

Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH NO. 1

In the matter of

Appeal No. 27 of 2017

FM Securities (Private) Limited
through its CEO Mr. Fakhar Rashid

... Appellant

Versus

Executive Director, Securities Market Division (SMD),
Securities and Exchange Commission of Pakistan

...Respondent

Date of Hearing 20/04/18

Present:

For the Appellant:

- i. Mr. Syed M. Zulqarnain
- ii. Mr. Fakhar Mirza, CEO

For the Respondent:

- i. Mr. Asif Khan, Deputy Director (SMD)
- ii. Mr. Salman Arshad, Deputy Director (SMD)

ORDER

1. This Order is passed in the matter of Appeal No.27 of 2017 filed under section 33 of the Securities and Exchange Commission of Pakistan (Commission) Act, 1997 (SECP Act) against the order (Impugned Order) dated 03/10/16 passed by the Respondent.
2. The brief facts of the case are that the FM Securities (Pvt.) Ltd (Appellant) was a Trading Entitlement Certificate Holder of the then Lahore Stock Exchange Limited



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(LSE) and is registered as a broker with the Commission under Brokers and Agents Registration Rules, 2001 (Brokers Rules). The Commission vide Order dated 31/08/15 appointed an inspection team to inspect the books and record of the Appellant. The inspection team observed that the net capital balance (NCB) of the Appellant was Rs. 4,208,081. The NCB of the Appellant is reproduced below for ease of reference.

M/S. F.M. Securities (Private) Limited
NET CAPITAL BALANCE STATEMENT
As at June 30, 2015

RUPEES

CURRENT ASSETS

Cash & Bank Balances:

Cash in Hand	4,280,931
Cash at Bank	
- Client account	291,882
- Brokerage house	13,052
	4,585,865

Trade Receivables

Receivables	3,415,091
Less: Overdue for more than 14 days	3,381,165
	33,926

TOTAL CURRENT ASSETS

4,619,791

CURRENT LIABILITIES

Trade Payables:

Payables	279,785
Less: Overdue for more than 30 days	279,785

Accrued & Other Payables:

Overdue for more than 30 days	279,785
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Accrued & Other Payables	131,925
	411,710
TOTAL CURRENT LIABILITIES	411,710
<u>NET CAPITAL BALANCE</u>	4,208,081

3. The inspection team advised the Appellant to provide documentary evidence to substantiate the cash in hand appearing in the aforesaid NCB. In response, the Appellant informed that its chief executive (CEO) had provided loan amounting to Rs 2.5 million to the Appellant in shape of cash and gold. The Inspection team's observation with regard to loan and cash in hand are as under:

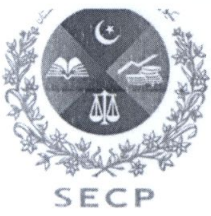
- (i) The Appellant classified the loan obtained from the CEO as long term loan. However, the Appellant did not provide copy of the written agreement executed on a stamp paper for the said loan.
- (ii) The Appellant did not provide any documentary evidence for the remaining amount of Rs 1,780,931/- shown as cash in hand.
- (iii) The Appellant informed that the cash and gold were in the personal custody of the chief executive.
- (iv) The NCB, prima facie, was overstated by Rs.4,280,931/- in violation of rule 2(d) of the Securities and Exchange Rules, 1971 (SE Rules).

4. The Commission served the Notice on the Appellant under section 22 of the Securities and Exchange Ordinance, 1969 (Ordinance). The Appellant vide letter dated 28/12/15 submitted its written response to the Notice along with a copy of loan agreement executed between the Appellant and its CEO and board resolution to this effect. The Respondent assumed the charge of the post of Executive Director before the matter could be concluded by the then Director/HOD (PRPD), and the instant case along with some other pending adjudication matters was placed before him. Hearing in the matter was scheduled for 22/07/16. On the given date, CEO of the Appellant appeared before the Respondent and submitted their written as well as verbal submissions.



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5. The Respondent dissatisfied with the response of the Appellant held that the Appellant is expected to ensure compliance with the applicable regulatory framework in letter and spirit. Furthermore, the Appellant was required to exercise due skill, care and diligence in the conduct of its business. The Appellant, however, did not exercise the requisite diligence while calculating its NCB and submitted an overstated NCB to the then LSE. As a result of the overstatement, the exposure limit calculated by the then LSE were also overstated. A penalty of Rs.100,000 was imposed on the Appellant by the Respondent and the Appellant was directed to comply with the regulatory framework in letter and spirit in future. Moreover, the CEO of the Appellant was advised by the Respondent to attend training courses in order to educate himself regarding differences between company and partnership structure, duties and responsibilities of chief executive and directors of company, etc.
6. The Appellant preferred the instant appeal on the following grounds:
- a) The Impugned Order is illegal as the Appellant duly fulfilled all the requirements of rule 2(d) of the SE Rules while preparing and getting the NCB of the brokerage house audited. The Respondent was unjustified in imposing such a high penalty and creating a bad name of the Appellant in the industry, when the Appellant was performing its responsibilities with due care, due diligence and competence. During the audit, the auditors demanded from the Appellants to present the cash in hand and gold which were presented before them and physically counted. A cash and cash equivalents certificate was also provided in support of the management assertions. Therefore, after the performance of these necessary audit procedures there was nothing to create doubt regarding the legal ownership of the cash and cash equivalents. Furthermore, the cash was kept in the possession of the Appellant's CEO by agreement of board of directors (BOD) and there is no harm in keeping Appellant's asset safe with the person who is in charge and responsible for company matters and who is also a director/member of the Appellant. It is incorrect to state that not depositing cash into the bank is proof that cash was not legally given by the CEO/lender; and
 - b) The Appellant prepared the NCB in accordance with the applicable law and also got it audited by the qualified auditors who performed all their procedures to verify the correctness



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of the NCB and issued a verification report. Therefore, the response of the Respondent is not justified and against the spirit of law and natural justice.

