

Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH I

In the matter of

Appeal No. 16 of 2013

BMA Capital Management Limited
Appellant

.....

Versus

Director/HOD (SMD), Securities and Exchange Commission of Pakistan
.....Respondent

Date of hearing

30/05/14

ORDER

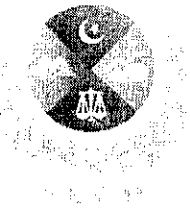
Present:-

For the Appellant:

1. Mr. Naveed Ul Haq, Advocate Supreme Court of Pakistan
2. Ms. Sidrah Jameel, Advocate Lower Court

For the Respondent:

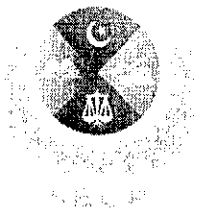
1. Mr. Amir Saleem, Deputy Director (SMD)
2. Ms. Tayyaba Nisar, Assistant Director (SMD)



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1. This order is in appeal No. 16 of 2013 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 against the order dated 19/02/13 (the "Order") passed by the Director (SMD).
2. Brief facts of the case are that the Appellant is registered with the Commission as Broker under the Brokers and Agents Registration Rules, 2001 (the "Rules"). As per the trading data of Karachi Stock Exchange ("KSE"), for 24/08/12, the Appellant purchased 578,000 shares of Bata Pakistan Limited ("BATA") in the Off Market at rate of Rs. 920 in its proprietary account from its client, namely National Bank of Pakistan ("NBP"). Subsequently, on 29/08/12 and 30/08/12, the Appellant sold a cumulative of 587,500 shares of BATA at the rate of Rs. 1,000 in the Off Market to its client, BAFIN (NEDERLAND) B.V. ("BAFIN"), an associated Company of BATA. It is pertinent to mention that the aforementioned transactions resulted in an approximate profit of Rs. 46 million to the Appellant.
3. The Commission sought clarification from the Appellant vide letter dated 03/09/12 regarding the abovementioned transactions which resulted in a significant gain to the Appellant. The Appellant was further advised to submit complete documentation exchanged between NBP, BAFIN and the Appellant for examination of the aforesaid transactions. The Appellant after being granted extension by the Commission submitted its reply vide letter dated 03/10/12, through which it informed the Commission that the share price of BATA was Rs. 789 on 17/08/12 and on the same day negotiations were initiated with NBP for purchase of shares of BATA at the rate of Rs. 920 which was at a premium of 16.6%. On 24/08/12 the Appellant purchased 578,000 shares of BATA at the rate of Rs. 920 from NBP. The Appellant further informed that BAFIN agreed to pay Rs. 1,000 per share of BATA. The Appellant provided copies of two emails exchanged with

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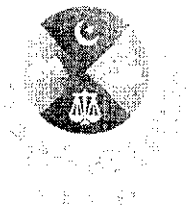


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NBP whereas it failed to provide copies of communication exchanged between BAFIN and the Appellant regarding the abovementioned transaction. The response of the Appellant was found unsatisfactory and was not supported by sufficient evidence.

4. Show Cause Notice dated 17/10/12, ("SCN") was issued to the Appellant under section 22 of the Securities and Exchange Ordinance, 1969 ("Ordinance") stating that the Appellant has *prima facie* contravened clauses A(1), A(2), A(5) and B(6) of the Code of Conduct set forth under the third schedule of the rules. The Appellant through SCN was asked to explain its position through written reply within 10 days of issuance of SCN and also appear in person or through an authorized representative before the Respondent at the Commission's head office, Islamabad, on 31/10/12 for hearing. On request of the Appellant the Respondent granted extension to the Appellant and shifted the hearing venue from Islamabad to Karachi. RIAA LAW advocates and corporate counselors submitted written reply to the SCN on behalf of the Appellant. The Appellant was also provided a hearing opportunity on 12/11/12. Having heard all the arguments made by the Appellant, the Respondent held that the Appellant was in violation of clauses A(1), A (2), A (5) and B (6) of the Code of Conduct set forth under the third schedule of the Rules. The Respondent exercising his powers under section 22 of the Ordinance imposed a penalty of Rs. 50,000,000/-(Rupees fifty million only). The Appellant was directed to ensure that full compliance be made of all rules, regulations and directives of the Commission in the future for avoiding any punitive action under the law;

