

Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH

In the matter of

Appeal No. 19 of 2019

Adam Securities Limited

...Appellant

versus

The Commissioner, Securities Market Division, SECP

...Respondent

Date of Hearing: 28/11/19

Present:

Appellant's representatives:

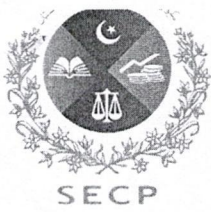
- i. Mr. Noman Abdul Majeed, CEO
- ii. Mr. Muhammad Rizwan Haroon, CFO & Company Secretary
- iii. Mr. Ali Lakhany, ACA
- iv. Mr. Syed Ahsan Ali Shah, Advocate High Court

Respondent's representatives:

- i. Ms. Amina Aziz, Director (SMD)
- ii. Ms. Mehwish Naveed, Management Executive (SMD)

ORDER

1. This Order is passed in the matter of Appeal No. 19 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 Adam Securities Limited (the Appellant) is a Trading Right Entitlement Certificate (TREC) holder of the Pakistan Stock Exchange Limited (PSX) and licensed as a securities broker under the Securities Act, 2015 (Securities Act). The Joint Inspection Team of PSX, Central



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Depository Company and National Clearing Company of Pakistan Limited (JIT) conducted an inspection of the Appellant (Inspection) to assess its compliance with the regulatory requirements contained in the 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 failed to mention the dates on which it performed customer due diligence (CDD) of its seventeen (17) clients.
- ii. The Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) policy of the Appellant had not been approved by its board of directors.
- iii. The Appellant had failed to develop an ongoing mechanism to ensure that the transactions are consistent with its knowledge of the customers.
- iv. The Appellant 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.
- v. The Appellant had extended a loan of Rs 50 million to another brokerage house in violation of Securities Act.

3. The Appellant *prima facie* acted in violation of the AML Regulations and the Securities Act. The Commission took cognizance of the aforementioned facts and served a show cause notice dated 07/02/19 (SCN) to the Appellant. The Appellant submitted its reply through email dated 19/02/19. Hearing in the matter was held on 26/02/19 and Mr. Noman Abdul Majeed, Chief Executive Officer and Mr. Muhammad Rizwan Haroon, Company Secretary appeared on behalf of the Appellant and made their submissions.

4. The Respondent dissatisfied with the response of the Appellant held that while the AML Regulations were issued in 2018, the requirements contained therein are not new, therefore, contraventions of AML Regulations had been established. The Respondent in terms of powers conferred under section 40A of the Securities and Exchange Commission of Pakistan Act, 1997 (Act) imposed a penalty of Rs 250,000/- on the Appellant under section 40A of the Act. The Appellant was further advised to examine its Anti Money Laundering/Countering Financing of Terrorism (AML/CFT) policy & procedures and the accounts of its clients to ensure that the requirements contained in the AML Regulations are met in letter and spirit and in this regard submit a report to the Commission within sixty days of the date of the Order. The Appellant was also warned by the Respondent that any non-compliance of the AML Regulations noticed during future inspections/investigations would attract significantly higher penalties.



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

- a) The Appellant is a public unlisted company and has been in the business of brokerage and securities since 2001. The AML Regulations were new at the time of the proceedings when they came into force on 13/06/18. The claim made by the Respondent that AML Regulations were similar to the requirements introduced in 2012 when then Karachi Stock Exchange (presently PSX) through regulation 4.18 of the Rule Book (PSX Regulation), made it mandatory for the securities brokers to formulate and implement an effective KYC and CDD policy in accordance with the KYC and CDD Guidelines issued by PSX (PSX's KYC and CDD Guidelines) does not hold merit. The subsequent report after the Inspection (Report) does not make any mention or give reference of the PSX Regulation and PSX's KYC and CDD Guidelines. Furthermore, as the AML Regulations were new, it took time for their full implementation and multiple awareness sessions were being conducted not only by PSX but also by the Commission at the time of the proceedings.
- b) The Appellant carried out an exercise to obtain information regarding the source of income from clients and did everything in their control to obtain such information which is a part of the record. As per the Frequently Asked Questions (FAQs) by the Commission on AML/CFT Regulations, in case of low risk customers, no specific evidence is required for source of income. The Respondent's claim that the dates on all the KYC forms were missing is completely incorrect. Firstly, there were only a few forms on which the date was not documented while dates on all other KYC forms were duly documented. Secondly, it is nowhere explicitly mentioned in the Regulations that the Appellant is required to input date on KYC forms. The Regulations only require risk assessment of the clients to be updated on a periodic basis. Thirdly, the Appellant later ensured that dates on such forms were duly inserted which is a procedural lapse at best and this certainly does not imply that the Appellant is in violation of the AML Regulations.
- c) The Respondent has himself admitted in the Impugned Order with respect to approval of the AML/CFT policy that the said policy was approved by the Board of the Appellant and has been put in place. Furthermore, the Respondent's claim that the Appellant did not assign any risk rating to its clients is incorrect as this can be established by the Report itself which mentions that out of a sample of twenty-three clients, risk rating was duly assigned to twenty-one clients and for the remaining two clients, due diligence was carried out and risk rating was established, however, it was just not documented on the form. The Appellant later ensured the same was documented and submitted evidence in this regard.

