Respondent was unaware of the illegality of the said transactions.*
 - ii) *The Representatives accepted that the Respondent did not properly monitor the trading activity in the said accounts. The Representatives stated that all the trades in question were executed through its KATS terminal and it did not have any system in-place to detect such trades. Moreover, there was no CDC movement in mentioned accounts; therefore, it was difficult to identify any malpractice involved in the said transactions.*
 - iii) *The Representatives further added that all the trades were initiated through the Respondent's Lahore Office; therefore, geographical distance from head office, which is located in Karachi, might be another factor for the negligence.*
 - iv) *The Representatives also stated that the Respondent caters approximately 3,000 registered clients at its brokerage house, which makes it a difficult job to monitor and scrutinize all the trades executed by each client.*



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- v) *The Representatives explained that the Respondent had taken sufficient measures to ensure cooperation with the Commission including suspension of the accounts of MS and SNE, freezing the accounts balance and taking resignation from the concerned trader.*
- vi) *The Representatives further informed that the Respondent had recently deployed new software for the detection of such transactions in future.*

The Representatives prayed that keeping in view the aforementioned contentions the Commission may take a lenient view in this matter because the said violations were the result of ignorance, unawareness and without having any fraudulent intentions on Respondent's part.

10. I have reviewed the submissions made by the Legal Counsel and the Representatives during the course of the hearing and in written reply to SCN and same are addressed as under:

- i) The Respondents contention that the trades in question were executed in two independently operated accounts and as a result change in beneficial ownership did take place is not correct. It is very evident from the AOFs of MS and SNE that their accounts were not being operated independently; the AOFs of both clients indicate clear linkages as explained in Para No. 7. Moreover, the orders for buy and sell, in the accounts of MS and SNE, which resulted in trades in question, were placed through the same terminal and by the same trader. It may be noted that the trades were reversed same day which ultimately did not result in change in beneficial ownership of the shares. Further, the trades in question resulted in price inflation and generation of artificial volume which in turn created false market as elaborated in Para No. 2 and Para No. 3.
- ii) During the hearing the Representatives accepted that it was the responsibility of the Respondent to properly monitor the trading activities of its clients. The Respondent showed negligence in conduct



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of its business which ultimately resulted in creation of false market and illegitimate activity in the mentioned scrips. Moreover, it is the duty of the Respondent to ensure that its employees (traders) are vigilant and well trained to detect and prevent execution of such transactions. The magnitude and volume of the trades in question and no movement in CDC accounts of MS and SNE, for the said transactions should have captured the attention of Respondent for further scrutiny. Hence, had the Compliance Department been working diligently and cautiously, the transactions in questions would not have been overlooked.

- iii) The Respondent should ensure that full compliance is being made of all the rules and regulation of the Commission and stock exchanges in all its offices. It is the prime responsibility of the Respondent to monitor all trading activities being carried out through its brokerage house and keep track of any transaction which is being made with a view to create any misleading impression. Therefore, a justification of geographical distance from head office of the company does not suffice.
- iv) The Respondent contention that it is a renowned brokerage house at KSE with over 3,000 clients registered does not provide any justification for failure to comply with applicable rules and regulations. The reason for not monitoring trading activity for any of its clients due to concentration of client-base and high turn over does not absolve the Respondent from its responsibilities; the Respondent is responsible for each and every trade executed through its terminals.
- v) The measures taken by the Respondent, after the matter was brought to it's notice by the Commission, were timely but the Respondent must focus upon monitoring execution of the trades with a proactive approach rather than following a reactive strategy. The impact of the



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artificial price surge and enhanced activity by a group of people can be harmful to public's interest.

vi) It is expected that the Respondent would have better controls and measures for compliance after deployment of the automated system for business monitoring and scrutiny.

11. Considering the contentions made in the written replies of the Respondent and the arguments and averments made by the Representatives during the course of hearing, it is clear to me that the transactions in question executed through the Respondent's brokerage house had not resulted in any change in beneficial ownership, artificially inflated share price and generated artificial volumes in the scrips of RAVT and CML, thus created false market. Such attempts to generate artificial turnover and price movement leads to inducing unsuspecting innocent investor to trade in that scrip. This is harmful to the interest of small investors as well as development of a fair and transparent market.
12. Rule 12 of the Broker Rules requires that Respondent should abide by Code of Conduct set fourth under the Broker Rules ("Code of Conduct") which 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 and abstain from interfered in smooth and fair functioning of the market. The Respondent is one of the reputable brokerage house and is expected to be conversant and fully complied with the Code of Conduct. The obligation to fully comply with the regulatory requirements is further amplified by the fact that Respondent belongs to one of the largest and prominent corporate group in Pakistan.
13. The trades in question have disrupted smooth and efficient functioning of the market and inability of the Respondent to monitor such trades indicates that the Respondent has failed to conduct its business with due diligence, care and has interfered in smooth and fair functioning of the market. It is the responsibility of the Respondent to ensure that all the employees adhere to the rules and regulation



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of the stock exchanges. It is also the duty of the Respondent to maintain high standards of integrity, promptitude and fairness, in the conduct of its business and refrain from indulging in acts, which lead to false market and are detrimental to the investor's interest.

14. Keeping in view the aforementioned it is evident to me that the Respondent failed to abide by Rule 12 of the Brokers Rules by violated Clause A1, A2 and A4 of the Code of Conduct. 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. 400,000 (Rupees Four Lakhs only). I further 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.
15. 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 August 3, 2009

Islamabad