5. The Appellant has preferred the instant appeal against the Impugned Order. The Appellant's counsel made the following arguments:



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- a) the Appellant is a corporate member of KSE, Pakistan Mercantile Exchange and is licensed by the SECP to carry out business of a Non-Banking Finance Company. The Appellant also holds SECP granted Asset Manager, Investment Advisor, Foreign Exchange and Fixed Income licenses. To-date the Appellant has conducted its business affairs not only in accordance with the laws and rules of Pakistan but has also maintained a stellar professional record, exhibiting excellence in all of its business affairs by upholding values of integrity and reliability in providing service to its clients;
- b) the counsel of the Appellant challenged the maintainability of the impugned order on various grounds, including its arbitrariness on the benchmark of the principles of natural justice. The counsel contended that in reaching its decision, the Respondent has failed to take into account the relevant facts and circumstances surrounding the Subject Proprietary Trades and has misunderstood the nature and role of the Appellant in the said transactions, both in fact and law. By doing so, the Respondent has arbitrarily and unfairly reached a decision against the Appellant in an inequitable manner, without appreciating the factual and legal position of the case. The true facts are that the Appellant executed the Subject Proprietary Trades from its proprietary trading account. Proprietary trades are permitted under the laws of Pakistan, as governed under the Regulations for Proprietary Trading, 2004 (“**Proprietary Regulations**”). Section 3 (h) of the Proprietary Regulations explicitly describe proprietary trading as:

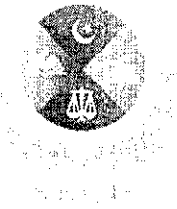
“trading conducted by a broker, agent or an associated person trading on his own account for direct gain instead of commission.”

- c) the counsel further contended that proprietary trading explicitly segregates the broker’s role of trading for or on behalf of a client/customer from that of the broker’s own

Appellant No. 1

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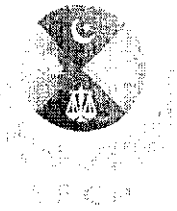


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personal trading account, which is operated at his own risk. The laws of Pakistan clearly permit and allow brokers to conduct trading for direct or personal gain, as prescribed under the Proprietary Regulations. The only restriction set under the Proprietary Regulations on brokers partaking in proprietary trades, for their own direct gain is given in Section 4 (ii) of the said regulations. The said Section restricts brokers from engaging in proprietary trades for securities that a customer has already placed an “at best” or “limit order” for, with the broker. An “at best” order is defined under the Regulations as *“an order to buy or sell a security as soon as possible at the best available market price”*. Whereas, a “limit order” is defined as an order *“to buy or sell a security at a customer specified price”*. Therefore, in Pakistan by law a broker is only restricted from engaging in proprietary trades for those securities for which a customer has already placed a firm order with the broker. Additionally, the broker is also restricted from engaging in proprietary trade in such securities for the time period the trade remains unexecuted. The counsel relied on paragraph two of Section 4 (ii) (a) of the Proprietary Regulations, which provides:

“if a broker, agent or an associated person who has his own “at best” order to buy or sell a security prior to an order from a customer, the same shall have priority over the “at best” order of a customer subject to disclosure of such order by the broker, agent or an associated person to his customer.”;

- d) the counsel submitted that a broker can legitimately and lawfully prioritize his own interest to buy or sell a security at his own risk, as permitted by the Proprietary Regulations, as long as a customer has not placed an order in the particular security with the broker. The counsel further stated that the latter text of the section, requiring disclosure by the broker is interpreted to mean that if a customer places an order in the



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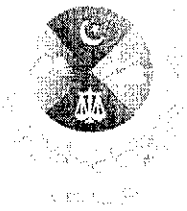
same security that a broker has placed an “at best” order in, then the broker must disclose to the customer its own interest in order to avoid any conflict of interest. This is in order to avoid misleading the customer that the broker may act in the customer’s best interest instead of his own to make a profit. Additionally, once the broker discloses his interest in a particular security, he automatically also clarifies to the customer his position as the principal in the particular trade, and not that of a broker, thereby eliminating any threat of misleading the customer or creating a potential conflict of interest;

