



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

5

**BEFORE APPELLATE BENCH**

In the matter of

**Appeal No. 56 of 2011**

Adam Securities (Pvt.) Limited ..... Appellant

Versus

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

Date of hearing 04-07-11

**ORDER**

**Present:**

**For the Appellant:**

Mr. Haider Waheed, Advocate  
Mr. Basil Nabi Malik, Advocate  
Ms. Rubab Dhanji, Advocate  
Mr. M. Farhan Rafiq, C.E.O  
Mr. Adnan Abdul Majeed

**Respondent**

Mr. Imran Inayat Butt, Director

**Department representatives:**

Mr. Muhammad Ali, Deputy Director  
Mr. Kapeel Dev, Assistant Director



## SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

1. This order shall dispose of appeal No. 56 of 2011 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 (the "SECP Act") against the order dated 15-04-11 (the "Impugned Order") passed by the Respondent.
2. Adam Securities (Pvt.) Limited (the "Appellant") is a corporate member of Karachi Stock Exchange (Guarantee) Limited ("KSE") and Lahore Stock Exchange (Guarantee) Limited ("LSE") and is registered with the Commission under the Brokers and Agents Registration Rules, 2001 (the "Rules").
3. On perusal of the trading data of Karachi Automated Trading System ("KATS") of KSE and Unified Trading System ("UTS") of LSE from 02-05-10 to 30-08-10, it was observed that the Appellant repeatedly bought and sold shares in such a manner that orders for buy and sell matched each other and did not result in any change in the beneficial ownership of shares. The transactions, therefore, fell within the meaning and ambit of the term '*wash trades*'. Following is the summary of transactions:
  - i) in the month of May 2010, the Appellant bought and sold 820,423 shares at KSE and 968,183 shares at LSE. As a result of these transactions, the Appellant executed 530 '*wash trades*' in 33 different scrips through different proprietary codes at KSE and 339 '*wash trades*' in 36 different scrips at LSE;
  - ii) in the month of June 2010, the Appellant repeated the same activity by buying and selling 1,055,315 shares at KSE and 944,346 shares at LSE. As a result of these transactions, the Appellant executed 1,003 '*wash trades*' in 37 different scrips through



## SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

proprietary codes at KSE and 583 'wash trades' in 36 different scrips at LSE;

iii) in the month of July 2010, the Appellant bought and sold 372,053 shares at KSE and 376,695 shares at LSE. As a result of these transactions, the Appellant executed 576 'wash trades' in 44 different scrips through different proprietary codes at KSE and 814 'wash trades' in 35 different scrips at LSE;

iv) in the month of August 2010, the Appellant bought and sold 257,077 shares at KSE and 494,390 shares at LSE. As a result of these transactions, the Appellant executed 402 'wash trades' in 34 different scrips through different proprietary codes at KSE and 451 'wash trades' in 40 different scrips at LSE.

4. Show cause notice dated 28-09-10 ("SCN") was issued to the Appellant by the Respondent under section 22 of the Securities and Exchange Ordinance, 1969 (the "Ordinance") for contravention of the Code of Conduct prescribed in Third Schedule of the Rules read with rule 12 of the Rules and section 5A of the Ordinance. The Appellant submitted a reply to the SCN dated 27-10-10 and representative of the Appellant was also heard by the Respondent. The Respondent, dissatisfied with the response, passed the Impugned Order and imposed a penalty of Rs. 50,000 on the Appellant.
5. The Appellant has preferred the instant appeal against the Impugned Order. The Appellant's counsel argued that:
  - a) the SCN did not clearly mention contravention of any specific provision of law, instead it alleged the violation of the 'Code of Conduct', prescribed in the Third Schedule of the Rules. Section



## SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

22 of the Ordinance, referred to in the Impugned Order, prescribes penalties for violation of law and does not of itself specify any particular violation of the Ordinance;

