

Securities and Exchange Commission of Pakistan

BEFORE THE APPELLATE BENCH

In the matter of

Appeal No. 48 of 2019

Alfalsh Securities (Private) Limited

...Appellant

versus

The Commissioner (Securities Market Division), Securities and
Exchange Commission of Pakistan

...Respondent

Date of Hearing: 03/09/2020

Present:

For the Appellant:

- i. Mr. Atif Mohammed Khan, Chief Executive
- ii. Mr. Muhammad Aslam Memon, Senior Manager Risk and Compliance

For the Respondent:

- i. Mr. Osman Syed, Joint Director (Adjudication-1)
- ii. Mr. M. Akram, Assistant Director (Adjudication-1)

ORDER

1. This Order is passed in Appeal No.48 of 2019 filed under section 33 of the Securities and Exchange Commission of Pakistan Commission Act, 1997 (the SECP Act) against the order dated 03/06/19 (the Impugned Order) passed by the Commissioner (Securities Market Division) (the Respondent).
2. The brief facts of the case are that Alfalah Securities (Private) Limited (the Appellant) is a Trading Rights Entitlement Certificate holder of the Pakistan Stock Exchange Limited (the PSX) and licensed as a securities broker under the Securities Act, 2015 (the Securities Act). An inspection conducted by the Securities and Exchange Commission of Pakistan (the

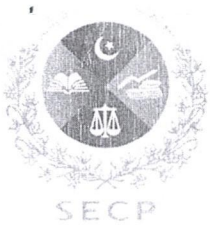


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Commission) revealed that the Appellant was non-compliant with the Securities and Exchange Commission of Pakistan (Anti-Money Laundering and Countering Financing of Terrorism) Regulations, 2018 (the AML Regulations). Keeping in view that the AML Regulations were new at the time of inspection, the Commission ordered to conduct a follow up review (the Review Period) to assess the Appellant's compliance with the AML Regulations.

3. The Inspection, *inter alia*, revealed the following:

- i. Annexure I under Regulation 6(2) of the AML Regulations explains the documents to be obtained by the regulated person. A Regulated person is required to design/update their systems which can generate alerts about the expiry of CNICs atleast one month before actual date of expiry and continue to take reasonable measures to immediately obtain copies of renewed CNICs, whenever they have expired. It was observed that CNIC of four of the Appellant's customers had expired and they did not have a system to generate alerts regarding expiration of CNIC.
- ii. The Appellant had not obtained documents as required under Regulation 6(2) of the AML Regulations [Annexure I] including Memorandum & Articles of Association, resolution of board of directors, certificate of incorporation, identity documents etc. of three of its corporate clients. Consequently, Regulation 6(2), Regulation 7(a) and 7(b) of the AML Regulations were, *prima facie*, contravened.
- iii. The Appellant had not performed Customer Due Diligence (the CDD) of three of its clients and information such as source of income, expected investment level etc. was not obtained at the time of opening of the account in violation of Regulation 6(2) of the AML Regulations which requires that a regulated person shall apply CDD measures when establishing business relationship with a customer.
- iv. Regulation 9(1) of the AML Regulations regarding Enhanced Due Diligence (the EDD) requires that a regulated person shall implement appropriate internal risk management systems, policies, procedures and controls to determine if any customer presents high risk of Anti-Money Laundering/Counter Terrorism Financing (the AML/CFT). However, it was observed that the Appellant did not have any mechanism to this effect. In addition, the Appellant had not conducted EDD of three (3) of its clients categorized as high risk.



