

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

Before the Joint Director (Securities Market Division)

**In the matter of Show Cause Notice dated 23.08.2005
issued to KASB Securities Limited**

Date of Hearing

7th September 2005

Present at the Hearing:

Representing KASB Securities Limited.

Mr. Farrukh H. Sabzwari, CEO KASB Securities Limited

Mr. Moeen Sheikh, CFO, Company Secretary, KASB Securities 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(131)/2005 issued on 23.08.2005 by the Securities and Exchange Commission of Pakistan (“the Commission”) to KASB Securities Limited. (“the Respondent”).
2. Summary of the facts of this case are that between 1st March 2005 and 31st March 2005, the Respondent carried out 13 trades in the shares of National Bank of Pakistan Limited (“NBP”), Oil & Gas Development Company (“OGDC”), Pakistan

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

Oil Fields Limited (“POL”) and Pakistan Petroleum Limited (“PPL”) through the Karachi Automated Trading System (“KATS”) of Karachi Stock Exchange (KSE).

3. In the course of these trades, the Respondent purchased and sold 143,800 shares of NBP, 121,400 shares of OGDC, 39,500 shares of POL and 50,000 shares of PPL. 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 13 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
1/03/2005	4317	PPL-REG	50,000	258.5	1359360085
2/03/2005	024427	POL-REG	4,500	332	1247230007
4/03/2005	013304	NBP-REG	1,000	144	1544430053
9/03/2005	012364	OGDC-REG	37,800	159.5	1341240057
9/03/2005	012364	OGDC-REG	58,500	159.5	1341320048
9/03/2005	116654	OGDC-REG	100	152	1016350044
16/03/2005	013600	NBP-REG	100,000	161	1245100041
16/03/2005	013600	OGDC-REG	25,000	191	1251200048
16/03/2005	013600	POL-REG	10,000	335.3	1245520013
17/03/2005	013758	NBP-REG	42,800	159.5	953470073
18/03/2005	013600	POL-REG	10,000	325.1	1015220048
30/03/2005	013758	POL-REG	10,000	262.9	1044380016
31/03/2005	013758	POL-REG	5,000	269	947370023

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

6. After examining the aforesaid data, the Commission issued a Show Cause Notice (“SCN”) to the Respondent on 23.08.2005, 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 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 07.09.2005. 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 31.08.2005 and the Chief Executive Officer and Company Secretary of the Respondent appeared in person on 07.09.2005. 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 are trades executed by the Respondent on behalf of its clients and none of the trades are house or proprietary trades. There is a prohibition on proprietary trades and no “prop-books” are maintained as part of strict policy pursued by the Respondent.
 - The Respondent agreed that the beneficial ownership in some of the transactions mentioned in the Show Cause Notice has not changed. The trading strategy of the clients is such that trades without change in beneficial ownership have taken place, although un-intentionally.

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

However, there is not much that the Respondent can do to avoid such trades which happen not only through orders routed to the KATS operators but also via on-line trading.

- Most of the trades identified in the Show Cause Notice were limit orders. No false and misleading activity as alleged in the Show Cause Notice had taken place at the Respondent's brokerage house as all trades identified in the Show Cause Notice had been made by identifiable clients and there is presence of the beneficial owner in 100% of these trades. The copies of Account Opening Forms of all the clients whose trades were identified in the SCN were also provided to the Commission.

- The Respondent also submitted that it had the option to trade through the C-to-C (client to client) window of the Karachi Automated Trading System (KATS) but instead it routed every trade through KATS normal trading window which indicates that the aforesaid trades were not intended to give an impression of false trading in the market.

- The action under the SCN of the Commission is not warranted under the law as the Respondent had not committed any violation of law and that the Respondent had not executed the said thirteen trades without any change in beneficial ownership. The said trades were executed by the Respondent in capacity of a broker while rendering brokerage services to the pertinent active clients. All the aforesaid transactions were undertaken on account of and upon instructions of identifiable clients whose particulars and credentials are available in our records. One of the transactions was undertaken online by a client over whom

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

they have no control. Such online transactions undertaken by the clients are legally permissible as there is no bar as such under the law.

- The presence of beneficial owner in 100% of these trades is the undeniable proof that these trades were genuine and as such were not illegal and fall completely within the scope of the normal business conduct of any brokerage house. The assumption that was made the basis of the change that the orders for purchase and sale of the identified shares ultimately cancelled out each other and did not result in change in the beneficial ownership is also challenged on the same grounds.
- The prohibitions rightly contained in Rule 8 of “the Rules” cited in the Show Cause Notice relate to price manipulation, rigging or cornering activities, which is not the case. By the same token, the prohibitions contained in Section 17 of the Securities and Exchange Ordinance 1969 relates to fraudulent trading involving no change in beneficial ownership or false or misleading appearance of active trading in scrip, which is also not the case here. These transactions are undertaken by or on account of identifiable clients, against which we have requisite purchase and sale bills generated internally.
- It is a universally accepted concept of trading in securities that an investor has every right to buy and sell the same security at any time and he can also place orders during rising markets and at the same time place sale orders so that the securities purchased against his early orders can be sold at higher prices and no body can stop the investors from doing so. There is no law prohibiting a purchaser of securities from reselling the same. A purchase contract can therefore be squared

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

up against a sale contract if the quantity is covered by a sale order or orders. This does not mean that there is no change in beneficial ownership. The beneficial ownership changes by minutes.

