BEFORE APPELLATE BENCH

In the matter of

Appeal No. 42 of 2019

Aba Ali Habib Securities (Pvt.) Limited

Appellant

Versus

The Commissioner, (SMD), SECP, Islamabad.

Respondent

Date of hearing: September 3, 2020

Present:

For Appellant:

1. Mr. Zahid Ali Habib, Chief Executive Officer
2. Mr. Muhammad Hasnain, Compliance Officer

For Respondent:

1. Mr. Osman Syed, Joint Director (Adjudication-I), SECP
2. Mr. Muhammad Faisal, Assistant Director (Adjudication-I), SECP

ORDER

1. This Order shall dispose of Appeal No. 42 of 2019 filed by M/s. ABA Ali Habib Securities (Pvt.) Limited (the Appellant) against the Order dated June 10, 2019 (the Impugned Order) passed by the Commissioner, SMD (the Respondent) under Section 40A of the Securities and Exchange Commission of Pakistan Act, 1997 (the SECP Act) read with Section 150 the Securities Act, 2015 (the Act).

2. The brief facts of the case are that the Securities and Exchange Commission of Pakistan (the Commission) vide its inspection notice dated March 12, 2019, conducted a compliance review of the Appellant (the Review) to assess the compliance of the regulatory requirements contained in the Securities and Exchange Commission of Pakistan (Anti Money Laundering and Countering Financing of Terrorism) Regulations, 2018 (the Regulations). The Inspection team (the Team) submitted its report on March 21, 2019, which revealed the following non-compliances;

i. In violation of Regulation 4(a) of the Regulations, the Appellant had not updated its AML policy;

ii. In violation of Regulation 13 of the Regulations, the Appellant had failed to provide documentary evidence, to prove adequate ongoing monitoring mechanism of its clients along with accurate risk categorization;

iii. In violation of Regulation 6(3) (c) of the Regulations, the Appellant had not provided necessary evidence relating to income, business, ownership and control structure of twenty-four clients;

iv. In violation of Regulation 6(8) of the Regulations, the Appellant had assigned incorrect risk categories to eight clients, however, same were rectified subsequently;

v. In violation of Regulation 9 of the Regulations, the Appellant had failed to provide evidence of Enhanced Due Diligence (EDD) in case of seventeen high risk clients and two politically exposed persons (PEPs) during the Inspection and before the Respondent;

vi. In violation of Regulation 11(2) of the Regulations, the Appellant had not justified in writing the decision to rate six clients as low risk;

vii. In violation of Regulation 3(a) of the Regulations, the Appellant had failed to ensure that risk categories of clients mentioned in Know Your Customer/Customer Due Diligence (KYC / CDD) forms and in back office record are same;

viii. In violation of Regulation 15 of the Regulations, the Appellant had failed to mention Cheque numbers on Journal Vouchers;

ix. In violation of Regulation 4(d) of the Regulations, the Appellant had not developed independent audit function;

3. In view of the above violations, a show-cause notice dated May 3, 2019 (the SCN) was issued to the Appellant. The Appellant submitted a written reply to the SCN vide letter dated May 22, 2019 and hearing in the matter was held on May 24, 2019, which was attended by the Appellant's representatives. In terms of powers conferred under section 40A of the Act, the Respondent imposed a penalty of Rs. 450,000/- (Rupees four hundred fifty thousand) on the Appellant.

4. The Appellant *inter alia* filed this Appeal on the grounds that the Respondent had no jurisdiction to conduct the Review under Section 169 of the Act, as Section 169 of the Act only empowers the

Commission to make regulations rather than conduct a Review (referred paragraph 2 of the SCN). The Appellant further stated that any violation of KYC and CDD requirements, which were introduced in 2012 by the Karachi Stock Exchange (presently PSX), does not imply that requirements of the Regulations had been violated and accordingly the Respondent had no authority to take penal action on violation of alleged non-compliances of regulatory framework of 2012.

