



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Adjudication Department-I

Adjudication Division

Before Ali Azeem Ikram, Executive Director/HOD (Adjudication-I)

In the matter of Show Cause Notice issued to
M/s. Fawad Yusuf Securities (Pvt.) Limited

Date of Hearing

March 13, 2020

Present at the Hearing
Representing the Company

1. Mr. Fawad Yusuf
Chief Executive
(Authorized Representative)
2. Muhammad Shafi
(Authorized Representative)
3. M. Ali Ahmed
(Authorized Representative)

ORDER

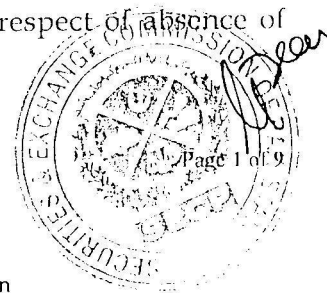
This Order shall dispose of the proceedings initiated against M/s. Fawad Yusuf Securities (Pvt.) Limited (the "Company") through its Chief Executive vide Show Cause Notice No. 1(138)SMD/Adj-1/KHI/2018-108 dated February 7, 2020 (the "SCN") issued under Section 40A of the Securities and Exchange Commission of Pakistan Act, 1997 (the "Act") on account of alleged non-compliances of Regulation 4(a), 6(3), 6(4) read with Annexure I, 6(7), 6(8), 7(1), 9(3), 9(4), 13(1), 13(7) of the Securities and Exchange Commission of Pakistan (Anti Money Laundering and Countering Financing of Terrorism) Regulations, 2018 (the "Regulations")

2. The Company holds the Trading Rights Entitlement Certificate ("TREC") from the Pakistan Stock Exchange Limited ("PSX").

3. An onsite inspection of the Company was conducted in order to assess the compliance of the Company with Anti-Money Laundering (AML) and Countering Financing of Terrorism (CFT) requirements as provided in the Securities and Exchange Commission of Pakistan (Anti Money Laundering and Countering Financing of Terrorism) Regulations, 2018 (the "Regulations").

4. The inspection team observed a number of instances where the Company, *prima facie*, failed to comply with the applicable provisions of the Regulations, which gave rise to initiation of the instant proceedings vide SCN dated February 7, 2020. The contents of SCN are summarized hereunder:

- (a) The Company does not have a database of beneficial owners for performing screening of its clients. The Company does not have a database with respect to joint account holder, board of directors and nominee of its clients. Instead of responding in respect of absence of





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aforesaid database, the Company has replied that database of proscribed persons/organizations is being maintained by it. However, the Company did not provide evidence in this regard. Therefore, in the absence of the said database, prima facie, it appears that screening of account/joint account/nominee/board of directors of its clients on continuous basis is not being conducted by the Company and adequate procedures and controls are not in place to mitigate the ML/TF risk. In view of the foregoing observation, the Company, prima facie, is in violation of Regulation 13(7). Furthermore, in view of the above, the existing mechanism is not effective and the Company, prima facie, has also violated Regulation 4(a);

- (b) Regulation 9(3) of the AML Regulations requires that a Regulated Person shall perform Enhanced Due Diligence (EDD) proportionate to risk posed to the business relationships by the customers that are identified as high risk. It was observed that the Company did not perform EDD against 'high risk' clients, in violation of the Regulation 9(3) of the AML Regulations. In response to letter of findings, the Company submitted that all these clients pertain to Karachi; therefore, need of EDD does not arise.
- (c) Regulation 6(4) of the AML Regulations requires a Regulated Person to obtain such documents from different types of customers as provided in Annexure-I. It was observed that the Company did not validate the identity documents of its 13 specified customers from NADRA Verysis, in violation of Regulation 6(4) of AML Regulations.
- (d) Regulation 6(3)(a) of the AML Regulations requires a Regulated Person to perform Customer Due Diligence (CDD) by identifying the customer or beneficial owner and verifying the customer's/beneficial owner's identity on the basis of documents, data or information obtained from customer and/or from reliable and independent sources. It was observed that in 7 instances, the Company failed to identify the customers or the beneficial owner of its customers from independent and reliable sources, in violation of the Regulation 6(3)(a) of the AML Regulations.
- (e) Regulation 13(1) of the AML Regulations stipulates 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, its business and risk profile and where appropriate, the sources of funds. It was observed that in two instances Company failed to monitor on an ongoing basis to ensure that the





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transactions are consistent with the intimated source of funds, in violation of the Regulation 13(1) of the AML Regulations.

