



# Securities and Exchange Commission of Pakistan

## BEFORE THE APPELLATE BENCH

In the matter of

Appeal No. 52 of 2019

Foundation Securities (Pvt.) Ltd

...Appellant

versus

Commissioner, Securities Market Division

...Respondent

Date of Hearing: 03/09/2020

### Present:

For the Appellant:

- i. Mr. Zahid Ali Khan, CFO Foundation Securities (Pvt.) Ltd
- ii. Mr. Shahbaz Akbar, Compliance Head, Foundation Securities (Pvt.) Ltd

For the Respondent:

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

### ORDER

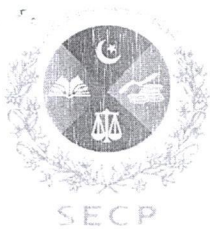
1. This Order is passed in the matter of Appeal No. 52 of 2019 filed under section 33 of the Securities and Exchange Commission of Pakistan Commission Act, 1997 (the SECP Act) against the order dated 10/06/19 (the Impugned Order) passed by Commissioner, Securities Market Division (the Respondent).
2. The brief facts of the case are that Foundation Securities (Private) Limited (the Appellant) is a trading rights entitlement certificate holder of the Pakistan Stock Exchange (the PSX) and is licensed as a securities broker with the Securities and Exchange Commission of Pakistan (the



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Commission). The Commission in exercise of the powers conferred under section 137 of the Securities Act, 2015 vide order dated 29/10/18 conducted a follow-up review of compliance status with the regulatory requirements contained in the Securities and Exchange Commission of Pakistan (Anti-Money Laundering and Countering Financing of Terrorism) Regulation, 2018 (the AML Regulations). The team submitted its Report on 12/04/19 (the Review Report) after receiving comments on the letter of findings dated 25/03/19. The Review Report revealed that the Appellant was found non-compliant with the AML Regulations as under:

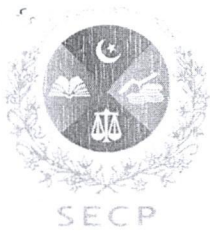
- i. The Appellant had not developed an independent audit function.
  - ii. The Appellant had not adequately performed Customer Due Diligence (the CDD) of five of its clients. In case of one of these clients, CDD of joint account holder was also not performed. Further, despite the fact that the said client was categorized as high risk, the Appellant did not conduct its Enhanced Due Diligence (EDD).
  - iii. The Appellant did not have a mechanism for ongoing monitoring of its clients.
  - iv. One of the clients of the Appellant had deposited Rs 1 million in cash, whereas, rest of the receipts from the said client had been in form of cross cheques. The Appellant, however, had not investigated the unusual transaction or reported to Financial Monitoring Unit (the FMU).
  - v. Circular 10 of 2017 requires 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 one (1) of its clients whose net traded value during the month of January 2019 was greater than Rs 5 million.
  - vi. Annexure I under Regulation 6 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 and continue to take reasonable measures to immediately obtain copies of renewed CNICs, whenever, expired. The Appellant had no such system in place. Moreover, CNICs of fourteen (14) of its clients had expired.
3. The Show Cause Notice dated 03/05/19 (the SCN) was served to the Appellant. The Appellant filed a written reply to the SCN vide letter dated 10/05/19 and hearing in the matter was held on 10/05/19. Mr. Farhan Sarwar (the Head of Operations) and Mr. Abdullah Naveed (the



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Compliance Officer) attended the hearing as authorized representatives on behalf of the Appellant and made their submissions.

