

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

Before the Joint Director (Securities Market Division)

**In the matter of Show Cause Notice dated 26.08.2005
issued to Bawa Securities (Private) Limited**

Date of Hearing

12th September 2005

Present at the Hearing:

Representing Bawa Securities (Private) Limited.

Mr. Muhammad Hanif Bawa, Chief Executive Bawa Securities (Private) 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(132)/2005 (the “SCN”) issued on 26.08.2005 by the Securities and Exchange Commission of Pakistan (“the Commission”) to Bawa Securities (Private) Limited. (“the Respondent”).
2. Summary of the facts of this case is that between 2nd March 2005 and 31st March 2005, the Respondent carried out 29 trades in the shares of National Bank of Pakistan Limited (“NBP”), Oil & Gas Development Company (“OGDC”), Pakistan Oil Fields Limited (“POL”) and Pakistan State Oil (“PSO”) through the Karachi Automated Trading System (“KATS”) of Karachi Stock Exchange (KSE).

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3. In the course of these trades, the Respondent purchased and sold 3,800 shares of NBP, 7,400 shares of OGDC, 300 shares of POL and 11,300 shares of PSO. 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 29 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
2/03/2005	95	NBP-REG	500	140.4	1126410030
2/03/2005	95	NBP-REG	500	140.4	1126420058
2/03/2005	95	NBP-REG	500	140.4	1126440005
2/03/2005	95	NBP-REG	500	140.4	1126580035
2/03/2005	95	NBP-REG	1,000	140.4	1127020013
2/03/2005	95	NBP-REG	100	139.5	1304510059
2/03/2005	95	PSO-REG	2,400	430.5	1326520036
3/03/2005	95	POL-REG	100	327	1154560010
3/03/2005	9/1	PSO-REG	8,900	426.5	1115480056
7/03/2005	95	OGDC-REG	500	139.6	1207300035
7/03/2005	95	OGDC-REG	100	141.15	1335020032
7/03/2005	95	OGDC-REG	100	141.15	1335040002
7/03/2005	95	OGDC-REG	1,500	139.6	1351150030
8/03/2005	95	NBP-REG	100	147.4	1405580005
8/03/2005	95	NBP-REG	100	147.4	1405590033
8/03/2005	95	NBP-REG	100	147.4	1406000057
8/03/2005	95	NBP-REG	100	147.4	1406030018
8/03/2005	95	NBP-REG	100	147.4	1406060006

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8/03/2005	95	OGDC-REG	700	148.85	1354090038
9/03/2005	95	OGDC-REG	1,800	158.95	1239200013
10/03/2005	95	NBP-REG	100	162.25	1139560052
10/03/2005	9/42	OGDC-REG	1,000	158.7	1343050069
15/03/2005	95	OGDC-REG	1,000	178.4	956030025
16/03/2005	95	NBP-REG	100	161.3	1208010005
16/03/2005	5/39	OGDC-REG	500	193.25	1122450047
16/03/2005	5/39	POL-REG	100	339.9	1106270053
16/03/2005	95	POL-REG	100	339.9	1120590012
31/03/2005	95	OGDC-REG	100	115	1204380053
31/03/2005	95	OGDC-REG	100	115	1204410027

6. After examining the aforesaid data, the Commission issued a Show Cause Notice (“SCN”) to the Respondent on 26.08.2005, 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 12.09.2005. 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 05.09.2005 and the Chief Executive of the Respondent appeared in person on 12.09.2005. The main points raised by the Respondent in the written reply and the hearing are 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

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four of its clients and none of the trades were house or proprietary trades.

- The Respondent categorically stated that none of the clients were involved in manipulating the market in any manner. All the trades were “normally genuine” although, their trading volume was sometime in quite a high quantity. The Respondent further elaborated during the hearing that normally genuine trades mean where identifiable buyers and sellers settled their trades through delivery versus payment (DVP).
- Defending his case, the Respondent stated that as the stock market was “very erratic and trading pattern in market was very fast” sometimes the KATS operators were unable to cope with the flow of orders they were receiving and mistakes were therefore made by the KATS operators while entering client’s code. As a consequence if an order was received from another client, (other than for which the default code was set), the KATS operator would enter the order for this other client without changing the code by mistake. Once executed the code for these transactions in KATS can not be changed, however the back office records and systems reflect transactions of clients by their specific codes allotted to them.
- The KATS operators as a normal practice set default codes on the KATS for certain clients, such as client number 95 and 9/1 which carried out trades in bulk/ high volume. While orders of these two clients were entered in KATS, some other clients also placed orders in the same scrip that resulted in matching of these orders. All the

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twenty six trades of clients trading through account no. 95 and 9/1, identified in the Show Cause Notice got executed in this way.

