Before The Director (Securities Market Division)

In the matter of Show Cause Notice issued to

M.R.A Securities (Pvt.) Limited

Date of Hearing: November 05, 2010

Present at the Hearing:

Representing M.R.A Securities (Pvt.) Limited

i)	*Mr. Muhammad Farhan*	*Chief Executive Officer*
ii)	*Mr. Haider Waheed*	*Legal Counsel*

Assisting the Director (SMD)

i)	*Mr. Adnan Ahmed*	*Deputy Director*
ii)	*Mr. Kapeel Dev*	*Assistant Director*

ORDER

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1. This order shall dispose of the proceedings initiated through Show Cause Notice **(the "SCN")** bearing No. Wash/SMD-South/MSW/INV/121 dated September 28, 2010, under Section 22 of the Securities and Exchange Ordinance, 1969 **(the "Ordinance")** and the Brokers and Agents Registration Rules, 2001 **(the "Brokers Rules")** issued to M.R.A Securities (Pvt.) Limited **(the "Respondent")** by the Securities and Exchange Commission of Pakistan **(the "Commission")**. The Respondent is a Corporate Member of the Karachi Stock Exchange (Guarantee) Limited **("KSE")** and Lahore Stock Exchange (Guarantee) Limited **("LSE")** and registered with the Commission under the Brokers Rules.

2. The brief facts leading up to this order are that after examination of trading data of Karachi Automated Trading System **("KATS")** of KSE and Unified Trading System **("UTS")** of LSE for the period from May 02, 2010 to August 30, 2010, it was noted that the Respondent

repeatedly bought and sold shares in such a manner that orders for buy and sell matched with each other and did not result in any change in ownership of the shares. Thus, the transactions fall within the meaning and ambit of the term '**Wash Trades**'. A summary of the said transactions is noted in chronology, as follows:

i. In the month of May 2010 the Respondent bought and sold 2,017,027 shares at KSE and 1,179,330 shares at LSE. As a result of aforementioned trades, the Respondent executed 1,720 Wash Trades in 38 different scrips through different proprietary codes at KSE and 517 Wash Trades in 34 different scrips at LSE.

ii. In the month of June 2010 the Respondent repeated the same activity by buying and selling 2,653,882 shares at KSE and 682,099 shares at LSE. As a result of these transactions the Respondent executed 913 Wash Trades in 27 different scrips through proprietary codes at KSE and 175 Wash Trades in 24 different scrips at LSE.

iii. In the month of July 2010 the Respondent bought and sold 1,390,912 shares at KSE and 808,312 shares at LSE. As a result of these transactions the Respondent executed 869 Wash Trades in 35 different scrips through different proprietary codes at KSE and 247 Wash Trades in 22 different scrips at LSE.

iv. In the month of August 2010 the Respondent bought and sold 2,765,035 shares at KSE and 740,539 shares at LSE. As a result of these transactions the Respondent executed 1,286 Wash Trades in 35 different scrips through different proprietary codes at KSE and 298 Wash Trades in 27 different scrips at LSE.

3. As mentioned earlier these transactions fall within the scope and meaning of Wash Trades, therefore, the Commission vide its letter dated August 09, 2010 requested the Respondent to provide the comments and documentary evidence to clarify its position regarding the execution of Wash Trades in its proprietary accounts. The Respondent vide its letter dated August 16, 2010 made certain submissions, important and pertinent portion of which is reproduced as under:

> *"It has the membership of both the exchanges i.e. KSE and LSE therefore; operators are arbitrating the trades between the LSE and KSE".*
>
> *"The couple of operators are sitting together in the market such as one operator executing trade orders in KSE and other executing trade orders in LSE simultaneously same security with equal quantity, therefore did not appear any*

change in beneficial ownership of the shares. Also please note that these operators are sitting at our different offices, who they are using the same proprietary account".

"Operators are unable to see the number of these undisclosed transactions. They have issued separate account numbers to a couple of LSE and KSE operators to control and monitor operation activities during the month".