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

- a) The Impugned Order was passed as the Appellant failed to calculate its NCB as per the regulatory framework. The reported NCB of the Appellant was Rs 4,208,081/-, wherein, total current assets were reported as Rs 4,619,791 including cash in hand Rs 4,280,931/. The Inspection Team advised the Appellant to provide documentary evidence to substantiate the "cash in hand" (Rs.4,280,931) appearing in the aforesaid NCB. In response, the Appellant stated that CEO of the Appellant had provided loan amounting to Rs 2.5 million to the Appellant in shape of cash and gold pursuant to a loan agreement, but the loaned cash and gold remained in personal custody of the lender i.e. the CEO instead of the debtor i.e. the Appellant. Moreover, it was observed that the loan agreement was executed on the Appellant's letterhead instead of a stamp paper. Furthermore, the Appellant did not provide any documentary evidence for the remaining amount of 1,780,931/- shown under the head "cash in hand"; and
- b) The Appellant is a company registered under Companies Ordinance, 1984, therefore, it has a separate legal status from its chief executive, directors and shareholders. In order to qualify as assets of the Appellant and to be eligible for inclusion in NCB, the title and possession of the loaned cash and gold were required to be transferred to the Appellant. In the instant case, the possession and title of loaned items remained with the CEO, therefore, the cash and gold could not be considered assets of the Appellant and were ineligible for inclusion in NCB. Therefore, the NCB of the Appellant was not calculated in accordance with Third Schedule of the SE Rules and in violation of rule 2(d) of the SE Rules. It is worth to be noted that if the NCB of the Respondent was calculated in strict compliance with the regulatory framework, it would have been negative Rs 72,850/- instead of positive Rs 4,208,081/- as reported by the Appellant as on 30/06/15. Therefore, the Appellant was found to have violated rule 2(d) read with Third Schedule of the SE Rules.



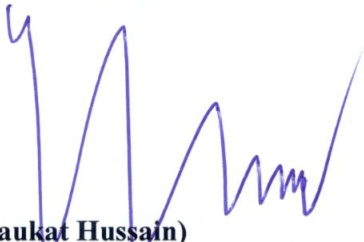
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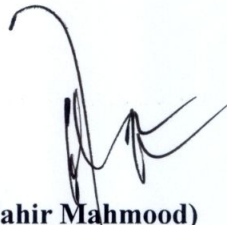
8. The Appellate Bench (the Bench) has heard the parties and perused the record. The audited accounts of the Appellant show that on 30/06/15 cash in hand was Rs. 4,280,931/- out of which Rs. 25,00,000/- had been provided by the CEO, as a loan to the Appellant and remaining amount of Rs. 1,780,931/- was the opening balance of cash in hand, brought forward from the previous year accounts. Therefore, the record is clear and the Bench has no doubt to believe that Rs. 4,280,931/- did exist as cash in hand as on 30/06/15.
9. The Respondent had primarily one objection that the possession and title of cash and gold were not transferred in the name of Appellant, therefore, these cannot be used in calculation of the NCB. The Bench has pursued the contents of the Resolution and the Agreement, which reveal that cash (Rs. 15,00,000/-) and gold (Rs. 10,00,000/- cash equivalent value) were provided to the Appellant as unconditional and interest-free loan by the CEO. The Resolution and the Agreement also state that cash and cash equivalent shall remain in the custody of CEO and be utilized in case of extreme need.
10. The Bench is of the view that the Agreement and the Resolution are sufficient to prove that the Appellant has undisputed legal title of cash and gold therefore, the Respondent's objection is not cogent. The other objection of the Respondent pertaining to the possession of cash and gold that was not transferred to the Appellant, has also failed to draw the attention of the Bench. Admittedly, cash and gold were in possession of CEO, during inspection and proceedings before the Respondent, however, for all practical purposes, the CEO is the most relevant person to hold the properties and assets of a company in his possession as a trust for safe custody. Furthermore, the Board of the Appellant had authorized the CEO to hold cash and gold; therefore, we find no anomaly in this regard. The audited accounts for the year ended 30/06/15 also contain the figure of directors loan Rs. 25,00,000/- under the heading of long term liabilities, therefore, we have no doubt that amount of loan belongs to the Appellant and the CEO has been duly authorized by the Appellant to hold cash and gold in his possession.



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11. The Bench has also examined the Respondent's objection with regard to non-execution of the Agreement on a Stamp Paper. In Bench's view, execution of the Agreement on a letterhead of the Appellant does not render it invalid because the Respondent has failed to substantiate this requirement through any provision of law.
12. In view of the foregoing, the Bench is of the view that the Appellant has calculated the NCB in accordance with the third schedule of the Rules, and guidelines issued by the Commission. Therefore, we hereby set aside the Impugned Order and accept the Appeal without any order as to cost.


(**Shaukat Hussain**)
Commissioner (CCD-CLD)


(**Tahir Mahmood**)
Commissioner (CSD-CLD)

Announced on: **27 JUN 2018**