

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

Before the Joint Director (Securities Market Division)

**In the matter of Show Cause Notice dated 07.09.2005
issued to First Capital Equities Limited**

Date of Hearing

23rd September 2005

Present at the Hearing:

Representing First Capital Equities Limited.

Mr. Faooq Habib, Chief Operating Officer, First Capital Equities Limited.

Assisting the Joint Director (SM):

Mr. Muhammad Hasan Zaidi, Junior Executive

ORDER

1. The case arises out of a Show Cause Notice No. SMD/SE/2(134)/2005 issued on 07.09.2005 by the Securities and Exchange Commission of Pakistan (“the Commission”) to First Capital Equities Limited. (“the Respondent”).
2. Summary of the facts of this case are that between 3rd March 2005 and 30th March 2005, the Respondent carried out 06 trades in the shares of Pakistan State Oil Limited (PSO), Pakistan Oil Fields Limited (“POL”), Pakistan Telecommunications Company Limited (“PTCL”) and Oil & Gas Development Company Limited

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(“OGDCL”) through the Karachi Automated Trading System (“KATS”) of Karachi Stock Exchange (KSE).

3. In the course of these trades, the Respondent purchased and sold 200 shares of PSO, 700 shares of POL, 34,000 shares of PTCL and 5,000 shares of OGDC. 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 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 worked to the detriment of the interests of the investors.
5. The Commission obtained the following KATS data from the Karachi Stock Exchange regarding the 06 transactions executed by the Respondent in the month of March 2005, which revealed as follows:

| TRADE DATE | CLIENT CODE | SCRIP | NO. OF SHARES | PURCHASE AND SALE PRICE | TRADE TIME |
|------------|-------------|----------|---------------|-------------------------|------------|
| 3/03/2005 | 111191 | PSO-REG | 200 | 428 | 1257270002 |
| 7/03/2005 | 110296 | POL-REG | 100 | 331 | 1153500048 |
| 7/03/2005 | 110296 | POL-REG | 600 | 333 | 1321070046 |
| 8/03/2005 | 110520 | PTC-REG | 19,000 | 84.6 | 1410080049 |
| 10/03/2005 | 110407 | PTC-REG | 15,000 | 87.5 | 1344240081 |
| 30/03/2005 | 110915 | OGDC-REG | 5,000 | 129 | 1401170067 |

6. After examining the aforesaid data, the Commission issued a Show Cause Notice (“SCN”) to the Respondent on 07.09.2005, detailing the aforesaid trade information and asking the Respondent to show cause as to why action should not be initiated against the Respondent under Brokers and Agents Registration Rules, 2001 (“the

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Rules”) for failure to maintain high standards of integrity, promptitude and fairness and not exercising due care and skill in the conduct of business and indulging in activities which have interfered with the fair and smooth functioning of the market and have been detrimental to the interest of the investors. The Respondent was asked to submit a written reply to the Show Cause Notice and the hearing was fixed in Islamabad for 23.09.2005. The Commission also provided a copy of the summary of KATS data so that the Respondent would have adequate opportunity to explain the same.

7. The Respondent submitted a written reply to the Show Cause Notice on 23.09.2005 and the Chief Operating Officer of the Respondent appeared in person on 23.09.2005. The main points raised by the Respondent in the written reply and in the course of hearing are summarized as follows:

- The Respondent stated that all the trades referred to in the Show Cause Notice were trades executed by the Respondent on behalf of its clients and none of the trades were house or proprietary trades.
- The Respondent stated in the hearing that the concept of trades which did not result in change in beneficial ownership was new to him and has never been an issue in the past. The Respondent has never been intimated for any such trades previously. Upon hearing this, I read out Section 17 (e) of the Securities and Exchange Ordinance 1969 to the Respondent. The said Section prohibits any person to enter into an order for the purchase and sale of security, which will ultimately cancel out each other and will not result in any change in the beneficial ownership of such security. The Code of Conduct attached to Brokers and Agents Registration Rules 2001 (the “Code”) also

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require a broker to act with due skill, care and diligence in the conduct of his business.

- The Respondent stated that he had a very high regard for law and would always abide by it. He did not obtain any benefit from engaging in trades which had not resulted in any change in beneficial ownership.
- The trades identified in the SCN were of small quantity and their overall impact on the stock market would be minimal. The Respondent further stated that he had no intention to manipulate the stock market.
- While replying to another question the Respondent stated that he was well aware of provisions of Securities and Exchange Ordinance 1969 and the traders were aware of the relevant rules and regulations.
- The trades identified in the Show Cause Notice were not misleading in any way. The aforesaid trades were made at the time when market was overshadowed by day traders. As the prices of scrips were rising, buy orders were placed at various prices by investors. Some of these orders did not get executed and remained queued for execution in KATS. As the prices started coming down the investors started selling off these scrips and some of the sale orders got matched with the buy orders in KATS.
- The Respondent also submitted that all trades identified in the SCN were market orders and none of them was a limit order.