4. The aforementioned reply of the Respondent was examined by this office and was not considered satisfactory as same did not contain any evidence or reasonable justification for execution of Wash Trades in its proprietary accounts. Accordingly, the SCN dated September 28, 2010 was issued to the Respondent with a direction to submit a written reply within seven days of issuance of the SCN and appear on October 13, 2010 for a hearing. However, on the request of the Respondent the date of hearing was fixed on October 25, 2010. The written reply to the SCN was submitted by the Respondent through Mr. Haider Waheed, Advocate, (the "Legal Counsel") on October 27, 2010 the key points of which are summarized as follows:

5. The Legal Counsel, in the written reply raised the following preliminary objections against the SCN the summary of which is as follows:-

(i) The SCN does not elucidate upon or clearly state a contravention of any provision of law on the basis of which the said notice could have been sent to Respondent. The Commission is bound by law to make apparent its charges in the SCN issued to the Respondent and pinpoint any violation of law on the basis of which Section 22 of the Ordinance had been invoked. The SCN only cited the violation of the 'Code of Conduct' prescribed in the Third Schedule of the Brokers Rules, lacking any specific violation of the law or the provision. Therefore, SCN can not be sent under Section 22 of the Ordinance, considering that the same is simply a provision, which prescribes penalties for violation of law.

(ii) The said SCN is against the provision of the Constitution of the Islamic Republic of Pakistan, 1973, and more specifically against the Article 4 and 25 of the Constitution. The Commission erred in so much as it failed to disclose the grounds upon which the proceeding were to be undertaken and the allegedly violated the provisions of law, which necessitated such a SCN against the Respondent. Furthermore, the said SCN is clear violation of deprive the Respondent of a fair opportunity to defend itself generally and against any changes brought to its knowledge thereafter and/or at a belated stage.

6. Following is a summary of paragraph wise comments to the SCN provided by the Legal Counsel:-

(i) *The contents of the paragraph 2 of SCN are denied in totality as substantiated and false. The Black's Law Dictionary, Eighth Edition, characterize such an activity as 'a sale of securities made at about the same time as a purchase of the same securities, resulting in no change in beneficial ownership', but at the same time emphasize that securities laws prohibit a 'wash sale made to create the false appearance of the market activity'. This in fact depicts and establishes that "Intention" to create such a false impression is pre-requisite for establishing a wash trade and prescribing penalty hereunder. The Legal Counsel referred to the Report of Taskforce on March 2005 crises of the Pakistan Stock Market wherein 'wash trades' defined as "illegal stock trading whereby an investor simultaneously buys and sells shares in company through two different brokers". He further emphasis that there has been no willful violation of the Respondent because word willful implies "knowledge or intention" and is an act or omission intended to achieve a certain result. In this regard, the Legal Counsel giving the reference of certain case laws regarding the word "willful".*

(ii) *The Respondent has executed all the alleged wash trades in liquid securities, which are traded on daily basis, where the possibility of market manipulation with minor quantum is relatively non-existent. Further, wash trades normally takes place in the dead shares in which trade of significantly minimal volume is undertaken.*

(iii) *Trading details of alleged transaction provided by the SECP is incomplete and misleading; however, numbers of transactions have been repeated/duplicated on the several pages of the list, which in turn inflated the number and volume of instances. In trading details provided by the SECP, every purchase or sell by the one trader of the Respondent have equal purchase and sell of the other trader of the same Respondent, which was not the case. Whereby in numerous instances orders placed by the traders of the Respondent were not completely matched with each other. Therefore, the pre-requisites have not been fulfilled, the alleged impugned activities can not be termed as the Wash Trades as defined and understood in law as well the markets and may better be described as lawful 'matched trades'.*

(iv) *It should be noted that the total volume of trades by the Respondent during the month of May 2010 at KSE was 128,728,729 shares, LSE was 41,362,008 shares and alleged wash trades were only 2,017,027 shares and 1,179,330 shares respectively, which is only 1.56% of total trading at KSE and 2.85% of total trading at LSE by the Respondent. In*

the same manner during the month of June 2010 total trading at KSE was 112,328,644 shares, whereas alleged wash trades were 2,653,882 shares i.e. 2.36% of total trading, while at LSE 3,1050,323 shares, whereas alleged wash trades were 682,099 which is 2.19% of total trading by the Respondent at LSE. In the month of July 2010 alleged wash trades at KSE were 1,390,912 shares i.e. 1.30% of total trading of 106,583,273 shares, whereas at LSE alleged wash trades were 808,312 shares i.e. 4.03% of total trading of 20,060,369 shares. During the month of August alleged wash trades at KSE were 2,763,035 shares which is only 2.53% of total trading of 109,058,808 shares whereas, alleged wash trades at LSE were 740,539 i.e.3.46% of total trading of 21,377,402 shares.