- e) the counsel contended that in terms of Section 4 (ii) (a) of the Proprietary Regulations, the Appellant in a clear and explicit manner advised BAFIN of its at best order to purchase the BATA shares at a price of PKR 920 on its own proprietary account. In terms of Section 4(ii)(a) of the Proprietary Regulations, if a broker has on its own placed an at best order prior to an order from a customer, the same shall have priority over the at best order of that customer, the only requirement of the said Section being that such priority of the at best order is disclosed to the customer. The counsel pleaded that the Appellant under the said Section is fully entitled to prioritize its own at best order, provided the Appellant made the requisite disclosure to BAFIN. The said letter dated 03/10/12 demonstrates that the Appellant was fully within the four corners of the said Section 4(ii)(a). The question of any breach or violation in this regard does not even arise;
- f) the counsel contended that neither on the day of, nor on any day preceding the purchase date of August 24, 2012, when the Appellant purchased the 587,000 BATA shares from National Bank of Pakistan had BAFIN placed an order with the Appellant. The Appellant lawfully and legitimately, as per the second paragraph of Section 4 (ii) (a) of the Proprietary Regulations conducted the proprietary trade with National Bank of Pakistan for purchase of the said BATA shares. Moreover, when a broker engages in a proprietary

Appellant's Name

Appellant No. 10 of 2013

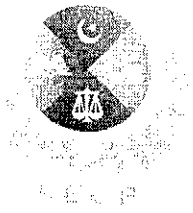
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trade with another party, it instantly becomes clear that he is acting in his capacity as principal and not as an agent;

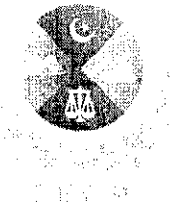
- g) the counsel of the Appellant further described the manner in which interested customers or clients place an order with brokers, for the purchase or sale of securities. The counsel submitted that any investor who is interested in a particular security first places an order with the broker, which is duly recorded and further verified for margins and cash requirements. Once the broker has determined that the order is within the required parameters, it is forwarded to the Exchange and queued in the respective security book, which is then confirmed by the said Exchange of having received the order. In the case at hand, there was no such order placed by BAFIN for the BATA shares. This fact has also been verified by the Commission vide e-mail correspondence with Mr. Tim Jude, Vice President of Finance, BATA Brands SA, Switzerland, dated November 30, 2013. In his e-mail, Mr. Tim Jude confirmed to the Commission that BAFIN had not placed any order of BATA shares with the Appellant and they had not entered into any agreement for the BATA shares from the Appellant up until around 27/08/12. The email dated 18/11/12 ("**email dated November 18, 2012**") substantiates the position that BAFIN had not entered into any agreement or placed any firm order with the Appellant for the purchase of shares until 27/08/12. In view of this evidence, it becomes explicitly clear that if BAFIN had been treated in an unfair manner by the Appellant and suffered a loss as a result, then it would clearly communicate the same to the Commission. On the contrary, upon inquiry by the Respondent, BAFIN clarified that it had not placed any order for the BATA shares with the Appellant. Therefore, in view of the fact that BAFIN itself does not believe it was treated in an unfair manner and thereby suffered a loss, the Respondent cannot allege that the Appellant violated and contravened the provisions of the BARR



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Code of Conduct. The Respondent has drawn a conclusion against the stance taken by BAFIN in the correspondence as reflected in the email dated 18/11/12;

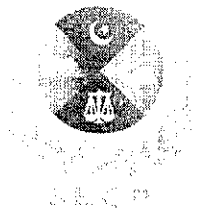
- h) the counsel of the Appellant reiterated that in the execution of the Subject Proprietary Trades, the Appellant purchased 587,000 BATA shares from National Bank of Pakistan at a premium of 16%, which the Respondent in the Impugned Order has already acknowledged was at a steep price. The market price of the BATA shares on the day of the trade was PKR 789 per share. The Appellant in purchasing the BATA shares from NBP took a significant risk on its own books. Therefore, it becomes imperative to emphasize that at the time the Appellant purchased the BATA shares from National Bank of Pakistan, BAFIN had not placed an order in connection with the purchase of such shares from the Appellant, and neither was there any confirmation that any future trade between the Appellant and BAFIN would be materialized. Therefore, the Appellant legitimately purchased the BATA shares from its proprietary account at for direct gain instead of commission under the Proprietary Regulations, as the Regulations permit brokers to prioritize their interest in securities, where no order exists or has been placed by a customer; .
- i) the counsel of the Appellant further pleaded that since BAFIN had not placed any order with the Appellant, and the Appellant had purchased the BATA shares at a steep premium, thereby taking a risk on its own books, it is the Appellant that would have suffered a substantial loss with no recourse to any remedy. Therefore, the Subject Proprietary Trades executed by the Appellant were not in fact a loss of profit suffered by either NBP or BAFIN. The Commission in the Impugned Order at paragraph 8 (vii) also states *"the Appellant approached NBP for purchase of four or five different scrips but NBP showed its interest for sale of shares of BATA only and bought these shares*



