



Before The Director (Securities Market Division)

In the matter of Show Cause Notice issued to

Highlink Capital (Pvt.) Limited

Date of Hearing:

June 30, 2010

Present at the Hearing:

Representing Highlink Capital (Pvt.) Limited

Mr. Mahmood A. Awan

Legal Counsel

Assisting the Director (SMD)

Mr. Muhammad Ali

Deputy Director (SMD)

ORDER

1. This order shall dispose of the proceedings initiated through Show Cause Notice (the "SCN") bearing No.1 (03) /Wash/LSE /MSW/SMD/ 09 dated May 28, 2010, under Section 22 of Securities and Exchange Ordinance, 1969 (the "Ordinance") and the Brokers and Agents Registration Rules, 2001 (the "Brokers Rules") issued to Highlink Capital (Pvt.) Limited (the "Respondent") by the Securities and Exchange Commission of Pakistan (the "Commission"). The Respondent is a Corporate Member of the Lahore Stock Exchange (Guarantee) Limited ("LSE") and registered with the Commission under the Brokers Rules.



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2. After examination of Karachi Automated Trading System ("KATS") data for the month of March 2010, it has been observed that Respondent executed 160 trades in 39 different scrips through different client codes. The Respondent bought and sold shares through three different brokers of Karachi Stock Exchange (G) Limited ("KSE") in such a way that orders for buy and sell matched with each other to the tune of 1,498,535 shares and did not result in any change in beneficial ownership of the shares.
3. Further in the month of April 2010, the Respondent executed 142 trades in 34 different scrips through different client codes. The Respondent bought and sold shares through three different brokers of KSE in such a way that orders for buy and sell matched with each other to the tune of 1,110,713 shares and did not result in any change in beneficial ownership of the shares.
4. These transactions fell within the scope and meaning of the term known as "wash trades". Therefore, the Commission vide its letter dated April 15, 2010 requested the Respondent to provide an explanation and documentary evidence to clarify its position regarding the execution of trades from March 01, 2010 to April 15, 2010. The Respondent vide its letter dated April 16, 2010 informed the Commission that it has maintained trading accounts with three different brokers of KSE for the execution of its client's orders. The Respondent further informed that it has used online terminals and in case of connectivity problem of internet it had placed clients order directly to the KSE brokers wherein the account numbers of clients were not entered and trades were highlighted as proprietary trades. The aforementioned reply and evidence submitted by the Respondent was not considered satisfactory by this office and warranted the initiation of formal proceedings.



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5. Accordingly, the SCN was issued to the Respondent with a direction to submit a written reply and appear on June 10, 2010 for a hearing. However, Legal Counsel of the Respondent vide letter dated June 07, 2010 requested to adjourn the hearing. The request was acceded to and the hearing was adjourned till June 16, 2010. The Legal Counsel vide its letter dated June 14, 2010 submitted record containing more than 2,000 pages and also requested further time for submission of formal / comprehensive written reply. The Commission through its letter dated June 17, 2010 fixed the next date of hearing on June 23, 2010. On the further request of the Legal Counsel of the Respondent the final date of hearing was fixed on June 29, 2010. Subsequently, the hearing was held June 29, 2010 which was attended by the Legal Counsel on the behalf of the Respondent and written reply to the SCN was also submitted, the key points of which are summarized as follows:

(i) The SCN is issued on presumption that the Respondent bought and sold shares in its proprietary accounts. The documentary evidence filed with the preliminary reply to the SCN would show, the said presumption is based on incomplete data and, therefore, the conclusion to the effect that the matching of the buy and sell orders did not result in any change in beneficial ownership. The buy and sell orders were entered by the agent of the Respondent and all the transactions in question were executed independently on behalf of the Respondent's clients.

(ii) It is further asserted that several buy and sell orders were matched quantities and they were in fact client to client transactions which were routed through KATS in the interest of the transparency. The presumption that buy and sell orders in 39 scrips were executed for the benefit of the Respondent is not true as these orders were executed on behalf of the clients of the



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Respondent. The Respondent exercised due diligence and care in ensuring that none of the clients were conducting wash trades.

