



Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH NO.1

In the matter of

Appeal No. 46 of 2013

M/s First National Equities Limited

.....Appellant

Versus

Director/HOD (MSRD),

Securities and Exchange Commission of Pakistan

.....Respondent

Date of Hearing

02/04/15

ORDER

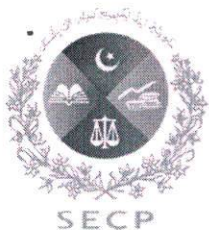
Present:

For the Appellant:

1. Mr. Jabran Tariq Butt, Advocate

Department representatives:

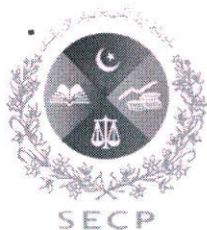
1. Mr. Imran Inayat Butt, Director (SMD)
2. Ms. Najia Ubaid, Deputy Director (SMD)



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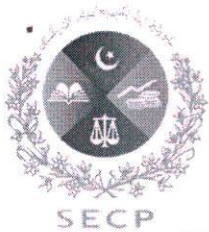
1. This order is in appeal No. 46 of 2013 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 against the order dated 06/06/13 (the "Impugned Order") passed by the Respondent.
2. Brief facts of the case are that M/s. First National Equities Limited (the "Appellant"), submitted its application for renewal of certificate of registration as Broker. The scrutiny of the Appellant's application revealed that the Net Capital Balance ("NCB") as on 31/12/12 submitted by the Appellant had major irregularities as the NCB was not calculated in accordance with Third Schedule of the Securities and Exchange Rules, 1971 (the "SE Rules") and prima facie was overstated. The adjusted NCB calculated by the Commission is as under:

<i>First National Equities Limited</i>				
<i>Adjusted Net Capital Balance</i>				
<i>As at December 31, 2012</i>				
<i>Particulars</i>	<i>Amount in Rupees</i>			
<i>Current Assets</i>	<i>As per FNEL</i>		<i>Adjusted by SECP</i>	
<i>Cash in Hand or in Bank</i>				
<i>Cash in hand</i>	9,275		9,275	
<i>Bank Balances</i>	1,921,826	1,931,101	1,921,826	1,931,101
<i>Trade</i>				



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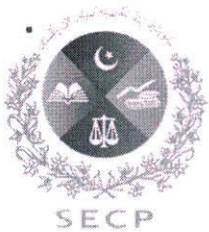
Receivables				
Book Value	601,117,101			
Less: Overdue for more than 14 days	(600,120,126)	996,975	1,495,378	1,495,378
Investment in Listed Securities in the name of Broker				
Securities on the exposure list marked to market	224,600,737		129,968,777	
Less 15% discount	33,690,111	190,910,626	(19,495,317)	110,473,460
Securities held for client		173,830,448		29,565,650
Total Current Assets		367,669,150		143,465,589
Current liabilities				
Trade Payable				
Book value	180,333,188		179,854,685	
Less: Overdue For more than 30	(160,477,464)	19,855,724	(160,168,395)	19,686,290



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<i>days</i>				
Other Liabilities		211,646,905		1,049,424,566
Total Current Liabilities		231,502,629		1,069,110,855
Net Capital Balance		136,166,521		(925,645,266)

3. Show Cause Notice dated 19/04/13 ("SCN") was issued to the Appellant under section 22 of the Securities and Exchange Ordinance, 1969 (the "Ordinance") read with Rule 7(2) and Rule 5 of the Brokers and Agents Registration Rules, 2001 (the "Brokers Rules") stating that the Appellant had prima facie miscalculated the NCB in violation of Rule 3(b) of the SE Rules and given false/misleading information in contravention of section 18 of the Ordinance and Rule 8 of the Brokers Rules. The Appellant's legal counsel appeared on its behalf on the date of hearing on 06/05/13 and submitted a request to the Respondent to provide basis of calculation of the revised NCB enabling the Appellant to respond to the SCN. The request was acceded to by the Respondent and a second hearing in the matter was held on 15/06/13 which was attended by Mr. Aslam Malik, CEO and Syed Shahab Qutab, Advocate on behalf of the Appellant. Further arguments were made by the Appellant in its written response and during the course of the hearing.
4. The Respondent dissatisfied with the response of the Appellant, held that the violation of the Rules and Regulations is a serious matter which entitles the Commission to suspend the Appellant's registration, however, taking a lenient view, the Certificate of Registration of the Appellant is being renewed with the condition that the Appellant will be required to