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from NBP at a steep premium.” Accordingly, it becomes clear that NBP did not suffer a loss in the sale of BATA shares to the Appellant, since the Appellant purchased the shares at a higher price than the prevailing market price per share on that day. The Appellant was one of the many different investors that were interested in the purchase of the BATA shares from NBP. Additionally, the proprietary trade between NBP and the Appellant was an off-market trade, which was executed on the NDM of KSE and prompt disclosure was made by the Appellant, as the trade was recorded in the NDM report published for viewing on the KSE website. Therefore, the Appellant was not in violation of the Code of Conduct under the BARR and did not take advantage of either NBP or BAFIN;


- j) the counsel of the Appellant contested the Respondent’s allegations in the Impugned Order, which described the Appellant’s trades as “*unusual and abnormal*” and held that the Appellant failed to “*safeguard the interest of its customers in order to make a profit in a very short span of time*”. The counsel refuted these allegations on the grounds that first, there was nothing unusual and abnormal about the trading patterns of the Appellant. This is because it is common practice for brokers to watch the market for months and trade in securities that may result in significant gains in the future. Additionally, there are no restrictions in Pakistan under the Proprietary Regulations that brokers cannot make a direct gain from trading instead of commission. Neither is there a restriction under the laws of Pakistan to purchase illiquid scrips, especially if there is no evidence of manipulation of the share price. The learned counsel of the Appellant submitted that the Respondent cannot unjustly accuse the Appellant of any wrongdoing or violation, which is based on groundless assumptions and where clear evidence exists that no order had been placed by BAFIN concerning the purchase of BATA shares. The Respondent took the view, that the Appellant as a Broker owes a duty of care to its clients and as such



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should have put aside its own economic interest, in order to accommodate the needs of its client. Further, the Respondent stated that the Appellant should have disclosed to both NBP and BAFIN whether it was acting as principal or as an agent. In response, the counsel of the Appellant submitted that the issue of principal or agent becomes irrelevant, when a broker deals with its own proprietary account. In the execution of the Subject Proprietary Trades, NBP or BAFIN were not the Appellant's customers, as neither NBP nor BAFIN had placed any orders for the trade of the BATA shares. Therefore, there was no broker-client relationship between the parties and the Appellant lawfully engaged in the Subject Proprietary Trades. The very nature of proprietary trade transactions is such that a firm or a broker trades for a direct gain at their own risk, instead of on behalf of a customer for commission. As previously stated, proprietary trading is permitted under the laws of Pakistan and in executing the Subject Proprietary Trades the Appellant took a substantial risk on its own books to trade the securities with both NBP and BAFIN. Further, at the time of executing the Subject Proprietary Trades BAFIN had not placed any such order, as prescribed under the Proprietary Regulations with the Appellant. It was contended that by law, the Appellant was not restricted to engage in proprietary trades but as a matter of fact was permitted to prioritize its own "at best" order over a customers;

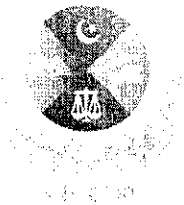
- k) the counsel further pleaded that the Respondent has wrongfully and unfairly relied on the contents of Appellant's first letter dated 03/10/12 in which, the Appellant had stated "*our instruction from BAFIN were to try to reduce the price of BATA shares we buy from National Bank to the best of our ability.*" The letter was a simple response to the query put forward by the Respondent inquiring about the said transactions. The Appellant had submitted its initial response with the view that it had conducted its business in a fair and transparent manner and within the parameters of the law.. The Respondent independently