- (f) Note (ii) of Annexure-I read with Regulation 6(4) of the AML Regulations requires that in case of salaried person, in addition to CNIC, an attested copy of his service card or certificate or letter on letterhead of the employer will be obtained. It was revealed in the findings of the Inspection that in two instances, the Company did not obtain the required information in violation of the said Note (ii) of Annexure-I read with Regulation 6(4) of the AML Regulations.
- (g) Regulation 9(4)(b) of the AML Regulations requires a Regulated Person to take the Enhanced Due Diligence (EDD) measures and establish, by appropriate means, the sources of wealth and/or funds or beneficial ownership of funds, as appropriate; including regulated person's own assessment to this effect. The findings of Inspection revealed that in one instance, the Company did not perform EDD of 'high risk' categorised customer as appropriate source of funds were not established, in violation of the Regulation 9(4)(b) of the AML Regulations.
- (h) Regulation 6(8) of the AML Regulations requires a regulated person to categorize each customer as high or low risk, depending upon the outcome of the CDD process. It was revealed in Inspection that in one instance the Company has assigned it 'medium risk' instead of classifying either as high or low, in violation of Regulation 6(8) of the AML Regulations.
- (i) Regulation 6(3)(c) of the AML Regulations requires a Regulated Person to perform Customer Due Diligence (CDD) by monitoring of accounts/transactions on ongoing basis to ensure that the transactions being conducted are consistent with the regulated person knowledge of the customer, the customer's business and risk profile, including, the source of funds and, updating records and data/ information to take prompt action when there is material departure from usual and expected activity through regular matching with information already available with regulated person. Inspection revealed that in one instance, the Company has not updated record for on-going monitoring by not obtaining information regarding source of income, copy of Audit Accounts, bank statement and copy of income tax return, which constitutes violation of the Regulation 6(3)(c) of the AML Regulations.
- (j) Regulation 6(7)(a) of the AML Regulations requires a Regulated Person should determine whether the person is acting on behalf of a customer





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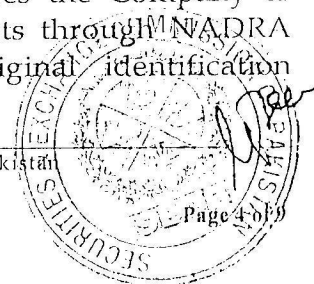
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and should take reasonable steps to obtain evidence to determine authority of such person to act on behalf of the customer, which shall be verified through documentary evidence including specimen signature of the customer. It was revealed in the Inspection that in one instance, the Company failed to obtain any required information/document, which is in violation of Regulations 6(7) of the AML Regulations.

- (k) Regulation 7(1)(b) of the AML Regulations requires a regulated person to identify and verify the identity of the natural persons (whether acting alone or together) who owns or ultimately has controlling ownership interest in the legal persons. It was revealed in the Inspection that in one instance, the Company failed to provide copies of CNICs of all the directors of a corporate client, which constitutes violation of the Regulation 7(1)(b) of the AML Regulations.

5. In response to SCN, the Company vide reply dated February 25, 2020 made the following submissions:

- a. In response to para 3(a), it was submitted that the Company is maintaining the database of proscribed individuals against which screening process was undertaken in the presence of the inspection team and provided screenshots of the system for screening of clients. As the second observation on effectiveness of existing mechanism for screening all related individuals pertains to misinterpretation of above mechanism by the inspection team, so the question relating to non-compliances of Regulation 4(a) has been addressed automatically.
- b. Regarding para 3(b) of SCN, it was stated that the Company's reply dated November 13, 2019 (at Point # 01) may be referred which was related to comments on findings in respect of the Thematic Review Report. The Company explained in the reply to the inspection team that the due to system error, all the clients were marked "High Risk" because their address was entered as Peshawar City, an area close to the porous border. However, after realizing that all the said clients are actually from Karachi, the Company has updated its system accordingly. Therefore, there is no need to perform Enhance Due Diligence (EDD) of the said customers.
- c. Responding to para 3(c) of SCN, the Company is of view that Annexure-I to AML/CFT Regulations requires the Company to verify photocopies of identification documents through NADRA Verisys and in case customer shows original identification



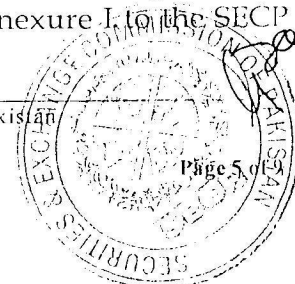


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document during account opening along with providing photocopy of same, then NADRA Verisys is not required. The Company has already explained to the inspection team during inspection that while opening of customers' accounts, we accepted photocopies of identity documents if their originals are presented to the Company. The Company assumes that as NCCPL has been designated as CKO which requires verification of CNICs/Passports of customers through its NADRA Verisys, the requirement under Annexure I to the Regulations becomes a duplicate effort (Verification of identity documents of specified 13 customers has been obtained now and the same is attached to the reply)

