

**SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN**

NIC Building, Jinnah Avenue, Blue Area, Islamabad.

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**BEFORE THE DIRECTOR (SECURITIES MARKET DIVISION)**

**IN THE MATTER OF SHOW CAUSE NOTICE DATED 08/09/2005  
ISSUED TO ARIF HABIB SECURITIES LIMITED, MEMBER-KSE**

**Date of Hearing**

**23<sup>rd</sup> September 2005**

**Present at the Hearing:**

*Representing Arif Habib Securities Limited*

*Mr. Tahir Iqbal, Head of Internal Audit*

**To Assist the Director (SM):**

*Mr. Shaukat Hameed, Joint Director*

**ORDER**

1. The matter arises out of a Show Cause Notice dated 08/09/2005 (hereinafter referred to as "the Notice") issued by the Securities and Exchange Commission of Pakistan (hereinafter referred to as "the Commission") to Arif Habib Securities Limited (hereinafter referred to as "the Respondent") Member-broker of Karachi Stock Exchange (Guarantee) Limited (hereinafter referred to as "the KSE").
2. Brief facts of this case are that between 2<sup>nd</sup> March 2005 and 29<sup>th</sup> March, 2005, the Respondent carried out 6 trades of the shares involving an aggregate of 214,400 shares of Pakistan Oilfields Limited ("POL") and Pakistan State Oil Limited ("PSO") through the KSE Karachi Automated Trading System ("KATS") on behalf of three of its clients.
3. In the course of these trades, the Respondent purchased and sold, on behalf of three clients, 212,500 shares of POL and 1,900 shares of PSO. Each of these trades cancelled each other out with the effect that there was no change in the beneficial ownership of the shares.
4. This practice on the part of the Respondent is likely to interfere with the fair and smooth functioning of the market. Such practices are also contrary to the behavior expected of a broker and are detrimental to the investors' interests.
5. The Commission obtained the KATS data from the KSE for the relevant period, which showed that during the month of March 2005 the Respondent had executed the following trades which cancelled each other out and did not result in a change in beneficial ownership:

<b>Date</b>	<b>Client Code</b>	<b>Name of Share</b>	<b>No. of Shares</b>	<b>Purchase &amp; Sale Rate</b>	<b>Time of Execution</b>
2/03/2005	0001	POL-REG	2,500	337.00	1003180002
7/03/2005	0001	POL-REG	5,000	330.00	1409040048
8/03/2005	0001	POL-REG	5,000	345.00	1141570009
29/03/2005	0003	POL-REG	100,000	241.00	1330050001
29/03/2005	0003	POL-REG	100,000	241.00	1330100027
4/03/2005	0022	PSO-REG	1,900	439.95	1158250032

6. In view of the aforesaid data, the Commission issued the Notice to the Respondent. In this Notice, the details of the aforesaid facts were provided and the Respondent was asked to show cause as to why action should not be initiated against it under the Brokers and Agents Registration Rules 2001 (“the Rules”). A copy of the summary of the KATS data was also sent to the Respondent so that it would have the opportunity of answering the same. The Respondent was asked to submit a written reply to the Notice within seven days from the date of the Notice and first hearing was fixed in Islamabad for 23/09/2005.
7. The Respondent submitted a written reply to the Notice on 14/09/2005. On the date of hearing, Mr. Tahir Iqbal, Head of Internal Audit, the authorized representative of the Respondent appeared before me. The main points raised by the Respondent in its written reply and in the course of hearing are as follows:
- (a) The Respondent confirmed to have executed all 6 trades between March 02, 2005 and March 29, 2005 in the shares of POL and PSO as detailed in the Notice.
  - (b) The Respondent stated that the numerical codes against the trades which are understood to be clients’ codes in the Notice are in fact Traders Codes. The Respondent elaborated that all clients’ codes in its company begin with the prefix “CC” or other alphabets in case of institutions.
  - (c) The Respondent admitted that it follows the practice of using traders’ code and client’s codes for entering orders into KATS. However, it is the trader who decides to enter traders’ code or client’s code for entering orders into KATS. The orders executed through Traders’ Code are then allocated to various clients by the traders at the day end.
  - (d) The Respondent provided evidence that these trades were executed on the behalf of different clients by the same trader. The Respondent

reiterated that the trades referred to in the Notice resulted in a change in beneficial ownership of the shares and were neither false nor misleading.

- (e) During the hearing, the Representative of the Respondent pointed out that in KATS screen of KSE there is heading of "Account" and it is upon will of a trader to enter either client code or trader code. On an enquiry, Representative informed the Commission that traders at the Respondent's brokerage take orders from the clients and enter orders into KATS themselves or hire a KATS operator. The Representative of the Respondent further stated that there is no recording system installed at the Respondent's office for recording orders received from different clients through telephone calls.
  - (f) The Representative of the Respondent informed the Commission that it has approximately 800 clients, out of which approximately 200 clients are active. The Respondent has 6 Traders/KATS operators in its house.
  - (g) The Representative of the Respondent explained that after the close of the market, trading data for the house is downloaded from KATS by its back office staff for transferring/posting to the respective clients' account. The daily positions of clients where client codes are entered into KATS are updated automatically in the back office record on the basis of clients' codes mentioned in the KATS sheet. However, for the trades which bear traders' code, trades carried out in the name of respective traders are printed and handed over to traders whereupon the traders allocate trades to the respective clients in their handwriting on the basis of order sheets being maintained by them and then these trades are posted and allocated manually in the back office record to the respective clients accounts.
8. The Representative of the Respondent, on the date of hearing, reiterated that its brokerage house is one of leading brokerage houses and as such it feels its responsibility to behave ethically with regard to its clients and the investing public as a whole. Thus, it makes every effort to stay within all rules and regulations of the stock exchange and the Commission. The Respondent emphasized that all trades mentioned in the Notice are executed as per requirements of KATS Regulations. Moreover, the Respondent stated that it is clear from the evidence provided that the trades identified by the Commission

were neither false nor misleading and did in fact result in a change of beneficial ownership.

