

Before Shauzab Ali, Commissioner (SMD)

In the matter of Show Cause Notice issued to M/s. HG Markets (Pvt) Limited

Date of Hearings:	February 28, 2019 September 19, 2019 October 01, 2020
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Order-Redacted Version

Order dated November 10, 2020 was passed by Commissioner (SMD) in the matter of HG Markets (Pvt) Limited. Relevant details are given as hereunder:

Nature	Details
1. Date of Action	Show cause notice dated January 22, 2019
2. Name of Company	HG Markets (Pvt.) Limited
3. Name of Individual*	The proceedings were initiated against the Company i.e. HG Markets (Pvt) Limited
4. Nature of Offence	Proceedings under Section 94 of the Futures Act, 2016 ("the Act ") for violations of the provisions of Rule 20(1)(a)(b) and Rule 20(2)(d) of the Commodity Exchange and Future Contract Rules, 2005 ("the Rules ") and sub-section (a), (b), (c), (f) and (i) of the Section 57 of the Futures Market Act, 2016.
5. Action Taken	<p>Key findings of default of Regulations were reported in the following manner:</p> <p>I have examined the submissions of the Respondent and its Representatives.</p> <ol style="list-style-type: none">1. In this regard, I observe that with regard to the contention of the Respondent regarding the exercise of judicial power by the Commission in violation of the Constitution, it must be noted here that the Commission reserve the powers to conduct quasi-judicial proceedings for compliance of its Regulations governing the capital markets. In this regard, the Commission can initiate disciplinary proceedings under Section 94 of the Act for violations of regulatory framework.2. The Respondent had further contended that the Commission has made various allegations on account of default of the Respondent in discharging its obligations under rule 20 of the Commodity Exchange and Future Contract Rules, 2015 which have been repealed under the Repeals and Savings clause of the Futures Brokers (Licensing & Operations) Regulations, 2018. The Respondent may note that the repealed rules were applicable at the time of operation of these accounts between 2016-2017. The Rules were repealed vide notification of Futures Brokers (Licensing & Operations) Regulations in September, 2018. Therefore, the argument of the Respondent is not tenable.



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3. The Respondent had further submitted that the Commission has not provided the copy of complaints and other related documents as provided in the SCN. In this regard, it may be noted that that copy of investigation report was shared with the Respondent and its legal counsel vide letter dated March 15, 2019 on their request during the first hearing held on February 28, 2019.
4. In view of the submissions and documentary evidence by the Respondent, it may be noted that when a client entrusts control of his account to a broker, the broker assumes fiduciary responsibility to exercise that control in favor of the clients. Liability of excessive trading rests upon the breach of fiduciary duty that occurs if the broker subsequently abuses his control by engaging in a pattern of trading that advances self-interest in a manner detrimental to the interests of the client. Churning involves excessive trading of a client's account by a broker for the sole purpose of generating brokerage commission as provided in Rule 20(2) (d) of the Rules. In one sense, excessiveness is a subjective determination. A volume and frequency of trading that might be acceptable for the account of a wealthy investor might be totally unacceptable for an investor of modest means who is interested in current income and conservation of capital. Thus, excessiveness could be determined according to client's financial resources and investment objectives. Another aspect to incorporate here is the degree of sophistication of the client in business and financial matters. The Respondent was inquired regarding the complainants during the hearing, however, the Respondent had failed to demonstrate knowledge of the client, their occupations, source of income/ wealth or investment objectives in all instant cases. The Respondent had submitted copies of account opening forms, discretionary trading authorities, risk disclosure documents and commission structure agreed with the complainants. However, no information with regard to the business relationship, risk assessment of the client, and/ or KYC/CDD documents of the complainants were provided by the Respondent. It reveals that there was a high degree of client reliance on the broker in the instant cases which is an important factor to determine the fiduciary responsibility of the broker and the agency relationship with regard to the trading activity in the accounts of their clients. The investigation report reveals that the broker has initiated trading into the accounts of the claimants and that the clients had invariably followed the brokers recommendations thus conclusive to the evidence of high reliance placed on the knowledge of the Respondent regarding their investment objectives and financial goals.
5. The Respondent was inquired regarding the investment objectives of the clients in correlation to the trading activity carried out in their accounts. However, the Respondent had not obtained sufficient evidence regarding the client's income/ source of funds or obtained investment objectives as no such document or evidence was produced by the Respondent which may explain the trading activity in the claimants' accounts. The Respondent had failed to demonstrate knowledge of the client's financial position or investment goals in instant cases with respect to their Know Your Customer / Customer Due Diligence policy (KYC/CDD). Section 57 (d) of the Act also requires a broker to obtain information from their clients regarding their