(v) *The figure of alleged trades is so insignificant and minor that the Respondent would gain no benefits whatsoever from indulging in the same. Furthermore, it would have been illogical and counter-productive for the Respondent to undertake in the same on such a miniscule scale thereby exposing themselves to liability whilst at the same time leaving no possibility for the accrual of any benefit to themselves Therefore, manipulation or influencing the market is not possible and even the Respondent can not derive any benefit form such alleged wash trades on this miniscule scale.*

(vi) *The Respondent has over 60 trading work stations in both the KSE and LSE and the regulation 6.6 of UTS, which states that all the trading on the exchange shall be anonymous, and a similar requirement in the KSE, clearly requires and in fact deprives the Respondent from being humanly able to avoid lawful yet undesired trades. The Respondent has written a letter to the KSE explaining how the introduction of multiple client codes under the same UIN not only encourages wash trades but also inflicts damage upon the arbitrage business by way of giving a false impression of wash trades in the same. KSE vide its reply dated 06.10.2010 explicitly recognizing the arbitrage business as legitimate and stated that the same had been done "to facilitate broker member to map or link their existing multiple client codes maintained in their back office system as a single client for the various purpose including the arbitrage business. Furthermore, the same issue was raised in the meeting of Development, Technology and Trading Affairs of the KSE management, whereby, no immediate remedy was suggested by the Committee regarding the issue of said match trades.*

(vii) *The characterization of wash trades as envisioned by the SCN would render the KATS Regulation as well as the UTS Regulation null an void considering that the same have created a structure of trading wherein such unintentional activates are invariably part*

and parcel of the system envisioned by the exchanges, so much so that the violation of the law is made inevitable.

(viii) *In order to avoid inequitable situation which would result injustice to a party and/or redundancy of rules and regulations, the legal maxim 'Ad Ea Quae Frequentius Accidunt Jura Adaptantur', that is, the laws are adapted to those cases which more frequently occur, is often cited. As per above cited maxim, laws are customarily made for certain frequently occurring activities rather than such as are of rare or accidently occurrence. In pursuance of the well settled legal maxim stated above the only manner in which injustice may be avoided and the sanctity of law maintained, is by making a clear distinction between 'wash trade' and a 'match trade'. In the case of wash trade the intention of defraud or deceive for the purpose of taking benefit is explicitly required whereas in regard of matched trade the same is an inevitable and unintentional buying and selling of the same security by the same member via different terminals due to anonymous mode of trading established by the respective exchanges.*

7. The Respondent through the Legal Counsel prayed to dismiss the charges levied in the SCN and afford costs to the Respondent because the sub section (c) of Section 22 of the Ordinance is not attracted in the case as no violation of the law has been show-caused by the Commission nor has taken place.

8. On the further request of the Legal Counsel the final date of hearing was fixed on November 05, 2010. Subsequently, the hearing was held on November 05, 2010, which was attended by representatives of the Respondent, Mr. Muhammad Farhan **("the Representative")** and the Legal Counsel.

9. The Legal Counsel at the time of hearing reiterated the stance of the Respondent as stated in the written reply to the SCN. The arguments of the Legal Counsel were anchored around the assertion that the Respondent had not executed any Wash Trade and all the trades were only matched trades, which is not a violation of the regulatory framework. Further, the Legal Counsel argued that to determine whether an offence has been committed, the Respondent's intention to commit such an act requires to be proved. The Legal Counsel argued that in the instant case this pre-requisite i.e. intention/willfulness of the Respondent to have violated the law in conducting Wash Trades is missing. The Legal Counsel argued that the Respondent has 60 trading terminals located at various locations, so the occurrence of the matched trades can not be restricted at the member level. He asserted that the Exchanges should be advised to restrict these types of activities at the Exchange level by making necessary changes in the trading system. He emphasized that the exchanges should develop automated mechanism

whereby orders of a member cannot match with its own orders. The Legal Counsel further argued that the Respondent is not involved in any deceptive transactions and/or any fraud, and this has never been the intention to get involved in illegal activities inclusive of Wash Trades. Further the Legal Counsel vehemently denied that the Respondent has failed to exercise due care, skill and diligence in the conduct of its business.

10. In addition to the arguments of the Legal Counsel, the Representatives at the time of hearing stated that the Respondent's primarily dealing is in the business of arbitrage both at KSE and LSE by the virtue of the allotment of terminals sanctioned by the KSE and LSE boards. The Respondent makes arbitrage transaction, by buying the securities in one market & selling the securities in other market or vice verse. As the arbitrage business is conducted through various proprietary accounts and the Respondent has many trading terminals through which it conducts its trading, the traders at two different terminals may place orders at the same price for the sale and purchase of securities resulting in matching of trades with each other and giving an impression of Wash Trades.