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- v. Regulation 10(3) requires that in case of domestic politically exposed persons (the PEPs), where business relationship poses higher risk, regulated person shall carry out EDD. However, the Appellant did not perform EDD of six (6) of its clients categorized as PEPs.
 - vi. Circular 10 of 2017 required the Appellant to maintain record of its clients who had traded in excess of Rs 5 million during a month. However, the Appellant has not maintained record of ten (10) clients whose net traded value during the month of November 2018 was greater than Rs 5 million.
 - vii. The Appellant had not developed an independent audit function in violation of Regulation 4(d) of the AML Regulations.
 - viii. The Appellant had assigned incorrect rating to three of its foreign customers as low risk transpiring that the Appellant had not absolutely conducted CDD in violation of Regulation 3 of the AML Regulations.
 - ix. The Appellant did not have a mechanism for ongoing monitoring of its clients in contravention of Regulation 13 of the AML Regulations which requires that all business relations with customers shall be monitored on an ongoing basis to ensure that the transactions are consistent with the regulated person's knowledge of the customer.
4. The Show-Cause Notice dated 03/05/19 (the SCN) was issued to the Appellant and hearing in the matter was held on 10/05/20. Mr. Atif Mohammad Khan (the Chief Executive Officer), Mr. Faisal Mehmood Sheikh (the Company Secretary) and Mr. Muhammad Aslam Memon (Sr. Manager Risk & Compliance) appeared for and on behalf of the Appellant and made their submissions.
5. The Respondent held that submissions in regard of two of its clients were satisfactory, however, for the third client the Appellant could not provide evidence that CDD/EDD measures had been adequately applied. Furthermore, the Respondent held that the Appellant had admitted that it did not have a system that could generate alerts one month before the expiry of the CNICs. Furthermore, with regard to conducting EDD of clients which were classified as PEPs, the Appellant's submission was also satisfactory and with regard to failure to maintain record of 10 clients whose net traded value during a month was greater than 5 million, the Respondent held that Circular 10 of 2017 had been repealed which is why the Respondent was not penalizing the

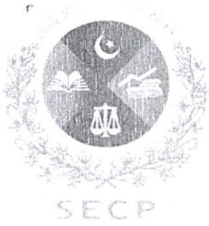


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Appellant on this count. However, the Respondent held that the letter of engagement of the audit function to BDO Ebrahim & Co. Chartered Accountant (the BDO) did not include test of systems relating to AML/CFT. In this regard the Appellant's assertion that they would broaden the scope to cover the AML requirements in the engagement letter of 2019 does not undo the default of the Appellant. Therefore, for the violations which had been established, in terms of powers conferred under section 40A of the SECP Act, a penalty of Rs 250,000 was imposed on the Appellant. The Appellant was further advised to examine the 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. Furthermore, it was directed by the Respondent that a report in this regard shall be submitted to the Commission within sixty (60) days.

6. The Appellant preferred the appeal *inter alia* on the following grounds:

- i. The process of identifying expired CNICs is currently carried out manually and expired card holders are informed in writing. However, out of more than 2000 clients, only 4 clients were identified as not being timely informed of their expired CNICs which is still a compliance of 99.8% and demonstrates effective measures. The Appellant has worked with the vendor, Softech, to ensure compliance and a system which carries out automatic check is now in place. The updated system now runs at the start of each month where it identifies all those clients whose CNIC is about to expire over the next 30 days. Furthermore, it is reiterated that even in a fully automated system there will be a tolerance threshold for non-receipt of expired CNICs post intimation. Therefore, evidence of 4 expired CNICs does not constitute a violation of AML Regulations.
- ii. A total of 3 clients were highlighted for failure to obtain required documents in contravention of Regulation 6(2) of the AML Regulations. The said documents were submitted and the Commission found them satisfactory for two out of three clients. For the third client, being a housewife, the supporting documents in terms of the returns filed by her husband were also submitted which adequately established the client's source of income. The inspection revealed that the Appellant has taken all reasonable measures resulting in a high level of compliance and all queries were adequately addressed.
- iii. The inspection revealed that the AML Regulations are applicable from November 2018 and the Appellant had already submitted the revised adopted KYC/CDD policy to the internal



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auditor. The Appellant has both internal and external auditors. Internal audit function has been outsourced to BDO since 2016 prior to the promulgation of AML Regulations demonstrating a desire for good governance and best practice. For the compliance of SRO No. 245 (1)/2019 dated 22/02/19 of the Commission, the Appellant had already requested BDO to include KYC/CDD scope in the June 2019 internal audit review. Therefore, the Appellant has not contravened the regulations.

- iv. The Commission was of the view that even before AML Regulations came into effect, foreign clients/non-residents had to be marked as high risk as per KYC and CDD Guidelines issued by PSX in 2012. The three (3) foreign clients pointed out by the Respondent, however, were marked dormant in the Appellant's database and revised KYC was not done due to non-interest of the said clients to operate in Pakistan even though their account opening files were complete with all documentation. Therefore, whenever the clients request the Appellant to mark its status as active, the Appellant will make sure that the updated KYC/CDD is adequately done. Furthermore, the Appellant has also updated the risk category from low to high for all their foreign clients.

