



# Securities and Exchange Commission of Pakistan

## BEFORE APPELLATE BENCH

In the matter of

Appeal No. 46 of 2019

Sherman Securities (Pvt.) Limited

Appellant

Versus

The Commissioner, (SMD), SECP, Islamabad.

Respondent

Date of hearing:

September 3, 2020

Present:

For Appellant:

Mr. Abdullah Azzaam Naqvi, Advocate High Court

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. 46 of 2019 filed by M/s. Sherman Securities (Pvt.) Limited (the Appellant) against the Order dated June 3, 2019 (the Impugned Order) passed by the Commissioner, SMD (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 Appellant is a Trading Rights Entitlement Certificate holder of the Pakistan Stock Exchange Limited (the PSX) and licensed as a securities broker. The Joint Inspection Team of PSX, Central Depository Company and National Clearing Company of Pakistan Limited conducted an inspection of the Appellant (the Inspection) to assess its compliance with the Securities and Exchange Commission of Pakistan (Anti Money Laundering and Countering Financing of Terrorism) Regulations, 2018 (the Regulations). The Inspection, inter alia, revealed the following non-compliances;



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- i. The Appellant had not implemented the requirement of independent audit function.
  - ii. The Appellant had failed to conduct customer due diligence (CDD) and Know Your Customer (KYC) of twenty-five clients and assigned incorrect risk profile ratings to fourteen clients.
  - iii. The Appellant had not obtained evidence of income from twenty-five clients.
  - iv. The Appellant failed to ascertain/ obtain details regarding the beneficial ownership of clients in thirteen cases.
  - v. The Appellant had not developed mechanism and procedure to monitor clients' business on an ongoing basis.
3. The Respondent issued a show-cause notice dated May 2, 2019 (the SCN) to the Appellant. The Appellant submitted a written reply to the SCN vide letter dated on May 8, 2019 and hearing in the matter was held on May 9, 2019. In terms of powers conferred under section 40A of the Act, the Respondent imposed a penalty of Rs. 250,000/- (Rupees two hundred fifty thousand) on the Appellant.
4. The Appellant *inter alia* filed this Appeal on the grounds that the Respondent had passed the Impugned Order without proper appreciation of the facts or law and contents of the SCN are mere reproduction of the various observations of the Inspection. The Appellant stated that it has been wrongly observed that it had admitted default. The Appellant stated that development of software for monitoring its clients relatively took a longer period to implement as opposed to the other requirements of the Regulations. The Appellant stated that the Respondent has carried out CDD and KYC at the time of opening of the client's account of twenty-five clients and this fact was communicated to the inspection team and the Respondent, however, same has not been considered. The Appellant has ascertained beneficial ownership of clients as per the Regulations, which require that beneficial ownership shall be determined on the basis of documents, data or information obtained from the customer. The Appellant further stated that that as per Annexure I of the Regulations, it has adequate mechanism to ascertain beneficial ownership of corporations and individuals. The Appellant stated that the Regulations also do not require the Appellant to investigate the veracity of each document or information provided by the customers.
5. The Appellant stated that the Respondent has failed to appreciate its contentions regarding assigning of risk profiles to its customers. The Appellant stated that the inspection team had



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assigned high risk profiles to certain customers which the Appellant otherwise had assigned to low or medium risks profiles, however, no reason was provided for such reassignment of risk profile. The Appellate submitted that without assigning any reason, the Respondent adopted Inspection observation and reproduced the same in the SCN. The Appellant refuted the same on the grounds that even though the Regulations provide parameters, however, discretion to devise a suitable policy remains with the Appellant. The Appellant stated that as per the policy of the Appellant, customers with lower trade volumes are logically assigned low risk profiles while others are assigned medium or high-risk profiles accordingly. The Appellant stated that the Appellant has mechanism of enhanced due diligence (EDD) for all of its customers with high-risk portfolios and on the basis of ongoing monitoring, the Appellant changes the risk profiles and conducts EDD as and when required.