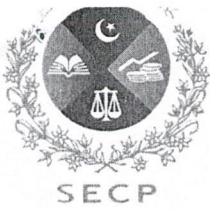


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d) The person namely Mr. Syed Minhaj ul Huda (Mr. Syed) was never an employee of another brokerage house at the time of account opening with the Appellant. The Appellant opened an account of Mr. Syed after getting confirmation that his account with the other brokerage house had been closed on 17/03/17. Furthermore, a registered employee of a brokerage house is not allowed to open client account with another brokerage house as per National Clearing Company of Pakistan Limited (NCCPL) UIN registration system.

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

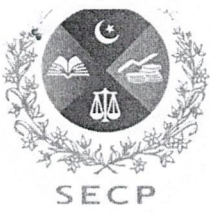
- a) The AML Regulations were issued in 2018 but the requirements contained therein are not new as the requirements were introduced in 2012 through PSX Regulation which made it mandatory for the securities brokers to formulate and implement an effective KYC and CDD policy in accordance with PSX's KYC and CDD Guidelines. Therefore, argument by the Appellant that sufficient time was not available for compliance is baseless and with regard to training sessions, many awareness sessions were also conducted by the Commission.
- b) The Appellant was non-compliant during the Inspection period as the concept of CDD does not just relate to business risk assessment but also requires establishing the true source of funds and beneficial ownership to ensure that funds are not proceeds from money laundering, tax evasion, fraud and other financial crimes. The Appellant failed to perform CDD of seventeen of its clients in violation of Regulation 3 of the AML Regulations and wrote letters to clients to provide information for beneficial ownership only after the observations were highlighted during the Inspection. Moreover, the Appellant was also unable to furnish any valid justification for not inserting relevant dates in the KYC/CDD forms of its clients.
- c) The Appellant did not assign any risk rating to two clients and gave incorrect risk rating to nine of its clients in violation of Regulation 6(8) of the AML Regulations which was subsequently corrected only after the Inspection. Furthermore, AML/CFT policy and mechanism for ongoing monitoring of its clients was not in place at the time of Inspection in violation of Regulation 13 of the AML Regulations.
- d) The argument by the Appellant that NCCPL system would automatically bar the opening of a client account of an employee of another brokerage house is unacceptable as it further signifies the shortcomings in due diligence process of the Appellant. The CDD exercise by the Appellant does not



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meet the required standards and was done merely as a formality as it is evident from the sub-account opening form No. 19831 dated 03/03/17 which shows that the Appellant had failed to appreciate the disclosure given by client as an Equity Dealer for another brokerage house. Clause 4.21.5 of the Rule Book of Pakistan Stock Exchange Limited (PSX) provides that. *“A TRE Certificate Holder shall now allow trading on behalf of another TRE Certificate Holder’s employees”*. Furthermore, Regulation 16(6) of the Securities Brokers (Licensing and Operations) Regulations, 2016 provides that, *“a securities broker shall formulate policies and take reasonable measures to restrict its employees, including employees serving as directors on its board, from trading through another securities broker of the same securities exchange”*.

7. We have heard the parties i.e. the Appellant and Respondent. We have also perused the documents sent to the Appellate Bench by the Appellant vide letters dated 28/11/19 and 30/11/19 after the hearing. 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. Furthermore, the Appellant had to ensure full compliance with the AML Regulations at all times, therefore, their assertion that it was not possible for the AML Regulations to be fully implemented as they were new at the time does not hold merit.
8. We have reviewed the letter dated 29/11/19 from NCCPL addressed to the CEO of the Appellant stating that, *“As per NCCPL UIN registration system, registered employee of a brokerage house is not allowed to open client account with another brokerage house”*. We accept the evidence i.e. NCCPL UIN Post Report provided by the Appellant which shows that the account of Mr. Syed was only opened after closure of his account with the other brokerage house on 17/03/17. We also accept the Appellant’s evidence of training of employees in AML policy which was done within the time frame as also accepted by the Respondent in the Impugned Order, however, we are not satisfied with their response on other fronts. The Appellant has admitted there were two clients for which risk rating was done but which was not documented on the form. The fact that it was not documented clearly shows that the Appellant has not fully complied with Regulation 6(8) of the AML Regulations. Furthermore, CDD requires establishing the true source of funds and beneficial ownership to prevent cases of money laundering and terrorism financing, which the Appellant has also failed to do in many cases, and it was only subsequent to the Inspection that the Appellant wrote to its clients asking for information pertaining to beneficial



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ownership and obtained evidence relating to the source of funds of twenty-one clients. Furthermore, the Appellant has admitted there were KYC forms on which date was not documented. This cannot be considered to be a procedural lapse as it is a requirement of the law to implement an effective KYC and CDD policy. The Appellant has given evidence to show that AML/CFT policy was in place by providing a copy of the Board Resolution dated 21/01/16, however, looking at the evidence it seems the AML/CFT policy and mechanism for ongoing monitoring of its clients was clearly not in place at the time of the Inspection which is in violation of Regulation 13 of the AML Regulations. Furthermore, the Respondent has already taken a lenient view and not penalized the Appellant for providing a loan to another brokerage house in violation of Securities Act.

9. Therefore, we are of the view that the Appellant did not fully comply with the requirements of the AML Regulations in letter and spirit and penalty was rightly imposed on the Appellant under the Act. The Impugned Order is upheld with no order as to cost.


Shaukat Hussain

Commissioner (CCD, Insurance)


Farrukh H. Sabzwari

Commissioner (SCD, AML)

Announced on

17 JAN 2020