

**THE ROLE OF SECP IN CONTROLLING MARKET
MANIPULATION IN THE LIGHT OF THE LAWS IN
VARIOUS JURISDICTIONS**

by

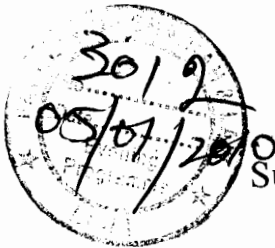
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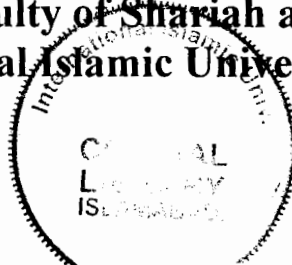


A dissertation submitted in partial fulfillment
of the requirements for the degree of
MASTER OF LAWS
(Faculty of Shariah and Law)
in The International Islamic University, Islamabad
1430 A.H /2009 C.E.



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15.7.2010

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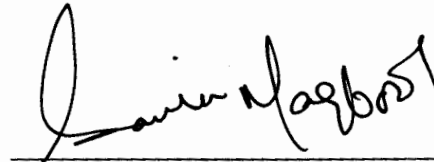
Accession No. TH 6670 ~~10~~ ~~11~~

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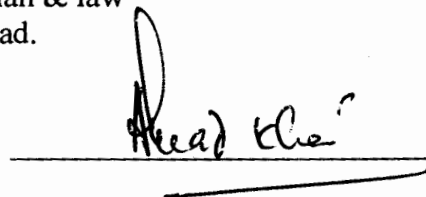
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ABSTRACT

THE ROLE OF SECP IN CONTROLLING MARKET MANIPULATION IN THE LIGHT OF THE LAWS IN VARIOUS JURISDICTIONS

The idea of market manipulation is now almost a century old. Having a look at the history of market manipulation it becomes obvious that common law is the basic law in this regard. Common law has made a significant contribution by developing rules on it. Although U.S.A securities law is quite comprehensive but it has its bases in common law too. Section 9 and 10 of the USA Securities and Exchange Act 1934 directly deals with market manipulation.

Market manipulation gives false indication in the market as to the supply or demand or price of any financial instrument. In Pakistan, the law on market manipulation is outlined in chapter IV of The Securities and Exchange Ordinance 1969 and is considered the basic law on market manipulation but this law is not sufficient to control the market manipulation. In March 2005, Pakistani stock market met a big crash and market manipulation was a basic cause. This crisis raised many legal issues generally regarding the role of Securities and Exchange Commission of Pakistan as a regulator to control the crisis and particularly market manipulation. Significance of the law of market manipulation for Pakistan is extremely important because as globalization and its various

trends brought new challenges to the stock market and the prevailing economic activity and extension of industrialization has made the role of stock market more significant. The present laws of Securities and Exchange Commission of Pakistan dealing with market manipulation and fraudulent practices have not been able to control the persistent crashes and unlawful practices so the laws need upgrading. The motivation behind writing this thesis was to analyse the existing laws of Securities and Exchange Commission of Pakistan regarding prevention of market manipulation and fraudulent practices that led to stock market crash and to compare these laws with the parallel laws of securities in various other jurisdictions. Like many jurisdictions United Kingdom has also considered market manipulation a civil wrong as well as a criminal offence. For instance Financial Services and Market Act, 2000 introduces market manipulation as a civil wrong and Criminal Justice Act 1993 considers market abuse as a criminal offence. Moreover, the Code of Market Conduct gives some particular types of manipulative behavior. In the USA, basic law on market manipulation is Securities and Exchange Act of 1934. Section 9 and 10 of this Act are directly dealing with the offence of market manipulation. Indian law on this issue is very comprehensive. Key law on Indian securities market is The Securities Exchange Board of India Act, 1992. Chapter V A Section. 12A of this Act directly prohibits manipulation in securities market. At the international level organization like International Organization of Securities Commission is there to give direction to its member state's stock markets. The Organization recognizes this fact that investors must be sheltered from deception. In Pakistan Securities and Exchange Commission of Pakistan is the apex regulatory body to control the stock markets of the

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LIST OF ABBREVIATIONS

CTTL	Callmate Telips TelecommunicationCo.Ltd
CFS	Continuous Funding Syste
FMC	Fund Mnagement Company
FSMA	Financial Services and Market Act, 2000(UK)
IOSCO	International Organization of Securities Commission
ICP	Investment Corporation of Pakistan
KSE	Karachi Stock Exchange
KAPCO	Kot Adu Power Company
LSE	Lahore Stock Exchange
NIT	National Investment Trust
NSEI	National Stock Exchange of India
SECP	The Securities and Exchange Commission of pakistan
SEBI	Securities and Exchange Board of India
USA	United States of America
UK	United Kingdom

DEDICATION

This work is dedicated to my parents and to all my teachers.

ACKNOWLEDGMENTS

I would like to acknowledge support of my parents and am grateful to them for all their kindness and support. It is their support and concern that has made me able to complete my studies with thoroughness and with tranquility . I would like to acknowledge next the support of my supervisor, Assistant Professor Samia Maqbool Niazi, who helped and guided me in writing this thesis. Another person to whom I want to acknowledge is Professor Imran Ahsan Khan Nyazee, who helped me in this thesis at very initial stage. I would also acknowledge the support of my sisters Shazia, Asma and brother Dr.Asmat, they always encouraged and helped me in the time of stress and depression. It will be unjust here, not to acknowledge all of my friends and specially Aisha Tariq, without their support and encouragement it would be difficult for me to achieve my task. I am thankful to all my friends who gave me courage and support in writing this thesis.

PREFACE

This thesis is an attempt to explain the market manipulation laws in Pakistan and the role of SECP in controlling the offence of market manipulation. This thesis is also an endeavor to explain the historical background and an overview of the market manipulation laws in USA,UK and India. It is divided into five chapters. Chapter I defines the market manipulation and describes its different forms. It also attempts to prove market manipulation as an offence and its illegality. Chapter II gives an overview of the market manipulation laws in USA,UK and India and discusses the regulations of IOSCO. Chapter III is about the market manipulation laws in Pakistan. It gives introduction of the stock markets of Pakistan. The cases, that investigated by the SECP on market manipulation are being discussed in this chapter. Chapter IV gives an overview of the prevalent and draft securities laws of SECP. Chapter V contains a short conclusion and recommendations.

CHAPTER 1

THE ORIGIN AND SIGNIFICANCE OF LAW ON MARKET MANIPULATION

Market manipulation is an observable fact that emerged almost a century ago. The history of the stock market manipulation shows that substantive law is still the common law and history proves its reliability too.¹ Common law theories and rules have contributed significantly to fraud provisions and in the beginning Common law established well recognized rules for the securities market which were about fraud.² It is generally considered that U.S.A. Securities and Exchange Act 1934 is the major source of the law on market manipulation because of its comprehensive and definite provisions, mainly section 9 and 10 that directly deals with manipulation of securities prices.³ Yet, statute is not the only reason of this development.⁴ In the start of twentieth century, fraudulent stock schemes were so common in the USA that in 1921 the Martin Act passed as the blue sky law of New York the Act gave unusual powers and discretion to an

¹A.A Berle, Jr., "Stock Market Manipulation", *Columbia Law Review*, vol.38, No3 (March: 1938), 401. Available online at:<http://www.link.jstor.org/sici?sici=0010-1958>. (last visited: July 14, 2007)

²see *Ottinger v. Bennet*, 203 N.Y.554, 96NE.1124 (1911). The rule was that "a buyer who purchased in the open market, had relied on a misrepresentation which was made with the intent that it should be acted upon, called proceed against the liar exactly as through the lie had induce him to buy a horse." Holding that the plaintiff could recover if the declaration of the defendant was part of a scheme to include the public to purchase shares in the companies. See also *Ridgly v. Kenne*, 134 APP div.647, 119 N.Y, supp.451 (1909) *Columbia Law Review*. Available online at: <http://www.jstor.org> (last visited, July14, 2007)

³Berle, "Stock Market Manipulation", 393.

⁴*New York General business Law*, Article.23 (a) c.649, N.Y.Laws 1921,as amended, available on <http://www.jstor.org> (last visited 21, July 2007)

attorney general to deal with financial frauds.⁵ Different measures were adopted by the New York authorities under the Martin Act⁶ to make the market clean and strong that were consequently an application of the common law rules for the public advantages as well as private relief. It is stated in the Act that sales of securities could be brought under Common Law to avoid all false descriptions. This was the situation of law in USA in 1931 the “ideas were all out, and their fast crystallization was widely expected.”⁷ Then the Act of 1934 came. It contributed significantly in the submission of remedies and the basic doctrines.⁸

On international level a lot of work has been done to analyze this issue legally. For example, it is in the objectives and Principles of International Organization of Securities Commission that it will recognize the right of investor from manipulative market or deceptive practices.

In Pakistan, law on market manipulation is outlined in chapter IV of the Securities and Exchange Ordinance 1969. This law is not sufficient to control the market manipulation. In March 2005, Pakistani stock market met with a big crash. This crisis raised a number of legal issues regarding the role of Securities and Exchange Commission of Pakistan (SECP), as it is the apex regulatory authority, especially to control the market manipulation.⁹ Significance of market manipulation laws for Pakistan is very important as globalization and its various trends brought new challenges to the

⁵Robert A. McTamoney, New York’s Martin Act, “Expanding Enforcement in an Era of Federal Securities Regulation,” Vol.18, No, 5, *Washington Legal Foundation*. Feb 28, 2003. 2. The whole text is available on <http://www.wlf.org/upload/022803LBMctamoney.pdf> (last visited ,16.5.2009)

⁶Berle, “Stock Market Manipulation,” 395.

⁷Ibid., 395.

⁸Ibid.,401.

⁹Securities and Exchange Commission of Pakistan. Report of the taskforce: *Review of the stock market situation March 2005*. June2005.Avaiable online at: <http://www.secp.gov.pk/Reports/rpt-taskforce-stockmarket%20>. (last visited on February 24, 2007)

stock market. Moreover prevailing economic activity and expansion of industrialization has made the role of stock market more important because the Stock market plays a key role in the economic situation of a country and the stock market stability makes sure the stability of the economy of a state. The laws in countries like UK, USA, Europe and India, as regards to market manipulation, are much developed as compare to Pakistan. The existing laws of Securities and Exchange Commission of Pakistan dealing with market manipulation and deceptive/fraudulent practices have not been able to control the persistent crashes and unlawful practices, therefore, need improvement.

This brings us to the purpose of this thesis, to analyze the existing laws of Securities and Exchange Commission of Pakistan regarding prevention of market manipulation and fraudulent practices leading to stock market crash, in comparison with parallel laws of securities in various other countries.

1.1 The Meaning of Market Manipulation

Fiscal and Ross¹⁰ combine the various definitions of manipulation given by the courts, commentators and concluded: “conduct is manipulative if it is designed to interfere with the free play of supply and demand, induce people to trade or force a security price to an artificial level”. Further Fiscal and Ross concluded: “Market manipulation is a fundamental concern of the regulations of a financial market but manipulation is not

¹⁰D.R .Fiscal and D.J Ross, “Should the Law Prohibit Manipulation in Financial Markets?”, “Item no: 07 Seminar in Law and Economics, University of Chicago, 1991. As quoted in Arkadev Chatterjea; Joseph A. cherian; Robert A Jarrow, “Market manipulation and corporate finance: A New perspective”, *Financial management*, Vol.22, No.2. (Summer, 1993), 208 www.jstor.org (last visited on July 24, 2007. 200-209)

defined in any of the regulatory statute and despite much academic and judicial commentary, no satisfactory definition of the term has been offered.”¹¹

The term market manipulation has been defined comprehensively in few articles. For example, Consultation Paper No. 6 of the Jersey Financial Services provides a tremendous definition of market manipulation the definition is as follows:

“Market manipulation involves transactions or orders to trade which

- give, or are likely to give, false or misleading signals as to the supply and demand or price of financial instruments
- alter by one or more persons acting in collaboration, the price of one or several Financial instrument to an abnormal or artificial level or
- Employ fabricated devices or any other form of deception or contrivance.

Market manipulation includes the broadcasting of information through the media, including the internet, or by another means, which give, or are likely to give, false or misleading signals as to the supply, demand or price of financial instruments, including the Dissemination of rumors and false or misleading news”.¹²

Dictionary meaning of manipulation is as follows:

“A series of transaction involving the buying and selling of a security for the purpose of

Creating a false or misleading appearance of active trading or to raise or depress the price to

Induce the purchase or sale by others.”¹³

Market manipulation can also be described as,

“Deliberate attempt to interfere with the free and fair procedure of the market and create fake, artificial or confusing appearances with respect to the price of, or market for, a security, commodity or currency.”¹⁴

¹¹Ibid.

¹²Consultation paper No 6, Paper 2003-06, *Market Manipulation and insider Dealing* (Jersey Financial Services Commission, 2006) 6. Available at <http://www.jerseyfsc.org> (last visited February 12 .2007)

¹³ *Black's Law Dictionary*, s.v “manipulation.”

¹⁴http://en.wikipedia.org/wiki/market_manipulation (last visited on 25.5.2008)

Market manipulation is a malevolent behavior that affects the reliability of securities market place. The price of the securities should be set by, without any hindrance, and with the mutual decision of buyer and seller¹⁵. While manipulation alters the independent trading and pricing mechanism of the market place and turns it into a stage- managed performance and this can lead to great losses to investors.¹⁶ Market manipulation can be explained in different forms, for example **Price manipulation**, where buying and selling orders both are placed into the market to modify or maintain the price of the stock.¹⁷ The other instance is **wash trades and pre- arranged trading**; a wash trade is a type of trade where there is no alteration in the beneficial ownership of securities. The buyer may also be the seller or is linked with the seller. In pre-arranged trade, two parties' trades on the basis that these transaction will be reversed later. "Pooling or churning" can engage wash sales or pre-arranged trades. They executed in order to give a sense of active trading and it creates investor's interest in the stock.¹⁸ **False or misleading information** is another major example of market manipulation. In this category, investor and companies try to re-release information or present information in an over positive manner so that it generates interest in the company's securities or help a declining stock price. **Capping and pegging** is also an example of market manipulation, where activity is "involved on both, the stock market and derivative markets".¹⁹ In capping and pegging a trader writes an option, which obliges the traders to sell or buy from the option holder a specified number of shares at a specific price. The trader then trades in the shares covered by the

¹⁵ ASX Australian Securities Market. *Market manipulation*, the text is available at, www.asx.com.au/supervision/participants/market-manipulation.htm (last visited on January 13,2008)

¹⁶Ibid.

¹⁷Ibid.

¹⁸Ibid.

¹⁹Ibid

option in order to affect the share price in a direction that will make the option unprofitable to exercise.²⁰

1.2 Different kinds of Market Manipulation

Market manipulation can be classified into three kinds.

- Action- based manipulation :
It is a form that is based on actions that changes the real or supposed price of a firm's assets.²¹
- Information- based manipulation: It is based on spreading inside information or dispersal of fake rumors.²²
- Trade-based manipulation: This is done by buy and sale of Securities without taking of any actions to change the value of the firm or to discharge the forged information that could change its value.²³

The Securities Exchange Act 1934 of Unites States of America made numerous instances of law within the first two types of manipulation, these manipulative actions are categorized as deception.²⁴ The above two kind of manipulation can took place when the manipulator conceals his dealings by way of less offensive actions or projects, and gives

²⁰Ibid.

²¹ Arkadev Chatterjea; Joseph A. cherian; Robert A Jarrow. *Financial management, Vol.22, No.2.* (summer, 1993), "Market manipulation and corporate finance: A New perspective", 202 www.jstor.org (last visited on 24.7.2007)

²²Ibid.