5. The Appellant stated that after the Review, the Commission was informed vide a letter dated May 22, 2019 regarding compliance with the Regulations, therefore, the Respondent should not have imposed severe penalty without allowing the Appellant an opportunity to rectify the non-compliances. The Appellant had relied upon the Appellant Bench's orders passed in Appeal Nos. 26, 27 & 28 of 2014, wherein without imposing penalty, the parties were provided opportunity to rectify non-compliances.

6. The Appellant stated that in paragraphs 7(d) and 7(e) of the Impugned Order, the Respondent had passed conflicting judgements regarding beneficial ownership structure. The Appellant stated that in paragraph 7(d) the Respondent had stated that beneficial ownership records are not satisfactory whereas, in paragraph 7(e) of the Impugned Order, the beneficial ownership records were found properly maintained. The Appellant stated that in the Impugned Order's paragraph 7(c) the Respondent had claimed that the mechanism for ongoing monitoring of clients was not appropriate, whereas, in paragraph 7(j) of the Impugned Order the mechanism to check and control suspicious transactions/ accounts was found appropriate. The Appellant stated that the aforesaid conclusion is conflicting because suspicious transactions/ accounts cannot be controlled without an adequate mechanism of ongoing monitoring of clients. The Appellant stated that as per the requirements of Regulation 9 of the Regulations, adequate procedure was followed regarding EDD of high-risk clients and, in this regard, the required approvals were obtained from the Appellant's senior management to establish or continue business relations with such customers. The Appellant further stated that source of funds and beneficial ownership information from all the clients were obtained and regular monitoring of clients as part of ongoing monitoring was ensured.

7. The Appellant stated that in paragraph 7(f) of the Impugned Order the Respondent had wrongly claimed that incorrect risk categorization of clients was rectified subsequently vide reply dated 20 May 2019, as the same data was provided during the Review and to the Respondent, therefore, the allegation of subsequent rectification is out of question. The Appellant stated that in paragraph 7(i) of the Impugned Order the Respondent had claimed that risk ratings mentioned in the client database (maintained in soft form) and KYC/CDD forms (physical forms) were inconsistent, however, the

Respondent had failed to consider that the client database was duly updated. The Appellant stated that it was maintaining deposit slip numbers on vouchers, therefore, requirements of Regulation 15 were duly met. The Appellant further stated that all the copies of cheques demanded during the Review were also provided.

8. The Respondent had denied the Appellant's assertion and stated that the Appellant is trying to defeat the purpose of law by raising a technical issue, which has no implication on the merits of the case. The Respondent submitted that the Commission has issued Joint Inspection Regulations, 2015 (the JIT Regulations) under section 169 of the Act, whereas, the Appellant has misconstrued and raised an issue in question that the Respondent has conducted a review under section 169, therefore, mere omission in the Impugned Order does not defeat the merit of the case.

9. The Respondent contended that the arguments put forth by the Appellate are not tenable as the Regulations were promulgated on June 13, 2018 and the Appellant's policies were not updated in consonance with the Regulations till the Review. The Respondent stated that irrespective of issuance of the AML Guidelines on September 11, 2018, the Appellant was required to comply with the Regulations after promulgation. The Respondent stated that the Appellant had not been penalized for the violation of the AML Guidelines 2012, rather the Impugned Order had been passed for violation of the Regulations. The Respondent clarified that in the Impugned Order it had been stated for clarity that the Regulations are new but the requirements contained therein were also a part of the regulatory framework of 2012. The Respondent stated that as per preliminary findings of the Review, the Appellant was found non-compliant with the Regulations, therefore, a SCN was issued and consequently, the Impugned Order was passed after following the due legal process. The Respondent stated that the referred case laws (Appeal nos. 26, 27 & 28) are not relevant in the instant case since the scope of the Review was to determine whether the securities brokers are compliant with the Regulations, whereas, Regulation 5.2 of the System Audit Regulations provides that the Broker has to rectify any non-compliance identified in the audit report.

