



Securities and Exchange Commission of Pakistan

BEFORE THE APPELLATE BENCH

In the matter of

Appeal No. 18 of 2019

Mohammad Muneer Mohammad Ahmed Khanani Securities (Pvt.) Ltd

...Appellant

versus

Commissioner, Securities Market Division

...Respondent

Date of hearing: 27/02/2020

Present:

For the Appellant:

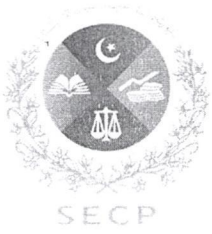
- i. Mr. Abdullah Azaan Naqvi, Advocate High Court
- ii. Mr. Munir Khanani, CEO
- iii. Mr. Abdul Razzaq, CFO
- iv. Mr. Abdul Hadi. Head of Operations

For the Respondent:

- i. Mr. Osman Syed, Joint Director (Adjudication-1)
- ii. Mr. Muhammad Akram, Assistant Director (Adjudication-1)

ORDER

1. This Order is passed in the matter of Appeal No. 18 of 2019 filed under section 33 of the Securities and Exchange Commission of Pakistan Commission Act, 1997 (SECP Act) against the Order dated 08/04/19 (Impugned Order) passed by Commissioner, Securities Market Division (Respondent).
2. The brief facts of the case are that Mohammad Munir Mohammad Ahmed Khanani Securities (Private) Limited (Appellant) is a trading rights entitlement certificate holder of the Pakistan Stock Exchange (PSX) and is licensed as a securities broker under the Securities Act, 2015 (Securities Act). The Joint Inspection Team of PSX, Central Depository Company and National Clearing



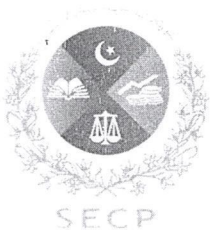
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Company of Pakistan Limited (JIT) conducted an inspection of the Appellant (Inspection) to assess its compliance with the regulatory requirements contained in Securities and Exchange Commission of Pakistan (Anti-Money Laundering and Countering Financing of Terrorism) Regulations, 2018 (AML Regulations). The Inspection, inter alia, revealed the following:

- i. The Appellant had not documented the date on which the Customer Due Diligence (CDD) was performed.
- ii. The Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) policy did not meet the requirements of AML Regulations.
- iii. The Respondent had not established an internal audit function.
- iv. The Respondent had not conducted CDD of three (3) clients. Moreover, it did not obtain evidence of source of funds and failed to establish beneficial ownership of various clients.
- v. The Respondent had assigned incorrect risk ratings to its clients.
- vi. The Respondent had not performed Enhanced Due Diligence (EDD) of its high-risk clients.
- vii. The Respondent had not developed an ongoing mechanism to ensure that the transactions were consistent with its knowledge of the customers.
- viii. The job description of the compliance officer did not meet the requirements of AML Regulations.
- ix. The Respondent had failed to chalk out and implement a training program for its employees to effectively implement regulatory requirements relating to anti-money laundering and terrorism financing.

It appeared that the Respondent prima facie acted in contravention of the AML Regulations and the Act.

3. Show Cause Notice (SCN) was served on the Appellant on 15/02/19. The Respondent submitted its reply and hearing in the matter was held on 07/03/19. Mr. Muhammad Munir Khanani, Chief Executive Officer, Mr. Abdul Razzaq, Head of Operations and Mr. Abdullah Azam, Legal Counsel of the Appellant appeared for and on behalf of the Appellant and made their submissions.
4. The Respondent dissatisfied with the response of the Appellant held that regulatory requirements relating to KYC/CDD and anti-money laundering have been implemented since the year 2012 considering public interest, the integrity of the Pakistani capital market and the country's international commitments. The Respondent held that all licensed persons are expected to ensure

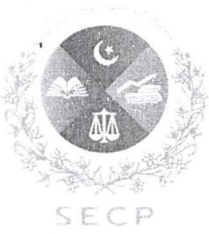


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strict compliance with this regime by remaining vigilant and putting in place requisite policies and procedures to curtail activities relating to money laundering and financing of terrorism. Furthermore, the Respondent held that the Appellant had subsequently provided the training to its employees within the time frame, therefore, it would be unjust to hold the Appellant accountable on this count. Lastly, the Respondent held that establishing an independent internal audit function, updating the AML/CFT policy and devising a mechanism for ongoing monitoring of its clients post Inspection does not undo the default of the Appellant and the Commission has adopted a zero tolerance policy towards any gaps in this area. The Respondent, therefore, held that it will not show any leniency and in terms of powers conferred under section 40A of SECP Act, 1997 imposed a penalty of Rs.250,000 on the Appellant. The Appellant was further advised to examine its AML/CFT policy and procedures and the accounts of its clients to ensure that the requirements contained in the AML Regulations are met in letter and spirit.