²³Ibid.

²⁴Ibid.

a forged image to the other market participants.²⁵ Trade- based manipulation is a wider category of manipulation in which all other types of manipulation fall and it includes manipulations that involve primary sales and consequent buys.²⁶ It also includes manipulations those effects markets separately but financially linked.²⁷

1.3 Market Manipulation as an Offence

Market manipulation indicates any extended information through the media, including internet or any other resources that gives misleading information of the financial instrument; as a result, innocent investors may buy or sell their investment at a fake price²⁸. In this sense market manipulation may be called an offence. In different jurisdiction it is treated as an offence. Before looking at market manipulation as an offence, first we should know what is an offence? and whether market manipulation fits on the criteria of the offence. According to Black's law dictionary offence means a "felony or misdemeanor; a breach of criminal laws, violation of law for which penalty is prescribed". The word offence sometimes used in various senses generally implies a felony or a misdemeanor infringing public rights, and punishable under the criminal laws, though it may also include the violation of a criminal statute for which the remedy is merely a civil suit to recover the penalty.²⁹ Generally violation of Market manipulation

²⁵Ibid,202.

²⁶Ibid.

²⁷Ibid.

²⁸Samia Maqbool Niazi, *The Law of Insider Trading in Pakistan*, Rawalpindi, published by Federal Law House, 2007. 9.

²⁹Black, *Black Law Dictionary 6th Edition*, s.v."Offence."

creates a civil liability. It is a violation of securities laws of almost every country of the world. It is a criminal offence too because misrepresentation of facts, deceiving practices and fraud are involved in market manipulation. Consequently, a common investor may buy or sell financial instruments on forged prices.³⁰ Moreover manipulation of stock prices is considered to be fraud and “harms both society and individuals by decreasing the accuracy of pricing by the market.”³¹ Fraudulent acts are prohibited in Securities laws of different jurisdictions. In Pakistan’s securities law, fraudulent acts are prohibited under section 17 of Securities and Exchange Ordinance, 1969.³² Section 17 is dealing with the offence of market manipulation. It is considered an offence in many jurisdictions as it is stated in the consultation papers No.6, Jersey financial Services Commission:

“Market manipulation, insider dealing and unauthorized businesses are Three key criminal offences that are usually investigated by securities regulators even where these crimes are committed by people who are not themselves regulated by financial services Providers.”³³

In different jurisdiction market manipulation has been treated as an offence. In some jurisdictions it is treated as civil offence and in others it is treated as criminal offence. It will be significant here to discuss that whether market manipulation creates any criminal liability? Generally criminal liability refers to a liability that is mandatory under a criminal statute instead of a civil statute. It means that law must specifically point out that definite activity is illegal and person who commits such an act shall be subject to jail,

³⁰Niazi, *The Law of Insider Trading in Pakistan*, 9.

³¹Ibid.

³² The Securities and Exchange Ordinance, 1969. Text also available at official website of Securities and Exchange Commission of Pakistan. www.secp.gov.pk (last visited July 24, 2008)

³³Consultation paper no.6. Paper 2003-06, *market manipulation and insider dealing*. (Jersey Financial Services Commission) 6.

fine or to pay compensation to any one injured by that criminal act.³⁴ In United Kingdom Securities law, market manipulation has considered both, a civil and a criminal offence.³⁵ For instance two offences of market manipulation were introduced in the Financial Services and Market Act, 2000

- False or misleading impressions.
- Distortion of the market.

It identified two types of market manipulation that is indicated in Art.1 of the draft European Directives on market abuse. The common provisions on market abuse has been measured in chapter, 6 of The FSMA 2000, the section 118(2) (b) (c) of the said Act provides the specific situations that should be fulfilled in regard of market manipulation.³⁶ These situations give a forged or deceptive impression to the regular user of the market, as to the supply or demand of the shares in question.³⁷ In United States law market manipulation is also prohibited in Section 9 of Securities Exchange Act of 1934 that prohibits manipulation of security prices. Section 20 (A) (1) of Securities Exchange Act of 1934 has given discretion to security commission that it can investigate any person who violates any provision of this code. It shows that these sections are dealing with all these offences, their investigation, injunction and prosecution. The Sarbanes Oxley Act of 2002 of United States also protects the investors by improving the exactness and consistency of corporate disclosures made pursuant to

³⁴ Text available on <http://www.opsi.gov.uk> last visited (23.6.2008)

³⁵ Barry Rider, Kern Alexander & Lisa Linklator, *Market Abuse and Insider dealing*, London, Butterworth, 2002, 93.

³⁶ Ibid.

³⁷ Ibid.

the securities law. The offence of market abuse in United States' securities law has a civil liability as well as Criminal.³⁸

International Organization of Securities Commission (IOSCO) which was established in 1983 is a truly international cooperative body. "Today International Organization of Securities Commission has been recognized as the international standard setter for securities market due to the organization's wide membership, it regulates more than 90% of the world's securities market."³⁹ International Organization of Securities Commission is the world key International cooperative forum for securities regulating agencies. Today International Organization of Securities Commission has also been accepted as the international regulatory bench mark for all securities market.⁴⁰ It is clearly embodied in the objectives and principles of securities regulations of International Organization of Securities Commission that the "trading regulations of the the secondary market must forbid market manipulation, deceptive conduct, insider trading and other fraudulent or deceptive conduct, which may distort the price discovery system, distort prices and unfairly disadvantage investors."⁴¹

It is clear that market manipulation is prohibited not only in every country's domestic securities laws but it is also prohibited in the international organizations like IOSCO regulations too. This prohibition proves the intensity of the offence of market manipulation.

³⁸Securities Exchange Act of 1934. United States of America. *Selected Corporation and Partnership Statutes, Rules, and Forms*, Ed. by Lewis D. Solomon, Jeffrey D. Bauman, Revised 1991 Edition, St. Paul Minn, West Publishing Co. 1992.

³⁹Available on official website of International Organization of Securities Commission, www.iosoc.org/about/index.cfm?section=history (last visited on May 26,2008)

⁴⁰International Organization of Securities Commissions, *Objectives and Principles of Securities Regulation*. May 2003, www.iosco.org (last visited on May 20, 2008)

⁴¹Public document no 103, *investing and prosecuting market manipulation*, IOSCO technical committee, May 2000. text also available at <http://www.iosco.org> (last visited May 20, 2008)

1.3.1 Illegality of Market Manipulation

Market manipulation has been considered illegal in many jurisdictions. It is because that the basic function of a stock exchange market is to supply liquidity for securities at a price near to the estimated price to their asset worth.⁴² Classical economic theory shows that this estimation of price should take place as a consequence of the free relationship of the individual assessment of equally up to date traders buying and selling in a open market.⁴³ For this reason, manipulation that is a planned raising, lowering or fixing of prices, breaches this purpose because it forms a mock price.⁴⁴ Due to these characteristics market manipulation has received condemnation by the court.⁴⁵ In the case of United States v Brown, “illegality was attached to the combination of the following manipulation of prices; disregard and distortion of value, an antisocial purpose and the use of the operative devices were employed.”⁴⁶

1.4 Market Manipulation and Insider Dealing

In Consultation Paper No.6 “Insider Dealing” has been defined as follows:

“Insider dealing is the illegal use of insider information by an individual to secure a profit or reduce a loss resulting from dealing in investments. This illegality is extended to any person who knowingly uses insider information

⁴² “Illegality of Stock Market Manipulation”, *Columbia law Review*, Vol.34, No.3. (Mar., 1934), 500. available <http://www.links.jstor.org/sici?sici=00101958%28193403%2934%3A3%3C500%3AIOSMM%3E2.0.CO%3B2-1> (Last visited on June 28, 2008)

⁴³ *Ibid.*, 500.

⁴⁴ *Ibid.*

⁴⁵ *Ibid.*, 501.

⁴⁶ *Ibid.*, 503.

passed by the first person to secure a similar result.”⁴⁷

Mostly Insider dealing and Market manipulation are considered as one offence but it is not, the two notions are distinctive to each other.⁴⁸ Both are different offences but are identical and innocent investors may be deceived as a result of insider dealing and market manipulation. Moreover, this kind of market abuse damage confidence of the stock markets.⁴⁹ As compare to insider dealing market manipulation is a wider term and all kinds of market abuse falls under it including insider trading.⁵⁰

1.5 Market Manipulation and Stock Market Crisis

Before looking at the link between market manipulation and stock market crisis first it will be significant to know the role of a stock market.

1.5.1 Stock Market and Its Role

A stock market or a stock exchange provides a place where securities are bought and sold. Market dealing with the trading of financial assets can be categorized as being either formal or informal. The stock exchanges with centralized trading floor are the formal kind of markets.⁵¹ Here our main concern is also of formal markets. The prime responsibility of stock markets is to offer equity finance for the corporate division and it

⁴⁷Consultation paper no.6. Paper 2003-06, “market manipulation and insider dealing,” 4.

⁴⁸Niazi, *The Law of Insider Trading in Pakistan*, 9.

⁴⁹Consultation paper no.6. Paper 2003-06, *market manipulation and insider dealing*, 6.

⁵⁰Securities and Exchange Commission of Pakistan. Report of the taskforce: *Review of the stock market situation March 2005*. June 2005. Available online at: <http://www.secp.gov.pk/Reports/rpt-taskforce-stockmarket%20>. (Last visited on 24.10. 2007)

⁵¹Mohibul Haq Shahibzada, ed. *Emerging Role of Stock Markets in Pakistan Economy*. Islamabad, Published by Institute of Policy Studies. 1995, 11.

promotes broad basing possession of financial assets and the reallocation of finances amongst the corporations .⁵²

1.5.2 What is Stock Market Crash?

“A stock market crash is an abrupt dramatic turn down of stock prices across a significant cross-Section of a stock market.”⁵³ Crashes are motivated by anxiety as well as by basic economic reasons. They often follow approximate stock market bubbles.

“Stock market crashes are social phenomena where external economic events combine with common behavior and psychology of investors in a positive response that drive them to sell. It can be rightly said that crashes occur under the subsequent conditions: an expanded period of increasing stock prices and economic optimism, a market where P/E ratios exceeds long- terms averages and widespread use of margin debt and leverage by market participants.”⁵⁴

Numerically there is no exact definition of a stock market crash but this term commonly applies to vertical double digit percentage losses in a stock market index over a period of several days. “Although crashes are often distinguished from bear market by dramatic price declines but crashes are also associated with bear market. However, it is not necessary that it always runs together.”⁵⁵

⁵²Ibid.

⁵³*Stock market crash* , www.wikipedia.org/wiki/stock-market-crash (last visited January28, 2008)

⁵⁴ Ibid.

⁵⁵Ibid.

1.5.3 Market Manipulation as a Factor of Stock Market Crash

In the financial record there are various examples wherever yet well- functioning and extremely developed securities market have not been protected from the manipulation.⁵⁶

There are many instances of market manipulation for example the collapse of a gold corner on Black Friday, September 24, 1869.⁵⁷ It is prudent to say that international securities market have also effected by manipulation. When Japanese bank prices of shares fall by 31%between March 31 and April 9, 1992, the majority of the short- sellers benefiting from the price turn down at that time were those supposed to be non- Japanese securities firms.⁵⁸ The Japanese finance ministry and a major financial news paper made an intensive effort to depress Japanese institutional investors from lending the shares to short seller that accidentally led to even more dramatic results. Institutions demanded back the shares they had lent out. The surplus requirement for shares by short-seller amounted to a near- squeeze as they recovered their positions at puffed up prices.⁵⁹

1.7 Rationale of Thesis

A question can come in reader's mind that why a thesis on the topic of market manipulation law in Pakistan should be needed. The answer is that, the world is considered to be global village now a days. The industrialization made the role of stock market fundamental to the development of any state. In this scenario stock market has the

⁵⁶Chatterjea, cherian & Jarrow," Market manipulation and corporate finance: A New perspective", 202.

⁵⁷Ibid.

⁵⁸Ibid.

⁵⁹Ibid.

major role to play in the economic condition of country. Its stability interrelates with the stability of the state's economy. In a country like Pakistan where economy is developing, needs stability to ensure people's confidence in the investments in the local stock market. There is a need to improve our laws related to market manipulation. A lot has been done in this aspect in different states, for example countries like U.S.A, and U.K did much to develop their laws in this aspect. This thesis will focus on the point to analyze the existing laws of Securities & Exchange Commission of Pakistan viz---a ---viz securities laws of various other countries, related to prevention of market manipulation and fraudulent practices which lead to stock market crash. In this thesis main focus will be on the following issues:

- Is market manipulation an offense?
- If market manipulation is an offense then how different jurisdictions deals with it?
- Is the market manipulation a main factor involved in the stock market crash?
- What is the regulatory role of Securities and Exchange Commission of Pakistan particularly to control the market manipulation?
- To analyze the prevailing as well as draft laws of Securities and Exchange Commission of Pakistan on market manipulation.

1.8 Research Methodology

This research will first deal with the offence of market manipulation as it is understood all over the world and will also deal with many forms and manifestation of offence.

Secondly, it will analyze various different stock market crashes and market manipulation in Pakistan. When this task has been accomplished, the stage will be set for analysis of the law prohibiting the offence of market manipulation in Pakistan and to look at the shortcomings of the law. It will be followed by proposal and recommendations deemed necessary for improvement. The Securities and Exchange Ordinance, 1969 and the Securities and Exchange Commission of Pakistan Act 1997 will be taken as a source.

CHAPTER 2

MARKET MANIPULATION IN DIFFERENT JURISDICTION

2.1 History of the Regulations of Market Manipulation in U.S.A

The Roosevelt administration period in USA is considered to be the most important for its legislative programmes.¹ The significant legislative programme was the reform of the securities markets at that time. Reform program has a subsequent general notion that the stock market crash of 1929 was a principal reason of the manipulation and excessive speculation and these were considered the fundamental reasons of the stock market crash.² The new regulatory arrangement was in process which came in the light later in the form of securities Act of 1933 and became final in Securities Exchange Act of 1934.³ While drafting the law it was felt for a “working hypothesis about the nature and effects of trading in securities.”⁴ A contrast was made between speculation and investment and it became adverse for investment.⁵ The purchase of securities for the predictable change in their money value had been felt a small productive type of financial activity than the buy of securities for dividends.⁶ Although, the speculation was not the fundamental idea of the legislation at that time but a large extent of the force might have been intended at

¹“Regulation of stock market manipulation,” *The Yale Law Journal*, Vol.56, No.3 published by The Yale Law Journal Company, Inc. (Feb., 1947), 509. the whole text is available on <http://www.jstor.org/stable/793284> (last visited on 27.01.2009)

²Ibid.

³Ibid.

⁴Ibid., 510.

⁵Ibid.

speculation to eradicate the so-called abuses of the markets.⁷ Manipulation and fraud in the sale of securities were the two key substance of this legislation.⁸ The crash of 1929 and the consequential investigations provided the momentum for the reform programme. Numerous details of the securities laws which came into being, had rented a lot from the common law.⁹ Mostly it is true to the provisions made for fraudulent practices. In a broad sense, it might be said that the eradication of fraud was the purpose of the legislation.¹⁰ The History of market manipulation in USA can be divided into two phases:

- The control on market manipulation before the Securities and Exchange Act of 1934
- Control under the Securities Exchange Act 1934.

2.1.1 The Control on Market Manipulation before Act of 1934

Before the Securities Exchange Act of 1934 the control over manipulative activity is notable in two phases. First phase is about the development of a legal doctrine.¹¹ Second phase is expansion of enforcement techniques.¹² Primarily, the problem of market manipulation was legally approached through the notion of fraud. Legal remedies were taken when the persons had this thought that they had been cheated by the manipulators and went to courts to resolve their disputes.¹³ Wash sale and matched order were also considered to be fictitious transactions from *ab initio*. False rumours disturbed the security prices so had been condemned because of it the investors can be deceived.¹⁴ The

⁶Ibid,

⁷Ibid.,511.