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circumstances and investment objectives which might reasonably be expected to be relevant in enabling the broker to fulfil his fiduciary responsibility to its clients. The broker is also required to ensure fair treatment of its clients and disclose any conflict of interest which is evident in the instant cases. Commodity trading involves high frequency of trades and significant commission rates and therefore, the broker is required to disclose any such conflict of interest which may arise due to deduction of such charges from the clients as per their trading activity. The clients though apparently signed the commission structure, however, the Respondent exercised effective control over the clients account in respect of the Discretionary Trading Authority ("DTA"). The inherent conflict of interest which existed in light of the DTA signed by the complainant, had to be disclosed in a proper manner keeping in view the client's sophistication and knowledge of the commodities market.

6. It was noticed that the Respondent had failed to cater to the investor's interest and had carried out excessive trading in the accounts of the complainants while neglecting the client's investment objectives and financial positions. It was observed that most of the complainants had limited exposure to commodities market, therefore, the Respondent was required to disclose any possible conflict of interest which may arise in carrying out trades on behalf of the client on the basis of DTA. It was the duty of the management of the Respondent to fulfill its prime fiduciary responsibility towards its clients as provided under the Standard of Conduct of the Act. The broker's control over the account as established through the DTA and its lack of information regarding the client's investment objectives also indicates that the broker had carried out excessive trading in self-interest while ignoring the financial standing and objectives of its clients. The Respondent has therefore, contravened its fiduciary responsibilities as provided under Rule 20(1)(a)(b) and Rule 20(2)(d) of the Rules and sub-section (a), (b), (c), (f) and (i) of the Section 57 of the Act.
7. The Respondent had also contended that the Commission that needs to prove that the Respondent acted with the intent to defraud or with reckless and willful disregard to the Complainant's interest. The term "willful default" has been defined in Oxford Dictionary of Law Fifth Edition as "the failure of the person to do what he should do, either intentionally or through recklessness". Further, the Respondent also provided definition of the term scienter in its arguments.... *"the term scienter has been defined in Black's Law Dictionary, Sixth Edition, at p. 1345, in following terms: Scienter. Knowledge by the misrepresenting party that material facts have been falsely represented or omitted with an intent to deceive."* In the instant cases, the argument of the Respondent holds little merit as even though there may not be knowledge or intent, the Respondent had not exercised due care and diligence required of it as a broker.
8. The responsibility also lies with the investor to adequately equip himself with requisite knowledge to understand the products and risks associated with commodities market before investing, As observed in the instant cases, the Respondent had produced copies of DTA duly signed by certain clients which signifies the fact that the client had placed reliance on the Respondent for effective control of their account and trading activity without having



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	<p>adequate knowledge of the products of the commodities markets and its commission structure. The Respondent timely sent information regarding their trading activity through emails/ SMS however, the clients failed to raise concern or highlight the same when the trading was actively being carried out in their accounts. Some of the clients had not reviewed their accounts summary during the active trading and had subsequently realized when their investment had reduced to a minimal amount. Therefore, lack of awareness exists also on part of the clients who had only invested their money for the purpose of profit generation while ignoring the elements of risk and inherent conflict of interest arising due to the commission structure of the Respondent in the presence of DTA.</p> <p>In the view of the foregoing and the admission by the Respondent, contravention of the provisions of Rule 20(1)(a)(b) and Rule 20(2)(d) of the Rules and sub-section (a), (b), (c), (f) and (i) of the Section 57 of the Act have been established. Therefore, in term of the power conferred under Section 94 of the Act, a penalty of Rs. 5,000,000/- (Rupees five million only) is hereby imposed on the Respondent. The Respondent is advised to enforce the provisions of the relevant rules and regulations in letter and spirit.</p> <p>Furthermore, relevant department of the Commission is advised to undertake comprehensive inspection in respect of all activities being performed by the Respondent, to ensure its compliance with all applicable AML/CFT as well as prudential regulatory framework including but not limited to provisions of SECP AML/CFT Regulations, Futures Act, Rules & Regulations made thereunder, PMEX General Regulations and Regulations governing Market Making at PMEX, if applicable.</p> <p>Penalty Order dated November 10, 2020 was passed by Commissioner (SMD).</p>
6. Penalty Imposed	A penalty of Rs. 5,000,000/- (Rupees five million only) was imposed on the Company.
7. Current Status of Order	Appeal was filed against the Order.

Redacted version issued for placement on the website of the Commission.