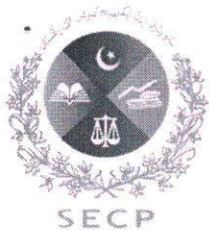


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submit a revised NCB (duly audited) within three months of the Order which shall be in strict compliance with the Third Schedule of the SE Rules and shall meet the minimum specified requirement. Further, in view of the Regulatory violations and in exercise of the powers under section 22 of the Ordinance, a penalty of Rs.500,000 was imposed on the Appellant. The Appellant was further directed to ensure full compliance of all rules, regulations and directives of the Commission in the future avoiding any punitive action under the law.

5. The Appellant has preferred to file the instant appeal against the Impugned Order. The Appellant's counsel argued that:

- (a) the NCB Certificate submitted was prepared in accordance with Rule 2(d) of SE Rules read with the Third Schedule thereto. The Impugned Order incorrectly holds that the NCB Certificate submitted as of 31/12/12 had irregularities or that the same was not calculated in accordance with Rule 2(d) of the SE Rules read with the Third Schedule thereto and that it was overstated by an amount of Rs 1,061,811,788/-. The adjustments made by the Respondent under the head of "Securities held by the Client" are not in accordance with the valuation basis provided in item 4 of the Third Schedule of the SE Rules. The basis for adjustments provided by the Respondent reveal that the adjustments were made on the basis of sampled data instead of analysis of the entire data. The approach is fundamentally flawed and is bound to produce inaccurate results. Furthermore, analysis on the basis of sampling is not warranted by item 4 of the Third Schedule of the SE Rules. The Respondent has erred in restricting the valuation of shares to the value of the overdue balance. A clear and plain meaning of the aforesaid item 4 is that securities purchased for the client and held by the member where the payment has not been received within fourteen days are to be included under this head;
- (b) the Respondent has relied on CDC Balance Statements of the clients only to determine the securities purchased and held for clients and has not taken into consideration the Share Balance Report of clients provided by the Appellant. There are several instances

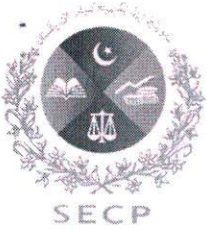


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when shares purchased and held for the benefit of a client may not appear in the client's sub-account. For example in respect of several clients whose debit balance is outstanding, the Appellant would bridge the gap through financing obtained against the collateral of shares held for the benefit of such defaulting clients. For this purpose the Appellant would transfer the shares from the client's sub-account to the financier's sub-account. As a result the shares would not appear in the client's sub-account even though they will still be in the beneficial ownership of the client and held for the benefit of the client. As such, the Respondent's position that the benefit of the valuation should only be passed on to the respective clients, who hold securities in their respective CDC Sub-accounts is not warranted by law or facts. It should be noted that no such restriction is envisioned by item 4 of the Third Schedule of the SE Rules. The Respondent never sought evidence of such holding or the same would have been readily provided to the Respondent. The observation of the Impugned Order that in certain instances the amount of shares in the Appellant Company's Share Balance Report show negative balance is untenable. The instances are exceptional and occur possibly due to an accounting error that has no bearing on the overall strength and credibility of the Share Balance Reports; and

- c) paragraph 73 of the International Accounting Standard 1 "(IAS 1") provides that, "if an entity expects and has the discretion to refinance or roll over an obligation for at least twelve months after the reporting period under an existing loan facility; it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. However, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for re-financing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current."

The Respondent has taken the view that loans should be categorized as Current Liabilities as they are an existing loan facility in terms of Paragraph 73 of IAS 1. It is submitted that there is no existing loan facility as the financial institutions/creditors have brought



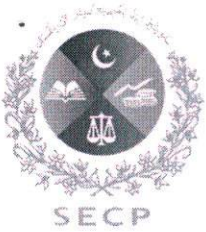
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recovery suits against the Appellant. This includes the loans/finances related to Bank of Punjab and United Bank Limited ("Banks") who have filed suits for recovery against the Appellant. Para 73 of IAS 1 does not relate to such loans, the repayment of which is subject to determination by a court of competent jurisdiction.

In so far as the loan from Bank Alfalah is concerned, it is submitted that the Appellant is in the process of restructuring its credit lines with Bank Alfalah and no demand has yet been made by Bank Alfalah in respect of the finance facility obtained by the Appellant. Moreover, the Appellant's management is confident that the re-structuring will materialize very soon. The loan from Bank Alfalah Ltd, therefore, is not liable to be classified as a current liability.