⁸Ibid.

⁹Ibid.

¹⁰Ibid,

¹¹Ibid.,516.

¹²Ibid.

¹³Ibid.

¹⁴Ibid, Rex v. De Berenger, 3 M &S. 67,105 Eng.Rep.R. 536 (K. B. 1814), 516.

notion of fraud was failed to control the manipulation and before 1934 there was no case that had recognized the misdemeanor of any form of manipulation in the United States although the case of *United States vs. Brown*¹⁵ has been broadly quoted as establishing such a rule.¹⁶ There were shortcomings in the legal doctrine that had developed an idea of market manipulation and legal remedies became fail to measure up the control on it.¹⁷ The securities market crisis were frequently followed by investigations to establish the reasons;

“The pujo committee, Governor Hughes’ Committee, and the state banking and currency committee, each at different periods of time, found that manipulation had not been effectively outlawed.”¹⁸

Wash sales and matched orders were considered as fraudulent but there was no civil liability on these acts.¹⁹ Before 1934 the lawful control of manipulative practices denoted undoubtedly that the reforms made in the Act were long in overdue amount.²⁰ The formation of an enforcement agency was the most momentous step.²¹

¹⁵*Ibid*, *United States vs. Brown* (S. D. N. Y 1933), 517.

¹⁶Regulation of stock market manipulation,” *The Yale Law Journal*, Vol.56, No.3,517

¹⁷*Ibid*.,518.

¹⁸*Ibid*.

¹⁹*Ibid*.

²⁰*Ibid*.,533.

²¹*Ibid*.,

2.1.2 Control under the Securities Exchange Act of 1934

The Act of 1934 contrasted market manipulation with the common law in two aspects one of legal doctrine and the second enforcement machinery, the Act of 1934 definitely contributed a lot in developing of a sufficient enforcement agency to regulate the markets.²² More precisely it can be stated that there was a definite progress as compare to the earlier law in aspect, legal doctrine and enforcement techniques.²³ The Act not only expanded the conception of fraud, but also it took all the various techniques of manipulation with in its scope.²⁴ It can be undoubtedly exemplified by the rule that is well-known now;

“that the failure to disclose the price at which a security is bought or sold is affected by manipulative activity of any sort is a misrepresentation by omitting to state a material fact.”²⁵

The above doctrine is not stated clearly in the Act it is a little explanation of these sections those prohibits or control manipulation.²⁶ A few definite provisions those are dealing with manipulation have their bases in the law of fraud like Section 9, that relate to exchange trading and declares wash sales and matched orders unlawful. In section 9 the law states as follows: “for the purpose of creating a false or misleading appearance of active trading in any security..... Or a false or misleading appearance of active trading with respect to the market for any such security.” The above phrase puts the wash sales and matched order in same category of misrepresentation and is an absolute notion

²²Ibid.,519.

²³Ibid.

²⁴Ibid.

²⁵Ibid.

²⁶Ibid.

of fraud.²⁷ The Act decreased the space between legal theory and the real practice as for as enforcement machinery was concerned it also gave wide powers to the commission of investigation so that the commission may identify manipulation and commission was also empowered with a variety of remedies to proceed in using of these powers.²⁸ The purpose of the commission is to recognize manipulation at the beginning and avoid it. The all enforcement activity based upon the organization of market watching.²⁹

2.1.3 Different Forms of Market Manipulation in the History of USA

Generally Market manipulation refers to different types of strategies that are used to encourage or to discourage the sale and purchase of securities.³⁰ Individual judgment is based on the Information whether it is right or wrong, absolute or partial and leads investors or speculators to buy, sale or hold the securities.³¹ In manipulative methods therefore publicity has been one of the most commonly manipulative methods.³² The dispersal of fake rumors regarding political or economic affairs are measured one of the initial forms of market manipulation.³³

Publicity is a successful form in a greatly liquid securities market and most prominent publicity is the appearance of the market itself and its published proof of the trading volumes and prices.³⁴ The prime utilization of manipulation by real purchase and sales is to create a bigger market price because it may be a chunk of stock that is to be

²⁷Ibid.

²⁸Ibid.,521.

²⁹Ibid.

³⁰Ibid.

³¹Ibid., 512.

³²Ibid.

³³Ibid.,513.

circulated, and the distributors want to get an enhanced price for the stock than the offered market price.³⁵

Another very important use of manipulation by real buy or sale is to fix or stabilize the market price.³⁶ In this form the supply starts on a raised distribution price that is raised by manipulation and it is in distributor's interest to sustain to price.³⁷ When speculators abandon the stock in the market which they brought in the direct distribution the market price can become subjected to depression.³⁸ Market sponsorship is another activity that involves manipulation by genuine buy and sale usually sponsorship is practiced in these common situations. These situations are as follows:

- At the final time of supply of a security, it is not good and the value of the security may become subject of great flux due to the resale of large amounts of the securities.
- Other activity of the identical sort is that of sustaining the market beside abrupt breaks and prices.³⁹

In USA securities law, securities Exchange Act provides comprehensive provisions on market manipulation. Section 9 of the Securities Exchange Act 1934 prohibits against manipulation of securities prices which is entitled as Prohibition against manipulation is in fact a prohibition against doing certain acts which are as follows:

- "To enter into the matched orders for the purpose of creating misleading appearance of active trading.

³⁴Ibid.,512.

³⁵Ibid.

³⁶Ibid.,514.

³⁷ Ibid.

³⁸Ibid.,514.

³⁹Ibid., 515.

- To effect a series of transaction to give appearance of active trading for the purpose of inducing the purchase or sale of securities by others.
- To circulate the information so that the price of the securities are likely to raise or fall.”⁴⁰

It is also clear that this Act declares the information unlawful only in the case of brokers, dealers, seller or buyers of a security.

- “To make false or misleading statements with reasonable ground to know of its false or misleading quality and to induce the sale or purchase of a security.”⁴¹

It also applies only to brokers, dealers, seller or buyer of securities.

- “To circulate the statement that the price of a security is likely to raise or fall because of market operations conducted for that purpose. It applies only to individuals making such statements where they have received a consideration for so doing to induce the purchase or sale of the security.
- To change, fix or stabilize the price of securities in infringement of such rules and regulation as the commission may prescribe.”⁴²

According to Section 9(a) (2) of the Act it is illegal to cause a registered security with a series of transactions alone or with more other persons; consequently the price raises or decreases with the purpose to obtain or sale of securities by others.⁴³ A person who buy or sell a security and the transaction has been done it is to be said that he has “effected” a transaction in that security.⁴⁴ If such transaction has done by many persons every one would be said that he has affected that security.⁴⁵ If Section 9 (a) (2) constrained to such extent then range of the section would became very short. The interpretation has been

⁴⁰The U.S.A Securities Exchange Act of 1934.

⁴¹Ibid.

⁴²Ibid.

⁴³“Regulation of stock market manipulation,” The Yale Law Journal Vol.56 No. 3(Feb., 1947), 519.

⁴⁴Ibid.,524.

⁴⁵Ibid.

made broad because of necessity. For example it has been held in *the matter of Meehan*⁴⁶ that transaction by friends, relatives, business associates⁴⁷ employees, persons acting upon the advice of persons bribed by the manipulators⁴⁸ and business deal done by the manipulators themselves in the name of discretionary accounts⁴⁹ all are within the range of the phrase.⁵⁰ Section 9(a) (2) is only a rational sequence of the common law; it is still lingering on the theory of fraud.⁵¹ Although the short selling is within the limit of Section 9 (a) (2) but the commission made regulation by a separate section for short sale. The reason behind these provisions was in fact the belief that manipulation may injure the public by pointless speculation and unbalance security prices.⁵² Section 9(a) (2) which sets a minimum standard of fraud sets also broader implications. If this section being contrasted with the wash sales and matched orders' sections which apply those devices only if it proposes to lead manipulation by real purchases and sale and to encourage others to buy or sell these securities.⁵³ Orders which relates to the future manipulated price change and induce the purchase or sale of securities are prohibited in Section 9 (a) (3) and (5) the central aim of the policy here is to keep away the public from incentives to the excessive speculation rather than safety of buyer and sellers from fraud.⁵⁴

By taking a look at the gist of S.9 of Securities Exchange Act of 1934 it can be assessed that it has particularized the expression by identifying the followings acts as manipulative:

⁴⁶Ibid., In the matter of Meehan, 2 S.E.C 588,605 (1937)

⁴⁷Ibid., In the matter of Merrill, 8 S.E.C 620(1941)

⁴⁸S. E. C. v Torr, 22F. Supp.602(S. D. N. Y. 1938); R.J. Koeppel & Co. v. S. E. C., 95 F.(2d) 550 (C.C. A. 7th, 1938) a

⁴⁹In the matter of Meehan, 2 S. E. C. 588(1937); In the Matter of Wright, 3 S. E. C. 190(1938)

⁵⁰"Regulation of stock market manipulation," *The Yale Law Journal* Vol.56 No. 3(Feb., 1947), 524.

⁵¹Ibid.

⁵²Ibid.,525.

⁵³Ibid.,509.

- “The making of fictitious statements of material facts.
- To oversight to state a material fact.
- Falsification by brokers or dealers as to their registration.
- A broker or dealer fails to relate any connection of control with the issuer of any security which is the subject matter of the transaction, or when brokers or dealer fails to reveal the existence of any financial interest in the main or secondary supply of such security.⁵⁵
- It is represented that unlisted securities are offered at the market but for these securities there is infact a market other then that made by the brokers or dealers.”⁵⁶

Further in section 10 and mainly 10(b) of the Act of 1934 gives right to the Securities and Exchange Commission to lay down rules and regulation that are required in the public interest or for the safety of investors.⁵⁷ Section 10 (b) of the Act of 1934 also gives right to the Securities and Exchange Commission to prohibit the use of manipulative or deceptive device⁵⁸ in association with the buy or sale of any security, “whether the security is registered or not on the national securities exchange.”⁵⁹

⁵⁴Ibid.

⁵⁵A.A Berle, Jr., “Stock Market Manipulation”, *Columbia Law Review*, vol.38, No3 (March: 1938), 400. Available online at: <http://www.link.jstor.org/sici?sici=0010-1958>. (last visited: July 14, 2007)

⁵⁶Ibid.

⁵⁷Ibid.,399.

⁵⁸Ibid.

⁵⁹Ibid.

USA also has vast case law which prohibits the manipulative practices in securities law as in the case of *Securities and Exchange Commission vs. Torr*.⁶⁰ Injunction proceedings were made on the opinion that proceedings on the New York exchange dishonored section 9 of the Act of the 1934 and 17(a) 1933.⁶¹ It was a case where false impression of activity and the normal volume of trading in the stock market had created.⁶² The court gave injunctions “by way of maxim that the creation of undue activity was a fraud.”⁶³

The Securities Exchange Act of 1934 is the extended solution of Federal government to prevent the evils of over speculation and manipulation of security prices. Its principal objects are:

- to control the undue speculation
- to give the public adequate financial information concerning the securities traded in, and;
- to avoid illegitimate manipulation of security prices and protect the public interest next to unfair practices.

The Act made certain general policies and plans for regulation to make effective the above mention principal objects. The most important part of this plan was to set up the Securities and Exchange Commission and grant it with wide regulatory and investigatory powers.⁶⁴ Section 9 and 10 specifically prohibits manipulative and deceptive devices. In discussing section 9 and 10 on manipulation it will be helpful to know about the devices which were engaged in the past. The term manipulation is functional to any practice

⁶⁰15 F. (S.D.N.Y.1936). As quoted in Article, Berle, “Stock Market Manipulation”, 402.

⁶¹Ibid.,402

⁶²Ibid.,402.

⁶³Ibid.

which intentionally rise, lower or fixing of security prices. Purchase and sale also effect prices but in a liberated and open market it is a natural outcome and do not have their any inflexible purpose. But manipulation leads to an artificial and controlled prices.⁶⁵

Another crucial form of creating a fake appearance of demand and market price is wash sale and matched orders. These are prohibited by section 9(a) (1) of the Act. Other effective manipulative devices are rumors, false statements and touting related to a security.⁶⁶ All these are prohibited by section (9) (a) (3) (4) and (5). The pool operation is another manipulative tool that is generally understood to be legitimate. Its use is intensive action among a number of traders to lift, lower or uphold the price of a security at certain point. When this purpose has achieved artificial price fall out and that price would not be reached by the self-governing buyer and sellers.⁶⁷ That pool operation is divided into the legitimate and illegitimate and recognized by the Exchange Act. In nutshell it can be said that Section 9 (a) (2) prohibits speculative pool operations while section 9(a) (6) only prohibits pegging fixing, or stabilizing the price of a security.⁶⁸

2.2 The U.K Securities Law as Regard to Market Manipulation.

Before discussing the law on market manipulation in UK it will be important to have an overview about the historical background of UK stock market.

⁶⁴James wm. Moor and Frank M. Wiseman. "Market Manipulation and the Exchange Act", *The University of Chicago law Review*, Vol.2, No.1 (Dec., 1934), 46. Published by the University of Chicago Law Review. [Http://www.Jstor.org/stable/1596296](http://www.Jstor.org/stable/1596296) (last visited on 21.4.2008)

⁶⁵Ibid.,50.

⁶⁶Ibid.

⁶⁷Ibid.

⁶⁸Ibid.,51.

2.2.1 Historical Back ground of U.K Stock Market.

As it is stated earlier that common law is considered to be the base of Securities laws of the modern world and on market manipulation too, it seems to lead even the securities law of U.S.A. History tells us that as early as thirteen century King Edward declared that broker in London should be licensed.⁶⁹ Common law made rules in Securities Market as regard to fraud very early.⁷⁰ The history of stock market in England is probably oldest in the world. Stock market has its foundation, as early as in 1688. There was a royal exchange and other Exchange like Edward Lloyd coffee house that was establish at tower street in the city of London and moved to the Lombored street in 1691- 92. By that time the coffee house recognized as a resort of marine insurance brokers and underwriters and they decided to form themselves into a society and admitted persons only of good repute. The society later was shifted to Royal exchange.⁷¹ As Dr. clapham said, "It was a type of commercial association that dealt with in many trades notably in the trade of stock brokers and stock jobber."⁷²

The purpose of stating all this is to make it clear that common law is the base of modern Securities law. The current era of stock market started on July 1st 1965 when the federation of stock exchanges in Great Britain and Ireland was created, then on 25th March 1973 a scheme of join up was implemented, under which deed of settlement 1875 embodied the constitution of stock exchange London, renaming it The Stock Exchange.⁷³ The history of market manipulation in common law is as old as the stock market itself. From ab initio Securities Law recognized conspiracy in stock market as a criminal offence. It had been considered criminal conspiracy to give a fabricated value to

⁶⁹<http://www.wdi.org/fi/securities/regexemp/history.htm> State of Wisconsin, Department of Financial Institution (last visited on 20.10.2008)

⁷⁰Berle, "Stock Market Manipulation," 393.

⁷¹Sir William Holdsworth, *A History of English Law*, Ed. by A.L. Goodhart, H. G. Hansbury, Volume xiii, London, Published by Methuen & Co.Ltd. 331.

⁷²Ibid.,332.