(iii) The volumes in various listed scrips, except for the heavily traded equities including predominantly small banks, are so low that wash trades in the said scrips could not in any way possible lead to manipulation of the market and in case of heavily traded equities, the volumes were a fraction of the turnover for the day and could, therefore, not be treated as capable of influencing the market. The Legal Council referred to the reply dated June 14, 2010 wherein detail record was provided, that clearly shows that the buy and sell orders were executed for and behalf of different clients of the Respondent and none of the listed trades constituted wash trades.

(iv) The documentary evidence available on the record clearly shows that if the factum of buy and sell orders for certain scrips originating from the accounts of different parties were seen as being executed for and on behalf of the Respondent, it was not on account of any failure or lack of care or skill on part of the Respondent but on account of non-entry of the Respondent's client accounts by the executing member of the KSE. This error was rectified when the Respondent took remedial steps after receipt of the letter of the Commission dated April 15, 2010. Therefore, the Respondent contents that no contravention of Code of Conduct or the Brokers Rules and imposition of penalty is not called for.

6. The Legal Counsel at the time of hearing reiterated the stance of the Respondent as stated in the written reply to the SCN. The argument of the Legal Counsel was anchored around the assertion that the Respondent had not executed any wash trades and all the trades were executed on behalf of Respondent's clients. During the course



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of hearing the Legal Counsel referred to definition of wash sale as described in the Black's Law Dictionary wherein the key ingredient of wash sale is '*made to create the false appearance of market activity*'. The Legal Counsel also made a reference to the Report of Taskforce on March 2005 crises of the Pakistan Stock Market wherein 'wash trade' has been defined. Lastly, reference was made to the Committee of European Securities Regulations wherein the common ingredient of wash trade is no change of beneficial ownership. The Legal Counsel argued that the case of the Respondent did not fall within the meaning and definition of wash trade as the record provided to the Commission evident that the beneficial ownership of the scrips traded were changed.

7. The Legal Counsel prayed that keeping in view the aforementioned arguments the Commission may take a lenient view in this matter because the transactions in question were not willful and the transparency of the market was not affected.
8. I have perused the record, the written reply filed by the Respondent and heard the arguments raised by the Legal Counsel during the hearing. Accordingly, my findings on the issues enshrined in the SCN and the response thereto is as follows:

(i) The record provided by the Respondent shows that shares were bought and sold in the proprietary accounts and later on buy and sell position were assigned to the different clients of the Respondent. Accordingly, it may be argued that since the Respondent has placed the buy and sell orders in its proprietary accounts on its client's behalf, such trades would not, per se, fall within the ambit of the term 'wash sale'. However, in this regard, it is noted that the Respondent has asserted that the erroneous trading / buy and sell orders were entered by the agents of the Respondent and all the transactions in question were executed independently on behalf of the



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Respondent's clients. The argument that its agent entered the buy and sell orders does not absolve the Respondent from culpability considering the provisions of Rule 17 (2) of the Brokers Rules are clear in this regard. For convenience the said sub-Rule is reproduced as follows:

17. *Agent not to deal with clients in his name.-(1).....*

(2) Notwithstanding anything in sub-rule (1), a member or broker shall be liable for the acts and dealings of his agent. (emphasis added)

The accentuated language of the sub-rule above is flawless reflection of the principle mentioned below that is deeply entrenched in Law of Contract concerning the relationship of agent and principal:

***Qui per alium facit per seipsum facere videtur:** (He who does an act through another is deemed in law to do it himself).*

(ii) In order to have fair, efficient and transparent market it is critical that every trade executed at stock exchange should be tracked to recognize true identity of the beneficial owner and it may not be possible if the Respondent keeps on executing the client's trades in its proprietary accounts. There is no doubt that the trades in question have been executed in a manner that was in contravention of the Code of Conduct with particular reference to standard of fairness and exercising due skill and care.

(iii) The Respondent's assertion that the transaction executed in different scrips could not lead to manipulation of the market does not justify the execution of such large number of erroneous trades. The Respondent has adopted a practice which has potential risk to the Respondent itself, its




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clients and consequently the whole market. The Respondent has in fact act indulged in improper and undesirable conduct on the stock exchange that is violation of the Code of Conduct as stated in the SCN.