Appellate Bench No. 1

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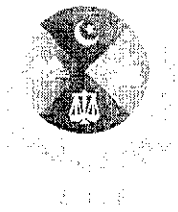
contacted Mr. Tim Jude, Vice President Finance of BATA Brands SA, Switzerland by email, dated November 30, 2012 inquiring about the purchase of the BATA shares to which, Mr. Tim Jude clarified that it was *“only around August 27, if I recall correctly, that a firm opportunity arose for BAFIN to acquire some shares.”* In view of this fact, the Appellant’s counsel pleaded the Respondent to place equal weightage to the correspondence evidence of the case. The counsel submitted that the Respondent should not use the contents of the first letter against the Appellant in an inequitable and arbitrary manner and, if so, should also give equal weightage on the clarification provided by Mr. Tim Jude from BAFIN;

- 1) the Respondent in the Impugned Order alleges, that the Appellant *“failed to fulfill its primary responsibility to execute the transactions at the best available market price in a transparent manner and the proprietary account evidently illustrates thatbought and sold the BATA shares with the mala-fide intention of making a personal gain, at the expense of its clients.”* The Appellant’s counsel reiterated its stance that Proprietary Regulations lawfully permit brokers to make direct gains or profits through their proprietary account. Additionally, there is no substantial evidence or proof indicating any form of mala-fide intent by the Appellant. The counsel submitted that the Respondent has based its allegations against the Appellant by assuming certain facts and has failed to substantiate them by not putting forward any evidence showing some form of mala-fide intent by the Appellant. Whereas, it is a matter of fact and an admitted position that neither BAFIN nor NBP have once claimed that they suffered any loss of profits. The Appellant has a proven stellar professional record. The Appellant has maintained a reputation of excellence and reliability amongst its clients, both locally and globally for over two decades;

Appellant's Counsel

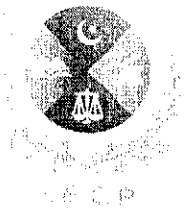
Respondent's Counsel

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- m) the learned counsel for the Appellant also challenged the maintainability and sustainability of the Impugned Order on the grounds that the Respondent assumed cognizance of the matter at its own surmises, presumptions and assumptions, which also contradicts the written representation of BAFIN. BAFIN has consistently maintained its stance stating, “*we did not enter into any agreement or placed any firm order with BMA for the purchase of BATA shares until 27 August 2012*”. The Counsel for the Appellant further contented that the Respondent cannot disregard the written communication of BAFIN as proof of evidence that no order had been placed by BAFIN with the Appellant for the purchase of BATA shares. This is because Article 102 of the Qanun-e-Shahdat Order, 1984, specifies that in all cases where terms of contracts have been reduced to writing or contained in a document, only the document itself can be submitted as proof or evidence. Therefore, the Respondent by law is obligated to give weightage to the e-mail correspondence of BAFIN and cannot presume anything contrary to the stance of BAFIN. Additionally, it is settled law that ‘*mutuality of obligations*’ comes into play after entering into a firm contract. In the present case, there is no firm order until 27 August, 2012 and the Respondent has no legal justification to presume anything contrary to the contents of a written document conveyed by BAFIN to the Appellant; and
- n) the learned counsel further submitted that the Respondent has wrongly assumed jurisdiction of the matter at hand. The Respondent unlawfully assumed authority in a legally valid proprietary trade executed by the Appellant, unilaterally treating it as client-broker relationship. The legal sequence is to first specify and establish the violation of law, only then may the competent authority impose the appropriate penalty. In the present case, the Respondent has invoked its authority in a reverse manner. The Respondent has first raised the penal clause under the applicable law, without establishing its violation by

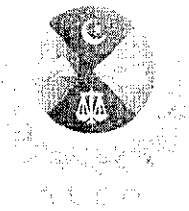


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the Appellant. The counsel contended that the Impugned Order is not sustainable in the eyes of law.

