



Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH

In the matter of

Appeal No. 103 of 2017

Azee Securities (Private) Limited

Appellant

Versus

The Commissioner (SMD), SECP, Islamabad.

Respondent

Date of hearing:

December 19, 2019

Present:

For Appellant:

- i. Mr. Abdallah Azzaam Naqvi, Advocate
- ii. Mr. Ghazi Naseem, Manager Compliance

For Respondent:

- i. Mr. Osman Syed, Joint Director (Adjudication-I), SECP
- ii. Mr. Sabeel Ahmed, Assistant Director (SMD), SECP
- iii. Ms. Mehwish Naveed, Management Executive (Adjudication-III), SECP

ORDER

1. This Order shall dispose of Appeal No. 103 of 2017 filed by the M/s. Azee Securities (Private) Limited (the Appellant) against the Order dated September 20, 2017 (the Impugned Order) passed by the Executive Director, PRPD (the Respondent) under the Securities Brokers (Licensing and Operations) Regulations, 2016 (the Regulations) read with the Securities Act, 2015 (the Act).
2. Brief facts of the case are that the Appellant is a Trading Right Entitlement Certificate holder of the Pakistan Stock Exchange (PSX), licensed as a securities broker with the Securities and Exchange Commission of Pakistan (the Commission) and a clearing member of the National Clearing Company of Pakistan Limited (NCCPL). The Appellant was registered as a Finanee/Financier for Margin Financing (MF), Margin Trading System (MTS) and securities

Appellate Bench

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lending and borrowing with NCCPL under the NCCPL Regulations, 2015 (the NC Regulations) read with Securities (Leveraged Markets and Pledging) Rules, 2011 (the Rules). The Commission conducted a compliance review under section 79(3) of the Act (the Review) to ascertain the Appellant's compliance with the regulatory framework regarding financing and extending credit (the Framework) during the period from March 1, 2016 to November 30, 2016. The Review, revealed the following non-compliances;

- a) The Appellant was extending credit by providing finance to its clients for trading of securities in violation of Rule 34 of the Rules. Moreover, the financing extended by the Appellant resulted in continued debit balance. The continued debit balance was in contravention of Regulation 4.18.1(c) of the PSX Rule Book (the Book), which require using of collateral account for settlement. The Appellant also charged mark-up of Rs. 23.6 million from its clients in the guise of late payment charges.
- b) The Appellant made payments to the clients who were having debit balance in contravention of Rule 34 of the Rules read with Regulation 4.18.1 (c) of the Book.
- c) In MTS transaction, the Appellant failed to recover Finance Participation Ratio (FPR) from its clients in violation of Regulation 19.5 of the Book read with Regulation 12.9.3 (c) of NC Regulations. The Appellant had not collected FPR from clients, hence, extended finance in violation of Rule 34 of the Rules.
- d) In MTS transactions, the Appellant failed to recover mark to market (MtM) losses in form of cash from its clients in Leveraged Market, which was a contravention of Regulation 12.9.3 of NC Regulations read with Regulation 19.5 of the Book. The Appellant had not collected MtM losses from its clients, hence, extended finance and violated Rule 34 of the Rules.
- e) In violation of the Regulation 19.5 of the Book read with Regulation 12.9.3 of the NC Regulations, the Appellant had failed to recover margins from its clients for the trades executed in the Ready Market. The Appellant had provided margins on behalf of its clients, hence, extended finance to its clients in contravention of the requirements of Rule 34 of the Rules.
- f) In violation of the Regulation 19.5 of the Book read with Regulation 12.9.3 (a) of the NC Regulations, the Appellant failed to recover MtM losses of Future Market, in form of cash from its clients. The Appellant had not collected MtM losses from its clients, hence, extended finance to its clients in contravention of the requirements of Rule 34 of the Rules.



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g) In violation of the Regulation 34 of the Securities Brokers (Licensing and Operations) Regulations, 2016 (the Regulations), the Appellate failed to make additional disclosures in quarterly accounts for the period ended September 30, 2016.

3. In view of the violations highlighted during the Review, a Show Cause Notice dated January 27, 2017 (the SCN) was served on the Appellant under Section 150 of the Act. The Appellant's written reply (the Reply) was received on February 21, 2017 whereas, hearing in the matter was held on February 22, 2017. The Appellant's representatives (the Representatives) reiterated assertions contained in the Reply and stated that after the issuance of the SCN, the Appellant has taken steps to rectify the non-compliances pointed out by the Commission. The Representatives informed that the Appellant is now significantly compliant with the Framework and the remaining non-compliances would be rectified in due course of time. In order to verify the Appellant's claim and assess the status of compliances with the Framework, the Commission conducted the Appellant's Follow up Review (the FL Review) for the period May 1, 2017 to May 31, 2017. The FL Review revealed the following:

- i. The Appellant collected late payment charges of Rs. 0.7 million from its clients for the month of May 2017. Whereas, the aggregate late payment charges were Rs. 4.9 million by May 31, 2017.
- ii. Instances with regard to execution of trades of clients despite existence of continued debit balance.
- iii. Instances of making payments to the clients who were having debit balance.
- iv. Instances with regard to non-collection of FPR and MtM losses in MTS transactions, non-collection of margins in the Ready Market and MtM losses in Future Market from its clients.