⁷³ Lord Hailsham of St. Marylebone, Lord High Chancellor of Great Britain. *Laws of England*, Fourth Edition, Volume 45, London Published by Butterworths, 1985, 6.

securities by fake rumors and by making deceptive trade in securities by false statement.⁷⁴

Common Law recognized stock market manipulation and took it as prohibition of abuse of information attained in official capacity.⁷⁵ Common law stated in constitutional law;

“A crown servant or former crown servant holding by virtue of that position or former position, information which he knows is unpublished price sensitive information or information in relation to securities of a particular company and which it would be reasonable to expect such an individual not to disclose except for the proper performance of the functions attaching to that position, and any such information knowing or having reasonable cause to believe that, that the information was held by virtue of his position may not;

- deal on a recognized stock exchange in any relevant securities.
- counsel or procure any other person to deal in any such securities, knowing or having reasonable cause to believe that other person would deal in them on a recognized stock exchange, or
- communicate to any other person, the information held or, as the case may be, obtained by him if he knows or has reasonable cause to believe that, that or some other person will make use of that information, for the purpose of dealing, or of counseling or procuring any other person to deal, on a recognized stock exchange in any such securities.”⁷⁶

TH 6670

⁷⁴ Ibid., 121.

⁷⁵ Ibid., 131.

⁷⁶ Ibid., 132.

2.2.2 The Development of Market Manipulation Law in United Kingdom

In the beginning English law recognized that there are some forms of conduct that could weaken the well-organized and fair procedure of the markets and these were 'forestalling, it mean to buy securities in the market in order to sell them at a higher price'⁷⁷ and cornering the market mean when a investor purchases enough stock and influence the stock or commodity's price.⁷⁸ In eleventh century these were offences in common law.⁷⁹ Later these offences converted into statutory offences and today these offences are conspiracy to defraud.⁸⁰ In early period scandals were not common in the financial market it became in the public eye in the early part of the last century. Legislation has been made specifically for fraud in the context of investment.⁸¹

In The Prevention of Fraud (investment) Act 1958 that was replaced and amended after the Prevention of Fraud (investment) Act 1939 according to the Act to tempt any venture transaction by making of a fake statement or by dishonestly concealing the material fact from the investors is a serious offence.⁸² The provision about this offence was re-enacted in the Financial Services Act 1986, s. 47(1) and a little valuable redrafting made too as in the FSMA 2000, s 397 and few prosecutions were effectively brought under these provisions.⁸³ Before the Financial Services Act 1986, no efforts were made to deal with the legislation and attempts to manipulate the market, other then through making false

⁷⁷ John Hobson Matthews, editor, Glossary, *Cardiff Records: volume 5* (1905), 557-598. URL: <http://www.british-history.ac.uk/report.aspx?compid=48215>. Supporting documents, Institute of Historical Resea (last visited 02 .8. 2009)

⁷⁸ www.investorglossary.com/cornering-the-market.htm. (last visited on 2.8.2009)

⁷⁹ Barry A K Rider , Kern Alexander, Lisa Linkder. *Butterworths Compliance Series, Market Abuse and Insider Dealing*. London, Butterworths, 2002. 109.

⁸⁰ Ibid.

⁸¹ Ibid.

⁸² Ibid.

statements, general criminal law and different self-regulatory provisions created a conduct for a fake market before the enactment of The Financial Services Act 1986, s 47(2) as a result of it the legislative control of manipulation practices was different than the enticement of transaction by fraudulent falsification and it is comparatively new in the United Kingdom.⁸⁴

In common law the judiciary have shown less sympathy for those who involved in manipulating the public markets for instance in *Rubery vs. Grant*⁸⁵ Sir Robert Malins VC considered it in these words,

“to charge that a person was a member of a share rigging syndicate amounted to an allegation that they were dishonest. He further said, “Going into the market pretending to buy shares by a person whom you put forward to buy them. Who is not really buying them, but only pretending to buy them, in orders that they may be quoted in the public papers as bearing a premium, which premium is never paid, is one of the most dishonest practices to which men can possibly resort.”⁸⁶

it was the most considerable period of law in England with regard to manipulation, prior to the enactment of the Financial Services Act 1986, s. 47 (2).⁸⁷ The earliest English case was determined or at least reported by the English courts was perhaps that of *R v De Berenger*.⁸⁸ This case involved one of the bold fraud ever perpetrated on a stock

⁸³Ibid.

⁸⁴Rider, Alexander & Linkder, *Butterworths Compliance Series, Market Abuse and Insider Dealing*, 109.

⁸⁵ see 1872. 13 LR 443. 110.

⁸⁶Rider, Alexander, & Linkder, *Butterworths Compliance Series, Market Abuse and Insider Dealing*, 109

⁸⁷Ibid.

⁸⁸ see [1814] 105 ER 536 as quoted in Barry A K Rider, Kern Alexander, Lisa Linkder. *Butterworths Compliance Series, Market Abuse and Insider Dealing*, London, Butterworths, 2002, 110.

market.⁸⁹ The English case law became familiar with market manipulation in the last decade of eighteenth century as in *Scott v Brown, Doreing, McNab & Co*⁹⁰ where

“brokers and client agreed to buy shares of a projected company on the stock exchange at a premium to induce the public to believe that there was a real market in the shares and real premium.⁹¹ *Held*: the contract was illegal.”⁹²

It means that the market manipulation is the formation of forged market in which the manipulator buys the securities in the market falsely and causes to fall the price.⁹³

The key statute of U.K securities law is the Financial Services Act 1986. The Criminal Justice Act 1993 which came into force on March 1994 has also recognized market manipulation as a criminal offence. Two types of market manipulation identified at Art.1 of the draft European Directives on market abuse. The section 118 of the FSMA 2000 explains two types of manipulation, first, manipulating devices and secondly manipulating transaction further FSMA 2000, s.118 (2) (b) (c) provides the particular condition that must be fulfilled in reverence of market manipulation and those conditions are; Firstly The behaviour in issue is liable to give, a fake or deceptive impression as to the supply or demand of or as to the usual user of the market. Secondly distort the investment market.⁹⁴ The behaviour described in section 118 (8) of the Act and section 118 (6) of the Act tells us about manipulating devices. Financial services authority also

⁸⁹Rider , Alexander, & Linkder. *Butterworths Compliance Series, Market Abuse and Insider Dealing*, 110.

⁹⁰see [1892] 2 QB 724.

⁹¹Ibid.

⁹² Philip R Wood, Law and Practice of International Finance, *International Loans, Bonds and Securities Regulation* ,London , published by Sweet and Maxwell, 1995, 347.
see [1892] 2 QB 724 ,347.

⁹³Ibid.

⁹⁴ Rider, Alexander, & Linkder. *Butterworths Compliance Series,Market Abuse and Insider Dealing*, 93-103.

published policy statement on the implementation of the market abuse directives in March 2005 which described the market manipulation.

The civil offence will run in equivalent to the legislative criminal offences of deceptive statements, practices and the common law criminal offence of conspiracy to defraud.⁹⁵ The legal offences were formerly limited in the Financial Services Act, 1986. s. 47, but in the FSMA 2000, s.397. It has been re-enacted.⁹⁶ The Code of Market Conduct gives particular examples of general types of manipulative behaviour instead of defining market manipulation.⁹⁷ This move toward manipulation is similar to that securities law in the USA where the Securities Exchange Act 1934 does not define manipulation or manipulative behavior but it states different rules made by the securities exchange commission related to the specific Act or activities that are prescribed as manipulative behaviour.

As it is stated earlier that before the enactment of Financial Services Act 1986 there was only general criminal law and other self regulatory provisions on the offence of creating a false market by conduct. As a result, the statutory control on manipulative practices is relatively new to the United Kingdom.⁹⁸

⁹⁵ see *R v De Berenger* [1814]105 ER 536 and *Scott v Brown* [1892] 2QB724

⁹⁶ *Ibid.*

⁹⁷ Rider, Alexander, & Linkder. *Butterworths Compliance Series, Market Abuse and Insider Dealing*,

95.

⁹⁸*Ibid.*

2.3 Indian Securities Law on Market Manipulation

The major securities law in India is The Securities Exchange Board of India Act 1992. The law on manipulation was enhanced by SEBI (Amendment) Act, 2002 with the addition of a full chapter on the question of manipulation.⁹⁹ It clearly shows the importance and significance of SEBI for such situation. Chapter V A directly prohibits the manipulation. It will be helpful to produce the actual words of the Act to understand the true meaning of what it describes in Chapter V A. s.12A states Prohibition of manipulative and deceptive devices, insider trading and substantial acquisition of securities or control.

“12 A. No person shall directly or in directly ---

- (a) use or employ, in connection with the issue, purchase or sale of any securities listed or proposed to be listed on a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or the rules or the regulations made there under;
- (b) employ any device, scheme or artifice to defraud in connection with issue or dealing in securities which are listed or proposed to be listed on a recognized stock exchange;
- (c) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed on a recognized stock exchange, in contravention of the provisions of this Act or the rules or regulations made there under;
- (d) engage in insider dealing. Deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provision of this Act or the rules or the regulations made there under;

⁹⁹ Niazi, *The Law of Insider Trading in Pakistan*, 49.

- (e) acquire control of any company or securities more than the percentage of equity share capital of a company whose securities are listed or proposed to be listed on a recognized stock exchange in contravention of regulation under this Act.”¹⁰⁰

The first three parts of the section 12A are directly dealing with the manipulation and market abuse. Although the Act does not provide a direct penalty for Manipulation as is given for insider trading but section 15 HA of the Act provides penalty for fraudulent and unfair trade practices. The Act states;

“If any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty of twenty – five crore rupees or three times the amount of profits made out of such practices, which ever is higher.”

The interesting aspect is that the amount of both penalties, insider trading and for fraudulent and unfair trade practices is the same. The SEBI stock brokers and sub-brokers rules and regulation contains a code of conduct which specifically prohibits broker and sub-brokers from engaging in the act of the market manipulation, regulation 7A states the following behavior as under:

- 1- “Manipulation: A stock broker shall not indulge in manipulation, fraudulent or deceptive transaction or scheme or spread rumors with a view to distorting market equilibrium or making personal gain.
- 2- Malpractices: A stock broker shall not create false market either singly or in concert with others or indulge in any act detrimental to investor’s interest or which leads to the interference with the fair and smooth functioning of the market.”¹⁰¹

Here the prohibition against market manipulation should extend to the conditions where

¹⁰⁰The Securities and Exchange Board of India Act,1992.No.15 of 1992. the whole text is available on www.sebi.gov.in/acts/act15.pdf (last visited on 24.10.2008)

¹⁰¹Schedule II Securities and Exchange Board of India (stock brokers and sub- brokers) Regulations 1992, Code of conduct for stock brokers Regulation 7. Text is available on <http://www.sebi.gov.in> (last visited 20.7.2008)

the brokers or sub- brokers are not the principal manipulators¹⁰². Market manipulation is also prohibited by SEBI (Prohibition of fraudulent and Unfair Trade practices relating to securities market) Regulation 1995. Regulation 4 of the law states that no person shall:

- (a) “effect, take part in or enter into ,either directly or indirectly, transactions in securities, with the intention of artificially raises or depressing the prices of securities and thereby inducing the sale or purchase of securities by any person;
- (b) Indulge in any act ,which is calculated to create a false or misleading appearance of trading on the securities market;
- (c) indulge in any act which results in reflection of prices of securities based on transaction that are not genuine trade transaction.
- (d) enter into a purchase or sale of any securities, not intended to effect transfer of beneficial ownership but intended to operate only a device to inflate, depress, or cause fluctuation in the market price of securities.
- (e) pay ,offer or agree to pay or offer ,directly or indirectly ,to any person any money or money’s worth for inducing another person to sell any security with the sole object of inflating, depressing, or causing fluctuations in the market price of securities.”¹⁰³

These regulations are vast in span because these are not only concerning to persons who are licensed individually and in entities but also to non-licensed individuals and entities such as purchaser.¹⁰⁴ National stock Exchange of India Ltd. had published an investigation module for market manipulation which was arranged by the Price Waterhouse LLP. It was published in August, 1997 and was titled as Financial Institution Reforms and Expansion (FIRE) project. In it a legal frame work had been given for the

¹⁰² “*Investigation module for Market Manipulation*,” National Stock Exchange of India Act Ltd. August 13, 1997 text is available on the <http://www.sebi.gov.in/PNACB457> (last visited on 3.11.2008)

¹⁰³ SEBI (prohibition of fraudulent and unfair trade practices relating to securities market) Regulation 1995. Text is available on <http://www.sebi.gov.in> (last visited on 3.11.2008)

¹⁰⁴ “*Investigation module for Market Manipulation*,” National Stock Exchange of India Act Ltd. ,7.

members of the NSEI. In this report it was stated that members of the NSEI staff must accept following three legal basics in investigation of manipulating;

- The member will identify of the individual or group who have a concern or purpose to engage in an activity that has the purpose of the intentional raising, lowering or fixing of the price of a script.
- They will also identify any conduct or activity that create real or obvious active trading, or caused a rise, decline or pegging off the price of a security.
- Any activity that was undertaken to encourage the buy or sale of script by others.¹⁰⁵

This investigating report also states that person engage in activities which causes the raise or fall is not always illegal since there is no objective to manipulate. For example a large investor who is present in a share holders meeting and come on this conclusion that the script of the company is overruled and sells all its securities. This act may lower the price of the script; here the goal is not to manipulate it is clear now that intention is the main constituent to establish in a manipulating case.¹⁰⁶ The general guidelines and unfair trade practices sections under part 4 trading regulation of the NSEI Regulations also prohibits manipulative trading practices. Especially in Regulation 4.5.5 (c) and Regulation 4.6, unfair Trading practices has a prohibition against market manipulation activity by trading members. The SEBI (stock brokers and sub- brokers Rules and Regulation 1992) chapter VI general obligations and responsibilities, 17 (1)¹⁰⁷ requires from the brokers to sustain definite records and this record can help and give important

¹⁰⁵ Ibid.,6.

¹⁰⁶ Ibid.,7.

¹⁰⁷ Ibid.

information in shaping the individuality and trading activity of customers who are occupied in price rigging.¹⁰⁸

After studying the Indian securities law on manipulation it can be said that Indian law is current and modernized on the issue of market manipulation. Direction can be taken from the Indian law to improve Pakistani law on market manipulation.

2.4 International Organization of Securities Commission as an International Body of Securities Regulation

International Organization of Securities Commission is an international association of securities regulators that was created in 1983 from the conversion of its ancestor inter-American regional association (created in 1973) into a truly international cooperative body.¹⁰⁹ From North and South America eleven securities regulatory agencies became united in Quito, Ecuador in April to take that significant resolution about the formation of the organization. Today International Organization of Securities Commission has known as an international standard setter for securities market.¹¹⁰ The organization has a vast membership and it is regulating more than 90% of the world's securities markets.¹¹¹ For securities regulatory agencies International Organization of Securities Commission is the world's most significant worldwide forum.¹¹² IOSCO is dealing to regulate more than one hundred jurisdictions and its membership is still growing day by day. Now the organization is the principal international alliance of securities market regulators.¹¹³

¹⁰⁸ Ibid., 14.

¹⁰⁹ Available at the official website of IOSCO, [http:// www.iosco.org/about/index.cfm?section=history](http://www.iosco.org/about/index.cfm?section=history) (last visited on 24.10.2008)

¹¹⁰ Ibid.

¹¹¹ Ibid.

¹¹² Ibid.

¹¹³ Ibid.

A comprehensive set of Objectives and Principles of Securities Regulation were adopted by the Organization in 1998.¹¹⁴ They are considered now as the international regulatory bench mark for all securities markets setting out basically 30 principles of securities regulations. These principles are based upon three objectives of securities regulation. Those three objectives are;

- The protection of investors.
- Ensuring that markets are fair, efficient and transparent.
- The reduction of systemic risk.¹¹⁵

Analysis of the above three objectives shows that all efforts are made to give Protections to the investors and to ensure that securities market should be fair and transparent. To remove all types of market abuse is also one of the objectives of IOSCO. Section “H” of the document is dealing with the principles of the secondary market. It is clearly stated as a principle of secondary market that regulation should promote transparency of trading.¹¹⁶ The other principle which directly deals with the offence of manipulation is stated in the principals of secondary market in these words “Regulation should be designed to detect and deter manipulation and other unfair trading practices”.¹¹⁷

Here transparency has defined as under the degree to which information about trading, whether it is pre- traded or post traded, is made publicly available.¹¹⁸ “Ensuring timely access to information is a key to the regulation of secondary trading. Timely access to

¹¹⁴Ibid.

