Securities and Exchange Commission of Pakistan

BEFORE THE APPELLATE BENCH

In the matter of

Appeal No. 84 of 2020

Akhuwat Islamic Microfinance (Private) Limited

...Appellant

versus

Executive Director (Adjudication-I)

...Respondent

Date of hearing:

March 6, 2024

Present:

For the Appellant:

1. Manahil Khan, Advocate High Court

For the Respondents:

1. Asima Wajid, Adjudication-I, SECP
2. Raja Farukh, Adjudication-I, SECP

ORDER

1. This Order shall dispose of the proceedings initiated through Appeal No. 84 of 2020 filed by Akhuwat Islamic Microfinance (the Appellant) under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997, against the order dated April 21, 2020 (the Impugned Order), passed by the Executive Director (Adjudication-I) (the Respondent), under Section 40A of the Securities and Exchange Commission of Pakistan Act, 1997 (the Act), read along with Section 282(1) and Section 282M(1) of the Companies Ordinance, 1984 (the Ordinance).

2. The brief facts of the case are that an inspection of the company, ordered vide inspection order dated August 8, 2019, *inter alia* revealed that the Appellant Company was in violation of the Anti-Money laundering and Countering Financing of Terrorism Regulations, 2018 (the AML Regulations). Consequently, a show-cause notice dated December 2, 2019 (the "SCN"), under Section 40A of the Securities and Exchange Commission of Pakistan Act 1997 (the "Act") was issued. A subsequent show-cause notice dated January 21, 2020 (the "Second SCN") under section 40A of the Act was also issued to the Board of Directors of the Appellant, and after affording an opportunity of hearing to the Appellant, the Respondent, in exercise of powers conferred under Section 40A of the Act, imposed a penalty of Rs. 2,500,000/- on the Appellant vide the Impugned order.

3. The Appellant has preferred this Appeal, *inter-alia*, on the grounds that in the Impugned order the Respondent has omitted to furnish any rationale for the imposition of a substantial penalty upon the Appellant. The Counsel for the Appellant argued that the element of wilful default has to be demonstrated before any offence is made out, while stating that that the Appellant had no intention to contravene any of the provisions mentioned in the SCN and that the Respondent's failure lies in their inability to recognize the Appellant's earnest endeavours to adhere to the Regulations. The Appellant further argued that it only forms a business relationship after reviewing the original CNICs of the customers and a copy of the CNIC of the customer is placed on record of the Company and meanwhile the Appellant had also entered into an Agreement with the National Database and Registration Authority ("NADRA") in order to avail the services of NADRA Verisys. The Counsel argued that the Second SCN is unwarranted and without any lawful authority as the contents of the second SCN were identical to the first SCN served upon the Appellant. The Counsel further argued that the requirements of the Regulation 9(2)(a) of the Non-Banking Finance Companies and Notified Entities Regulations, 2008 (the 'NBFC & NE Regulations') are also fulfilled by the Appellant as the Appellant always determines the true identity of its customer. Moreover, the Counsel for the Appellant further argued that the AML and CFT Regulations does not provide for a criteria of rating the customers and the same appears to be as per the discretion of the regulated person, however, Regulation 9(2) of the AML and CFT Regulations appears to only provide guidance in respect of customers which are vulnerable to high

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risk. The Appellant further stated that it categorizes all clients as 'low-risk' based on the size of the loan which is Rs. 100,000/- The Appellant argued that on instructions of the Securities and Exchange Commission of Pakistan (the Commission), screening against names of the proscribed persons was completed and the suspicious transaction report (the STRs) were reported to the Financial Monitoring Unit and also the Commission.

4. Controverting the arguments of the Appellant, the Respondent, *inter alia*, contended that the violation of the Regulations were manifestly discernible during the course of the inspection. The respondent argued that compliance with the AML Regulations was not conditional upon receipt of emails/instructions from the Commission since Regulation 6(5a) of the AML and CFT Regulations, requires to refrain from forming business relationships with individuals that are proscribed under the Anti-Terrorism Act, 1997 and associates/facilitators of those persons. The Respondent further argued in response to the Appellant's arguments that the Appellant does not have the choice to assume that each of its customer is 'low-risk' without carrying out the risk assessment of the customer and cannot categorize its customers as 'low-risk' merely on the basis of the size of the loan. The Respondent further stated that the Commission does not provide a criterion for rating of customers, rather it provides broad guidelines to facilitate its regulatees. Moreover, the Respondent stated that Regulation 9(2), without limiting the generality of Regulation 9(1), prescribes additional measures more specific to the clients, as defined therein, and that it was incumbent upon the Appellant to abide by the AML Regulations and its application is not limited or curtailed by the definition of 'client' provided in Regulation 9(2), thus stating that in terms of Regulation 9(1) of NBFC and NE Regulations 2008 the Appellant was bound to abide by the AML Regulations. The Respondent further argued that the proceedings under the first SCN examined the role and responsibility and discharge thereof by the company, and the SCN proceedings were limited to the company only, and whereas the second SCN proceedings were initiated to examine the discharge of the role and responsibility by the members of the Board of Directors of the Company, hence, the action does not violate the principles of fairness and natural justice.