5. The Appellant preferred the instant appeal on the following grounds:

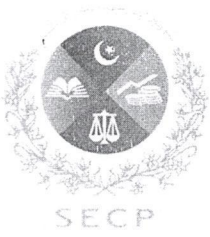
- (a) The Respondent has passed the Impugned Order without proper appreciation of the facts or law. The contents of the SCN are a reproduction of the various observations contained in the JIT Review. The Appellant has time and again provided detailed response to the said JIT Review as well as the SCN, however, the Respondent has not considered the same while passing the Impugned Order which has been passed mechanically by merely repeating earlier observations. In addition to not considering the response of the Appellant, the Respondent has wrongly observed that the Appellant contended that it had failed to comply with the AML Regulations due to its large clientele. The Appellant has never taken this stance and has always maintained that it is fully compliant with the AML Regulations.
- (b) The Respondent has also wrongly observed that the Appellant contended that since the AML Regulations were enacted recently, the Appellant required further time to implement them. As far as the "Know Your Customer" (KYC), guidelines made by the PSX are concerned, the Appellant has always done the required due diligence and to date no adverse report or order has been passed against the Appellant in respect of the same. Therefore, the Appellant has wrongly stated that the Appellant used such reasons to justify not complying with the said AML Regulations.
- (c) The Respondent has wrongly observed that the Appellant carried out the exercise of CDD as required by the AML Regulations subsequent to the Inspection conducted by the JIT. The



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Appellant had categorically stated in its reply to the JIT Review as well as its reply to the SCN that CDD and KYC exercise has always been conducted by the Appellant at the time of opening of the customer's account. It is the Appellant's strict policy that no account be opened without the relevant information and documents. At the outset it is submitted that the AML Regulations specifically provide that CDD is to be done "*on the basis of documents, data or information obtained from the customer*". The Appellant and its employees strictly adhere to this. Therefore, the said observation of the Appellant clearly shows that it has not considered the replies and the contentions of the Appellant at all while passing the Impugned Order.

- (d) The Appellant has laid down certain parameters for CDD and to ascertain the beneficial ownership and source of funds of its customers. For instance, in case of corporations, at the time of account opening, the Appellant calls for and relies on essential documents such as Board Resolutions, Form A and Form 29 of the Company, details of the shareholders and directors, memorandum and articles of association/trust deeds and details of trustees, etc. Such documents are already registered and filed with the Commission as required by the Companies Act, 2017. Therefore, for the Respondent to say that such documents are not adequate and insufficient for reliance by the Appellant defeats the entire regulatory framework of the Commission. Furthermore, in cases of individual customers the Appellant requires them to give their visiting cards, salary slips/NTN details. This clearly shows that the Appellant takes every measure possible to ascertain the beneficial ownership and sources of funds of its customers. The Appellant cannot reasonably be expected to hold inquiries before opening of accounts for its customers or to investigate the veracity of information provided by them. The documents provided for opening of accounts with the Appellant correspond with the documents required by Annexure 1 of the AML Regulations and the Respondent has erred in observing that such documents are not adequate for CDD. Even otherwise, even it is assumed, without conceding, that the Respondent's observation is correct, and the documents relied on by the Appellant are not adequate, the Respondent should have at least provided some explanation, direction or clarity in this regard. The Respondent, however, has just arbitrarily decided that the Appellant has not done the requisite due diligence.
- (e) In the Impugned Order, the Respondent has highlighted the case of one of the customers of the Appellant, namely Fouzia Fawad. At the time of opening of her account, the said customer provided various documents that were required by the Appellant. Since the said customer is a housewife, she gave an undertaking that her source of funds is the savings from her husband's



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salary. The Respondent has observed that reliance on written undertakings and submissions by customers making such disclosures are inadequate for ascertaining a customer's source of funds, however, the logic of the Respondent cannot be accepted as it would essentially mean that individuals who are not salaried; are self-employed; or carry on personal businesses cannot invest in the brokerage industry. This obviously cannot be the intent of the law or the regulatory framework of the Commission. Furthermore, AML Regulations also do not require the Appellant to investigate the veracity of each document or information provided by the customers.