11. I have heard the arguments of the Legal Counsel and the Representative at length during the hearing. Additionally I have perused the record, the written reply filed by the Respondent. Accordingly, my findings on the arguments made by the Respondent to the issues raised in the SCN are as follows:

(i) The preliminary objection raised by the Legal Counsel regarding the Section 22 of the Ordinance is not valid because the said Section 22 is an enforcement clause of the Ordinance under which the SCN has to be issued for violation of any provision of the Ordinance and the Rules (inclusive of the Code of Conduct prescribed under the Broker Rules). The Legal Counsel has confused the provision of law that has been contravened and the one under which the Commission is empowered to impose penalty. The contravention is of the Code of Conduct that is prescribed in the 3rd Schedule to the Brokers Rules. The Schedule is part and parcel of the said Rules and any contravention thereof is a violation of the Rules. Further, the registration of every broker under Section 5A of the Ordinance is subject to, inter alia, 'such conditions are may be prescribe'. These conditions are prescribed in the Brokers Rules and since Code of Conduct, as stated above, are an integral part of the Rules, a violation thereof will be considered a contravention of Section 5A of the Ordinance. This office also observes that the SCN has been issued under Section 22 of the Ordinance, with the view to ensure compliance by the Respondent to the regulatory framework. Although, the contraventions of law mentioned in the SCN also attract the penal

provisions contained in Section 7 of the Ordinance that includes Cancellation of registration.

(ii) The other preliminary objection wherein the Legal Counsel contested the SCN as being against the Article 4 and 25 of the Constitution of the Islamic Republic of Pakistan, 1973 **(the "Constitution")**. It is pertinent to mention here that learned Legal Counsel has raised objections whilst misreading the facts and law stated in the SCN. The argument of the Legal Counsel raised here is to be read conjunctively with his first preliminary argument. The discussion in the preceding paragraph has put the assertion of the Legal Counsel relating applicability of Section 22 of Ordinance to rest. Hence, the question of SCN being hit by Article 4 and 25 of the Constitution does not arise. The SCN has clearly stipulated the provisions of law that have been violated which can be read by a cursory overview of the SCN. The argument of the Legal Counsel that the issuance of the SCN has deprived the Respondent of a fair opportunity to defend itself is severally misconceived. In fact, the SCN was issued in compliance of the statutory requirement of Section 22 of the Ordinance wherein it is ordained to 'give the person an opportunity of being heard'. In addition, the issuance of SCN is reflective of the Commission's policy to adhere to the cardinal principle of equity and natural justice enshrined in the Latin maxim Audi Alterum Partem (no one is to be condemned unheard). It is to maintain this principle that the Commission had issued the SCN informing the Respondent about the offences that have been committed with regards to the Code of Conduct read with Rule 12 of the Broker Rules and Section 5A of the Ordinance. It is also observed that this is the second opportunity the Respondent has been given to show cause for executing Wash Trades. Since the first response was found unsatisfactory the instant SCN was issued in the interest of justice and equity. The SCN is issued in accordance with law and due opportunity is being provided to the Respondent to defend itself. As for Article 25 of the Constitution in particular, the Respondent is not being prejudiced in any way or being treated in-equally against another or being discriminated against.

(iii) The Legal Counsel in his para-wise comments argued that Respondent is engaged in arbitrage trading, therefore, simultaneously, it placed buy and sell orders through various terminals located at different places which matched with each other and caused matched trades. It is argued here that arbitrage trading is buying the securities in one market and simultaneously selling the same

securities in another market, so buy orders placed in one market can not match with sale orders place in other market. However, in this case, the Respondent placed buy and sell orders in same market, which matched with each other and did not result in any change in beneficial ownership of the shares. Therefore, buy orders matched with sale orders in the same market can not fall within the ambit of arbitrage trading. In fact, few instances were taken randomly and further analyzed in depth and observed that the Respondent has placed buy and sell orders at the same exchange, no counter buy or sell orders were placed at another exchange, which is also not arbitrage trading and also against the contention of the Respondent that these transactions were result of arbitrage business.

(iv) The Legal Counsel contested that the details of the alleged transctions are incomplete and misleading, while the numbers of transactions have been repeated/duplicated on the several pages. In this regard, it is being clarified here that the repeated transactions as quoted by the Legal Counsel were only the printing mistake which had no impact on total number of Wash Trades; therefore, said argument that the transactions are misleading is denied in totality.

(v) The contention of the Legal Counsel that quantity of alleged trades from the traded volume of the Respondent are so insignificant and minor that the Respondent would not gain or benefit does not hold true. It is pertinent to mention here that it is the responsibility of the Respondent to monitor all the trading activities being carried through its terminals in order to track the transactions which might violate any rules and regulations. The fact cannot be ignored that violation of any rules and regulation is an offense irrespective of the magnitude of transactions and is liable to disrupt smooth and transparent operation of the market in violation of the Code of Conduct.