6. The department's representatives argued that:

- a) rule 3 of the SE Rules requires every broker of the exchange to maintain at all times NCB as calculated in accordance with the Third Schedule of the SE Rules. The Appellant's observation with regard to sampling holds no merit as the Respondent, while calculating 'Trade Receivables' and 'Securities held for Clients' selected a sample of 94.23% of total Trade Receivables. Further, regarding debit balances not forming part of the sample; the Respondent after applying the already mentioned rule for overdue, treated the Appellant's ageing as correct and took the value as provided by the Appellant;
- b) the Appellant significantly overstated its NCB by recording securities held for client on the basis of its Share Balance Report, which should not be different than CDC Account Balance Report, if prepared in accordance with the requirements. In most instances the statement prepared by the Appellant show excess amount of shares against overdue balance. The value of securities held for client cannot be taken in excess of overdue balance as well as balance up to a number of shares held by the Appellant on the client's behalf. The Appellant's insistence that shares of a particular account has been held by it in an account other than respective sub-account of the particular shareholder cannot be



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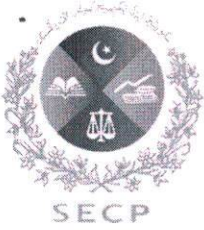
relied upon unless and until a proper justification and evidence is provided in respect of each instance with reasonable legal grounds. No such justification or evidence, however, was provided by the Appellant. Further, in certain instances the statement prepared by the Appellant also show amount of shares in negative balance which puts a question mark on the reliability of the statement and, therefore, cannot be used for valuation of shares purpose; and

- (d) each loan is required to be classified as current unless there is proper evidence or legal grounds to reclassify the same as long term liability. Paragraph 69(d) of IAS 1 states that an entity shall classify a liability as current, *“when it does not have an unconditional right to defer settlement of the liability for atleast twelve months after the reporting period (see paragraph 73). Terms of a liability could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.”* The loans payable to the banks have already been accounted for by the Appellant and counter parties are demanding its payment and the matters are pending before the court. It is obvious that the Appellant does not have an unconditional right to defer settlement of the liability, therefore, the loan facilities cannot be reclassified as long-term.

Moreover, with regard to the liability payable to Bank Alfalah, H.A.M.D & Co. Chartered Accountants (“Statutory Auditors”) of the Appellant in their annual audit report for the year ended 30/06/12 and review report on half-yearly accounts for the period ended 31/12/12 qualified their opinion/report with regard to reclassification of long term loans in non-current liabilities as opposed to current liabilities which substantiates the Respondent’s stance.

7. We have heard the arguments. Rule 3(b) of the SE Rules, sections 18 and 22 of the Ordinance are reproduced for ease of reference:

Rule 3(b) of Securities and Exchange Rules, 1971



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3. Qualifications for stock exchange membership, etc.

(b) A member shall, at all times, maintain a net capital balance of an amount which is,-

(i) in the case of a stock exchange which in the previous calendar year had on the cash counter a turn over of securities exceeding fifteen billion, Rs.2.5 million;

(ii) in the case of a stock exchange which in the previous calendar year had on the cash counter a turn over of securities exceeding 7.5 billion rupees but not exceeding fifteen billion, Rs. 1.5 million; and

(iii) in the case of a stock exchange which in the previous calendar year had on the cash counter a turn over of securities not exceeding 7.5 billion, Rs. 0.75 million;

Provided that a member who is also the member of other stock exchange shall maintain a net capital balance upto aggregate net capital balance requirement of all such exchanges put together;

Provided further that, in the case of partnership firm, the amount of net capital balance to be maintained shall be the amount obtained by multiplying the net capital balance required for each member of the stock exchange or exchanges, as the case may be, by the number of such partners of the firm as are members of the stock exchange;

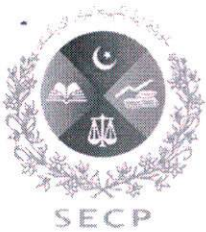
Section 18 of the Securities and Exchange Ordinance, 1969

18. Prohibition of false statements, etc.- No person shall, in any document, paper, accounts, information or explanation which he is, by or under this Ordinance, required to furnish, or in any application made under this Ordinance, make any statement or give any information which he knows or has reasonable cause to believe to be false or incorrect in any material particular.

