



Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH NO.1

In the matter of

Appeal No. 35 of 2015

Adam Securities (Pvt.) Ltd

..... Appellant

Versus

Director/Head of Department (MSRD)

Securities Market Division, Securities and Exchange

Commission of Pakistan

..... Respondent

Date of Hearing

11/11/15

Present:

For the Appellants (through video conferencing):

(i) Mr. Abdul Majeed Adam, Chief Executive Officer, Adam Securities (Pvt.) Ltd

(ii) Mr. Farhan Ahmed Memon, Audit Partner, Haroon Zakaria & Company

For the Respondent:

(i) Mr. Nasir Askar, Director (SMD)

(ii) Ms. Asima Wajid, Deputy Director (SMD)

ORDER

1. This order shall dispose of appeal No. 35 of 2015 filed under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the order dated 03/04/15 (Impugned Order) passed by the Respondent.



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2. Brief facts of the case are that the Respondent in exercise of its powers under section 6(1) of the Securities and Exchange Ordinance, 1969 (Ordinance) read with Rule 3 and Rule 4 of the Stock Exchange Members (Inspection of Books and Record) Rules, 2001 (Inspection Rules) ordered an inspection of the books and record required to be maintained by Adam Securities (Private) Limited (Appellant). The following officers were appointed as inspectors (Inspection Team) for the purpose vide order dated 04/09/14:

- | | | |
|----|-----------------|-----------------|
| a) | Mr. Adnan Ahmed | Deputy Director |
| b) | Mr. Kashif Ali | Deputy Director |

3. The Inspection Team submitted the report (Inspection Report) on 25/11/14 which was shared with the Appellant in accordance with Rule 7 of the Inspection Rules. The response of the Appellant was received vide letter dated 30/12/14. Upon evaluation of the Inspection Report, irregularities in calculation of Net Capital Balance (NCB) as of 30/06/14 were observed and it appeared that NCB certificate was not calculated in accordance with the Third Schedule of the Securities and Exchange Rules, 1971 (SEC Rules). The Inspection Report further highlighted that the Appellant failed to maintain segregation of clients' assets, did not have an effective Know Your Customer (KYC) and Customer Due Diligence (CDD) Policy; failed to be in compliance with Circular 34 of 2009 issued by Commission; and also failed to update Standardized Account Opening Form (SAOF) as specified in the regulatory framework.

4. In light of the Inspection Report and the comments received from the Appellant, the Respondent served a SCN to the Appellant under Section 22 of the Ordinance and Rule 8 of the Brokers and Agents Registration Rules,



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2001 (Brokers Rules). The Respondent submitted its written response to the SCN vide letter dated 06/02/15 under Section 22 of the Ordinance and Rule 8 of the Brokers Rules. Hearing in the matter was held on 02/03/15 and Mr. Abdul Majeed Adam, Chief Executive Officer of the Appellant, (Representative) attended the hearing on behalf of the Appellant on 02/03/15 at the Commission's Karachi office through video conference.

5. The Respondent held that with reference to implementation of KYC and CDD requirements, the Appellant assured that it shall automate the system to meet the requirements as specified in the context. Further to substantiate compliance with the qualification requirements of its employees, the Appellant provided copies of cheque through which the fees were paid and the copies of registration form of two of its employees. However after a detailed and thorough perusal of the facts/evidence available, it was evident that the Appellant failed to maintain NCB in accordance with the regulatory framework; did not provide complete information to the Respondent and failed to fulfill its regulatory obligations by not maintaining proper segregation of clients' assets. The Appellant being registered as a broker is expected to exercise due skill, care and diligence in the conduct of its business and ensure full compliance of the laws and relevant rules and regulations. Additionally the Appellant takes the responsibility of the custodian of clients' assets and is required to act diligently, prudently and cautiously. The Appellant must follow all the regulatory provisions in letter and spirit. Violation of rules and regulations was a matter of serious concern; therefore, in exercise of the powers conferred upon under Section 22 of the Ordinance, a penalty of Rs.300,000 was imposed on the Appellant. Moreover, the Appellant was directed to:

- i. Comply with the Rules 1971 and the guidelines issued in letter and spirit; and



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- ii. Ensure segregation of client's assets and maintain separate bank account for the clients 'funds.