6. The Appellant has argued before the Appellate Bench (the Bench) that issuance of the Regulations by the Securities and Exchange Commission of Pakistan (the Commission) was without jurisdiction because under Section 44 of the Anti-Money Laundering Act, 2010 (AML Act), power to issue regulations is vested with the Financial Monitoring Unit established under section 6 of the AML Act. The Appellant submitted that the Respondent had passed the Impugned Order for alleged violations of the Regulations, therefore, as stated above that the Regulations has been issued by the Commission without authority, hence Impugned Order is liable to be set aside.
7. The Respondent stated that the Appellant was afforded adequate opportunity of hearing and all relevant facts were considered while passing the Impugned Order. The Respondent stated that the Regulations were promulgated on June 13, 2018, however, the Appellant's policies were not updated in consonance with the Regulations till inspection period. The Respondent stated that the Appellant failed to conduct CDD of its twenty-five clients by not obtaining information such as source of funds, monthly/yearly income prior to opening of the accounts. The Respondent further stated that the Appellant also admitted its failure to establish the beneficial owner of fourteen clients therefore, it can be construed that the Appellant was non-compliant.
8. The Respondent stated that the Appellant had assigned incorrect risk ratings to eleven clients, therefore, the Appellant's claim that it had assigned ratings as per the Regulations does not substantiate and corroborate with the documentary evidence obtained during the Inspection. The Respondent stated that six months analysis of these accounts reveal significant trading activity ranging up to Rs. 245 million without any disclosure of source of income and in a few accounts



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substantial deposits and withdrawals were also observed. In view of the above, the Respondent stated that the Appellant had failed to ensure CDD of clients at the time of opening of account. The Respondent stated that the Appellant had no mechanism of ongoing monitoring of its clients. The Respondent stated that the Appellant had failed to gather vital information for ongoing monitoring including source of funds, establishing beneficial ownership and assigning incorrect ratings etc.

9. The Appellate Bench (the Bench) has heard the parties and perused the record. The Appellants' representatives and the Respondent's representatives reiterated their grounds of appeal and rebuttal thereof.
10. The Bench is of the view that the Respondent had applied its independent mind to pass the Impugned Order, therefore, we reject the Appellant's plea that SCN and the Impugned Order are reproduction of observations of the Inspection. The Bench has noted that certain observations of the Inspection was also not admitted by the Respondent, therefore, we believe that the Impugned Order has been passed in accordance with the facts and relevant law. The Bench has observed that in this case the Appellant had no effective mechanism of ongoing monitoring of its clients and in result thereof, incorrect risk ratings were assigned to its clients. The Bench has further noted that significant trade activities, deposits and withdrawals were observed in certain accounts and instead of rating such accounts as high risk, the Appellant has assigned low and medium risk ratings to such accounts.
11. The Bench is of the view that issuance of guideline was not a precondition to implement the Regulations, therefore, we have no doubt that after promulgation of the Regulations, the Appellant was required to comply with applicable requirements. The Bench is of the view that, the Regulations should have been followed from the date of promulgation. The Bench has noted that the Appellant had also not performed CDD of twenty-five clients and failed to ensure that it had adequate information regarding source of funds and monthly/yearly income prior to opening of the accounts. The Bench also noted that information of beneficial ownership of fourteen clients was also not obtained.
12. The Bench has observed that the Appellant was non-compliant at the time of Inspection, therefore, any subsequent compliance would not exonerate it from the consequences of violations committed in implementation of the Regulations. The Bench has perused the



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annexures “D” and “F” of the Appeal, which reflect the Appellant’s non-compliances and subsequent efforts to undo such non-compliances.

13. The Bench has also heard the argument of the Appellant that the Commission had no authority to issue the Regulations, which is without any substance. The Bench has perused the preamble of the Regulations, which clearly states that the Commission has issued these Regulations upon the recommendation of the FMU. The Bench has perused clause (i) of Section 6 (4) of the AML Act, which empowers the FMU to recommend to the regulatory authorities to formulate regulations to combat money laundering and terror financing activities and accordingly, upon recommendation, the Regulations were issued. The Bench has further examined Section 40 read with clause (w) of sub-section (4) of section 20 of the SECP Act, which empowers the Commission to issue regulations “to control and minimize misconduct, market abuse and financial crime in the financial services market and other sectors regulated by Commission”. The Bench is of the view that as the securities brokers, companies, and all insurance and non-banking financial entities are regulated and licensed by the Commission, therefore, the Regulations were issued accordingly.

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

(Farrukh Hamid Sabzwari)  
Commissioner ( SCD-PRDD )

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

Announced on: **30 DEC 2020**