- The Respondent submitted during the hearing that matching of buy and sell orders within the brokerage house occurred rarely. This was also supported by a comparison of volume and number of trades highlighted in the Show Cause Notice with the total trades made by the Respondent during that day.
- One of the clients of the Respondent who was transacting through account code 9/42 mistakenly placed the order for the purchase of 1,000 shares of OGDC and subsequently placed a reversal order in order to cancel the previous order.
- Another client of the Respondent, who transacted through account number 5/39 is a member of Islamabad stock exchange and routes his clients' business through the Respondent. In order to maintain a complete audit trail and for the sake of transparency, he sometimes placed orders for purchase and sale to be entered separately at the same time on behalf of his various clients instead of requesting for a client to client transaction.
- The Respondent admitted during the hearing that execution of orders for the purchase and sale of securities that ultimately cancel each other and which do not result in change in beneficial ownership is a violation of the Securities and Exchange Ordinance 1969 and the Code of Conduct for brokers as it creates false and misleading appearance of active trading. However, at times such trades are

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mistakenly entered in KATS and the Stock Exchange should devise means to prevent matching of any such orders.

- The Respondent also stated in the hearing that internal controls checks and balance system are in place at his brokerage house. These include issue of warning letter to KATS operator who repeatedly makes mistakes and a bar on changing the account code after entering an order. The account code can only be changed by the Chief Executive's written approval. However the Respondent noted with concern that in case a broker makes a mistake while entering orders he does not have any recourse or mechanism to report such trades to the stock exchange.
- While replying to a question in the hearing as to how the Respondent ensures compliance with Brokers and Agents Code of Conduct, the Respondent stated that all KATS operators employed are intermediate qualified and possess good typing speed. They are trained at the Respondent's brokerage house and are aware of the relevant rules and regulations. He further stated that he himself imparts knowledge of rules and regulations to the KATS operators. A total of six KATS operators work on nine KATS terminals.
- The Respondent proposed that preferential matching facility of trade orders within the same brokerage house should be withdrawn in the KATS as it encouraged matching of orders within a brokerage house.
- The Respondent requested in the hearing held on 12.09.2005 to grant him some time so that he could submit supporting documents to substantiate his defense that the KATS operators had mistakenly

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placed orders of some clients in KATS account codes 95 and 9/1, which was provided to him.

- The Respondent was also required to provide additional information including Account Opening Forms and transaction statements of clients mentioned in the Show Cause Notice whose trades had been entered mistakenly by the KATS operators in some other clients' accounts along with sufficient back office records and Account Opening Forms of the sub-clients of account code 5/39, who is a member of Islamabad Stock Exchange Limited.

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 the 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 29 trades on behalf of clients detailed in the Show Cause Notice.

Trades of Account Codes 95 and 9/1

11. The Respondent's plea that that "the stock market was very erratic and trading pattern in market was very fast" that sometimes the KATS operators were unable to cope with the flow of orders they were receiving and entered incorrect account codes for twenty six out of the twenty nine trades executed on behalf of clients with codes 95 and 9/1 is not tenable on the ground that the broker should act with due skill, care

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and diligence in the conduct of all his business. The Respondent has stated that the said transactions had been erroneously recorded due to errors of KATS operators. The Respondent's plea of human error in failing to change the account code while entering orders in the KATS does not hold weight in view of the fact that the KATS operators are highly skilled persons, whose job is to record such transactions within a short time period. The Code of Conduct for Brokers and Agents require a broker to have adequately trained staff and arrangements to render fair, prompt and competent services to his clients. The aforesaid trades would not have occurred had the KATS operators been diligent and had entered account codes in KATS with due skill and care. As an experienced stock broker and as an employer of KATS operator, it was the Respondent duty to ensure that its business was conducted with due skill and care.