- b) the Respondent imposed fine on the Appellant for allegedly engaging in manipulative, fraudulent and deceptive transactions i.e., 'wash trades', which fall within the purview of section 17 of the Ordinance and not the Code of Conduct;
- c) the securities laws prohibit 'wash trades' which create false impression of market activity. The intention to create false impression is a pre-requisite for establishing 'wash trades'. Since the action of the Appellant was not 'willful', therefore, it does not attract the penal provisions of section 22 of the Ordinance. Reliance was placed on case law cited at 1990 PLC 373, 2002 CLC 1925 and 1984 CLC 2456;
- d) the trading details of the alleged transactions, relied upon by the Respondent in the Impugned Order, is incomplete and misleading. Number of transactions have been repeated and duplicated which in turn inflated the number and volume of trades. The alleged trades can not be termed as 'wash trades' but may better be described as lawful 'match trades'. Moreover, the volume of the alleged trades is so insignificant that the Appellant would gain no benefits whatsoever from indulging in the said transactions;
- e) the Appellant does arbitrage business by buying securities in one market and selling the same in another by virtue of allotment of terminals, sanctioned by KSE and LSE boards. The arbitrage business is conducted through various proprietary accounts and



## SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

the Appellant has many trading terminals through which it conducts trading. While trading at two different terminals, same price may be quoted for sale and purchase of securities, resulting in matching of quotes with each other, thus, giving the impression of 'wash trades'.

6. The Respondent argued that:
- a) SCN has been issued under section 22 of the Ordinance for contravention of the Code of Conduct, prescribed in Third Schedule of the Rules read with rule 12 of the Rules. The 'Code of Conduct' is part and parcel of the said Rules, therefore, penalty may be imposed under section 22(1) (c) of the Ordinance for contravention of the Rules. Moreover, the SCN specifically cited the relevant law and contravention thereof;
  - b) the contravention was that of the 'Code of Conduct' as prescribed in the Third Schedule of the Rules and the SCN specifically stated that the Appellant failed to maintain high standard of integrity and did not exercise due care, skill and diligence in conduct of its business. The Appellant was not show caused under section 17 of the Ordinance and no allegation of manipulative, fraudulent and deceptive transactions was made against it;
  - c) it is the act and the circumstances surrounding such act, which point towards the intention of a person committing an offence. Facts show that all the transactions were entered deliberately and intentionally and the Appellant was well aware of the eventual results of its actions, therefore, the acts were willful;



## SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

- d) the transactions which were duplicated, as quoted by the Appellant's counsel, were only a printing mistake which had no impact on the total number of 'wash trades', hence, the argument that the transactions are misleading and incomplete is denied in totality. Moreover, the contention of the Appellant that volume of the alleged trades is so insignificant and minor that the Appellant would not gain or benefit does not hold true. The Appellant violated the 'Code of Conduct', prescribed in the Third Schedule, irrespective of the magnitude of transactions;
- e) the arbitrage trading is buying the securities in one market and simultaneously selling the same securities in another market, as such, buy orders placed in one market can not match sell orders placed at another market. The Appellant in this case, however, placed buy and sell orders in the same market which matched each other and did not result in any change in beneficial ownership of the shares. Buy orders that match sell orders in the same market, cannot fall within the ambit of arbitrage trading. In fact, certain instances were taken at random and were analyzed in depth. It was observed that the Appellant had placed buy and sell orders at the same exchange, which is not arbitrage trading and the contention of the Appellant that these transactions were result of arbitrage business is baseless;

7. We have heard the parties. Rule 12 of the Rules, extract of Code of Conduct from Third Schedule and section 22(1)(c) of the Ordinance have been reproduced for ease of reference:



## SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

### ***Rule 12. Broker to abide by the Code of Conduct;***

*A broker holding a certificate of registration under these rules shall abide by the code of conduct specified in the Third schedule.*

Emphasis added

### ***THE THIRD SCHEDULE [See rules 8 (iv) and 12]***

#### ***CODE OF CONDUCT***

##### ***A. General***

- 1. Integrity.- A broker shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business.***
- 2. Exercise of due skill and care.- A broker shall act with due skill, care and diligence in the conduct of all his business.***
- 3. Manipulation.- A broker shall not indulge in manipulative, fraudulent or deceptive transactions or schemes or spread rumors with a view to distorting market equilibrium or making personal gains.***
- 4. Malpractices. - A broker shall not create false market either singly or in concert with others or indulge in any act detrimental to the investors' interest or which leads to interference with the fair and smooth functioning of the market. A broker shall not involve himself in excessive speculative business in the market beyond reasonable levels not commensurate with his financial soundness.***



## SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

5. *Compliance with statutory requirements. - A broker shall abide by all the provisions of the Act and the rules, regulations issued by the Commission and the stock exchange from time to time as may be applicable to him.*

Emphasis added

### **22. Penalty for certain refusal or failure;- (1) If any person-**

(a)....