(f) The Respondent further failed to appreciate the contentions of the Appellant regarding assigning of risk profiles to its customers. At the time of JIT Review, the JIT had assigned high risk profiles to certain customers which the Appellant otherwise had assigned to low or medium risk profiles. Similarly, without providing any reasoning the Respondent took the JIT's observation on face value and reproduced the same in its SCN. The Appellant refuted the same on the grounds that even though the AML Regulations provide parameters, they leave it at the discretion of the Appellant to devise a suitable policy. As per the policy of the Appellant, customers with lower trade volumes are logically assigned risk low risk profiles while others are assigned medium or high risk profiles accordingly. Therefore, had the Commission wanted the brokerage houses to follow a unified system it would have laid down a specific set of criteria to be followed across the board. Without providing this, the Respondent's observation that the Appellant assigned incorrect risk profiles is unfounded and baseless. Furthermore, no reasoning is provided as to how the same is in contravention of the AML Regulations. The Appellant conducts EDD for all of its customers with high-risk portfolios. Even otherwise, the Appellant has an in-built monitoring system, which constantly keeps track of the trading volumes of each customer. Based on such an ongoing monitoring, the Appellant changes the risk profiles and conducts EDD as and when required. Therefore, the observations and findings of the Respondent on this regard are incorrect and unwarranted. By arbitrarily assigning different portfolios to the Appellant's customers, the Respondent cannot hold the Appellant accountable and liable for not conducting EDD.

(g) It is a strict policy of the Appellant that it does not accept cash from any customer. At the time of the opening of each customer, the Appellant calls for account maintenance certificate from the customer's respective bank. Furthermore, the Bank Manager is also required to attest the account opening form and only cheques and other such instruments from such account of the

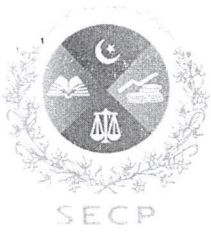


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customer are accepted by the Appellant. On the other hand, all payments made by the Appellant to a customer are through cross cheque in their favour. This practice ensures that transactions are strictly between the Appellant and its customers and are documented. Through this, the possibility of money laundering is greatly reduced.

6. The Respondent rebutted the arguments of the Appellant on the following grounds:

- (a) The Impugned Order is a speaking order in its nature, which covers factual and legal aspects of the matter. Moreover, the contraventions of the AML Regulations are clearly mentioned in the Impugned Order on how the Appellant was non-compliant during the Review Period. The Appellant submitted that it had conducted the KYC/CDD of the corporate clients at the time of opening of account, however, the documentary evidence suggests that the KYC/CDD exercise was carried out after the matter was highlighted in the Inspection dated 21/11/18. Furthermore, the documents revealed that the Appellant did not ascertain the ultimate beneficial ownership of the corporate clients as per the requirement prescribed under Regulation 7 of the AML Regulations. Based on the aforementioned, the Appellant was required to follow the law in a prescribed manner as provided under AML Regulations.
- (b) The Appellant did respond to the reply vide letter dated 15/02/19 and stated that they had a large clientele and it was difficult to contact the clients for ongoing CDD from which it can be construed that no such compliance was made in this regard. In its reply to the SCN, the Appellant also submitted that AML Regulations are new and reasonable time was not available to be fully compliant. It is imperative to mention here that AML Regulations were issued in 2018 but the requirements contained therein are not new and rather the requirements were introduced in 2012 when the then Karachi Stock Exchange (presently PSX) with the approval of the Commission, through regulation 4.18 of the Rule Book, made it mandatory for the securities broker to formulate and implement an effective KYC and CDD policy in accordance with the KYC and CDD issued by the Exchange. Therefore, AML Regulations cannot be termed as new set of requirements and the argument of the Respondent that sufficient time was not available for compliance is untenable.
- (c) The Appellant submitted that it had conducted the KYC/CDD of the corporate clients at the time of opening of account, however, the documentary evidence suggests that the KYC/CDD exercise was carried out after the matter was highlighted in the Inspection dated 21/11/18.



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Furthermore, the documents which were acquired to ascertain the ultimate beneficial ownership of the corporate clients did not meet the requirement prescribed under Regulation 7 of the AML Regulations.

(d) The Appellant submitted undertakings on plain piece of paper from its clients, NTN inquiry receipts, business cards and a salary slip. While reviewing the documentary evidence submitted by the Appellant to establish the source of funds, it had been observed that the documents had been obtained after the Inspection. Moreover, obtaining undertakings or NTN queries do not fulfill the requirements of the AML Regulations. It is only possible to meet the requirements of AML Regulations when the Appellant establishes understanding of the source of funds of its clients at the time of opening of account. Furthermore, sole reliance on undertakings cannot be an adequate measure to address concerns of AML Regulations rather it should be supported by credible documentary evidence. Similar contention was put forth by the Respondent that confirmation of beneficial ownership cannot be sought on a recorded call. It is reiterated that reliance on disclosure of client does not discharge the Appellant from establishing true ownership. For instance, a client Fouzia Fawad of the Appellant had disclosed herself as a housewife who had executed trades of Rs.141 million without any identifiable source of income. The Appellant, however, failed to provide evidence of a reasonable effort to establish beneficial ownership and rather placed reliance on the disclosures made by clients. Moreover, the Appellant had assigned incorrect risk ratings to such clients who executed large value trades despite the fact that it did not have any identifiable source of income or beneficial owner. The Appellant, therefore, failed to provide any justification for its failure to conduct EDD of the clients that it had categorized as high risk.