9. After the hearing the Respondent vide its letter dated 26/09/2005 made some more contentions in respect of its practice of entering traders code. The Respondent stated that on the basis of independent examination of the evidence provided vide its letter dated 14/09/2005, it had established the correctness of its position.
10. During the hearing the Representative was heard in detail and was informed that all documentary evidence submitted by the Respondent had been considered and made part of record and order would be passed taking into consideration all the written and oral contentions made by the Respondent. After hearing the views and contentions of the Respondent at length and 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 constitute a breach of the 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 the Rules? If so, up to what extent?
- (i) In the course of written as well as oral contentions, the Respondent has admitted that the Respondent carried out all 6 trades detailed in the Notice. The Respondent submitted system generated print outs of bills/statement of transaction, ledger of the clients, contract memo regarding these trades to different clients, a table showing the break up and allocation of these trades to different clients as proof of a change in the beneficial ownership of the shares. These statements are generated by the computer system of the Respondent wherein postings are made to respective client accounts by the Respondent staff and KATS statements does not show that these trades are executed in the name of the clients for which different statements mentioned above were submitted to the Commission rather it is evident from KATS statements that these trades were carried out in the codes and accounts which the Respondent has clarified that these are not its client but the traders. These statements are however generated by the

Respondent's own computer system and can not be independently verified & may not be taken into account.

- (ii) Entering traders' codes into KATS is contrary to the KATS Regulations read with **Trading Work Station User Manual** ("TWS User Manual"). In this connection, I refer to the preamble of KATS Regulations that provides as under:

*"Whereas the Karachi Stock Exchange (Guarantee) Limited has decided to introduce automated trading through Karachi Automated Trading System(KATS)"*

*"And Whereas it is necessary and expedient to frame regulation for operation, regulation and control of the KATS"*

Further, Regulation 1.b of KATS Regulations is reproduced here as under:

*"These regulations shall apply to the members in respect of trading conducted through Karachi Automated Trading System (KATS)"*

The KATS Regulations provide for operations, regulation and control of KATS whereas TWS User Manual prescribes the manner in which orders are to be entered into KATS. Page 9 of TWS User Manual explains the method for entering an order and explains the different fields that are required to be filled-in. It states that final field for a regular order is "Account" and it provides as under:

*"9. Enter the Client's account number to keep track of orders"*

The Respondent has the practice of entering traders' code into KATS. This practice is in complete disregard to the requirements of KATS Regulations read with TWS User Manual and has been carried out by the Respondent with the specific purpose of hiding the identity of the client and therefore allocating trades to whoever it wishes. Such practice by the Respondent causes the trail of the orders to be lost. Additionally, by entering traders' code into KATS and at the day end transferring positions to the respective client's account, there exists a potential risk that the Respondent may change the trading positions of clients to cover any market abuse as this practice of the Respondent allows the Respondent to allocate trades to whom it desires.

- (iii) Further, the Respondent's practice of entering trader's code instead of client code compromises transparency because trail of the order is lost and as

trading is being carried out in the name of traders whereas movement of securities would take place from the account of the respective client. Therefore, the record does not reflect the true and fair trading positions of its clients. It is the duty of the Respondent to exercise due care and skill while entering information into the KATS. By not entering the correct and required information in the "Account" field of the KATS, the Respondent has failed to carry out its responsibility to provide accurate information on the KATS. Therefore, the Respondent has failed to exercise due care and skill in the conduct of his business.

- (iv) The representative of the Respondent told during the hearing that there are 800 clients and out of which 200 clients are active. Having 6 traders/KATS operator, average number of clients for each trader/KATS operator comes out to be 34 which are quite manageable. Further, traders / KATS operators are highly skilled personnel and their only job is to receive the order from the clients and placing the same by themselves or through KATS operator into KATS and they are not entrusted with any other work except receiving orders and placing the same into KATS. It is generally accepted that traders are highly experienced professionals and are very well trained for the job as they have to act on the orders of the clients and always within a very short time period. Under the code of conduct annexed to the Rules, it is required that broker should have adequately trained staff and arrangements to render fair, prompt and competent services to its clients. As an experienced broker and as an employer of the Traders/KATS operator, it is the duty of the Respondent to ensure that adequate arrangements for proper conduct of its business are in place to which it has failed.
- (v) From the preceding facts it is clear that the Respondent has failed to follow the requirements of the Code of Conduct prescribed in the Rules. Therefore, the Respondent failed to maintain high level of integrity, promptitude and fairness in the conduct of its business and has in fact indulged in improper conduct on the stock exchange. The Respondent did not comply with the requirements of the Code of Conduct of the Rules. Therefore the Respondent acted in violation of Rule 8(iv) read with Rule 12 of the Rules.

(b) What should the order be?

11. In view of what has been discussed above, I am of the considered view that the Respondent acted in violation of Rule 8(iv) read with Rule 12 of the Rules and therefore, 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 deposited with the Commission not later than 30 (thirty) days from the date of this Order and furnish the receipted Challan to the undersigned.
12. Additionally, I hereby direct the Respondent to refrain from practices such as entering traders' code into KATS instead of clients' code as it makes difficult to find the trails of these trades and other consequences discussed in the paras above. I am of the view that such practices should not be followed as these create hurdles in detecting market abuses, proper surveillance and smooth market functioning.
13. 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.

**(Imtiaz Haider)**  
**Director (SM)**

**Dated: 12/10/2005**