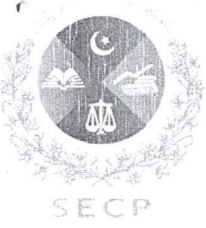
7. The Respondent rebutted the arguments of the Appellant on the following grounds:

- i. The Appellant did not have automatic alert generation system which could generate alerts one month before the expiry of CNICs, however, it was observed that the Appellant was in the process of updating its system to generate alerts. Furthermore, the Respondent was informed by the Appellant that email is sent to customers at the end of the month whose CNIC has either expired or is about to expire. In this regard, the Appellant produced sample emails to show that efforts were made to obtain valid CNICs. However, email sent to the four clients were all sent on 04/04/19 i.e. after the letter of findings was shared with the Appellant on 01/04/19. Therefore, the Appellant was found non-compliant during the Review Period.
- ii. With regards to the failure to obtain documents required under Regulation 6(2) of the AML Regulations, the submissions of the Appellant in regard to two of its clients was found satisfactory. However, for the third client, the Appellant could not provide evidence that CDD/EDD had been done adequately and source of income of the said client had been established.



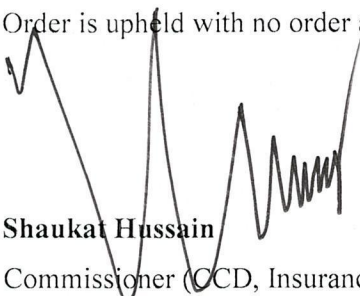
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- iii. The Appellant submitted that it had outsourced its audit function to BDO vide letter of engagement dated 26/09/16. However, review of the engagement reflected that its scope did not include test of systems relating to AML/CFT. The Appellant subsequently submitted that they would broaden the scope to cover the AML requirements in the engagement letter of 2019, however, it does not undo the default of the Appellant.
 - iv. With regard to assigning incorrect ratings to three of its foreign clients, the said clients had to be marked as high risk. The Appellant's argument that the said accounts had been dormant and the regulatory framework applicable in 2016 were the KYC and CDD Guidelines issued by PSX in 2012 is not tenable as even as per those guidelines foreign clients/non-residents had to be marked as high risk. Therefore, the argument of the Appellant does not hold merit.
 - v. The Appellant could not present any practical mechanism, system or design to monitor its clients on an ongoing basis. The requirement of ongoing monitoring of customers to ensure that the transactions are consistent with its knowledge is, not merely met, by formulating a policy without mechanism for its practical implementation. Therefore, it can be construed that no such compliance was made in this regard.
8. We have heard the parties i.e. the Appellant and the Respondent. The Appellant did not have an automatic alert generation system which could generate alerts one month before the expiry of CNICs and they were still in the process of updating their system to generate alerts at the time of inspection. Therefore, even if there was compliance post inspection, the violation of Regulation 6 of the AML Regulations had been established. Furthermore, with regards to CDD of the third client, we are satisfied with the evidence provided by the Appellant i.e. Statement of Assets/Liabilities filed with the Federal Board of Revenue by the client's husband which establishes the source of income of the client. We are of the view, however, that the Appellant did not assign correct rating to three of their foreign clients and its audit function outsourced to BOD did not include test of systems relating to AML/CFT. Furthermore, it is apparent that the Appellant did not have a system in place to monitor its clients on an ongoing basis. We are of the view that it is absolutely essential for a regulated person to be fully compliant with the AML Regulations at all times, therefore, even if the Appellant has subsequently complied with the requirements post inspection, the violations of the AML Regulations have still been established. Therefore, penalty was rightly imposed on the Appellant.

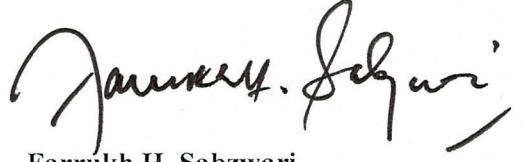


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9. In view of the foregoing, we see no reason to interfere with the Impugned Order. The Impugned Order is upheld with no order as to costs.


Shaukat Hussain

Commissioner (OCD, Insurance)



Farrukh H. Sabzwari

Commissioner (SCD-PRDD)

Announced on:

24 NOV 2020