



Securities and Exchange Commission of Pakistan

Securities Market Division

Public Offering and Regulated Persons Department

No. 1(50)SMD/LCID/KSE-2015

June 2, 2016

**The Chief Executive Officer,
Fortune Securities Limited**
3rd Floor, Razi Tower, BC-13,
Block No.9, KDA Scheme No.5, Clifton
Karachi

**Subject: Order in respect of Show Cause Notice dated September 22, 2015 Bearing
Number 1 No. 1(50)SMD/LCID/KSE-2015**

Dear Sir,

Please find enclosed herewith a copy of order in the title matter for your record and necessary action.

Yours truly,

Muhammad Farooq
Additional Director (PRPD)

ORC



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Before Executive Director (PRPD)

In the matter of Show Cause Notice issued under Section 22 of the Securities and Exchange Ordinance, 1969 read with Rule 8 of the Brokers and Agents Registration Rules, 2001 to Fortune Securities Limited

Date of Hearing:	October 13, 2015 and March 22, 2016
Present at Hearing:	
Representing the Respondent:	(i) Mr. Anis Ur Rehman Chief Executive, Fortune Securities Limited (ii) Mr. Toabur Khaliq, Head of Settlements Fortune Securities Limited
Assisting the Executive Director (PRPD)	(i) Mr. Nasir Askar, Director (PRPD-SMD) (ii) Mr. Muhammad Farooq, Additional Director, (PRPD-SMD) (iii) Mr. Muhammad Tanveer Alam, Additional Director (SSED-SMD)

ORDER

This Order shall dispose of the proceedings initiated through Show Cause Notice bearing No. 1(50) SMD/LCID/KSE-2015 dated September 22, 2015 ("Notice") served under section 22 of the Securities and Exchange Ordinance, 1969 ("Ordinance") read with Rule 8 of the Brokers and Agents Registration Rules, 2001 ("Broker Rules") to Fortune Securities Limited ("Respondent") by the Securities and Exchange Commission of Pakistan ("Commission"). The Respondent is Trading Right Entitlement Certificate Holder/Broker of the Pakistan Stock Exchange (formerly Karachi Stock Exchange Limited) ("PSX") and registered as a broker with the Commission under the Brokers Rules.

2 The Commission vide Order No. SMD/MSRD-C&IW/(10-1(242)2014 dated September 30, 2014 ordered an onsite inspection of the Respondent. The inspection team before submission of its final report ("Inspection Report") shared its findings with the Respondent. The inspection team observed that the Respondent was non-complaint with the following regulatory framework:

#	Regulatory framework	Alleged Nature of irregularity
1	Securities and Exchange Rules, 1971 (SE Rules).	a) Observations regarding incorrect calculation of Net Capital Balance Certificate (NCB). b) Non-adherence to the prescribed format of NCB Certificate
2	Rule Book of PSX	a) Deficiencies noticed with regard to know your customer (KYC) and customer due diligence (CDD) b) Non-Segregation of Clients' Assets. c) Non-maintenance of Standardized Account Opening Form (SAOF).
3	CDC Regulations	a) Discrepancies in Sub Account Opening Forms.
4	Others	a) Non-compliance with Circular No. 34 of 2009 b) Change in accounting policy not disclosed c) Improper classification of loan in the trial balance. d) Contingencies and commitments not disclosed in financials e) Documentary evidence for adjustment in client ledger accounts not provided.

3 In light of observations contained in the Inspection Report, the Commission served the Notice to the Respondent and the Respondent was called upon through its chief executive

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officer ("CEO") to show cause in writing as to why penalty may not be imposed upon it. The CEO of the Respondent submitted his written response to the Notice on October 8, 2015.

4 Hearing in the matter was conducted on October 13, 2015. But, before the matter could be concluded by the then Director/HOD (LCID), I assumed the charge of post of Executive Director (PRPD) and the instant case was passed on to the undersigned.

5 In order to conclude the proceedings, another opportunity of hearing in the matter was scheduled for March 22, 2016. On the given date, the CEO and Mr. Toabur Khaliq, Head of Settlement of the Respondent (**Authorized Representatives**) attended the hearing through video conferencing from Karachi. The observations of the Inspection Team and the responses submitted by the Respondent are given below.