6. The department's representative argued that:

a) proprietary trading was not prohibited for the broker but the law has set certain parameters and restrictions, which a broker has to follow for trading in its proprietary account, in order to protect the interest of the clients. In the instant case, although the Appellant has conducted proprietary trades from its proprietary account, the pattern of trading by the Appellant is very unusual and abnormal. The transactions under question were very peculiar in nature since in a very short span of time huge profit was earned by the Appellant. The shares of BATA were bought from a local financial institution and sold to a foreign investor which was also an associated company of BATA. It is important to note that BAFIN was already accumulating the shares of BATA from KSE through Respondent. The perusal of record revealed that BAFIN has only one trading account which is maintained with the Appellant and was opened in the month of May 2011. Since the opening of its trading account BAFIN only traded in the scrip of BATA and before the above mentioned transactions BAFIN bought 562,366 shares through Ready Market and Off Market. Further, for purchase and sale of a scrip in the Of – Market, the concept of the “Limit Order” or “Best Order” is not relevant, as it is a negotiated deal between the buyer and the seller and both agree with the target price of the transaction. There is no option for price discovery in the Off – Market and the deal is agreed between the buyer and the seller. Therefore, the broker being the intermediary possessed informational advantage over its clients and executed the transaction through its proprietary account, rather than having it done directly

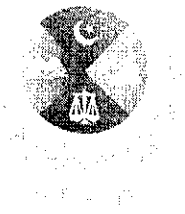


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between the buyer and the seller clients, which resulted in realization of profit of Rs. 46 million for the Appellant; and

b) there is a contradiction between the Appellant's first reply dated 03/10/12 and reply to SCN submitted to the Commission. In the first reply the Respondent mentioned that BAFIN had instructed it to negotiate with NBP on lower rates for purchase of BATA shares whereas in the reply to the SCN, legal counsel stated that the Appellant was acting as buyer and seller in the scrip and not negotiating on behalf of BAFIN. It is pertinent to note that Mr. Tim Jude through email dated 04/12/12 informed the Commission that BAFIN had been discussing the prospects of acquiring the shares of BATA with the Appellant for quite some time, whereas instead of providing communication between the Appellant and BAFIN at the time of execution of transactions, the Appellant provided a post transaction email dated 18/11/12 sent by Mr. Tim Jude to the CEO regarding the execution of above-mentioned transactions in the scrip of BATA. The contradiction in the statement of the Appellant shows that the Appellant was aware of the fact that BAFIN had a keen interest in buying the large quantity of shares of BATA, whereas the Appellant acted as buyer and seller in the whole deal instead of acting as intermediary between the parties which was the primary responsibility of the Appellant.

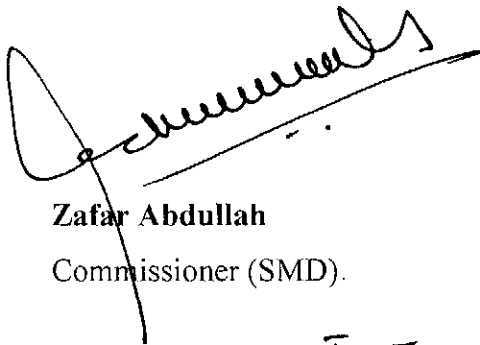
The Appellant Bench heard the matter at length. In our considered view, these were separate and independent trades undertaken at different dates, using the conventional mode and medium provided by the Karachi Stock Exchange. Firstly NBP sold the BATA shares to BMA, whereby the consequential settlement established that the ownership and risks and rewards attributable to the ownership were duly transferred to



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the buyer – BMA. Subsequently, after a time interval, the subject shares were sold by BMA, to BAFIN at a mutually agreed price. Moreover, during this time interval there was no firm buy order from BAFIN pending with BMA.

One more paramount and decisive factor to arrive at a decision is to establish that in the subject trades whether BMA was a broker between NBP and BAFIN or the proprietary buyer in the first leg and proprietary seller in the second leg. This could be established from finding the answer to a question that who was the owner of these shares between the time lag of the trades, i.e. from NBP to BMA and from BMA to BAFIN. Who owned these shares during this period and carried the risks and rewards associated with the ownership? After going through the entire process from execution of trades to their respective settlements, it can be established that the ownership during this period belong to BMA. Thus keeping in view the nature of trades and the legal position of the ownership of shares in consequence of such trades, this Bench set asides the Impugned Order, remitting the whole penalty and vacating the show cause issued.



Zafar Abdullah
Commissioner (SMD).



Tahir Mahmood
Chairman

Announced on: 7th July, 2014