¹¹⁵“*Objectives and Principles of Securities Regulation*, “May 2003. The whole text is available on the official website of IOSCO. www.IOSCO.org/about/index.cfm?section=history. (Last visited 23.4.2007)

¹¹⁶Ibid., 43.

¹¹⁷Ibid.

¹¹⁸Ibid., 43.

relevant information about secondary trading allows investors to better look after their own interests and reduces the risk of manipulation or other unfair trading practices”.¹¹⁹

The regulation of trading in the secondary market is supposed to prohibit market manipulation, misleading conduct, insider trading and other fraudulent or deceptive conduct which may change the price discovery system, change prices and disadvantage investors.¹²⁰ Such conduct may be addressed by direct surveillance, inspection, reporting, product design requirements, position limits, settlement price rules or markets halts complemented by vigorous enforcement of the law and trading rules.¹²¹ It is the duty of the regulators that they must guarantee, that there are in place arrangements for the continuous monitoring of trading.¹²² It should start inquiry whenever abnormal and potentially offensive trading occurs.¹²³ The fact that regulation is adequate to cover up market conduct must be assured by giving a particular care for example, conduct in which the price of an equity product is manipulated in order to benefit through the trading of option, warrants or other derivative instrument in trade, or where identical financial products are traded in two jurisdictions, there may be increased potential for fraud and manipulation because of the difficulty of a regulator in one jurisdiction to monitor market activity directly to complete investigation of market activities in another jurisdiction.

¹¹⁹ see generally the discussion in Public Document No,27 at section 3 and 4 on the content of information. Available on <http://www.IOSCO.org> website (last visited on 27.10.2008)

¹²⁰ see IOSCO Public Document No.103, “*Investigating and Proceeding Market Manipulation*,” IOSCO Technical Committee, May 2000; and IOSCO Public Document No, 145. “*Insider Trading – how Jurisdictions Regulate it*,” IOSCO Emerging Markets Committee, May 2003. Available on <http://www.IOSCO.org> website (last visited on 12.8.2008)

¹²¹ see also IOSCO Public Document No,85. “*The Application of the Tokyo Communique' to Exchange Traded Financial Derivatives Contracts*,” IOSCO Technical Committee, September 1998. Available on <http://www.iosco.org> (last visited on 21.10.2008)

¹²² *Objectives and Principles of Securities Regulation*, 243.

¹²³ *Ibid.*

There must be adequate information sharing between relevant regulatory authorities, sufficient to ensure effective enforcement.¹²⁴

2.4.1 Market Abuse and International Organization of Securities Commission

IOSCO recognizes this fact that investors should be sheltered from fraud and manipulation.¹²⁵ A wide explanation of manipulative or fraudulent practices has been adopted by the organization behavior of insider trader and operation of purchase is also included in that definition.¹²⁶ IOSCO has selected the principle for ensuring investor's protection. The reason is that full revelation not only reduces information asymmetries in the market but also benefits the investor's position to review the possible risks and rewards of their investment¹²⁷. Organization also considers that a main constituent of full disclosure requires a sufficient accounting and auditing standard.¹²⁸ Besides of all principals and considerations, only properly licensed and certified persons should be permitted to provide the investment services to the public.¹²⁹ The organization encourages state establishment to implement strict principles of supervision for market intermediaries for the reason of achieving investor's protection by setting minimum standards for market participants.¹³⁰ International Organization of Securities Commission sets out the standards too that investors should have access to impartial venue/forum such as courts and tribunals, to inquire about remedy for damages and other injuries arising

¹²⁴ see also IOSCO Public Document No.143."Indexation :Securities Indices and Index Derivatives,"IOSCO Technical Committee, February 2003, 35- 40. Available on <http://www.iosco.org> (last visited on 21.10.2008)

¹²⁵*Objectives and Principles of Securities Regulation*, 242.

¹²⁶Ibid.243

¹²⁷Ibid.

¹²⁸Ibid.

¹²⁹Ibid.

¹³⁰Ibid.

from market abuse and other misdemeanors and remedies should comprise sufficient damages or compensation.¹³¹ National regulators have encouraged adopting network of joint assistance in this regard and it must lead to more effective enforcement.¹³² International Organization of Securities Commission has 109 member countries all over the world including Pakistan.¹³³

¹³¹ Rider, Alexander & Linkder. *Butterworths Compliance Series Market Abuse and Insider Dealing*, 243.

¹³² Ibid.

¹³³ <http://www.iosco.org/lists/display-members.cfm?memID=1&orderby=none> (last visited 25.11.2008)

CHAPTER 3

MARKET MANIPULATION LAWS IN PAKISTAN

3.1 Introduction of Stock Markets in Pakistan

As it has been discussed in chapter one that major role of stock market is to give a suitable way to investors for their investments.¹ In Pakistan the history of stock market is not very old. After the emergence of Pakistan in 1947, the very first stock market came into existence in 1949 in Karachi.² At primary stage just five companies were listed with a paid up capital of Rs. 37 million. With this ordinary launch the Karachi stock exchange now has turn into the main organization in the financial sector of Pakistan.³ KSE is the principal, most liquid exchange and according to the international magazine Business Week⁴ has been declared as the best performing stock market of the world for the year 2002.⁵ 653 companies were listed on July 31 2008 with the KSE.⁶ After two decades of the establishment of KSE, the Lahore stock Exchange came into being in October 1970 and it is the second largest Exchange in the country with a market

¹ Muhammad Soebhaehullah khan, *The Securities Market in Pakistan*, Karachi, Published by the Royal Book company, 1993, 1.

² Mohibul Haq Sahibzada, ed. *Emerging Role of Stock Markets in Pakistan Economy*, Islamabad, Institute of Policy Studies, Pakistan 1995, 49.

³ Ibid.

⁴ <http://www.kse.com.pk> website (last visited on 16.11.2008)

⁵ Ibid.

share of around 12 – 16% in terms of daily traded volumes. It is working mainly as a regional market. LSE has 519 companies, spanning 37 sectors of the economy that are listed on the Exchange with total listed capital of Rs.555.67 billions having market capitalization of around Rs.3.64 trillion.⁷ LSE has 152 members of whom 81 are corporate and 54 are individual members.⁸ Activities of Lahore stock exchange have enlarged notably in all operational areas since its beginning. After few years of its start Lahore Stock Exchange has successfully met different challenges and now is ready to compete with its associate exchanges.⁹ Although Lahore stock Exchange is contributing a lot towards the growth of capital markets in Pakistan but it has been taken a number of momentous initiatives to advance the regulatory regime and the trading setting for the advantage of institutional investors as well as listed companies.¹⁰ The list of such project is comprehensive, LSE is the first Exchange in the country to undertake automation of trading at the Exchanges in 1994, and it is the first exchange in Pakistan that is offering internet based trading to its member since year 2001.¹¹ The third biggest stock exchange is Islamabad Stock Exchange which start trading with 35 listed companies, it is incorporated on October 25, 1989 and becomes fully operational on August 10, 1992.¹² Since Islamabad stock Exchange is shifted into computerized trading in September 1997 it has registered great growth in its business volume, previously the main difficulty from which all stock exchanges in Pakistan are suffering is the time consuming and inefficient working system which block real growth in trade volume

⁶Ibid.

⁷<http://www.Lahorestock.com/Default.htm> (last visited on 25.2.2007)

⁸Ibid.

⁹Ibid.

¹⁰Ibid.

¹¹Ibid.

¹²www.nationmaster.com/encyclopedia/islamabad-stock-exchange (last visited on 17.2.2009)

manual handling of investor's accounts has now become outdated.¹³ Automation has been introduced in the trading houses because without automatic of trading system it is not feasible to meet the requirement of growing number of investor so the Islamabad Stock Exchange is the second in line to start to computerization after Lahore Stock Exchange¹⁴The Karachi Stock Exchange is the biggest of the two stock markets and accumulation of its trading nearly 80% takes place on its floor.¹⁵ Karachi Stock Exchange has also considered being the main test of Pakistani stock markets. Generally brokers are considered to be the members of the exchange and foreigner can only utilize the exchange by employing a member as an agent.¹⁶ Foreigners are not permitted to hold seats in the exchange.¹⁷ There are two types of brokerage houses which are working here in Karachi Stock Exchange; one are small operations brokerage houses, consist of two or three persons relying upon brokerage commission for revenue. On the other hand the bigger brokerage houses, those are enthusiastically concerned in the fixed income security market and offer wide market research.¹⁸ Karachi Stock Exchange is principally recognized as a guarantee company and its members are responsible for its administration the managing committee and president of KSE are selected annually by the members. The managing committee has sixteen members, of that fourteen are elected and two are nomine of ICP and NIT. Since it is limited by guarantee, the liability

¹³Ibid

¹⁴Ibid.

¹⁵ Muhammad Soebhaehullah khan, *The Securities Market in Pakistan*, 4.

¹⁶M.B.Abassi, *Capital market in Pakistan*, Karachi, published by Ferozsons Printers (Pvt.) Ltd. 1994, 86.

¹⁷Ibid.,88.

¹⁸Ibid.

of the exchange members is restricted to such financial records as the member undertakes to add the assets of the company in the occurrence of its winding up.¹⁹

Securities and Exchange Commission of Pakistan is the apex body to regulate all the stock markets in Pakistan. The Securities and Exchange Commission of Pakistan become operational in January 1999 and since then it has come a long way. At the start it is concerned with the regulation of corporate sector and capital market.²⁰ By the time its obligation has extended to comprise administration and regulation of insurance companies, non-banking finance companies. The Securities and Exchange Commission has also giving various external service to the corporate and financial sectors, including chartered accountants, credit rating agencies corporate secretaries, brokers, etc. The challenge for the Securities and Exchange Commission has augmented with its increased mandate.²¹

3.1.1 Stock Market Crash of 2005 in Pakistan

Although the Pakistani stock market saw stock market crashes several times as in May, 2002 but the worst stock market crash in its history was that of March 2005. As earlier in chapter one it has been discussed in details what is stock market crash.

Here it will be sufficient to say that stock market crash is a situation where a sudden turn down of stock prices happens. As a result the stock market collapses and investors gets heavy loss. Here our purpose is not to discuss the stock market crash but here the discussion will be on those factors which lead to the stock market crash of

¹⁹Ibid.

²⁰<http://www.secp.gov.pk/abputs.asp>(last visited on 24.2.2009)

²¹Ibid.

benefited from the manipulation of the market sentiments, prices and liquidity. The Report also recognized the main reasons of the condition that developed in March 2005 and explained how the dealings approved outside the rules of the market presumably to 'save' the market, benefited some of the very few people who set these transactions.²⁶ The Report has also described that how public institutions managers made harm to common investor arising from the pre-arranged transaction using public money, in clear violation of their institutional mandates.²⁷

3.1.2 Whether the Market Manipulation was a Factor of Stock Market Crash of March 2005?

Market manipulation might probably be one of the main factors of stock market crash. As it was stated in the terms of reference of the Taskforce report, held by Securities and Exchange Commission of Pakistan, to inspect charge of market manipulation, insider trading and other market abuses and to propose regulatory and operational reforms for investors safety.²⁸

The study of the stock market crash of March 2005 recognized a number of possible cases of market abuse where market players had undertaken wash trades and brokers frequently manipulate the market different scrip were manipulated and played in diverse ways by the key brokers to their benefit.²⁹ It was also distinguished in The Taskforce Report that "one side brokers and their staff wore numerous hats simultaneously, of

²⁶Report of the Taskforce: *Review of the Stock Market Situation March 2005*. June 2005, 7. The whole text of this available on http://www.secp.gov.pk/Report/rpt_taskforce_stockmarket%20pdf (last visited on 20.11.2008)

²⁷Ibid.

²⁸ Ibid.,iii.

²⁹Ibid.,23.

brokers, of badla, of mutual funds, and the other side brokers and their staff regularly conducted trades among their own accounts and that of their client, in this manner they created many opportunities for market abuse.³⁰

At present there are no restrictions on the point of day trading by a broker, principally due to the lack of pre-trade confirmation systems and other money sufficiency measure. This weakness helps the market manipulation.³¹ It is attached with an approximately out of control exercise of wash trades. That is done openly by a broker's client or through the use of two or more brokerages, in breach of the rules. The Taskforce strongly urged that Securities and Exchange Commission of Pakistan have to take on a potential trial of alleged wash-trades and other manipulative practices.³²

3.2 Market Manipulation Laws in Pakistan

Laws on market manipulation in Pakistan are not as much developed as the laws in USA or UK. This weakness of law comes into the public eye due to the stock market crash of the year 2000.³³ The reforms in law started in year 2001. The principal law on market manipulation has been embodied in The Securities and Exchange Ordinance, 1969. Chapter IV of the Ordinance deals with the Prohibition and Restrictions. Section 17 is about market manipulation although the section 17 is not directly dealing with the offence of market manipulation but it only prohibits fraudulent acts in the context of manipulation.

³⁰Ibid.,24.

³¹Ibid.,26

³²Ibid.

³³Samia Maqbool Niazi, *The Law of Insider Trading in Pakistan*, Rawalpindi, published by Federal Law House,2007,60.

The section states the following;

Section 17. Prohibition of fraudulent acts, etc. - No person shall, for the purpose of inducing, discussing, effecting, preventing or in any manner influencing or turning to his advantage, the sale or purchase of any security, directly or indirectly, -

- (a) employ any device, scheme or artifice or engage in any act, practice or course of business, which operates or is intended or calculated to operate as a fraud or deceit upon any person; or
- (b) make any suggestion or statement as a fact of that which he does not believe to be true; or
- (c) Omit to state or actively conceal a material fact having knowledge or belief of such or belief of such fact; or
- (d) Induce any person by deceiving him to do or omit to do any thing which he would not do or omit if he were not so deceived; or
- (e) Do any act or practice or engage in a course of business, or omit to do any act which operates as a fraud, deceit or manipulation upon any person, in particular ---
 - i. Make any fictitious question;
 - ii. Create a false and misleading appearance of active trading in any security;
 - iii. Effect any transaction in such security which involves no change in its beneficial ownership;
 - iv. Enter into an order or orders for the purchase and sale of security which will ultimately cancel out each other and will not result in any change in the beneficial ownership of such security;
 - v. Directly or indirectly effect a series of transactions in any security creating the appearance of active trading therein or of raising of price for the purpose of inducing its purchase by others or depressing its price for the purpose of inducing its sale by others;
 - vi. Being a director or an officer of the issuer of a listed equity security or a beneficial owner of not less than ten per cent of such security who is in possession of material facts omit to disclose any such facts while buying or selling such security.³⁴

³⁴The Securities and Exchange Ordinance, 1969. Karachi, Ideal Publishers, 2007.

Having a look on the section 17 (e) of the securities & exchange ordinance, 1969 it becomes clear that it deals with the manipulative activities. Further the Ordinance provides the penalty on the offence states in section 17. The section 24 states as follows;

S.24, Penalty. --- (1) whoever contravenes the provisions of section 17 shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to thirty thousand rupees, or with both.

(2) Where the person guilty of an offence referred to in sub-section (1) is a company or other body corporate, every director, manager or other officer responsible for the conduct of its affairs shall, unless he proves that the offence was committed without his knowledge or that he exercised all diligence to prevent its commission, be deemed to be guilty of the offence.