- All activities highlighted by the honorable Commission in the Show Cause Notice are those, which are necessary to be performed by a brokerage house for conducting activities related and incidental to the stock broking business and as such are not liable to be classified as trades which would have created a false and misleading appearance of trading activity in the shares or which would have resultantly influenced the activity in those shares in terms of volume and share prices.

- On a question regarding the competence of the staff of the Respondent, the Respondent stated that it has the policy of hiring fresh graduates and provides in-house training to them. This is done to uphold integrity and independence in the conduct of business. The KATS operators are very well aware of the relevant rules, laws and regulations although chances of human error on part of the KATS operators is also possible.

A trade to trade explanation of the transactions as submitted by the Respondent is as follows:

TRADE NO. 3

The said transaction has a valid and identifiable beneficial owner, proving no involvement by KASB Securities whatsoever. The client placed an order to buy and subsequently to sell 42,800 shares of NBP. The Respondent during the hearing submitted that the client should

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

have cancelled the order; instead of placing a sell order of 42,800 shares.

TRADE NO.1

On 02.03.2005 one of the clients traded in total of 18,000 shares of NBP, buying 10,000 shares at Rs. 143.9 and selling them at Rs. 145.5. Further he bought another 3,000 shares in three different orders between Rs. 142.75 and Rs. 142.95 out of which he opted to sell only 2,000 shares at Rs. 143.40 and Rs. 143.50 respectively, while for the remaining 1,000 shares he placed a limit order at Rs. 144.

The client continued to take fresh positions in NBP by placing a buy order of another 5,000 shares at Rs. 144. As soon as the market shot up and the rate jumped to Rs. 144 all his orders got simultaneously executed, including the ones for selling 1,000 shares at Rs. 144 and buying 5,000 shares.

TRADE NO. 7

The account holder while trading through the Respondent (KASB) direct internet trading terminal took several positions in one security in a single trading session by using the limit order option. The fact that the transaction was processed through the remote trading terminal further substantiates Respondent (KASB) Securities' stance that all transactions have been placed by its identifiable and bonafide account holders and that these were purely client driven transactions for which KASB holds no control. The assumption that these transactions were initiated by KASB Securities for creating false and misleading appearance of trading activity in the shares which influenced the activities in terms of volume and share prices and that there was no

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

change in beneficial ownership of these shares are vehemently denied and discouraged as incorrectly perceived.

TRADES NO. 4 and 5

The beneficial owner behind these transactions traded in OGDC at various prices. The transactions highlighted by the honorable Commission included two such buys and sells in OGDC shares (37,800 and 58,500 shares respectively) which primarily occurred due to placement of buy and sell orders at various limits by the client.

During the hearing the Respondent submitted that the said trades were carried out through the 'Execution Account' of the Respondent which is used to execute heavy volume orders where secrecy and confidentiality of client placing the order is to be maintained. Thus even the trader placing orders in KATS is not aware of the client's identity for which he is placing the order. This is done to prevent any leaking out of information relating to trades of certain clients.

TRADES NO. 2 ,6 ,8 ,9, 10, 11, 12 and 13

Each account holder who requests for these trades was the actual beneficial owner of these shares, a fact that is duly supported by daily trade confirmations. Each of the trades identified above is actually an order placed by two different clients at the time when the KSE index was at its record high level, resulting in inter client order matching via KATS terminal.

The supporting documents for each of the above mentioned trades have been provided to the Commission.

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

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.
9. I have read and heard the arguments of the Respondent at length and after carefully examining the record, following observations are made:
10. In the course of the Respondent's written as well as oral contentions, the Respondent has admitted that he carried out all 13 trades on behalf of clients detailed in the Show Cause Notice.
11. The Respondent in its written reply states that all these transactions whether undertaken on account of its clients or undertaken by the online clients are legally permissible as there is no bar as such under the law. The Respondent undertook, on behalf of its clients five such transactions i.e. transactions no. 1, 3, 4, 5 and 7 whereby both buy and sell orders of shares were made by the same client. The provisions of section 17 (e) (ii), (iii) and (iv) of the Securities and Exchange Ordinance 1969 are:

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

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

(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

12. The Respondent has stated that there is no bar as such under the law for the transactions noted in the SCN and that it is a universally accepted concept of trading in securities that an investor has every right to buy and sell the same security at any time and he can also place orders for purchases during the rising markets and at the same time place sale order so that the securities purchased against his early orders can be sold at higher prices. No body can stop the investors for doing so. This plea of the Respondent 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 Securities and Exchange Ordinance 1969 and the Code of Conduct and is therefore incorrect.
13. Section 17 of the Securities and Exchange Ordinance 1969 prohibits any person from doing any act which operates or will operate as fraud, deceit, and manipulation upon any person, in particular creating a false and misleading appearance of active trading in any security and effect any transaction in such security which involves no change in its beneficial ownership. Further the respondent's contention that no body can stop the investors from doing so 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.
14. 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

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

Respondents 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.

15. The Respondent stated that since all the aforesaid trades were undertaken on behalf of identifiable clients and the presence of beneficial owner in 100% of these trades is undeniable proof that these trades were genuine and as such were not illegal and fall completely within the scope of the normal business conduct of any brokerage house. The Respondent's defense is irrelevant and baseless. The presence of identifiable clients and 100% beneficial ownership does not substantiate that the transactions no. 1, 3, 4, 5 and 7 as pointed out in the SCN did not result in change in beneficial ownership.
16. The Respondent's arguments regarding each of the trades undertaken by it are analyzed as follows:
17. TRADE NO. 3
The client on whose behalf trade No. 3 was executed carried out this trade by placing order to purchase and sale 42,800 shares of NBP. In this particular instance, the order for the purchase and sale of NBP was of the same quantity and the same price. This portrays negligence on part of the Respondent, as it allowed the client to place such order that ultimately cancelled each other out and did not result in any change in beneficial ownership of shares and created an impression of false active trading in the market.

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

18. TRADE NO. 1

The Respondent agrees that the client had placed a limit order on 1,000 shares of NBP at Rs.144 and while watching the market go up he placed another buy order of 5,000 NBP shares at Rs.144. It was the duty of the Respondent to prevent such trades from being conducted on behalf of the same client that could apparently match with each other and therefore not result in any change in beneficial ownership and give a false impression of active trading in the scrip. Therefore, the Respondent has failed to perform his duty of exercising necessary due diligence, skill and care as required under the Code of Conduct enshrined in the Rules.

19. TRADE NO. 7

The client on whose behalf trade no. 7 was executed was dealing through the Respondent via on-line trading placed limit orders for buy and sell of OGDC shares out of which orders for the sale and purchase of 100 shares matched at a price of Rs.152. The defense of the Respondent that the said trades were purely client driven trades for which the Respondent holds no control and neither has any involvement whatsoever, is not acceptable as all the said trades were executed through the Respondent's trading system and the Respondent should have in place adequate check and balance systems which prevent occurrence of such trades.

20. TRADES NO. 4 and 5

The client behind these two trades has traded in 37,800 and 58,500 shares of OGDC by placing buy and sell orders at various limits.

21. The Respondent took the plea that the matched orders as identified in the Show Cause Notice were part of a long queue of orders made by the client and had been placed without any intention to create a false impression of active trading in the stock market. I am of the considered view that the Respondent should have taken all

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

steps necessary to ensure compliance with the Laws and Rules and by not doing so the Respondent has breached the Code of Conduct enshrined in the Rules.

22. TRADES NO. 2 ,6 ,8 ,9, 10, 11, 12 and 13

Each of the aforesaid trades was made by two different clients, one client placing the buy order and the other placing the sell order. The Respondent has provided sufficient evidence in the form of Account Opening Forms of individual investors, trade confirmations sent out to the clients and ledger statements of clients. After detailed analysis of the supporting information provided by the Respondent, it is observed that each of the trades has been placed by a different client. Therefore on the evidence provided and the arguments presented the trades no. 2, 6 ,8 ,9, 10, 11, 12 and 13 did result in change in beneficial ownership and therefore no violation of the Law or the Rules has taken place with respect to these trades.

23. It is reiterated that the Respondent undertook, on behalf of clients transactions no. 1, 3, 4, 5 and 7 whereby both buy and sell orders of shares were made by the same client that did not result in change of beneficial ownership and which created false and misleading appearance of active trading and ultimately cancelled out each other. The Respondent by allowing such trades has failed to perform his duty of exercising necessary due diligence, skill and care as required under the Code of Conduct enshrined in the Rules. The Respondent should have in place adequate check and balance systems which prevent occurrence of such trades.

24. The violation of the Code of Conduct as enshrined in the Rules is a serious matter, therefore, 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

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

only) which should be deposited with the Commission, not later than thirty (30) days from the date of this Order.

25. 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.
26. 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)

9th September, 2005