



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Adjudication Department-I
Adjudication Division

Through Courier

Before the Executive Director (Adjudication I)

In the matter of Show Cause Notice issued to "Akhawat Islamic Microfinance"

Dates of hearing(s):

December 27, 2019

January 02, 2020

January 07, 2020

February 13, 2020

March 13, 2020

March 18, 2020

Present at the hearing (on behalf of Akhawat
Islamic Microfinance)

Mr. Mujtaba Ali Kazmi
(Legal Representative)

ORDER

This Order shall dispose of proceedings initiated through the Show Cause Notice (the "SCN") bearing No. SCD/ADJ/AIM/55/2019/101 dated December 02, 2019 and SCD/ADJ/AIM/55/2019/62 dated January 21, 2020 issued under Section 40A of the Securities and Exchange Commission of Pakistan Act, 1997 (the "Act"), to Akhawat Islamic Microfinance ("AIM", the "Company") and the following Directors and the CEO of Akhawat Islamic Microfinance (the "BOD"), hereinafter collectively referred as the "Respondents".

Sr.	Name	Designation
1.	Mr. Humayoun Ihsan	Chairman/ Director
2.	Dr. Izhar-Ul-Haq Hashmi	Director
3.	Dr. Kamran Shams	Director
4.	Mr. Abdur Rauf Khan	Director
5.	Mr. Khawar Rafiq Sheikh	Director
6.	Dr. Muhammad Amjad Saqib	Chief Executive

2. An onsite inspection (the "Inspection") of the Company was conducted by the Securities and Exchange Commission of Pakistan (the "Commission") to ascertain compliance with requirements contained in Securities and Exchange Commission of Pakistan (Anti Money Laundering and Countering Financing of Terrorism) Regulations, 2018 (the "AML Regulations").

3. The Inspection findings indicated, *prima facie*, non-compliances with the AML Regulations. Accordingly, the Commission took cognizance of the matter and served the SCNs, both



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to the **Company** and the **BOD** requiring the Respondents to explain their stance. The allegation contained in the SCN are detailed below:

- (i) Details of beneficiary (user of loan /other than the borrower) was neither being entered in MIS system nor being screened by AIM, against list of proscribed persons in violation of exposing AIM to the risk of forming business relationships with individuals that were proscribed under the Anti-Terrorism Act, 1997 and associates/ facilitators of those persons in violation **Regulation 6 (5a) of the AML Regulations;**
- (ii) CNICs of customers were not being verified through NADRA, in violation of Regulation 6 **(4) of AML Regulations;**
- (iii) AIM was not conducting CDD to identify the customer or beneficial owner and verify them on the basis of documents or information obtained from customer and/or from reliable and independent sources in violation of **Regulation 6(3)(a) of the AML Regulations;**
- (iv) AIM had not developed a criteria for classification of its customers among high and low risk, on the assumption that all microfinance borrowers were low risk and hence had placed them in low risk category contravening Regulation 6 **(8) of the AML Regulations.**

4. AIM vide its letter dated January 7, 2020 and March 18, 2020 submitted reply to the SCNs, which are reproduced below.

Contents of Letter dated January 7, 2020

.....

REPLY ON MERITS

Without prejudice to the contents of the Preliminary Submissions/Objections above, the Company reply to the observations stated in the SCN is as follows:

- (i) In reply to para 3(i) of the SCN, AIM stated, "*The Regulation 6(3)(a) of the Securities and Exchange Commission of Pakistan (Anti Money Laundering and Countering Financing of "Terrorism) Regulations, 2018 (the "AML & CFT Regulations") provides for the identification of the customer or beneficial owner and verification of the customer's /beneficial owner's identity. In light of the referred regulation, the Company has obtained identification documents in respect of all the customers/beneficial owners, data of all customers against all lists of proscribed persons. However, for the verification of beneficiaries, the list of proscribed persons is also shared with all field area offices for*

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verification. The record of beneficiaries is also maintained at the area office(s) of the Company. Furthermore, the Company employs, inter alia, social scrutiny measures to identify the risks of terrorism financing ("TF") and money laundering ("ML"). Moreover, the Company regularly screens the names of the proscribed persons to eliminate the risk of TF. Keeping in view the measure adopted by the Company, the risk of designated / proscribed persons obtaining financing facilities is negligible. Without prejudice to the aforesaid, the Company under instructions from the Commission, has commenced the screening of the names of the beneficial owners against the proscribed persons list. The said screening is expected to be completed by 20 February, 2020. Moreover the details pertaining to the beneficial owners are being incorporated in the MIS System."

ii) In reply to para 3(ii) of the SCN, AIM stated, "The Company regularly screens the names of the proscribed persons as prescribed by the AML & CFT Regulations. The Company enters into a business relationship with the customer and the names of all the customers are screened against the names of the proscribed persons. Hence, the Company is not in violation of this provision. Without prejudice to the above, the Company has, under instructions from the Commission, started screening the names of the beneficial owners against the proscribed persons lists".