10. The Respondent stated that there is no conflict in the findings of paragraphs 7(d) and & 7(e) of the Impugned Order because the Appellant had not provided satisfactory evidence to prove the income and business of twenty-four sample clients, whereas evidence regarding the beneficial ownership of eight clients was found satisfactory and was maintained adequately. The Respondent stated that there is no conflict in findings of paragraph 7(c) and & 7(j) of the Impugned Order because the ongoing

monitoring report contained only the investment amount of its clients, however, the Appellant had not mentioned and classified the risk of clients as low/medium/high. The Respondent stated that the Appellant had not provided evidence of EDD of seventeen high risk clients and two politically exposed persons, therefore, findings of paragraph 7(g) of the Impugned Order are correct.

11. The Respondent stated that the Appellant had informed the Team during the Review that they are updating the risk categorization of its clients, and thereafter, while replying to the SCN, the Appellant submitted the revised risk categorization of these 8 clients, which clearly establishes that the Appellant was non-compliant with the provisions of Regulation 6(8) of the Regulations during the Review and subsequently rectified the default. The Respondent stated that findings of paragraph 7 (i) of the Impugned Order are correct because the Appellant had admitted that they are in the process of updating the physical forms of KYC/CDD to avoid any disparity with the database maintained in soft form. The Respondent submitted that contents of paragraph 7(k) of the Impugned Order are correct because the Appellant had not provided actual cheque numbers as supportive evidence, therefore, the Appellant was found non-complaint as per Regulation 15 of the Regulations.

12. The Appellate Bench (the Bench) has heard the parties and perused the record. The Appellant's representatives and the Respondent's representatives reiterated their grounds of the appeal and rebuttal thereof.

13. The Bench has carefully gone through the contents of the Impugned Order and other relevant record. We are of the view that the Appellant's assertion with regard to apparent mistakes in the introductory paragraph (Paragraph two) of the SCN and the Impugned Order is immaterial and does not affect the merits of the case. The Bench is of the view that the content of the referred paragraphs lack clarity in terms of procedure adopted in this case. The Bench has examined the relevant record, which revealed that the Commission mandated the Oversight Committee to initiate the Review and thereafter, upon the receipt of the Report, SCN proceedings were initiated by the Respondent. In view of the record, the Bench has not found any anomaly in the procedure adopted in the Review and during the SCN proceedings. We have no doubt that the Commission and the Respondent had duly followed the legal process while initiating the Review, issuing the SCN and passing of the Impugned Order. Therefore, the ambiguity caused by poor drafting of the referred introductory paragraph does not vitiate the Review and SCN proceedings.

14. The Bench has also examined the arguments of the parties and found that the Appellant's assertions are insignificant to distort the findings of the Impugned Order because the requirements contained under the Regulations were not new, rather these were introduced in 2012 by the Karachi Stock Exchange (presently PSX), with the approval of the Commission, through Rule 4.18 of the Rule Book (current Regulation 4.17). The Bench is of the view that these requirements were made 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 the Karachi Stock Exchange in 2012. The Bench has compared the requirements of the regulatory framework of 2012 with the Regulations and SECP's AML guidelines 2018, and observed that they do not reflect any material difference. Therefore, the Bench has no doubt to hold that the Regulations had not introduced any significantly new regulatory requirements, rather prior regulatory requirements had been streamlined. The Bench has not observed any conflicting finding or judgment in the Impugned Order regarding violations committed by the Appellant. The Bench also endorses the Respondent's comments that case laws referred by the Appellant are not relevant to the facts of this case, therefore, we are not inclined to accept them.

15. In view of the forgoing, the Bench find no reason to interfere with the merits of the Impugned Order, therefore, we hereby dismiss the Appeal, without any order as to cost.

(Farrukh Hamid Sabzwari)
Commissioner (SCD-PRDD)

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

Announced on: 02 DEC 2020