4. The details of the FL Review were shared with the Appellant on July 14, 2017 whereas, another hearing opportunity was provided on August 10, 2017. The Representatives argued that on November 30, 2016 the Appellant's receivables were Rs. 446 million, however, by May 31, 2017 same were reduced to Rs. 347.5 million. The Representatives further stated that the Appellant's Board has decided to stop charging mark-up by July 31, 2017. After the Review and the FL Review, the following violations of the Framework were observed;



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- I. The Appellant was extending financing/credit to clients, in violation of Rule 34 of the Rules and in violation of para 2.1 of the guidelines dated July 3, 2013, charging mark-up on receivables (continued debit balance) from clients.
 - II. The Appellant made payments to the clients having debit balance in violation of rule 34 of the Rules.
 - III. The Appellant failed to collect FPR in MTS, margin in ready market and MtM losses in MTS and MtM losses in future market transactions from the client in violation of Regulation 19.5 of the Book read with Regulation 12.9.3 of NC Regulations. Furthermore, through the aforesated violation, the Appellant, in violation of Rule 34 of the Rules, had extended finance to its clients.
 - IV. In violation of the Regulation 34 of the Regulations, the Appellate failed to make additional disclosures in quarterly accounts.
5. In view of the above violations of the Framework, the Respondent issued a strict warning to the Appellant for its failure to collect FPR, margins, recover MtM losses, making payments on debit balance and non-disclosure of requisite information in quarterly Accounts. Whereas, the Respondent had imposed a monetary penalty of Rs. 1,000,000/- for the violation of the Framework regarding unregulated financing/credit extended by the Appellant to its clients and charging mark-up thereon.
6. The Appellant has challenged the Impugned Order Inter alia on the grounds that late payment charges were being collected from clients who did not clear their dues for extended periods. The Appellant stated that late payment charges are applied to cover the Appellant's financial cost and administrative cost. The Appellant contended that late payment charges should not be confused with the practice of in-house financing as the Appellant imposed late payment charges to clients at a rate of KIBOR + 3/4% despite the fact the Appellant has to finance such purchases itself at a rate of KIBOR + 2/3%. The Appellant submitted that late payment charges had never been a source of income to the Appellant but are applied so that the clients settle their overdue balance promptly. The Appellant further stated that its previous practices to debit balance and late payment chargers was not a violation of the Framework, however, the Appellant has decided to ensure strict adherence with the Framework.



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7. The Appellant stated that the Respondent failed to appreciate that subsequent to the SCN, the Appellant drastically reduced the receivables and the Appellant's Board has resolved vide resolution dated July 11, 2017 that the Appellant would cease to collect late payment charges/mark-up against outstanding debit balance of the individual clients after July 31, 2017. The Appellant further stated that in order to meet the requirements as set out in the Book and in NC Regulations, clients in general are required to ensure they maintain adequate margins (in the form of cash and or securities) upon taking exposure in any market. The Appellant contended that requiring the clients to maintain margins in the form of cash and or securities is also in line with requirements stated under Schedule II of the NC Regulations. The Appellant stated that the Respondent had failed to appreciate that majority of the clients paid margins in the form of cash.
8. The Respondent has rebutted the grounds of Appeal and stated that the Review has revealed that the Appellant was extending credit by providing finance to its clients for trading of securities. The Respondent submitted that the Appellant was also charging mark-up from its clients in the guise of late payment charges. The Respondent informed that the FL Review revealed that the Appellant collected late payment charges of Rs. 0.7 million from its clients for the month of May 2017 and the aggregate late payment charges were Rs. 4.9 million by May 31, 2017. The Respondent stated that as a matter of fact late payment charges were mark-up. The Respondent stated that as per para 2.1 of the Net Capital Balance Calculation Guidelines dated July 3, 2013 charging mark-up, late payment charges or any charges with any other name on the balance of trade receivable is strictly prohibited, if the same are charged for arranging/extending credits for /to the clients other than allowed under section 16 of the Securities and Exchange Ordinance, 1969. The Respondent argued that in view of above, the Appellant was not allowed to charge mark-up or late payment on the receivables from its clients.
9. The Respondent further stated that in terms of section 64 of the Act, a securities broker is restricted to carry out regulated activities for which it has not obtained licence and can only extend regulated modes of financing, therefore, extending finance beyond the prescribed scope is violation of the regulatory obligations. The Respondent submitted that non-collection of FPR and MtM losses in MTS transactions, non-collection of margins in the ready market and MtM losses in the futures market from its clients are examples of unregulated modes of financing. The Respondent contended that the Appellant has extended the aforesaid unregulated financing to its clients and failed to provide any evidence that MtM losses, FPR and margins were recovered from



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clients. The Respondent argued that in view of the above circumstances, violations of Regulation 19.5 of the Book read with Regulation 12.9.3 of NC Regulations were established.