6. The Appellant has preferred the appeal on the following grounds:

- a) The overstatement of NCB by Rs.3.59 million on 02/09/14 was because of timing difference between KSE and NCCPL. KSE claimed the deposit on 30/06/14 whereas NCCPL cleared the same deposit on 02/07/14 due to first Ramadan on 30/06/14 and bank holiday on 01/07/14. Due to the confusion the said difference arose and as soon as the mistake was realized, the Appellant immediately submitted the revised NCB of Rs.2.97 million on 22/10/14 as per the requirements of the Rules. Furthermore, there was also confusion about whether investment made by Adam Securities in Book Building of Pakistan Petroleum Ltd (PPL) amounting to Rs.85.5 million which is listed on KSE, is to be included in the calculation of NCB or not. One of the opinions on the matter was that the said amount should not be taken in the calculation of NCB, however, the Appellant's opinion was that as PPL is a listed security and the said amount is submitted in the treasury of Government of Pakistan which is fully secured, therefore, it should be taken as investment and should form part of the NCB calculation. The Appellant obtained advice on the said matter from the Respondent and they were of the opinion that the said amount should not be included in the calculation of NCB on the basis of which the revised NCB was submitted which shows the bonafide of the Appellant. The Appellant, however, after the receipt of PPL shares by the Appellant, submitted two NCB certificates on 11/09/14 and 24/10/14 depicting an amount of Rs.219.599 million and Rs.154.987 million in order to give an updated calculation of NCB.



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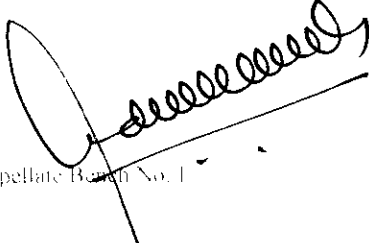
- b) Regulation 4.19.2 of the Rule book of KSE provides that clients' funds can be used upon authorization by the client in writing. However, the Respondent in its Order argued that condition 2(a) of the special terms and conditions contained in the Standardized Account Opening Form (SAOF) Annexure-1 of KSE Rule Book is applicable to the facts of the case which states "The Credit amount of the account holders shall be kept by the broker in separate bank account titled 'Account Holder/Client Account' and shall not be used by the broker for his own business on the basis of which Clients' funds cannot be used."

In this regard, it was unclear whether Rule 4.19.2 is an exception to the account opening condition mentioned above. The said matter was discussed in KSE's Regulatory Affairs Committee and it was proposed that the said condition of SAOF be amended to bring it in line with Rule 4.19.2.

- c) The Respondent was not justified to impose penalty upon the Appellant without establishing mens rea on the part of the Appellant. It is settled law that existence of mens rea is a mandatory condition for levying such penalty. The Appellant has committed no default nor violated any rules and regulations; therefore, the penalty imposed upon the Appellant is unlawful and arbitrary. The interpretation of the Respondent was different from the view taken by the Appellant on the calculation of NCB. The Impugned Order passed by the Respondent is, therefore, unlawful and malafide and not sustainable in the eyes of the law.

7. The Respondent rebutted the arguments as follows:

- a) The Appellant is the TREC holder of KSE and LSE and also a member of Pakistan Mercantile Exchange (PMEX). The NCB as of 30/06/14


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amounting to Rs.2.97 million was far below the required minimum NCB. Therefore, in order to meet the regulatory requirements pertaining to NCB, the Appellant submitted its revised NCB Certificate as of 02/09/14 stating balance of Rs.154.987 million. However, the certificate depicting NCB of 02/09/14 was issued by the Auditor on 08/09/14 and submitted to KSE and LSE on 24/10/14. Moreover, on query with the KSE, it was revealed that the Appellant submitted two different NCB Certificates depicting NCB as of 02/09/14 signed by M/s Zahid Jamil & Co. with different balances and both signed on 08/09/14. The Appellant did not provide any information about the submission of two different NCB certificates either to the inspection team or during the course of the hearing. The Appellant's NCB as of 30/06/14 did not meet the minimum required balance. The Appellant at first trading day of each week before commencement of trading is required to submit its status by clicking "Yes/No", as the case may be, regarding maintenance of minimum required NCB during the week at the functionality at the National Clearing House System (NCHS). The said functionality stops the brokers to proceed with trading, if the broker does not report the functionality. However, the Appellant despite being aware of the fact that it failed to meet the required minimum balance kept on clicking the "Yes" option of the functionality. The Appellant during the course of the hearing assured that it shall ensure adherence to the regulatory requirements in future but the same does not absolve the Appellant from complying with the NCB requirements as envisaged in the regulatory framework.

- b) The Appellant communicated that the clients' funds of only few familiar clients were being used by the Appellant on the basis of the authorisations under Clause 4.19.2 of KSE Regulations provided by them. Notwithstanding the authorisations obtained by the Appellant,



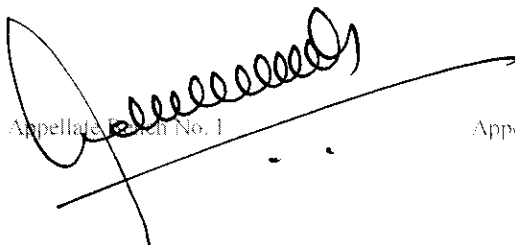
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the regulatory framework time and again provides very clear instructions to be followed by the brokers with regard to segregation of clients' funds. It is evident from Chapter 4.19.1 and Chapter 4.19.2 of the KSE Rule Books that the regulatory framework does not allow use of clients' assets other than for his/her own benefit. The Appellant must ensure proper segregation of clients' assets and should at all times have an amount equivalent to its trade payables/creditors in the bank account tagged as clients' account.