- d. With regard to para 3(d) of SCN, the Company stated that it has already been explained to the inspection team that procedures are already in place for identification of Beneficial Owner of the clients, where required.
- e. The Company replied to para 3(e) of SCN that in the inspection report dated November 08, 2019, no particular case was highlighted to the Company so that we could address their observations then and there. However, the procedures are already in place to monitor the transactions of the customers on an ongoing basis according to the Risk Profile of the Customer.
- f. Responding to para 3(f) of SCN, it was stated that the Company had already rectified the said short comings (copy of Employment Card along with Contract was attached with the reply).
- g. It was submitted with regard to para 3(g) of SCN that the Company has already rectified the said short comings. Furthermore, during inspection it was explained to the inspection team that the CDD and EDD of High Risk marked Clients are done on regular basis and are maintained in a separate file.
- h. In response to para 3(h) of SCN, the Company believes that Regulation 6(8) of the AML/CFT Regulations does not give quantitative parameters to the Company for categorization of its customers as high or low risk depending upon the outcome of the CDD process. There is a confusion in the Regulations and AML/CFT Guidelines. The Regulations provides that each customer shall be categorized as High or Low risk, depending upon the outcome of the CDD Process and there is no provision in AML/CFT Regulation for categorization of any customer as Medium Risk. Whereas, Annexure I to the SECP





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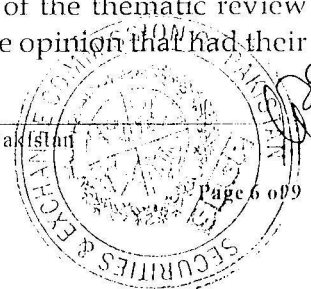
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Guidelines on AML, CFT and PF provides that the Customers' Risks should be identified into one of the three (3) risk categories, namely; High, Medium or Low. Therefore, the Company categorized all those customers as 'Medium Risk', which are not qualifying in High or Low Risk Categories. The Company has been preparing AML/CFT Assessment for establishing KYC-CDD and customer profiling prior to Risk Assessment process since the issuance of SECP Guidelines in September 2018. We request the SECP to clarify this confusion between AML/CFT Regulations and SECP AML/CFT Guidelines before alleging non-compliance of the Company on categorizing its majority of the Customers as 'Medium Risk'.

- i. With reference to para 3(i) of SCN, the Company had already provided evidence against the Inspection Team's observation No. 08. Annexure F of the Company's reply dated November 13, 2019. Therefore, non-compliance provided in 3(i) of SCN could be justified (A copy of tax returns of the customer was attached to the reply).
- j. In response to para 3(j) of SCN, the Company submitted that its comments We had provided our comments against point No. 08 of the Company reply dated November 13, 2019. (Board's Resolution along with specimen signatures of authorized signatories from the Corporate Client is attached with the reply).
- k. Regarding para 3(k) of SCN, it was submitted that the Company had provided its comments with evidence against point No. 08 of the reply dated November 13, 2019 related to comments on findings in respect of the Thematic Review Report. (In this regard, photocopies of CNICs of Directors of the client which is a private limited company were attached with the reply).

6. In order to afford the Company an opportunity of making personal representation, hearing in the matter was fixed on March 13, 2020. The hearing was attended by Mr. Fawad Yusuf, Chief Executive, Mr. Muhammad Shafi and Mr. M. Ali Ahmed as the Authorized Representatives. During the hearing proceedings, the Authorized Representatives were advised to explain the reasons for the alleged violations, as narrated in the SCN. The Authorised Representatives reiterated the written submissions and arguments as made by the Company vide its reply dated February 25, 2020.

7. Explaining the stance of the Company, the Authorised Representatives stated that their response dated November 13, 2019 on the findings of the thematic review report was not considered before issuing SCN. They were of the opinion that had their





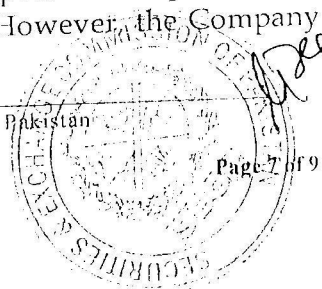
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response been considered, certain observations in the SCN wouldn't have arisen. They further stated that the specified clients were marked as high risk as their addresses were wrongly entered in the system as Peshawar, an area close to the porous border. But subsequently, when this fact came to the knowledge of the Company that the said clients actually belong to Karachi, necessary correction was made in their address as well as risk categorization; they are no more 'high risk' customers. They submitted that the facility of 'CKO' was being used by the Company for verification of identity documents of customers. The Chief Executive apprised that he personally knows the said clients. They submitted that value of custody accounts of customers should also be taken in to consideration while carrying out their CDD. As regards maintenance of clients' database, it was submitted that the Company had a total of 875 clients, out of which only 125 are active. Currently, the Company has 1739 names in its database which are screened regularly against the list of proscribed persons. However, they have managed to get some of the documents from the said clients. They submitted that the tax returns and gift deeds were subsequently collected from the respective clients in order to establish their source of income/funds.