12. The fact that the error has been repeated twenty six times goes on to show that the Respondent, an employer of KATS operator was responsible for his errors and omissions, as he failed to exercise due skill, care and diligence in the conduct of his business. The mistakes would not have occurred had the KATS operators been diligent and had entered a new code in KATS for every client. As an experienced stock broker and as an employer of KATS operator, it was the Respondent's duty to ensure that his business was conducted with due skill and care.
13. The Respondent provided two account opening forms and client transaction details of two clients whose orders had been placed mistakenly in the account codes 95 and 9/1 by the KATS operator. A statement was also submitted which provided details of the trading made by the clients on the days the 29 trades mentioned in the SCN were executed along with the highest and lowest prices of scrips in the aforesaid days.
14. Upon analysis of the aforesaid trade confirmations it was found that only sixteen out of the twenty six trades were substantiated by client confirmations. These sixteen

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trades were the orders of clients trading through account codes 9/2 and 9/28. These were erroneously entered into KATS by using account codes 95 and 9/1. Since orders for the same scrip and at the same price had already been placed in KATS through account codes 95 and 9/1, the orders got matched with each other and it appeared as if the trades had been made from the same account. Therefore, I do not hold the Respondent liable under Rules 8(a) and (b) for trades no. 1, 2, 3, 4, 5, 9, 10, 11, 12, 13, 18, 19, 20, 21, 23, and 28 executed by him on behalf of his clients in view of the documentary evidence provided by the Respondent which confirm that the said transactions did in fact result in a change in beneficial ownership. However the Respondent by allowing such transactions did not exercise necessary due skill, care and diligence in the conduct of his business, as enshrined in the Code of Conduct. The Respondent should have adequate checks and balance systems in place which prevent occurrence of such trades.

15. It is evident from the facts detailed above that the Respondent has failed to follow the requirement of Code of Conduct prescribed for the stock brokers by executing and permitting to execute trades which cancelled each other and did not result in transfer of beneficial ownership.
16. The Respondent's plea that the transactions highlighted in the SCN were insignificant in relation to the total volume of transactions undertaken on behalf of clients is not plausible 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 seller of the shares is the same person.

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Trade of client from account code 5/39

17. The Client trading through account number 5/39, on whose behalf two trades ie. trades no. number 15 and 25 regarding 500 shares of OGDC and 100 shares of POL were undertaken is a member of Islamabad stock exchange (ISE) and routes his client's business through the Respondent. The Respondent requested to allow him sufficient time to enable him to submit necessary back office record to prove that the said transactions were undertaken on behalf of different clients and the orders only matched because they were placed in KATS by using the same account code number. The documentary evidence provided by the Respondent was in form of a statement by the member ISE, specifying that each of the two trades was made by two different clients. Neither the Account Opening Forms, nor copies of National Identity Cards of the investors were provided to substantiate the defense. The said documentary evidence can not be accepted as it is insufficient and incomplete to prove the defense.

Trade through Account Code 9/42

18. The Respondent has accepted that one of the clients transacting through account code 9/42 mistakenly placed the order and subsequently placed a reversal order in order to cancel the previous order. If the client wanted to withdraw the order he should have cancelled it. The KATS operator by acting on the instruction of the investor has displayed his lack of knowledge; which leads me to believe that the Respondent does not have adequately trained staff and arrangements to render fair, prompt and efficient services to his clients. The Respondent is thus acting in breach of the Code.
19. By allowing his client to place simultaneous orders for purchase and sale of shares the Respondent is not acting with due skill, care and diligence in the conduct of his

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business. If the order had been placed by mistake, it ought to be cancelled by the KATS operators. The Respondent who is the employer of KATS operators has failed to act with due care, skill and diligence in the conduct of his business. The Respondent has also failed to maintain high standards of integrity, promptitude and fairness in the conduct of all his business and has indulged in dishonourable, disgraceful and improper conduct, acting in gross and blatant violation of the Code. Such trading activity also interferes with the fair and smooth functioning of the market by giving impression of shares being traded in the market, when in fact shares remain in possession of the same person.

20. It is reiterated that the Respondent, undertook on behalf of clients transaction number 6, 7, 8, 14, 15, 16, 17, 22, 24, 25, 26, 27 and 29 whereby both buy and sell orders were made by the same client and did not result in change in any beneficial ownership and which created a false and misleading appearance of active trading in the stock market and ultimately cancelled each other. The Respondent by allowing such trades has failed to perform his duty of exercising necessary due skill care and diligence as enshrined in the Code of Conduct. The Respondent should have had adequate check and balance systems which prevent such trades in future.
21. 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 only) which should be deposited with the Commission, not later than thirty (30) days from the date of this Order.
22. In addition to the aforesaid, I hereby direct the Respondent to abstain from buying and selling a scrip in such manner so as to create a false and misleading appearance

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of active trading in the scrip, which ultimately cancel out each other and does not result in change in the beneficial ownership of such scrip.

23. 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)

27th September, 2005