Section 22 of the Securities and Exchange Ordinance, 1969

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

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



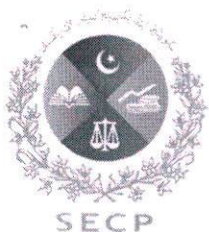
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the Commission may, if it is satisfied after giving the person an opportunity of being heard that the refusal, failure or contravention was willful, by order direct that such person shall pay to the Commission by way of penalty such sum not exceeding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

Emphasis Added

(a) rule 2(d) of the SE Rules provides the definition of net capital as, “...as excess of current assets over the liabilities determined in accordance with the Third Schedule to these Rules...” The valuation basis provided in item 4 of the Third Schedule is stated as “Securities purchased for the client and held by the member where the payment has not been received within fourteen days.” The Appellant has argued that the adjustments made by the Respondent under the head of “Securities held by the Client” are not in accordance with the valuation basis provided in item 4 of the Third Schedule. Further, the adjustments were made on the basis of sampled data instead of analysis of the entire data. The Respondent has stated that with regard to sampling, while calculating ‘Trade Receivables’ and ‘Securities held for Clients’ a sample of 94.23% of total Trade Receivables was selected and as far as debit balances not forming part of the sample is concerned; the Respondent after applying the said rule for overdue, treated the Appellant’s ageing as correct and had taken the value as provided by the Appellant. We are of the view that Item 4 of the third schedule to the requirements of calculation of net capital balance for purpose of Rule 2(d) does not provide any requirements that the adjustments were to be made on the basis of analysis of the entire data. The Appellant has, therefore, failed to establish how this would have a different outcome to the calculation of NCB which was misstated in violation of Rule 3(b) of the SE Rules;

(b) the Appellant has been unable to demonstrate why the NCB was significantly overstated by recording securities for its client on the basis of its Share Balance Report. The Share Balance Report should not be different from the CDC Account Balance Report if

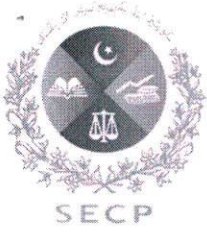


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prepared in accordance with the requirements of the regulatory framework. The Appellant has contended that there are several instances where shares of a particular account have been held by it in another account other than the respective sub-account of a particular client. As a result the shares would not appear in the client's sub-account even though they will still be in the beneficial ownership of the client and held for the benefit of the client. We agree, however, with the Respondent that this cannot be relied upon as no proper evidence was provided in respect of such instances; and

- (c) the Appellant has argued that Paragraph 73 of IAS 1 does not apply to existing loan facility, the repayment of which is subject to determination by a court of competent jurisdiction. Reliance is placed on Paragraph 74 of IAS 1 which provides that, "When an entity breaches a provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed, after the reporting period and before the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach. An entity classifies the liability as current because, at the end of the reporting period, it does not have an unconditional right to defer its settlement for at least twelve months after that date."

We have reviewed copies of pleadings provided by the Appellant which shows that the Appellant is in litigation with the Banks. The finance facilities granted to the Appellant may be a matter of determination before a court of competent jurisdiction but it can certainly not be treated as a long term liability as the outcome of the pending recovery suits filed by the Banks is still uncertain. In other words, the Appellant has not been given the unconditional right to defer the settlement of its liabilities for atleast 12 months after the end of the reporting period. Further, with regards to Bank Alfalah, even if no demand has been made and the Appellant is confident that restructuring will take place, no such restructuring has taken place as of yet and the said bank has not given the Appellant the



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unconditional right to defer settlement of its liability. Moreover, the Statutory Auditors of the Appellant have also qualified their opinion in their annual report for the year ended 30/06/12 with regard to reclassification of long term loans in non-current liabilities as opposed to current liabilities by stating that, *"the company has recorded current portion of its long term loans in non-current liabilities amounting to Rs 216,250,026/-. Had it been recorded in current liabilities, the total current liabilities would have been Rs 608,230,119/-."* The Appellant, therefore, has not been able to demonstrate that existing loan facility could be classified as a long term liability.

In view of the foregoing, we are of the view that NCB was not calculated in accordance with the Third Schedule to the SE Rules and penalty was rightly imposed under section 22 of the Ordinance. We see no reason, therefore, to interfere with the Impugned Order. The Appeal is dismissed with no order as to costs.

(Fida Hussain Samoo)
Commissioner (Insurance)

(Tahir Mahmood)
Commissioner (CLD)

Announced on: **24 JUL 2015**