8. I have examined the submissions and arguments of the Company and Authorised Representatives in light of the requirements of applicable provisions of the Regulations. The Company's response dated November 13, 2019 on the findings of the thematic review report was definitely taken into consideration while issuing the SCN. I am of the considered view that the Company did not ensure its compliance with the mandatory provisions of the Regulations as detailed hereunder:

- (i) It was submitted that the Company was screening more than double the number of its clients. No specific instance has been identified wherein beneficial owners, joint account holder, board of directors and nominee of its customers have not been screened. The submissions of the Respondents, in this regard, are tenable.
- (ii) The Respondents submitted copies of NADRA Verisys obtained on February 24, 2020 in respect of 13 sample cases along with its reply. Acquisition of Verisys on the mentioned date indicates that customers' accounts were opened without verification of identity documents through NADRA Verisys. The Regulations specifically require validation of identity documentation through NADRA Verisys. CNIC presented before the Company cannot be construed as original without due verification. Therefore, violations of Regulation 6(4) read with Annexure I to the Regulations are established.
- (iii) The Company has subsequently obtained identity documents of beneficial owners or joint account holders of 7 specified sample cases of individual customers as a remedial measure. However, the Company





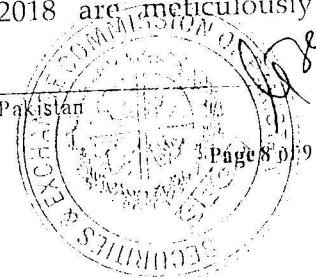
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failed to verify the identity of beneficial owners or joint account holders using independent or reliable sources prior to raising the observation by the inspection team. Therefore, violation of Regulation 6(3)(a) is established.

- (iv) The Company did not carry out an ongoing monitoring in the case of an account of a retired individual. Source of income cannot be established through copy of his available bank statement in order to ensure that the transactions in his account are consistent with its knowledge about the customer, his business and risk profile and sources of funds. Thus, violation of Regulation 13(1) is established.
- (v) In case of 2 individual customers of the Company, who are salaried persons, an attested copy of their service card or certificate or letter on letter head of the employer had not been obtained at the time of establishing the relationship. Though the documents were obtained subsequent to the inspection findings but the Company failed to obtain the requisite documents at the time of opening their accounts which resulted in violation of Regulation 6(4).
- (vi) In the case of a female client (a house wife who is categorised as high risk customer with custody value of Rs. 1.9 million), the Company has subsequently obtained a copy each of 3 gift deeds executed in her favour in respect of transfer of funds. However, the Company did not establish the sources of wealth/ funds or beneficial ownership of funds including its own assessment to this effect, which were required to be undertaken in respect of the high risk client as part of EDD. Therefore, violation of Regulation 9(4)(b) was made.
- (vii) Copy of Resolution dated July 29, 2019 passed by the Board of Directors of a corporate client of the Company does not specifically give authority to authorized signatories to open an account with the Company. Therefore, compliance with Regulation 6(7) has not been ensured in the case of the said corporate client.

9. In view of the foregoing reasons, I am of the considered view that multiple violations of the applicable provisions of Regulations, as narrated in the foregoing para 8, have been established. Therefore, in terms of powers conferred under section 40A of the Act, a penalty of **Rs. 650,000/- (Rupees Six Hundred Fifty Thousand Only)** is hereby imposed on the Company. The Company is hereby directed to fully implement counter ML and TF measures including but not limited to formulation and implementation of policies, procedures and controls to ensure that the applicable requirements contained in the AML/CFT Regulations, 2018 are meticulously





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complied in true letter and spirit. It is further directed that the Company shall submit its compliance report to the Brokers Compliance Department, Securities Market Division, Karachi within one month of the date of this Order in respect of all the obligatory measures under the Regulations particularly the required CDD/EDD measures in respect of its customers, monitoring of accounts/transactions of its customers and screening of its entire customers' database.

10. The Company is directed to deposit the aforesaid penalty in the bank account of the Commission being maintained in the designated branches of MCB Bank Limited within 30 days of the date of this Order and furnish original deposit challan to the Commission forthwith.

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

Ali Azeem Ikram
Executive Director/HOD (Adjudication-I)

Announced on: April 21, 2020
Islamabad