S.25, Cognizance of offence. ----- No court shall take cognizance of any offence punishable under this ordinance except on a report in writing of the facts constituting the offence by an officer authorized in this behalf by the commission and no court inferior to that of a court of session shall try any such offence.³⁵

The law seems not comprehensive in the context of manipulative practices and moreover penalties on market manipulation are not sufficient. The penalties are too low. All these penalties must be revised.

3.2.1 The Brokers and Agents Registration Rules, 2001.

The Brokers and Agents Rules, 2001 has some clauses on the manipulation.

The Rule 12 is as follows that;

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

The code of conduct prescribed for brokers in the Third schedule in the said Rules is as follows;

Clause A3 – Manipulation. - a broker shall not indulge in manipulative, fraudulent or deceptive transaction or scheme or spread rumors with a view to distorting market equilibrium or making personal gains.

³⁵Ibid.

Clause A4 – Malpractices. - a broker shall not create false market either singly or in concert with others or indulging in any act detrimental to the investors' interest or which leads to interference with 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.

Clause A5 – Compliance with statutory requirements. A broker shall abide by all 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.³⁶

Rule 12 provides a code of conduct for the brokers. Again Rule 8 of The Brokers and Agents Registration Rules, 2001, is about the suspension of the registration of the brokers who indulges themselves in the manipulating and price rigging. The clause 8(xi) states as follows;

Rule 8. Suspension of registration. – Where the commission is of the opinion that a broker- (xi) has indulged in manipulating price rigging or cornering activities in a stock exchange; the commission may, if it considers necessary in the public interest so to do, by order in writing:--

- (a) Suspend the registration of a broker for such period as may be specified in the order; or
- (b) Impose on broker a fine not exceeding one thousand rupees: Provided that an appropriate opportunity of being heard shall be provided to the broker to clarify his position with regard to suspension of registration.³⁷

By analyzing the Rule 12 it is obvious that it provides a code of conduct for brokers and Rule 8 gives a punishment to those brokers who indulge in manipulating price rigging or cornering activities in a stock exchange. This act suspends registration of the broker and brokers will be fined not exceeding one hundred rupees. That is not sufficient because the amount of fine is too low.

³⁶The Brokers and Agents Registration Rules,2001. The whole text is also available on [http://www.secp.gov.pk/corporatelaw/pdf/BrokersAndAgentsRegistrationRules2001\(2\).pdf](http://www.secp.gov.pk/corporatelaw/pdf/BrokersAndAgentsRegistrationRules2001(2).pdf). (last visited on 26.11.06)

³⁷ibid.

3.2.2 The Securities & Exchange Commission of Pakistan Act, 1997

Part VI of the SECP Act of 1997 is about powers and functions of the SECP. Section 20 of the Act states about the power and function of the commission. Clause 4(g) specifically tell about the prohibition of fraudulent practices. Clause 4(g) is as follows:

Clause 4- The commission shall be responsible for the performance of the following functions:

- (g) prohibiting fraudulent and unfair trade practices relating to securities markets.³⁸

Although the laws on market manipulation have been established from the beginning of securities market in Pakistan but they are not sufficient and the remedies against the offence of market manipulation does not create any criminal liability on the person who commits the crime of market manipulation as it is in UK securities law that treats market manipulation as a criminal offence.

It is discussed earlier in chapter two that according to U.K securities law the offence is treated as civil wrong and also as a criminal offence. Like the Criminal Justice Act 1993 of UK that recognizes market manipulation as a criminal offence and the Financial Services and Market Act 2000 introduces market manipulation as civil offence. In Pakistan the law on market manipulation comes into light after the stock market crash of March 2005 where some instances of stock market manipulation has been seen. The taskforce report on the stock market situation in March 2005 investigates the factors of market manipulation and insider dealing. The report takes market manipulation as a

broader term in which insider dealing and other market abuse falls under in it. The report also gives suggestion and proposals for reforms.

3.3 The Recent Cases of Market Manipulation

After the Taskforce Report SECP conducted two other investigation reports where market manipulation was involved in both cases. The first case was about the Callmate Tellips Telecommunication Co.Ltd from the period November 7, 2006 to December 8, 2006. The investigation was about the abnormal trading behavior in the shares of Callmates Telips Telecom Company Ltd. It was stated in the report that after the study of the trading records that was reviewed both at a broker's level and the client level, it became obvious that persons acting in it including main officials, were involved in insider trading and price manipulation of the shares.³⁹

In this case the group who were involved in market manipulation increased on one side the value of scrip by purchasing large quantity of scrip while, on the other side a false turnover was generated by buying and selling of the shares. In this case during pre-open sessions the cost of the scrip was manipulated by insertion of irregular bids and offers, during in this case shares were bought from various brokerage houses and financing was obtained through the CFS. Market profits were generated by making mock

³⁸The Securities & Exchange Commission of Pakistan Act, 1997.

³⁹Investigation Report, Callmates Tellips Telecommunication Co. Ltd, SECP, Securities Market Division, April, 2007, 3. the whole text is available on http://www.secp.gov.pk/Report/Nov_14CTTLreport.pdf (last visited on 11.12.2008)

turnover as well as manipulating prices upwards and downwards that were next used to get new shares.⁴⁰

In the course of the study it was observed that a big number of shares and cash were being transferred from one member of the group to another with no clear consideration.⁴¹

According to the investigation report CFO of Callmate Tellips Telecom Company Ltd. was found to be the chief players in the group and has been caught up in price manipulation and other prohibited practices.⁴² After reviewing the data and the records of report gave conclusion that there was violation of different laws, regulation and guidelines. In this case a clear violation of section 17 (e) of the Securities & Exchange Ordinance 1969 took place. Under this law price manipulation and wash trades are prohibited.

3.3.1 CTTL Investigation Report's Findings on the Issues

The investigation report gave findings on mainly three major issues.

- Findings linked to brokers
- Findings associated to Individual Members of the Group
- Findings linked to KSE⁴³

As for as individual members of the group were concerned it was found that a number of persons were indulged in sale and purchase of CTTL shares and they founded that a group consisted on the officials of the Callmate Tellips Telecommunication Ltd was caught up in trading of shares, falsely generated returns and make a high trend in the market place. The group was also involved in manipulating the price of the scrip so that it

⁴⁰Ibid.,3.

⁴¹Ibid.

⁴²Ibid.

⁴³Ibid.,14.

became twice increased in a month. There were evidences of the involvement of manipulating the price of Callmate Tellips Telecommunication Ltd shares by putting regularly high bids and offers.⁴⁴

Having a look at the related law for brokers it becomes clear that for a broker, having a certificate of registration, under the Broker and Agents Registration Rules, 2001 is obligatory. When a broker do not abide by these rules it is a clear violation of Rule 12 of the broker's Rules and as a result shall be penalized under Rule 8.⁴⁵ It is the duty of a broker under the code of conduct, to act with due skill, care and diligence in performing of his bussiness. Moreover, a broker is not likely to participate in any act that is disadvantageous to investor's interest or which leads to hinder the smooth and fair performance of the market. Further the investigation report states in its findings that as a market member, it is the duty of the brokers to guard the interest of the investors and to guarantee fair, well-organized and clear market. The brokers are expected to maintain high values of honesty, professionalism and equality in the ways of their business. It is also founded in the investigation report that brokers have acted in conspiracy with the clients to manipulate the price, undertook market manipulation; besides this brokers are a strong party to affect insider trading by officials of Callmates Tellips Telecommunication Ltd. These actions are the infringement of Rule -12 of Broker and Agents Registration Rules, 2001 that recommends the code of conduct for brokers.⁴⁶

Findings related to the Karachi Stock Exchange shows that there are several faults into the existing risk management system of Karachi Stock Exchange and the individual concern in the insider dealing, manipulation of prices and prohibitive

⁴⁴Ibid.

⁴⁵Ibid.,64.

practices have taken advantages of these faults. The investigation made clear this fact that Karachi stock exchange has not played its role as a leading regulator and did not correctly enforce its rules and regulations and did not take a solid action when evidence of insider trading and price manipulation become uncontrolled.⁴⁷

3.3.2 Court Judgment on CTTL Case

Although SECP conducted the investigation report on Callmate Tellips Telecommunication Ltd. case, further Securities and Exchange Commission of Pakistan filed a complaint in the court against the persons who were accused of the wrongful gain. The case was filed under the head of Securities and Exchange Commission of Pakistan vs. Muhammad Ajmal Ansari and others in the court of Additional Session judge Karachi South. The case was decided on 14.17.2007. The complaint was filed under section 15 – A and section 17 punishable under 15 B (4) and section 24 and 25 of the Securities and exchange Ordinance, 1969. The judge gave his order in these words:

“From the evidence which has been placed on the record including the SECP report the accused persons for obtaining their wrongful gain engaged in wash trades/circular trades insider trading and other manipulative practices, in which they aided and abetted each other. The accused persons created false and misleading appearance of active trading in CTTL shares with view to raising the price of the CTTL shares for inducing purchase by the public at large and also sold the CTTL shares to make unlawful gains. In addition, the accused persons used price sensitive insider information to indulge in trading in CTTL shares. Prima facie offence under section 15- A and section 17 punishable under section 15 B and sections 24 read with 25 is made out against the accused persons in the sum of Rs.100, 000/- (one lac each) with one surety and PR bond in the like amount each in terms of section 265-c Cr. P.C.”⁴⁸

⁴⁶Ibid.

⁴⁷Ibid.,104.

Securities and Exchange Commission of Pakistan after conducting the investigation, brought the case of Callmate Tellips Telecommunication Ltd to the court and it was a big step of SECP to eliminate the market Manipulation. But still a lot more has to be done in this regard.

3.3.3 The Case of Kot Adu Power Company Limited

The second investigation report conducted by SECP was the report on the manipulative and other prohibited activities into the Kot Adu Power Company Limited. (KAPCO) “Kot Adu Power Company was incorporated and on April 25, 1996 as a public limited company and was listed on April 18, 2005 on the Karachi, Islamabad and Lahore stock Exchanges. The major activities of KAPCO are to hold, operate and maintain a multi-fuel fired power station with fifteen generating units with a capacity of 1,600 MW.”⁴⁹

It was a representative market manipulation case moreover, there was other non-compliances of the securities market law. During January 24,2007 to May 25, 2007 an extraordinary trading movement had been seen in the shares of Kot Adu Power Company Limited.⁵⁰ The investigation Report showed that a “member of Karachi Stock Exchange planned a scheme of market manipulation in the shares of KAPCO, with the collusion of its various clients during the period under review. While part of the scheme, substantial quantity of KAPCO shares,197 million shares amounting to Rs.11 billion

⁴⁸The whole text of this Judgment is available on www.secp.gov.pk/orders/pdf/orders_7/ctl.pdf (last visited on 3.12.2008)

⁴⁹Investigation Report, *On the Manipulative and Other Prohibitive Activities into Kot Adu Power Company Limited Period Under Review January 24, 2007 to May 25,2007*, Securities & Exchange Commission of Pakistan Securities Market Division,3.The whole text is available on <http://www.secp.gov.pk/Reports/KAPCO%20Report.pdf> (last visited on 24.12.2007)

⁵⁰Ibid.

were brought by the group, out of which 173 million shares amounting to Rs.9.9 billion were sold during the period January 24, 2007 to May 25,2007.”⁵¹

The above mentioned trading volumes were executed with a view to make fake trading in KAPCO for the purposes of suggesting others to buy KAPCO shares. The group was found greatly caught up in execution of wash/circular trades wherein there was no change of useful ownership.⁵² It was stated in the investigation report that the methodology that have adopted in conducting the Enquiry into Kot Adu Power Company Limited, consisted of both broker and client level analysis for ready and CFS market trading activities that covers a period from January 3,2007 to May 25, 2007 the data that was analysed in investigation inquiry was of “scrip level trading details ready turnover, price and of client level trading ready market trading activities through UIN utilities,” based on the information obtained from the Karachi Stock Exchange and Brokers.⁵³ Based on the review of the trading information and records, it is evident that there has been a potential violation of the following laws:

1- Market manipulation.

Section 17 (e) of the securities and Exchange Ordinance 1969.

2- Rule 12 of the Brokers and Agents Registration Rules,2001.

3- Section 14 (1) of the listed companies (substantial Acquisition of voting shares and takeover) Ordinance 2002.

All sales of shares were completed by way of inter - group transfer of securities, while, the related brokerage house were asked about the causes for such transfers, a common

⁵¹Ibid,3.

⁵²Ibid.

⁵³Ibid.,9.

response was acknowledged that the shares were transferred on the order of their individual clients.⁵⁴ During the investigation analysis a doubtful trading relationship has been recognized among a relevant group of persons in which members of Karachi Stock Exchange were also caught up and purchased large quantities of Kot Adu Power Company Limited at lower values and then sold the shares at a high price.⁵⁵

In the case of Kot Adu Power Company there were mainly four persons who appeared to be involved in forbidden deceptive trading activities including, creation of false and misleading appearance of active trading activity in the scrip; in addition to other violation of laws and regulatory framework, these persons were engaged in buying and selling of Kot Adu Power Company shares and were found to be a part of a group. This group was occupied in trading of shares, artificially generated turnover and propagated in the market place, manipulating the price of the Kot Adu Power Company shares to the extent that it raised by 50% through the period in assessment.⁵⁶

The inquiry report showed that there was non-observance of regulatory framework in which wash/circular trades and a number of such transactions were executed in which there was no genuine change in real possession of the security and amounted to be wash trades, so a large quantities of Kot Adu Power Company shares were sold at a higher prices which were initially bought at a lesser price.⁵⁷ It became clear from the inquiry that group member were trading amongst themselves and false and confusing appearance of trading movement in the shares was created, and it was a clear breach of section 17(e) of

⁵⁴Ibid.,11- 12.

⁵⁵Ibid.,13.

⁵⁶Ibid.,16.

⁵⁷Ibid.

Securities and Exchange Ordinance 1969. The inquiry report observed that pumping and dumping of the shares had also been taken place it gave a notion of active trading in Kot Adu Power Company shares and give incentives to the other investors to buy the fake buying as a result the shares were sold at high price.⁵⁸

From the above discussion it is obvious that in both cases there is clear violation of the law on market manipulation. Laws on market manipulation are not Sufficient and comprehensive having some loop holes. Securities and Exchange Commission of Pakistan is although an autonomous body and even to some extent government may not interfere in its affairs. Securities and Exchange Commission of Pakistan does not make any comprehensive laws yet regarding market manipulation and deceptive/fraudulent practices.

⁵⁸Ibid.,23.

CHAPTER 4

REVIEW OF SECURITIES LAW IN PAKISTAN PREVELENT AS WELL AS IN DRAFT FORM

4.1 Establishment of The Securities and Exchange Commission of Pakistan

SECP was established in ensuing of the Securities and Exchange Commission of Pakistan Act,1997. It became functional in January 1999 replacing the Corporate law Authority under the Act of 1997.¹ The purpose of its establishment was to provide a well planned and well developed capital market in Pakistan .² The Act of 1997 is based on a well, thought out plan. It contained all the legal requirements that assured the revolutionary changes in the capital market of the country.³ The commission had been given all the powers which were required to achieve the objectives assigned to it. The objectives that had assigned to the commission included; improvement in the performance of the companies and the capital market in the interest of the commercial certainty and making investors' confidence in the capital market, cutting down fraudulent, unfair trade practices and assuring adequate protection to them.⁴ The Securities and Exchange commission of

¹Q.A.Wadud, *Law of the Commission Securities and Exchange*, Karachi , Published by Royal Book Company, 1998, 8-9.

²Ibid.,4.

³Ibid.

⁴Ibid.