(iv) The Legal Counsel assertion that the transactions executed by the Respondent do not fall within the ambit of willful default in terms of Section 22 of the Ordinance is not correct. In this connection it may be noted that the word 'willful default' has been defined in the Oxford Dictionary of Law, Fifth Edition as '*The failure of a person to do what he should do, either intentionally or through recklessness*'. This forum has already established the fact that one of the reason why the Respondent is in violation of the Code of Conduct is that it did not exercise due skill and care, in other words, the attitude of the Respondent concerning the trades in question was reckless, hence 'willful'.

9. The Respondent's assertion that the appearance of no change in beneficial ownership of scrips was on account of non-entry of Respondent's client accounts by the executing member of the KSE is not true. It is noted that the Respondent has not complied with the Circular dated July 01, 2008 issued by National Clearing Company of Pakistan ("NCCPL") and LSE Notice No 607 dated July 14, 2008 wherein it was made mandatory for all the Members of LSE to register Unique Identification Number ("UIN") of their clients in the National Clearing and Settlement System ("NCSS") before July 20, 2008 for execution of Inter-Exchange Trades. It is part and parcel of exercising due care and diligence by the Respondent to ensure that the broker enters the client's codes.
10. Considering the facts and thoroughly evaluating the evidence/information available on record and after perusal of assertions made by the Representative of the

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Respondent, it is established that the Respondent has placed the buy and sell orders in its proprietary accounts on its client's behalf. Allowing the Respondent to deal on behalf of different clients through proprietary accounts implies that there would be no audit trail of the trades and any dispute between the clients and the Respondent would be difficult to resolve. It is necessary to place orders of the clients through inter-exchange trades to keep track of the audit trail of the client trades.

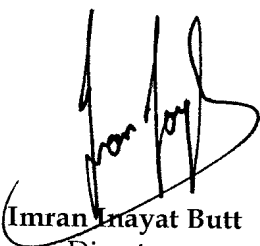
11. The execution of abovementioned trades shows that the Respondent has failed to maintain high standards of fairness in conduct of its business. This practice of the Respondent to use proprietary accounts for its different clients trading compromises transparency and completely defies the purpose of the client code introduced in order to record true identity of the person buying and selling the shares. The Respondent did not comply with the statutory requirements of the Code of Conduct as enshrined in the Brokers Rules. Therefore, the Respondent acted in violation of Rule 8 (iv) and Rule 12 of the Brokers Rules.
12. I am of the considered view that unfair trade practices are harmful for the development of the market and damage market integrity. It was the duty of the Respondent to put in place proper systems and controls at its Brokerage House to ensure compliance with applicable rules and regulations at all times. The violation of the Rules and Regulations is a serious matter which entitles the Commission to even suspend the Respondent's membership but I have elected not to exercise this power at present.
13. In view of the above, it is established that the Respondent has not complied with the Code of Conduct prescribed by the Commission in violation of Rule 8 and Rule 12 of the Brokers Rules. Accordingly, in exercise of the powers under Section 22 of the



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Ordinance, I hereby impose on the Respondent a penalty of Rs. 100,000 (Rupees One Hundred Thousand Only). Additionally, I strongly advise the Respondent to take immediate measures and put in place proper checks and procedures to eliminate the occurrence of such instances in future. I also direct the Respondent to ensure that full compliance be made of all rules, regulations and directives of the Commission in the future for avoiding any serious punitive action under the law.

14. The matter is disposed of in the above manner and the Respondent is directed to deposit the fine in the account of the Commission being maintained in the designated branches of MCB Bank Limited not later than thirty (30) days from the date of this Order and furnish the copy of the deposit challan to the undersigned.
15. The order is issued without prejudice to any other action that the Commission may initiate against the Respondent in accordance with law on matters subsequently investigated or otherwise brought to the knowledge of the Commission.



Imran Inayat Butt
Director

Securities Market Division

Announced on September 17, 2010
Islamabad.