5. The Appellate Bench (the 'Bench') has heard the arguments of both the parties and perused the record. The Bench is of the opinion that the Appellant had a responsibility to strictly adhere to the relevant requirements outlined in the Regulations, ensuring full compliance in both letter and spirit. However,

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the argument of the Respondent that the first SCN was issued to the Company and the second SCN was issued to the Board is correct, as the Respondents stated that the second SCN was issued due to the 'gravity' of the violations. This, however was not reflected in the conclusion of the second SCN proceedings as the Board of Directors were only given a warning. If the gravity of the violations was considered serious, then the penalty should have been imposed upon the Board to support the assertion of the Respondents. The Bench has also observed the fact that after initiation of the show-cause proceedings, the Appellant proceeded to avail NADRA Verisys which qualifies as an admission by the Appellant that it was so required to do so under the applicable legal regime. Failing to do so up until that point in time amounted to willful default on part of the Appellant. As such, the Appellant's stance that the default was not willful is not tenable. However, the Bench appreciates that the Appellant has endeavored to comply with applicable law by availing NADRA Verisys. Further, it is noted that the Appellant has taken other steps to prevent AML/CFT risks including screening against proscribed persons list, social scrutiny measures to identify risk of terrorism financing and money laundering. The record also indicates a significant reduction in the occurrence of non-compliances with the Regulations subsequent to the Impugned order.

6. Based on the abovementioned circumstances the Bench questioned the Appellant on its contention that its customers are all deemed to be 'low-risk' by virtue of the relatively small size of loans availed. The Respondents had stated that there is no financial threshold in law, however, all customers cannot be categorized as 'low-risk' solely on the basis of the small size of the loan. The fact that only 31 customers were found on the proscribed persons list should not be of comfort because the legal requirements have to be met to mitigate, as far as possible, any such incidents in the future. The applicable legal regime imposes the minimum requirements for categorization of 'high-risk' customers in letter and spirit. However, the law does not provide a *de-minimus* threshold for the risk classification purposes. Hence it seems that it was left up to the regulated entity to decide a minimum financial threshold.

7. The Bench has further noted that Regulation 9 of the AML Regulations, expressly categorizes a minimum of three categories of customers who are to be classified as 'high risk'; (i) customers belonging to countries which are non-compliant with the AML Regulations as per FATF; (ii) body corporates, partnerships, associations and legal arrangements including NGOS, and not for profit-

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organizations which receive donations, and (iii) legal persons or arrangements with complex ownership structures. A combined reading of Regulations 3, 6(8) and 9(1) of the AML Regulations reveals that the regulated entity is obliged to implement appropriate internal risk management systems, policies, procedures and controls. That being said, Regulation 9(2) presents a non-exhaustive list of circumstances where a customer should be deemed to be categorized as 'high-risk'. The Commission is empowered under Regulation 9(3) to notify any other types of customers for whom enhanced due-diligence should be conducted for posing 'high-risk'. Regulation 11(1) provides a carve out for simplification of the due diligence procedures for 'low-risk' customers. Regulation 11(2) provides that simplified due diligence can be extended in cases where financial products and services are aimed at increasing access to financial inclusion, but such a decision has to be justified in writing and the products or services are to be appropriately defined and limited in application. Therefore, the Bench expects that the Appellant will not only abide by these controls for future customers but will also conduct exhaustive review of existing customers to determine their risk profile afresh.

8. Based on the above-mentioned facts and circumstances of the case the Bench considers it justified to convert the penalty into a warning. Therefore, we hereby modify the Impugned Order to the extent that the penalty imposed on the Appellant vide Impugned order is converted into a warning with a direction to the Appellant to put in place an effective risk assessment system. The instant appeal is disposed of on above terms with no order as to costs.

(Akif Saeed)
Chairman/Commissioner

(Mujtaba Ahmad Lodhi)
Commissioner

Announced on: 04 SEP 2024