(e) It is reiterated that regulatory requirements relating to KYC/CDD and anti-money laundering have been implemented since year 2012 considering public interest, the integrity of the Pakistani capital market and the country's international commitments. Therefore, all licensed persons are expected to ensure compliance with this regime by remaining vigilant and putting in place requisite policies and procedures to curtail activities relating to money laundering and financing of terrorism. In view thereof, the Appellant should have followed the procedure laid down in AML Regulations. It is settled law that in case where statute provides a procedure for doing a thing in a particular manner, the same needs to be complied. Furthermore, reliance is

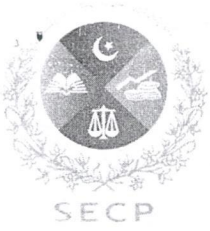


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placed on the judgment of the Honourable Supreme Court in the case of *Zia ur Rehman v. Syed Ahmed Hussain and others* cited at 2014 SCMR 1015, wherein, it was held that if the law requires a particular thing to be done in a particular manner it has to be done accordingly, otherwise it would not be in compliance with the legislative intent. Based on the aforementioned case laws, the Appellant was required to follow the law in a prescribed manner as provided under the AML Regulations.

- (f) During the review, it was observed the difference in rating assigned to the clients in KYC forms and back office list. Further to this, the Appellant had assigned high risk to five (5) of its clients, however, no EDD and risk management/mitigation process was performed. The Appellant also has not provided the approval from senior management to deal with high risk clients and the explanation provided by the Appellant was not justifiable.

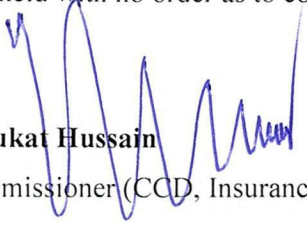
7. We have heard the parties i.e. the Appellant and the Respondent. We are of the view that the regulatory requirements prescribed in the AML Regulations were not new as all securities brokers since 2012 had to comply with PSX Regulation to formulate and implement an effective KYC and CDD policy in accordance with PSX's KYC and CDD Guidelines and put in place requisite policies and procedures to curtail activities relating to money laundering and financing of terrorism. The Appellant failed to establish that they had done EDD for clients who were given a high risk rating and, furthermore, could not show that they had received all documents which were required to establish beneficial ownership or source of funds. Therefore, without going into the argument whether the rectifications were made after they were highlighted during inspection or the KYC/CDD exercise had already been carried out before the inspection, the fact remains that the documents received from clients by the Appellant to establish source of funds and beneficial ownership were incomplete and unsatisfactory. While it may be true that documents obtained by the Appellant correspond with those mentioned in Annexure-1 of the AML Regulations, the intent should be to obtain clear evidence of source of income and mere undertakings, visiting cards and NTN queries alone cannot suffice. Furthermore, the Appellant also failed to ascertain beneficial ownership of corporate clients in terms of Regulation 7 of the AML Regulations which states that, "...a regulated person shall acquire and use requisite information and data obtained from a reliable source...". The Appellant at the hearing had argued that their client Fouzia Fawad's husband was also their client and she had given an undertaking that the source of funds were savings from her husband's salary, therefore, further documentation was not necessary. Moreover, the Appellant argued that it is also not practical to conduct an investigation of every client and verify all

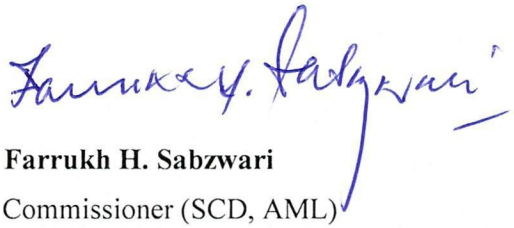


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documents. We concur with the Respondent, however, that the Appellant cannot rely simply on disclosures and undertakings given by clients to establish beneficial ownership and source of funds, therefore, more credible documentary evidence and data from a reliable source needs to be obtained. The Appellant, therefore, could not establish that they were fully compliant with the AML Regulations as a result of which penalty was rightly imposed by the Respondent.

8. In view of the foregoing, we see no reason to interfere with the Impugned Order. The Impugned Order is upheld with no order as to cost.


Shaukat Hussain
Commissioner (CCD, Insurance)


Farrukh H. Sabzwari
Commissioner (SCD, AML)

Announced on: **08 JUL 2020**