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- While elaborating his defense, the Respondent stated that the preferential matching facility which facilitates matching of transactions within a brokerage house led to matching of transactions. He proposed to withdraw the preferential in house matching facility from KATS. He also stated that his Brokerage house was dealing in about 20 million shares everyday which makes about 450 million shares for a month. Only six trades of 39,900 shares have been identified in the SCN from the trading data for the month of March 2005. The prices at which these trades are made are not the highest or lowest prices of scrips. The clients who made these trades did not indulge in any misleading trades. This provides sufficient evidence of the fact that the aforesaid trades were not intentional trades.
 - The Respondent requested for some time to provide additional supporting information in order to substantiate his defense, which he was provided. Additional information was provided in the form of Account Opening Forms and Client Confirmation Statements of five clients. The aforesaid evidence only substantiated the Respondent's claim that the trades mentioned in the SCN had been executed on behalf of the respective clients.
8. The Respondent therefore requested that the Show Cause Notice be withdrawn for the reason that the Respondent had not violated any of the provisions of the Code of Conduct, or any other law.
9. I have read and heard the arguments of the Respondent at length and after carefully examining the record, following observations are made:

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10. In the course of the Respondent's written as well as oral contentions, the Respondent has admitted that he carried out all 06 trades on behalf of clients detailed in the Show Cause Notice.
11. The Respondent's plea that the concept of trades which cancel each other and do not result in change in beneficial ownership is a new concept is not tenable as ignorance of law is not a valid defense. It is emphasized here that the provisions of section 17 (e) (ii), (iii) and (iv) of the Securities and Exchange Ordinance 1969 clearly state that:

17. No person shall for the purpose of inducing, dissuading, effecting, preventing, or in any manner influencing or turning to his advantage the sale or purchase of any security, directly or indirectly:

(e) do any act or practice or engage in a course of business, or omit to do any act which operates or would operate as a fraud, deceit, or manipulation upon any person, in particular

(ii) create a false and misleading appearance of active trading in any security

(iii) effect any transaction in such security which involves no change in its beneficial ownership

(iv) enter into an order or orders for the purchase and sale of security which will ultimately cancel out each other and will not result in any change in the beneficial ownership of such security.

The Respondent's assertion is clearly in contradiction to the restriction/ prohibition on purchase and sale of security as provided in Section 17 (e) (ii) (iii) and (iv) of the

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Securities and Exchange Ordinance 1969 and the Code of Conduct and is therefore void, without any legal or factual premise.

12. The Respondent was undoubtedly aware that the buy and sell orders of the same client placed in the same security at the same rate could match within the Respondent's brokerage house as such trades are preferentially matched within the KATS. Therefore by allowing the trades to take place, the Respondent effected transactions that:
 - (i) ultimately cancelled each other out;
 - (ii) created a false and misleading appearance of active trading and
 - (iii) which involved no change in beneficial ownership.

13. The Respondent's contention that he was not aware of any such Regulation which prohibits the investors from carrying out transactions that cancel each other out and which do not result in change in beneficial ownership evidently shows that the Respondent did not act with due skill, care and diligence in the conduct of his business to ensure compliance with the statutory requirements of the Law. A broker, who is engaged in the business of purchase and sale of securities, should be aware of all relevant rules and regulations which govern trading at the Stock Exchange, ignorance of law is not a plausible excuse.

14. The Respondent's plea that the transactions highlighted in the SCN had a minimal impact on the stock market is refuted on the grounds that whatever the number of shares traded by the Respondent the orders for purchase and sale of shares ultimately cancelled each other and created a false and misleading appearance of trading activity with no change in beneficial ownership. Such trading activity interferes with the fair and smooth functioning of the market due to the fact that it gives impression of shares being traded in the market, when in fact throughout the trades, buyer and

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seller of the shares is the same person. By engaging in these trades, the Respondent has failed to exercise high standards of integrity, fairness and has not exercised necessary due diligence in the conduct of his business.

15. In view of the above, in exercise of the powers under Rule 8(b) of the Rules, conferred by S.R.O. 847(I)/2005 dated 19th August, 2005 and in view of the foregoing, I hereby impose on the Respondent, penalty of Rs. 25,000 (Rupees Twenty five thousand only) which should be deposited with the Commission, not later than thirty (30) days from the date of this Order.

16. In addition to the aforesaid, I hereby direct the Respondent to abstain from buying and selling of a security in such manner so as to create a false and misleading appearance of active trading in such security, which ultimately cancel out each other and do not result in change in the beneficial ownership of such security.

17. 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.

Aly Osman
Joint Director (SM)

12th October, 2005