(vi) The Legal Counsel in his arguments has emphasized that as a pre-requisite to establishing liability under Section 22 of the Ordinance, the element of 'willful act' and the 'intention' is essential to be proved. The Legal Counsel argued that the actions of the Respondent were not 'willful' therefore they do not attract the penal provisions of Section 22 of the Ordinance. In this regard, the Legal Counsel relied on judicial decisions, 1990 PLC 373, 2002 CLC 1925 and 1984 CLC 2456. It has been argued that the judicial interpretation of 'willful' is 'knowledge or intention" and that "the word willfully is defined as meaning that the act is done deliberately and intentionally, not by accident or inadvertence....."

The facts of the present case flow towards the conclusion that the assertion of the Legal Counsel 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.

It is the observation of this forum that since 'knowledge' or 'intention' is a state of mind it is difficult to adjudicate the matter on this specific point alone. It is the act itself, the result and the circumstances surrounding the act which point towards the intention of a person committing an offence. If for arguments sake the contention of the Legal Counsel is accepted that the act of trading by the Respondent in the manner discussed in the preceding paragraphs was not 'willful', it would mean that the Respondent was not aware of the eventual result of its actions or is not capable or competent to understand the effect of trading. However, this is not the case as the Respondent has clearly stated that it has made the transactions as arbitrage business. Accordingly, the Respondent knew fully well the consequences of the said transactions, hence willful.

12. In view of the facts and my findings and observations thereon, it is established that the Respondent has placed the buy and sell orders at the same Exchange in such a way that orders for buy and sell matched with each other and did not result in any change in beneficial ownership of the shares, which created false and misleading impression in the market.

13. With particular reference to the assertion of the Legal Counsel that the Exchanges should be advised to restrict these types of activities at the Exchange level by making necessary changes in the trading system; I have discussed and deliberated the said matter with the Exchanges and at other relevant forums in order to assess its potential impact on the overall market and alternatives ways in which it can be addressed. Different proposals are reviewed to address this issue including post-trade volume adjustment and system modification in the trading system of Exchanges. Moreover, the possible limitations and outcomes of the above proposals have been carefully reviewed. It is pertinent to mention that applying universal changes in the trading system at the Exchange level would impact overall trading system performance. Given the fact that arbitrage transactions between the two exchanges are carried out by few Brokers only, it may not be advisable to bring changes in the trading system of the Exchange, which would impact the efficiency of the over all market. However, given the nature of these transactions, it is essential that the Brokers should implement the Order Management System embedded within Gateway Interface of the Exchange, wherein clear specifications should be placed by the Brokers to restrict such orders from the Brokers which may amount to Wash Trades before these are routed to the trading system of the Exchange for execution.

14. The execution of Wash Trades even due to the arbitrage business is not acceptable as it is still the violation of the regulatory framework as it did not result in any change in beneficial ownership of the shares and also created false and misleading impression in the market. I am of the considered view that unfair trade practices like Wash Trades are harmful for the development of the market and damage market integrity. There is no justification for the Respondent to carrying out the Wash Trades on the pretext of arbitrage business. The execution of abovementioned trades shows that the Respondent has failed to maintain high standard of integrity and has been unsuccessful in exercising due care, skill and diligence in conduct of its business. Consequently, it is established that the Respondent has contravened the provisions of the Code of Conduct.

15. It is pertinent to mention here that the Commission had earlier passed Orders dated March 05, 2010 and June 09, 2009 against the Respondent under Section 22 of the Ordinance. The Commission vide said Orders had directed the Respondent to ensure that full compliance be made of all rules, regulations and directives of the Commission and the stock exchanges in future for avoiding any punitive action under the law. Moreover, the Respondent was strictly warned through letters dated August 18, 2009 and August 25, 2009 to conduct its business with due diligence, care and skill failing which appropriate action can be taken against it. It is regrettable to note that despite of earlier warnings and cautions of the Commission, the Respondent continuously indulged in trading activities that are not permitted in the law.

16. The violation of the Rules and Regulations is a serious matter which can even lead to suspension or cancellation of the Respondent's registration as a broker by the Commission. However, I hereby impose on the Respondent a penalty of Rs. 150,000/- (Rupees One Hundred and fifty Thousand only). Additionally, I strongly advise the Respondent to take immediate measures and put in place proper checks in its Order Management System to restrict such orders which may amount to wash trades before these are routed to the trading system of the Exchange for execution 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.

17. 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.

18. 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 April 14, 2011
Islamabad.