10. The Appellate Bench (the Bench) has heard the parties and perused the record. The Representatives reiterated the grounds of Appeal, whereas, the Respondent's representatives rebutted the comments thereof. In light of the record, the Bench has observed that the Appellant's compliance status with regard to the Framework was examined in two phases i.e. the Review and the FL Review. The Bench has observed that certain violations of the Framework, which were highlighted during the Review were rectified before the FL Review. The Bench has further observed that the FL Review detected eight violations of the Framework, however, the monetary penalty was imposed on two counts only, whereas, warning was issued against six other violations.
11. In view of the record, the Bench has no doubt that that violations of the Framework regarding failure to collect FPR, margins, recover MtM losses, making payments on debit balance and non-disclosure of requisite information in quarterly Accounts were established against the Appellant. The Bench has observed that the Respondent has adequately mentioned the instances of aforestated violations. The Bench is of the view that instead of issuance of warning against the aforestated six violations, the Respondent should have imposed monetary penalty on the Appellant. As per law, the Respondent was empowered to suspend/ cancel the Appellant's license and impose monetary penalty, however, by issuing a warning, a lenient view was taken. The Bench has considered the Representatives conduct during the hearing whereby, they have not specifically contested the issuance of warning against the above six violations, therefore, we restrain ourselves to convert the warning into monetary penalty on six above counts.
12. The Bench has noted that the Appellant has never denied existences of the receivables (continued debit balance). The Bench has reviewed the contents of para "i" of the memorandum of Appeal wherein, the Appellant has stated that requirements of the Framework were never violated, however, now, adherence of the Framework has been ensured. We are of the view, that if the Appellant was compliant with the requirements of the Framework then, why adherence of the Framework has been ensured now? The Bench has also noticed the contents of para "m" of the memorandum of the Appeal wherein, the Appellant had stated that after issuance of the SCN, it had drastically reduced the receivables and management of the Appellant had passed the

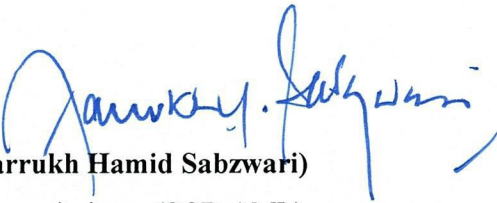


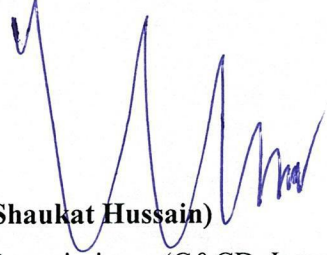
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resolution to cease collection of late payment charges by July 31, 2017. It is endorsed that financing clients through modes other than permissible under Rule 34 of the Rules is a grave violation and the Appellant was not licensed to operate in that manner. The Bench has no doubt that, charging mark-up on continued debit balance of clients, was a violation of para 2.1 of the guidelines dated July 3, 2013 issued by the Commission. The Bench is of the view that the Appellant's failure to stop charging mark-up on receivables (continued debit balance) from its clients is evidence that it has undermined the sanctity of the Framework.

13. The Bench is not inclined to accept the Appellant's assertion that it only recovered late payment charges to cover the Appellant's financial and administrative cost. The Bench has also reviewed the record which revealed that by May 31, 2017, the Appellant had charged aggregate mark-up of 4.9 million. In the above circumstances, we have no doubt that violations against the Appellant are established, however, the Appellant has taken steps to reduce the continued debit balance and has significantly reduced the quantum of mark-up. Furthermore, the Bench has also considered the Appellant's Board resolution whereby it had been resolved to stop charging mark-up from July 31, 2017.

14. Therefore, keeping in view the Appellant's efforts to become compliant with the requirements of the Framework, while maintaining the verdict of the Impugned Order, we hereby reduce the penalty of fine from Rupees 1,000,000/- to Rupees 500,000/- and direct the Appellant to comply with the requirements of the Framework, in letter and spirit, to avoid strict penal action in future. The Appeal is disposed of accordingly, without any order as to cost.


(Farrukh Hamid Sabzwari)
Commissioner (SCD, AML)


(Shaukat Hussain)
Commissioner (C&CD, Insurance)

Announced on: **06 FEB 2020**