(b)....

(c) *contravenes or otherwise fails to comply with the provision of this Ordinance or any other rules or regulations made thereunder;*

*The Commission may if it is satisfied after giving the person an opportunity of being heard that the refusal, failure or contravention was willful, by order direct that such person shall pay to the Commission by way of penalty such sum not exceeding fifty million rupees as may be specified in the order and, in case of continuing default, a further sum calculated at the rate of two thousand rupees for every day after the issue of such order during which the refusal, failure or contravention continues.*

Emphasis added





## SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

- (a) and (b) SCN was issued under the 'Code of Conduct', prescribed in the Third Schedule of the Rules read with rule 12 of the Rules. Section 22 of the Ordinance was referred to in the SCN as it provided penalty for contravention of the aforementioned provisions. The Appellant has not denied the transactions mentioned in para 3 (i), (ii), (iii) and (iv). The Appellant was alleged to have indulged in 'wash trades' by creating a false market and interfering with fair and smooth functioning of the market in violation of the Code of Conduct and the Rules. We do not concur with the Appellant's counsel contention that in case of 'wash trades', action can only be taken under section 17 of the Ordinance. Section 17 of the Ordinance would only be applicable if the creation of false trading and misleading appearance of active trading in any security is meant to operate as a fraud, deceit or manipulation. In the instant case no such charge has been leveled, thus, the Respondent rightly mentioned the relevant provisions of law in the SCN;
- c) on the issue of whether the act was willful, we have perused the case law. In one of the cases referred by the Appellant's counsel i.e., *1984 CLC 2456*, the definition of 'willful' has been reproduced from Black Law Dictionary as an act done with stubborn purpose, but not with malice, as done intentionally, knowingly and purposely as distinct from an act done carelessly, thoughtlessly, heedlessly or inadvertently. It is in fact the act, and the circumstances surrounding such act which point towards the intention of a person committing an offence. In the instant case, the transactions mentioned in para 3 (i), (ii), (iii) and (iv) above had the effect of 'wash trades'. The trades cannot be bracketed as being done carelessly, thoughtlessly, heedlessly or inadvertently, as the volume of trades was substantial



## SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

and was a continuing feature in four months from May 2010 to August 2010. The act, as such, was deliberate and was done with stubborn purpose;

- d) the duplicated figures are not accounted in the 'wash trades' alleged in para 3 (i), (ii), (iii) and (iv) above, as such the plea of the Appellant's counsel is without merit. The Appellant has not been alleged to have benefitted by indulging in the said transactions, however, the Appellant has certainly breached the Code of Conduct by indulging in practices which had the effect of interfering with fair and smooth functioning of the market;
- e) it is observed that the Appellant has placed buy and sell orders at the same exchange. The execution of 'wash trades' even due to arbitrage business is not acceptable as it is still the violation of the regulatory framework. There is no justification for the Appellant to carry out 'wash trades' on the pretext of arbitrage business. We are of the considered view that unfair trade practices like 'wash trades' are harmful for the development of market. The execution of abovementioned trades shows that the Appellant has failed to maintain high standard of integrity and has failed to exercise due care, skill and diligence in conduct of its business.

The Commission is bound to protect the interest of investors and in doing so it has been empowered to deal with elements which effect smooth and fair functioning of the stock exchanges. The Appellant, by creating false transactions induced other investors into buying the shares and have indirectly caused loss to many other investors. The Respondent could have suspended the license of the Appellant as a broker; however, it was



## SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

the first time such non-compliance was observed against the Appellant and the Respondent taking a lenient view rightly imposed a penalty of Rs. 50,000/- (Rupees Fifty Thousand only).

In view of the above, we see no reason to interfere with the Impugned Order. The Appellant is directed to ensure compliance of all the rules, regulations and directives of the Commission in future for avoiding any serious punitive action under the law. The appeal is dismissed with no order as to cost.

**(MUHAMMAD ALI)**  
Chairman

**(TAHIR MEHMOOD)**  
Commissioner (CLD)

Announced on: 12<sup>th</sup> August, 2011