Pakistan Act 1997 envisaged an organization that is three fold, a commission, policy board and the Federal Government, to give their best collectivity and make sure the emergence of a well organized and well developed capital market throughout the country.⁵

4.1.1 Securities and Exchange Commission of Pakistan as a Regulator

After analyzing the laws on market manipulation in chapter three now it will be of great importance to discuss that what is the role of Securities and Exchange Commission of Pakistan as a regulator. The stock market crash of March, 2005 raises many questions about the role of Securities and Exchange Commission of Pakistan as a regulator.

Taskforce report June 2005 states:

“There should an extraordinary group to investigate the situation that emerged in the stock market when the frontline regulators, the three stock exchanges in Karachi, Lahore and Islamabad, exist together with the apex regulator Securities and Exchange Commission of Pakistan”.⁶

This commentary of taskforce shows that there are weaknesses in the performance of regulatory bodies. SECP being an autonomous body can make rules and procedures to check the re-appearance of such events which occurred in March 2005. After analyzing the law, it becomes clear that as a regulator SECP has all the powers to check the securities Exchanges. But as for as market manipulation is concernd Securities and Exchange Commission of Pakistan does not have direct laws for it. There are only some

⁵Ibid.,5.

⁶Stock Market Review Taskforce. *Repot into stock Market situation March 2005*. 6.The whole text is Available on <http://www.Secep.gov.pk/Reports/rpt-taskforce-stockmarket%20pdf> (last Visited 20.11.2008)

provisions that are not sufficient. It will be Useful to produce the actual provisions of the law here. The SECP Act 1997 states in part VI section 20 as follows;

PART VI

POWER AND FUNCTIONS

20- Powers and functions of the commission. ---

(4) The commission may be responsible for the performance of the following functions:

- (a) regulating the issues of securities;
- (b) regulating the business in stock exchange , commodity Ex-change and any other securities market;
- (c) supervising and monitoring the activities of any central depository and Stock Exchange clearing house;
- (e) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue underwriters ,portfolio managers, investment advisers and such other intermediaries who may be associated with the securities market in any manner;
- (f) proposing regulations for the registration and regulating the working of collective investment schemes, including unit trust schemes;
- (g) promoting and regulating self regulatory organizations including securities industry and related organizations such as stock Exchanges and associations of mutual funds, leasing companies and other NBFIs;
- (h) prohibiting fraudulent and unfair trade practices relating to securities market;
- (i) promoting investor's education and training of intermediarie of securities market;
- (j) conducting investigations in respect of matters related to this Act and the ordinance and in particular for the purpose of Investigating insider trading in securities and prosecuting offenders.
- (k) regulating substantial acquisition of shares and the mergers and take over of

the companies;

- (l) calling for information from and undertaking inspections, conducting inquiries and audits of the stock Exchanges and intermediaries and self regulatory organizations in the securities market;
- (m) considering and suggesting reforms of the law relating to companies and bodies corporate, securities market, including changes to the constitution, rules and regulations of the companies and bodies corporate, stock Exchanges or clearing houses;

Further in sub – section 6 of this Section 20 states as under:

- (6) in performing its function and exercising its powers the commission shall strive-
 - (a) to maintain facilities and improve the performance of companies and of securities market, in the interest of commercial certainty, reducing business cost, and efficiency and development of the economy;
 - (b) to maintain the confidence of investors in the securities markets by ensuring adequate protection for such investors;
 - (c) to achieve uniformity in how it performs those functions and exercise those powers;
 - (d) to administer laws effectively but with a minimum of procedural requirements;⁷

It is clear from the above mentioned law that commission have some objectives which are as follows: commission grants a chance to companies and the securities market to develop their working capacity.⁸ Commission will also build confidence of investors in the securities market by making sure enough protection to them it is also in the objectives of the commission to continue consistency in the functioning and implementing the powers. Commission will also govern laws efficiently adopting easy process.⁹ According to the section 20 of the Act of the 1997, the Commission have all powers that are essential for

⁷The Securities and Exchange Commission of Pakistan Act, 1997

⁸Q.A.Wadud, *Law of the Commission Securities and Exchange*, 8-9.

⁹Ibid.

performing its duties and functions under the Act. However, the said section provides a list of the functions and powers of the commission which are as follows:

The commission will make sure that the securities will be issued according to the rules and commission will control the stock exchange bussiness and any other securities market.

Registration of stock brokers, underwriter,sub broker is also in the function of the commission to register the stock brokers, sub brokers and underwriters.¹⁰ Commission has the power to ban fraudulent and undue trade practices in the securities market and to encourage the investor's education and working out of the intermediaries of securities market.¹¹ It will inspect affairs which are linked to the Act of 1997 and the Companies Ordinance of the 1984 and particularly to catch insiders in the securities bussiness and penalize the the persons those are involved in it. Commission will manage too much shares owned by one person and also mergers and take – over of companies.¹² All these are powers and functions of the Securities and Exchange Commission of Pakistan to control the securities market and to regulate it. The Commission also have the powers to investigate any offence under this Act. The Act states as follows;

Part VIII

ENFORCEMENT AND INVESTIGATION

29 Investigation and Proceedings by the commission. – The commission may suo motu conduct investigations in respect of any matter that is an offence under this Act.

(2) The Commission may appoint such numbers of investigating officers to be known as investigating officers of the Commission as it considers necessary for the purposes of carrying out investigation of any offence or inspection under this Act , the Ordinance or any other law in respect

¹⁰Ibid.

¹¹Ibid.,14.

¹²Ibid.

of which it has been empowered to exercise the powers of the authority and such investigating officer shall have all the powers given to any person for the purposes of carrying out investigation of any offence under this Act, the Ordinance and any other law.¹³

The commission can carry out an investigation on its own movement in any subject which is considered to be an offence under the Act and for conducting the inquiry the commission can appoint investigating officers as many as are required.¹⁴ The investigating officers have the authority to continue inquiry of any offence under the Act and at the same time under the Companies Ordinance, 1984.¹⁵ All the above sections state that the Securities and Exchange Commission of Pakistan has power to investigate all offences mentioned in the Act as offences. In nutshell it is obvious that the Commission has all regulatory powers to prohibit and investigate the offence of fraud. Although it is not specifically mentioned about market manipulation and it is covered under fraud and misrepresentation that is not sufficient.

4.2 Securities and Exchange Commission of Pakistan on Conduct for Analysts

Securities and Exchange Commission of Pakistan have made preliminary draft for code of conduct for analysts. According to the code

“Analyst is a person who is preliminary accountable for preparation of the substance of writer reports, public appearance, or the basis for a recommendation, for distribution to clients or prospective clients of the firm or the investing public.”¹⁶

¹³The S.E.C.P Act, 1997, Karachi, Ideal publisher, 2007

¹⁴Q.A.Wadud, *Law of the Commission Securities and Exchange*, 49.

¹⁵Ibid.

¹⁶Draft Code of Conduct for Analysts, the whole text is available on [http://www.secp.gov.pk/DraftAmendments/CodeofConductforAnalysts\(new\).pdf](http://www.secp.gov.pk/DraftAmendments/CodeofConductforAnalysts(new).pdf) (last visited on 20.2.2009)

The code of conduct for Analysts establishes requirements that analysts must follow when preparing or publishing the venture research reports or making recommendations. These requirements signify the least policy and technical requirements of the policy that Analysts must have in place to minimize possible difference of interest. In the code, the expression "Analyst" means all legal and natural persons on whom this code is applicable.¹⁷

It is stated in the draft code that an analyst can be a "partner, director officer, employee or an agent of a financial institution, independent research firm, brokerage firm, fund management house or institutional investors, as long as the research or prepared recommendation is disseminated to clients or investing public."¹⁸ The third part of this draft code is about requirements. In this part it is stated that this code will apply to analysts and firms who employ analysts. The draft code also provide the minimum professional qualification further the draft code states about the disclosure requirements in part III under the head of Requirements as follows:

III Requirements

5- Disclosure Requirements

Each firm/Analysts shall prominently disclose in any research report

- i- Its relationship with issuer
- ii- Ownership of issuer's securities
- iii- Trading positions and involvement in preparation of report¹⁹

The draft code states about the prohibition of trading with knowledge of research

¹⁷ Ibid.

¹⁸ Ibid.

¹⁹ Ibid.

report. It states as follows;

10- Prohibition of Trading with Knowledge of Research Report

Each firm who distribute research reports to clients or prospective clients shall have policies and procedures reasonably designed to prohibit any trading by its associated companies, subsidiaries, partners, directors, officers employees or agents resulting in a increase, a decrease, or liquidation of a position in a listed security, with a knowledge of or in anticipation of the distribution of a research report, a new recommendation or a change in a recommendation relating to a security that could reasonably be expected to have an effect on the price of the security

11- Trading in Securities on Which Reports are Published

Permitting research analysts other covered employees to invest and trade in the securities of subject companies and industries may better align their personal interest with the interests of investing clients provided that precautions are taken to ensure that the interests of investing clients are always placed before the interests of the employee, members of their immediate families, and the firm. When research analysts are permitted to invest and trade in the securities of the companies they cover, it is critical that firms prohibit them from trading contrary to the published recommendations of the firm on these companies. There is one instance in which research analysts may be permitted to sell contrary to their recommendation. This is the case where the analysts would suffer "extreme financial hardship" if he or she could not liquidate these securities.²⁰

The draft code also gave recommendation on the education of the investors. It states as follows;

23- Investors Education

Analyst shall strive for investor education at personal, firm and association level. Analyst shall maintain website giving at least following information;

- Definitions of the terms they use in reports and recommendations.
- A breakdown comparison (in percentage or proportion term) of the number of the different types of recommendations that make over a given time period.
- A comparison of the target price forecasted in the past, versus the actual price of a covered security over a period of time from the date of the forecast.²¹

Penalties are given in part IV of the code of conduct for Analysts. According to the draft code;

Penalties that can be imposed by the commission for breach of this code of conduct will range from a nominal amount of Rs.5,000 to a maximum of Rs. 1,000,000 based on the nature of gravity of the breach as per the judgment of the commission.²²

²⁰Ibid.

²¹ Ibid.

²²Ibid.

Preliminary draft code for analysts does not provide any recommendation directly on market manipulation but provides code for conduct for the analysts those can help in avoiding market manipulation.

4.3 Draft Code of Conduct for Assets Managers

It is written in the introduction of the draft code for assets managers and Brokerage houses as follows:

This code of professional conduct for assets managers and brokerage houses outlines the ethical and professional responsibilities of firms that manage assets on behalf of clients. Ethical leadership begins at the highest level of an organization. The code should, therefore, be adopted by the managers, board of directors, senior management or similar oversight body. Such adoption sends a strong message regarding the importance of ethical behavior at the firm. Rather than creating rules that only apply to certain people or groups, this code is intended to cover all employees of the firm. Although not every employee is actively involved in conduct covered in the Code, a code that is broadly applied reinforces the need for all employees to understand the ethical issues involved in the asset management business. By adopting and enforcing a code of conduct for their firm, Managers demonstrate their commitment to ethical behavior and the protection of investors' interests. In doing so, the Managers also protect and enhance the reputation of their firm.²³

This code sets minimum ethical standards for providing asset management services for clients. It is meant to be general in nature and allow flexibility for asset managers of various sizes and structures to develop the particular policies and procedures necessary to implement the Code. The goal of this Code is to set forth a useful framework for all asset managers to provide services in a fair and professional manner and to fully disclose key elements of these services to clients, regardless of whether individual Managers are required to register or comply with applicable securities laws or regulation. Clients have a responsibility to be aware of, understand, and monitor how their assets are invested. But to fulfill this responsibility, clients must be able to count on full and fair disclosure from their Manager. Providing clients with a Code of Ethics that sets a framework for how the Manager conducts its business is an important step in developing the trust and confidence necessary for a successful investment management relationship.²⁴

²³Draft code of Conduct for Assets Managers and Brokerage houses, the whole text is available on <http://www.secp.gov.pk/DraftAmendments/CodeOfConductForAssetManagersAndBrokers.pdf> (last visited on 19.2.2009)

²⁴Ibid.

Further the code states about the loyalty to clients.it will be appropriate to provide the wording of the code. It states as follows;

A. Loyalty to Clients

Managers must:

1. Place clients interests beore their own.
2. Preserve the confidentiality of information communicated by clients with in the scope of the manger-clients relationship.
3. Refuse to participate in any business relationship or accept any gift that could reasonably be expected to affect their independence, objectivity,or loyalty to clients.

B. Investment Process and Actions

Managers must:

1. Use reasonable care and prudent judgment when manging client assets.
2. Not engage in practices designed to distort prices or artificially inflate trading volume with the intent to mislead market participants.
3. Deal fairly and objectively with all clients when providing investment information making investment recommendations, or taking investment action.

C. Trading

Managers must:

1. Not act, or cause others to act, on material nonpublic information that could affect the value of a publicly traded investment.

D. Performance and Valuation

Managers must:

1. present performance information that is fair, accurate, revelent ,timely and complete. Managers must not misrepresent the performance of individual portfolios or their firms.

2. Use fair market prices to value client holdings and apply, in good faith, methods to determine the fair value of any securities for which no readily available, independent, third party market quotation is available.

E. Disclosure

Mangers must:

2. Ensure that disclosures are prominent, thoughtful, accurate, complete and understandable and are presented in a format that communicates the information effectively.²⁵

In the draft Code of Conduct for Asstes Mangers there are definite measures that must be accomplish by the asstes mangers like devotion to clients, investment procedure, dealings, trading, observance and support, presentation, assessment and disclousers. The code provides that what a manager should do under the above all heads.

4.4 Prevelent Laws for Brokers

Securities and Exchange Comission of Pakistan made rules for brokers and agent for example Brokers and Agents Registration Rules,2001. The provisions of the law were mentiond in the previous chapter. Securities and Exchange Commission of Pakistan also made directives for brokers on conduct of business in Feb.07,2007. These directives were made to preserve public interest, bar unfair trade practices, inculcated good goverenence in business conduct and to ensure that a broker does not engage in certain types of conduct in the securities market that were against the interest of an investor, the commission in exercise of powers conferred upon it under clause (d) of sub- section (4)

²⁵Ibid.

and of section 20 and clause (g) of sub- section (4) of section 20 of Securities and Exchange Commission of Pakistan Act,1997 read with sub- section (1) of section 20 of the Securities and Exchange Ordinance, 1969 hereby directs as under;

- i. "A broker shall provide brokerage services to an investor only after ensuring that an account has been opened in the investor's name using an account opening form that is to be developed by the stock exchanges in consultation with the securities and Exchange Commission of Pakistan.
- ii. A broker shall not recommend to an investor the purchase or sale of a security that is unsuitable given the investor's age, financial situation, investment objective and investment experience. Without limitation, investment in a particular type of security may be considered unsuitable or the amount or frequency of transactions may be excessive and therefore unsuitable for a given investor.
- iii. A broker shall not guarantee investors that they will not lose money on particular securities transaction making specific price predictions, or agreeing to share in any losses in the investor's account.
- iv. A broker shall not purchase or sell securities in an investor's account without the investor's approval, unless the investor has given written discretionary authority to effect transactions in the account.
- v. A broker trade on his own behalf or on behalf of his brokerage firm in preference to an investor by trading ahead of a limit order from an investor.
- vi. A broker shall not remove funds or securities from a investor's account without the investor's prior authorization.
- vii. A broker shall not purchase or sell a security while in possession of material, non- public information regarding an issuer.
- viii. A broker shall not misrepresent material facts concerning an investment. Examples of information that may be considered material and that should be accurately presented to an investor inter alia include the risks of investing in a particular security, the charges or fees involved, company's financial information or any other material information.²⁶

²⁶Directives for brokers on conduct of business in Feb.07,2007 available on <http://www.secp.gov.pk> (last visited on 27.2.2009)

These directives are effected from 31st March 2003.