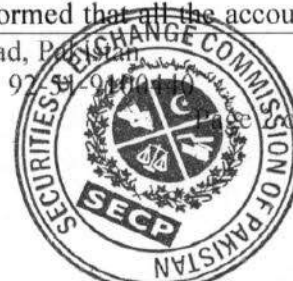
6 With regard to incorrect calculation of NCB, the inspection team observed that "Rule 2 of SE Rules read with Regulation 19.3.2 of Rule Book, provides that NCB is required to be calculated in accordance with Third Schedule [Rule 2(d)] of SE Rules. NCB of the Respondent as on June 30, 2014 was Rs. 59.769 million. The Respondent included an amount of Rs. 163.541 million in NCB as trade receivable. The trade receivables include an amount of Rs10 million, receivable from Mr. Noman Yakooob on account of payment made for subscription to shares in an IPO. The Inspection Team observed that payment of Rs10 million was made for investment in the name of the brokerage house. However, the said payment was not recorded as advance against IPO. The Inspection Team was of the view that advance against IPO appearing as on reporting date of NCB was not eligible for calculation of NCB." In this regard the Respondent informed that the shares were not applied for in the name of the brokerage house. Rather the shares were applied for by the client. Therefore, the Respondent correctly included the amount in its NCB. To substantiate its assertions, the Respondent provided copies of the application form filled by their client for the book building of PPL, letter of the client to the Respondent for making a pay order on his behalf for book building of PPL, pay order of Rs 10 million and CDC statement of the client evidencing receipt of PPL shares.

7 With regard to non-adherence to the prescribed format of NCB certificate, the Respondent stated that it had appointed a new auditor for preparation of NCB. The Auditor used the wording "NCB is arrived at or calculated on the basis of audited financial statements" in the NCB certificate. When the NCB certificate was submitted to PSX, they objected to the wording. The wording was subsequently changed to "NCB is calculated/ arrived at on the basis of number/ figure duly audited" and the NCB certificate was resubmitted to PSX. The initial copy of the NCB certificate was inadvertently provided to the inspection team.

8 On the deficiencies noticed by the inspection team with regard to KYC and CDD, SAOF and CDC account opening forms, the Respondent informed that all the shortcomings noticed by the inspection team have been rectified.

9 With regard to segregation of client assets, the inspection team observed that there was a difference of Rs 6.8 million between balance in "client bank account" and "accounts payable" as on June 30, 2014. Further, the inspection team observed that credit balance of Rs 14.9 million in a client account was used for adjusting the debit balances appearing in accounts of two other clients. Moreover, the inspection team observed that the Respondent had obtained loan against lien on client bank account. On the difference between client bank balance and account payable, the Respondent informed that it had deposited a cheque of Rs 7.5 million received from a client in the client bank account before year end. However, the cheque was cleared on July 2, 2014 and therefore was not reflected in the client bank balance. With regard to adjustments of debit balances, the Respondent informed that all the accounts

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belonged to the same family and provided a copy of the written authorization for adjusting the debit balance against the credit balance. With regard to lien on client bank accounts, the Respondent informed that it had obtained written authorizations from its clients for use of surplus funds in their accounts for meeting its working capital requirements. The Respondent provided copies of the written authorizations obtained from its clients.

10 With regard to inspection team observation regarding non-disclosure of change in accounting policy in the audited accounts, the Respondent informed that it was an inadvertent mistake. However, subsequent to the year end, it had reverted back to its old accounting policy keeping in view the observations of the inspection team. On the observation of the inspection team regarding improper classification of loan of Rs 15 million obtained from a brokerage house in the trial balance, the Respondent admitted the mistake. However, the Respondent informed that the correct reporting was done in the audited annual accounts. With regard to non-disclosure of contingencies of Rs 3.5 million, the Respondent informed that the case is pending for the last twelve years and the counter party is not regularly attending the hearings. Further, the chances of an adverse judgment are remote. With regard to compliance with requirement of ICM certification, the Respondent informed that it would encourage its employees to obtain ICM certifications.

11 With regard to observation of inspection team i.e. "documentary evidence for adjustment in client ledger accounts not provided" (mentioned at Para 9 (iv) of the Notice), the Respondent informed the inspection team that "*Mrs Anis had borrowed some funds from Mr. Noman Yakoob and Mr. Muhammad Naveed for personal reasons*". The same stance was repeated in the written response to the Notice dated October 8, 2015 and during the hearing held on October 13, 2015. During the hearing dated March 22, 2016, it was argued that the reasons put forth by the Respondent do not appear to be justifiable. In response, the Authorized Representatives informed that the funds raised by Mrs. Anis through borrowing from Respondent's clients were provided to the Respondent in form of long term loans. In its letter dated April 5, 2016, the Respondent stated that "*The funds raised by Mrs. Anis from Mr. Naveed and Mr. Noman were utilized for onward lending to FSL pursuant to long term agreements with FSL. Both transactions of borrowing and repayment therefore took place in short time spans. It is pertinent to note that while the loan proceeds provided to FSL consequently improved the current ratio of FSL, however that was never the objective or aim of the transaction in question*".