- c) Section 22(1)(c) of the Ordinance provides that a person who contravenes the requirement of the Ordinance or any rules and regulations made thereunder shall be penalized. The Appellant failed to maintain minimum NCB as of 30/06/14 and ensure segregation of clients' funds, therefore, penalty was rightly imposed on the Appellant.

8. We have heard the parties and pursued record with the able assistance of parties i.e. the Appellant and the Respondent.
9. We have reviewed the chronology of the NCB certificates provided by the Appellant in accordance with the date of submission to KSE which is as follows:

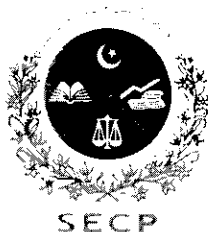
NCB as on	Amount (Rs. in million)	Date of the Certificate	Auditor Certifying the NCB	Date of submission with KSE	Remarks
June 30, 2014	5,889	September 4, 2014	Nasir Javaid Maqsood Ibrahim, Chartered Accountants	September 11, 2014	NCB was overstated because of overstating the amount of deposits with the


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					exchange by Rs.3.59 million as identified in the Inspection report
June 30, 2014	2,978	October 21, 2014	Nasir Javaid Maqsood Ibrahim Chartered Accountants	October 22, 2014	NCB was revised and adjusted by the amount of overstated deposits as referred above
September 2, 2014	219,599	September 8, 2014	Zahid Jamil & Company, Chartered Accountants	September 11, 2014	This NCB certificate was not submitted to the inspection team and came to the notice of the Commission subsequent the SCN
September 2, 2014	154,987	September 8, 2014	Zahid Jamil & Company, Chartered Accountants	October 24, 2014	As per the Appellant, this NCB was prepared after the receipt of PPL shares by the Respondent and the same was submitted to the inspection team.



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10. The Appellant has argued that the reason NCB as of 30/06/14 was not in accordance with the minimum requirement of NCB was because the advance payment for shares of PPL amounting to Rs.85.5 million could not be included in the calculation of NCB. However, as soon as the payments were received back for the purchase of PPL shares, the Appellant submitted a revised NCB of Rs.154.98 million as of 02/09/14. While we agree with the Appellant that requirement of NCB was subsequently fulfilled, the Appellant's NCB as of 30/06/14 did not meet the minimum required balance. It was the responsibility of the Appellant to ensure minimum required balance regardless of whether the amount of Rs.85.5 million could be included or not in the calculation of NCB as of 30/06/14. The Brokers must ensure that they maintain minimum NCB at all times of the year. Further, the Appellant must ensure segregation of clients' funds and should at all times have an amount equivalent to its trade payables/creditors in the bank account tagged as clients' account. Clause 4.19.2 of the KSE Regulations will prevail over special terms and conditions contained in the SAOF of KSE Rule Book, however, even if the clients had authorized the use of its accounts in writing, Clause 4.1.9.2 of KSE regulations provides that it has to be done in the "manner and procedure prescribed by the Exchange and/or CDC." There is no manner prescribed by the Exchange, therefore, the Appellant could not have relied on any other method not prescribed by the Exchange to be deemed as authorisations for use of clients' accounts.
11. The argument of the Appellant that the default was not "willful" or there was no "mens rea" holds little merit as even there may not be knowledge or intent, the Appellant did not exercise the due skill and care required of them as Brokers. The word "willful default" has been defined in Oxford

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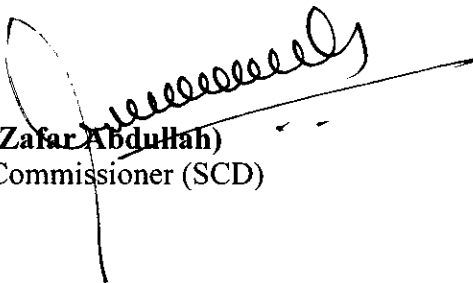
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Dictionary of Law Fifth Edition as “The failure of the person to do what he should do, either intentionally or through recklessness.” The default, therefore, would be considered as willful. This Bench is of the view that the Appellant has been unable to comply with the requirements of NCB and follow the Rules in relation to segregation of clients.

12. In view of the foregoing, the Impugned Order is upheld. The appeal is dismissed with no order as to costs.


(Zafar Abdullah)
Commissioner (SCD)


(Tahir Mahmood)
Commissioner (CLD)

Announced on: 03 DEC 2015