4.5 Draft Regulations for Private Equity and Venture Capital

The securities and Exchange Commission of Pakistan made draft regulations for private equity and venture capital in 2007. These regulations gave all the conditions which were necessary to start a Fund management company. It was in Section 3 of this draft code that a Fund management company will be set up by its promoters, proposed directors and chairman of the board of directors who satisfied the situation as are written in the fit and proper criteria. Further in Section 4 it was stated that a Fund Management Company can also be establish out side Pakistan.²⁷

The Securities and Exchange Commission of Pakistan gives permission to establish a Fund Management Company. Section 12 is about the inauguration of a Fund Mangement Company. Section 13 stated about the conditions which are applicable to Fund Management Company. The section states as follows;

13. Conditions Applicable to FMC

“An FMC shall,

- (a) Maintain such books of account and other record as specified ,which shall depict a true and fair view of its states of affairs,for perod of ten years.

Futher part “n” of section 13 states:

- (n) follow directions issued to protect FMC’s against their involvement in money laundering activities and other unlawfull trades.

²⁷The Private Equity and Venture Capital Fund Regulations 2007 the whole text is avaiable on <http://www.secp.gov.pk/DraftAmendments/August-13-PrivateEquity/Regulations.pdf> (last visited on 27.2.2009)

Section 14 states about the obligations of a Fund Management Company .

- (a) Manage the fund, in accordance with the constitutive document and all applicable laws in the sole and exclusive interest of unit holders, in good faith and to the best of its ability without gaining any value advantage for itself or any of its connected persons.²⁸

The commission can revoke or suspend the license of a FMC if it is not working according to the rules and regulations which are set by the commission. Chapter III of the draft law on Private Equity and Venture Capital regulation is about the registration of a Private Equity and Venture Capital fund . In this chapter it is stated that no fund shall be found except the FMC has registered the fund with the commission. The Private Equity and Venture capital regulations are made to give a comprehensive law for funds management companies.²⁹

4.6 Regulations for Short Selling Under Ready Market 2002

Another factor which finally leads to market manipulation is short selling. In different jurisdictions law had been made for short selling. In Pakistan only Karachi Stock Exchange made regulations for short selling in 2002. As market manipulation is wider term and short selling also falls in its domain. In these regulations short sale or blank sale are prohibited according to the regulations. Short sale is defined as; “Short sale means ‘a sale by a party that does not own shares or the sale does not constitute a sale with pre

²⁸Ibid.,10.

²⁹Ibid.

existing interest but is a sale by a party that has entered into a contractual borrowing arrangements to meet delivery requirements.”³⁰

Further blank sale is also defined as under; “blank sale means a sale by a party that does own shares or the sale does not constitute a sale with pre- existing interest or is sale by a party that has not entered into a contractual borrowing arrangement to meet delivery requirements”.³¹ The short sale Regulations imposed a penalty that the exchange shall impose penalties as may be prescribed by the board on members who are found violating these regulations.³²

In this chapter all laws whether prevalent or in draft form have been seen and one point is important that although securities and Exchange Commission of Pakistan is trying to make laws but SECP as a regulator still needs a lot to do to control market manipulation.

³⁰Regulation for Short Selling under Ready Market,2002, of the Karachi stock exchange (guarantee)limited. Notified on April 03.2002 the whole text is available on <http://www.kse.com.pk> (last visited 20.1.2009)

³¹Ibid.

³²Ibid.

CHAPTER 5

CONCLUSION AND PROPOSAL FOR REFORMS

5.1 CONCLUSIONS

The topic of the thesis is The Role of The SECP in Controlling Market Manipulation in the Light of the Laws in various Jurisdictions, In first chapter the study is about the definition and origin of market manipulation it is analyzed that market manipulation has its origin in common law even United States has its basis in common law rules. In Pakistan the law on market manipulation is outlined in chapter IV of the Securities and Exchange Ordinance 1969 and it is the basic law on market manipulation in Pakistan. A big crash occurred in the stock market in March 2005. This crisis lifted up many legal points concerning the role of Securities and Exchange Commission of Pakistan to organize the market manipulation. The other countries laws over market manipulation are greatly developed than Pakistan like United Kingdom, United States Europe and India.

The existing laws of Securities and Exchange Commission of Pakistan dealing with market manipulation and fraudulent practices have not been able to control the persistent crashes and unlawful practices, therefore, need improvement. Different kinds of market manipulation are also discussed in chapter one because it is necessary to understand all modes of market manipulation.

5.1.1 Is Market Manipulation an Offence?

The major issue that has been discussed in chapter one is that whether market manipulation is an offence. During our study it becomes obvious that it is an offence in various jurisdictions. Market manipulation is treated as a civil, as well as a criminal offence in many jurisdictions. The second issue in chapter one has been discussed over the illegality of market manipulation because its illegality can prove it an offence more strongly. The difference between market manipulation and insider dealing has also been defined. It is necessary first to define the two notions because generally both concepts are taken jointly and considered mostly as one offence but it is not true, both are separate to each other but have similar characteristics. Market manipulation is a wider phrase in which all sorts of market abuse including insider dealing, falls in it. A link between stock market crash and market manipulation has also been described.

5.1.2 If Market Manipulation is an Offence then how different Jurisdictions deal with it?

The main focus in chapter two is on the point that how different jurisdictions are dealing with the offence of market manipulation. At first the securities law of United States of America are analyzed. Section 9 of the Securities Exchange Act of 1934 directly deals with the offence of market manipulation. Section 9 prohibits few definite acts that are measured as market manipulation. The essence of the Section 9 of Securities Exchange Act of 1934 specified the expression by indicate the following as manipulation:

- The creation of fabricated statement of material information.
- The oversight to state a material fact.
- falsification by brokers or dealers as to their registration.
- stoppage of a broker to reveal any connection of control with the issuer of any security which is the subject matter of the transaction, or failure of brokers or dealer to release the subsistence of any financial attention in the principal or lesser sharing of such security.
- depiction that unlisted securities are presented at the market are not in reality. Infect there is a market other than that made by the brokers or dealers.

The securities law of the United Kingdom consider market manipulation as a civil as well as a criminal offence the most important statute of UK securities law is the Financial Services Act 1986. The Criminal Justice Act 1993 which comes into force on March 1994 it also recognizes market manipulation as a criminal offence and The Financial Services Act 2000 introduces market manipulation as a civil offence.

The major securities law in India is the Securities Exchange Board of India Act 1992. The law on manipulation is improved by the Securities and Exchange Board of India Act, 2002 with the addition of a full chapter on the issue of manipulation. The first three parts of the Section 12A are directly dealing with the manipulation and market abuse. Although the Act does not provide a direct penalty for manipulation as given for insider trading but section 15HA of the Act provides penalty for fraudulent and unfair trade practices.

On international level, International Organization of Securities Commission is an international association of securities regulators. In 1998 the International

Organization of Securities Commission accepted a broad set of objectives and principles of securities regulations.

These principles are based upon three objectives of securities regulation

- The safety of investors
- Ensuring that markets are just, well-organized and crystal clear.
- The decrease of systemic risk.

International Organization of Securities Commission recognizes that investors should be protected from deceptive, manipulative or deceitful practices. The organization encourages national establishment to approve strict standards of supervisions for market intermediaries for the point of achieving investor's protection by setting least standards for market manipulation.

5.1.3 Market Manipulation as a Main Factor involved in the Stock Market Crash

During our study in chapter three it becomes obvious that there are many factors in stock market crash a lot of other factors are caught up but market manipulation is also one of key factor. As in market manipulation false information of the financial instrument has been given to the investors and innocent investor buy or sells their investment at a fake price and when share price goes high then the manipulator or speculator gets their benefit. As a result stock market comes into crash . In our study it becomes clear that Pakistani stock market gets crashe in different times but stock market crash of March 2005 is most significant because this crash inflicts over Rs.700 billions losses mainly on small investors due to manipulation by a small member of influential brokers.

The analysis of the stock market crash of March, 2005, recognize a number of possible cases of market abuse where players have undertaken 'wash trades' and brokers manipulate the market. Many shares are manipulated and played in diverse ways by the major brokers to their advantages.

Pakistani securities law is also analyzed in chapter three. The law on market manipulation comes to public eye after the stock market crash of the year 2000. The reform in law starts in the year 2001. The principal law on market manipulation in Pakistan is the Securities and Exchange Ordinance, 1969. Chapter IV of the Ordinance is about the prohibition and restrictions and section 17 of the chapter is about market manipulation but it does not directly deals with the offence of market manipulation. It only prohibits fraudulent acts in the background of manipulation. Section 24 prescribes penalty for violating the Section 17, further The Brokers and Agents Registration Rules, 2001 has some clauses on the manipulation like the Rule 12 is about all brokers that they should follow the code of conduct specifies in the Third Schedule. In this schedule brokers are prohibited to indulge in manipulative, fraudulent or deceptive transactions. Rule 8 of the Broker and Agents Registration Rules, 2001 is about the postponement of the registration of the brokers who are involving in manipulating. The Securities and Exchange Commission of Pakistan Act, 1997 also gives some provisions on fraudulent practices. Clause 4 (g) of the above mentioned Act specifically tells about the prohibition of fraudulent practices.

5.1.4 What is the Regulatory Role of Securities and Exchange Commission of Pakistan Regarding the Control of Market Manipulation?

Securities and Exchange Commission of Pakistan is the main authority to regulate all the securities market in Pakistan. The stock market crash of March, 2005 highlight several legal matter about the role of the Securities and Exchange Commission of Pakistan as a regulator. There are weaknesses in the performance of regulatory body. The laws are not sufficient and are not directly dealing with the offence of market manipulation.

Securities and Exchange Commission of Pakistan carry out an investigation on the stock market situation on March, 2005 and that Taskforce Report investigates the factor of market manipulation, insider dealing and other market abuses. SECP also investigates two cases of market manipulation; the first one is about the Callmate Tellips Telecommunication Co. Ltd. The other is about the Kot Adu Power Company Limited. The market manipulation is involved in both cases. The case of Callmate Tellips is brought before the court by Securities and Exchange Commission of Pakistan. The court gives judgment on it as well. It is a big step taken by SECP to abolish the market manipulation but still a lot has to be done in this regard.

5.1.5 An Overview of the Prevailing as well as Draft Laws of Securities and Exchange Commission of Pakistan

In chapter four not only the role of Securities and Exchange Commission of Pakistan has been discussed as a regulator to control market manipulation but the existing laws of the Securities and Exchange Commission of Pakistan are also analyzed. The key law on

market manipulation is apparently Section 17, chapter IV of the Securities and Exchange Commission Ordinance, 1969. SECP has all the powers to check the Securities Exchanges. It is in the power of SECP to control the fraudulent and unfair trade practices relating to securities market.

Section 20 (g) of the S E C P Act 1997 deals with the prohibition of fraudulent and unfair trade practices relating to securities market. Further in sub section 6 of this section 20, the investors are protected by S E C P Act, 1997. Securities and Exchange Commission can take a suo moto action to conduct an investigation in respect of any matter that is an offence under this Act. Prevalent laws are not much comprehensive but SECP is paying attention to draft laws that are comprehensive and cover all loopholes in controlling market manipulation. The first one in this regard is the draft code of conduct for analyst. Analysts are liable for preparation of the subsistence of writer reports, public appearance, or the basis for a recommendation, for distribution to clients or prospective clients of the firm or the investing public. This draft code prescribes minimum qualification and all disclouser requirements. It has been stated in this draft code that an analyst must disclose its relationship with the issuer in any research.

This draft code also prohibits trading with knowledge of research reports to the clients. It is stated that interest of the investors are always positioned prior to the interest of the employee, members of their immediate families and the firm. The analysts are prohibited to trade in company securities. But this situation does not relate when an analyst would suffer extreme financial hardships.

Securities and Exchange Commission also drafts a law on the conduct of Asset Managers. The Draft code of Assets Managers outlined the just and specialized tasks of

the firm. It manages assets on behalf of the clients. This code generally reinforces the requirement for all employees to realize the right issues involved in the assets management services for clients. This draft code states that managers must be reliable to the clients and must manage investment process and actions carefully, while managing client's assets. Part (B) is about investment process and actions clearly states that managers must not engage in practices designed to distort prices or artificially inflate trading volume with the intent to mislead market participants and must not act or cause others to act on material nonpublic information that could affect the value of a publically traded investment.

The main prevalent law for broker is the Brokers and Agents Rules, 2001. Securities and Exchange Commission of Pakistan make directives to brokers on conduct of business in Feb.07 2007. These directives are made to preserve public interest, prohibits unjust trade practices, inculcates good governance in business behavior and to ensure that a broker does not remain in certain types of conduct in the securities market that are against the interest of an investor. The commission drafted regulations for the Private Equity and venture capital in 2007. The regulation laid down all the conditions that are necessary to establish a Fund Management Company. It is stated in the conditions of a Funds Management Company that it should follow all the directions against their involvement in money laundering activities and other unlawful trades but it is clear that all these laws, prevalent or in draft form are not covering comprehensively the offence of market manipulation. The other draw back that can be assessed that all laws are not directly dealing with the offence of market manipulation.

5.2 Recommendations and Proposal for Reform

5.2.1 Market Manipulation Laws must be Comprehensive

Currently Pakistani laws on market manipulation are not comprehensive. Only S. 17 of the securities and Exchange Ordinance, 1969 is not sufficient to overcome the problem of market manipulation. There is a need to make separate laws on the offence of market manipulation. Stock markets and SECP should be given more powers in those laws to wipe out the offence and to begin appropriate actions against the violators.

5.2.2 The Law Should Deal Directly With the Offence

The law should deal directly with the offence of market manipulation whereas Pakistani law does not directly deal with the offence as compare to the laws of USA and UK.

5.2.3 Need to Consider the Market Manipulation as an Offence

There is need to consider market manipulation as an offence. In many jurisdictions it is considered as an offence, criminal as well as civil wrong. Significantly it has been considered an offence in United States and in United Kingdom.

5.2.4 Importance of Criminal Liability for Market Manipulation

Currently Pakistani law does not impose any criminal liability for market manipulation for instance the Securities and Exchange Ordinance, 1969 provides only civil liabilities.¹ It is necessary that market manipulation must have criminal liability too. In many countries securities laws create criminal liability for market manipulation for example UK and Nigeria have provisions that outlawed market manipulation. Both jurisdictions

¹See section 23 of the Securities and Exchange Ordinance, 1969.

UK and Nigeria recognizes it criminal and creates a criminal liability on the offence. As a result it becomes more effective than ordinary civil liability²

5.2.4 Restrictions on Brokers

There must be restrictions on the level of day trading by brokers. As it is stated in the taskforce Report that presently there are no restrictions on the brokers for the day trading. It is mainly due to the lack of pre-trade verification system and other capital adequacy measure. This deficiency, coupled with an almost out of control use of wash trades by a broker directly or by the two or more brokerages in violation of the rules, facilitates market manipulation. There must be restrictions by laws on brokers to perform regularly trades between their own accounts and of their clients, because it generate chance for market abuse.³

At the same time law must be firm on the point that brokers should not involve in many activities at the same time as of badla providers, of mutual funds and investment bank. Apparently there is no sufficient control over this activity.⁴

In nutshell all these recommendations can be conclude in these words:

- Laws on market manipulation must be comprehensive.
- Market manipulation need to be considered as an offence.

²Eva Lomnicka, "Capital Market Regulation in Nigeria and the UK: The Role of the Courts," *Journal of African Law*, Vol, 46. No, 2. Text available on <http://www.journals.cambridge.org/download.php?file=52fjal%2fjal46-2> last visited 20.7.2009.

³Report of the Taskforce: *Review of the Stock Market Situation March 2005*. June 2005,

⁴Ibid.

- The law on market manipulation should deal directly.
- The Pakistani law must implement restrictions on the brokers for trading.

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