12 Review of this office record reveals that an amount of Rs 36.7 million was transferred from the accounts of Mr. Naveed and Mr Yakoob to the account of Mrs. Anis on June 26, 2013 and the said amount was transferred back to the accounts of Mr. Naveed and Mr Yakoob on July 1, 2013. Similarly, an amount of Rs 30 million was transferred from the account of Mr. Naveed to the account of Mrs. Anis on December 31, 2013 and the said amount was transferred back to the accounts of Mr. Naveed on January 1, 2014. Mrs. Anis utilized these loans for onward lending to the Respondent. In the hearing held on March 22, 2016 and response dated April 5, 2016, the Respondent informed that Mrs. Anis extended long term loans to the Respondent. However, on both the occasions, the amount borrowed by the Respondent was returned back to Mrs. Anis within a few days of availing the loans. The Respondent further informed that Mrs. Anis repaid the amount, borrowed by her to Mr. Naveed and Mr. Yakoob.

13 In view of the above, it is established that the Respondent structured the transactions for the purposes of improving its NCB as of June 30, 2013 and December 31, 2013. This fact has been acknowledged by the Authorized Representatives during the hearing held on March 22, 2016 and in the written response of the Respondent dated April 5, 2016. Considering the



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Respondent's request and in order to ascertain the magnitude of the issue, I have examined the NCBs of the Respondent from June 30, 2013 to December 31, 2015 and the exposures taken by the Respondent on the basis of these NCBs.

14 The audited NCB amounted to Rs. 62.3 million and Rs. 66.8 million as of June 30, 2013 and December 31, 2013, respectively. In case, the effect of long term loans of Rs. 36.7 million (June 30, 2013) and Rs. 30 million (December 31, 2013) provided by Mrs. Anis to the Respondent, is not taken in to account, the adjusted NCB works out to be Rs. 25.6 million as on June 30, 2013 and Rs. 36.8 million as on December 31, 2013. The adjusted NCBs were in excess of the then prevalent minimum regulatory requirement of Rs. 2.5 million. Further, on the basis of exposure taken by the Respondent during the calendar year 2013 (Rs. 81 billion) and 2014 (Rs. 78 billion), the adjusted NCBs were also in excess of the minimum NCBs that would have been required for the purpose. Based on these observations, it appears that as such no benefit of the enhanced NCB accrued to the Respondent. While examining the NCB as of June 30, 2014 which amounted to Rs 59.7 million, the inspection team did not observe any such instances. The reported NCB of the Respondent as of December 31, 2014, June 30, 2015 and December 31, 2015 were Rs. 66.0 million, Rs. 64.3 million and Rs. 39.0 million, respectively.

15 As far as the issue regarding enhanced NCB of June 30, 2013 and December 31, 2013 is concerned, it is established that the Respondent structured the transactions, but as such no benefit was availed by the Respondent.

16 With regard to calculation of NCB as of June 30, 2014, I tend to agree with the fact that the Respondent had correctly calculated its NCB. The Respondent has reportedly rectified the shortcomings noticed by the inspection team in KYC and CDD, SAOF and CDC account opening form. As far as the difference between balance in client's account and trade payables is concerned, the Respondent must ensure that there should be no difference between the two heads of account. With regard to non-disclosure of contingencies, the Respondent should make proper disclosure of the same in its audited accounts.

17 Based on the foregoing discussion and the assurance by the Respondent to comply with the regulatory framework in letter and spirit in future, I am not imposing any penalty on the Respondent. However, the Respondent is warned to ensure strict compliance of regulatory framework in letter and spirit in future.

18 This Order is being issued without prejudice to any other action that the Commission may initiate against the Respondent in accordance with the law on matter subsequently investigated or otherwise brought to the knowledge of the Commission.



Asif Jalar Bhatti
Executive Director (PRPD)

Islamabad.
Announced on May 24, 2016