4. The Respondent held that with regard to the internal audit function, the Appellant was non-compliant with Regulation 4(d) of the AML Regulations as there was no independent internal audit function. Furthermore, the Appellant was non-compliant with Regulation 6 of the AML Regulations as the Appellant accepted that CNIC expiry mechanism had been implemented after inspection and they did not have any proper mechanism to generate alerts about the expiry of CNICs at least one month before the actual date of their expiry. However, with regard to all the other observations by the Respondent in the SCN, the Appellant's stance had been found to be satisfactory. In view of the foregoing and admission made by the Appellant, contraventions of the provisions of Regulation 4(d) and Regulation 6 of the AML Regulations had been established. Therefore, in terms of powers conferred under section 40A of SECP Act, 1997, a penalty of Rs. 250,000 was imposed on the Appellant by the Respondent. The Appellant was further advised to enforce the provisions of AML Regulations in letter and spirit.
5. The Appellant preferred the instant appeal *inter alia* on the following grounds:
  - i. With regard to non-compliance of the CNIC expiry system, the Appellant's stance was very clear that an elaborate system was already in place, however, considering the objection raised by the Inspection team, the system was upgraded to exactly match the requirement. The said gradation was immediately done after the said pointing out by the Inspection team and the Appellant has since been fully compliant.
  - ii. There has been an extensive independent internal audit mechanism in place at the Appellant throughout its operations. Furthermore, the Appellant also appointed external auditor from time to time and at times when the external auditor was not appointed, the internal audit mechanism was still in place, therefore, there was no non-compliance with the AML Regulations.
  - iii. Explanations of the Appellant regarding most of the observations have been accepted as correct which shows that the Appellant has been in compliance with the AML Regulations. Moreover, the Appellant is the only brokerage house which has closed



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806 trading accounts, therefore, this not only proves that the Appellant is the most compliant brokerage house but also shows how much the Appellant values the regulatory regime. The Appellant has been penalized in a similar manner as other brokerage houses while the compliance of the Appellant has been far superior. Furthermore, the Appellant was also fully compliant with the said irregularities at the time of hearing of the SCN.

6. The Respondent rebutted the arguments of the Appellant *inter alia* on the following grounds:

- i. The Appellant accepted that CNIC expiry mechanism has been implemented post inspection. In this regard, the Appellant did not have proper mechanism to generate alerts about the expiry of CNICs atleast one month before actual date of their expiry. Therefore, the Appellant was found non-compliant with Regulation 6 of the AML Regulations and penalty has been imposed under section 40A of the SECP Act.
- ii. With regard to the internal audit function, the Appellant submitted that the internal audit function was outsourced in 2013 and for a short period of time, the function was conducted by group internal audit department, however, the Appellant failed to provide any evidence. Furthermore, it was observed that the Appellant did not disclose this fact before the Inspector, rather informed that it was in the process of hiring independent audit function. The Appellant was, therefore, found to be non-compliant with Regulation 4(d) of the AML Regulations. It is reiterated that regulatory requirements relating to KYC/CDD and Anti-Money Laundering have been implemented since 2012 considering public interest, the integrity of the Pakistani Capital market and the country's financial international commitments. Therefore, all licensed persons are expected to ensure compliance with this regime by remaining vigilant and putting in place requisite policies and procedures to curtail activities relating to money laundering and financing of terrorism.

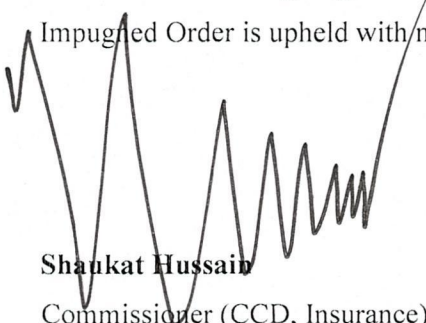
7. We have observed the parties i.e. the Appellant and the Respondent. We are of the view that the Appellant did not have a proper mechanism to generate alerts about the expiry of CNICs at least one month before the actual date of their expiry which proves that the Appellant was non-compliant at the time of inspection. Therefore, the violation of Regulation 6 of the AML Regulations has been established. Furthermore, the Appellant had failed to provide evidence

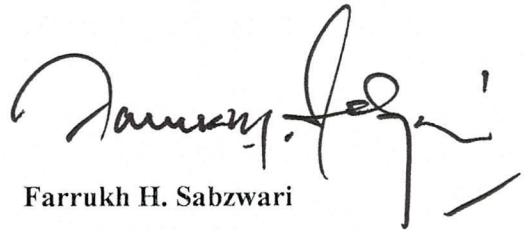


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with regard to the internal audit conducted by group internal audit department at the time of inspection and only informed that it was in the process of hiring the independent audit function. Therefore, the violation of Regulation 4(d) of the AML Regulations has also been established which provides that it is necessary for a regulated person to have an independent internal audit function to test the system. 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.

8. 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.

  
**Shankat Hussain**  
Commissioner (CCD, Insurance)

  
**Farrukh H. Sabzwari**  
Commissioner (SCD-PRDD)

Announced on: **26 NOV 2020**