(iii) In reply to para 3(iii) of the SCN, AIM stated, "The Company only forms a business relationship after reviewing the original CNIC s of the customers. The Company is in the process of making arrangements for verification of CNICs through NADRA Verisys, which shall be completed soon."

(iv) In reply to para 3(iv) of the SCN, AIM stated, "The Company has obtained identification documents in respect of all the customers as per the requirement of the Regulation 6(3)(a) of the AML & CFT Regulations. Furthermore, the Company employs, inter alia, social scrutiny measures to identify' the risks of terrorism financing ("TF") and money laundering ("ML"). Hence, the Company is in compliance of the said CDD process. Having said that, the Company has, under instructions from the Commission, started to inspect and screen the details and names of the beneficial owners, including but not limited to the proscribed persons list."

(v) In reply to para 3(v) of the SCN, AIM stated, "It is submitted that the AML & CFT Regulations does not provide for the criteria of rating the customers. The same appears to be determined by the regulated person. The Company has in place criteria for the customer due diligence which includes inter-alia.



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verification of customers through social scrutiny measures. Furthermore, the AML & CFT Regulations also provides that where low risk is identified through adequate analysis of risk or where adequate checks and control exist, regulated person may apply simplified or reduced Customer due Diligence. It is reiterated that out of 1 million customers only thirty-one (31) were identified against the list of proscribed persons, illustrating a ratio of 0.0031%. Thus, it is evident that the criteria employed by the Company in respect of the Customer Due Diligence is extremely effective. If required, the Company can justify in writing, the classification of its customers as low risk as well. Without prejudice to aforesaid, in the event the Commission provides or lays down the criteria for risk classification, the Company will be willing to follow the same."

Contents of Letter dated March 18, 2020

Preliminary Objections

1) At the very outset, it is pointed out that the subject SCN is unwarranted and without any lawful authority. A Show Cause Notice bearing No. SCD/ADJ/ AIM/55/2019/101 dated 2 December 2019 (the "Previous SCN") was issued to Akhuwat Islamic Microfinance (the "Company"). The subject matter and the content of the Previous SCN is similar, in fact almost identical, to the SCN. The Company duly responded to the Previous SCN and hearings were also conducted in respect of the same. However, no final order has been made or communicated to the Company by the Securities and Exchange Commission of Pakistan (the "Commission") so far. Therefore, issuance of the subject SCN is unwarranted and without any lawful authority inof the previous SCN. The same is also against the principles of natural justice. Hence, on this ground alone the subject SCN be withdrawn.

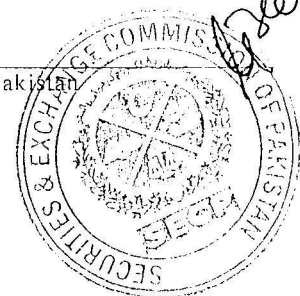
2) Without prejudice to the aforesaid, it is submitted that our Clients have not contravened any provision of law as alleged in the SCN. Additionally, our Clients does not have any personal knowledge or role of any nature in purported default or non-compliance of any of the provisions as stated in the SCN, if any. Our Clients are distinguished and respectable members of society and they have always strived to exercise due care and skills in performing their functions.

Applicability of relevant law:

3) The subject SCN has been issued, inter alia, under the following:

- Section 40A of the Securities and Exchange Commission of Pakistan Act, 1997 (the "SECP Act");

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- Securities and Exchange Commission of Pakistan (Anti Money Laundering and Countering Financing Terrorism) Regulations, 2018 (the "**AML & CFT Regulations**");
- Section 282I and 282M of the Companies Ordinance, 1984 (the "**Ordinance**");
- Regulation 9 of the Non-Banking Finance Companies and Notified Entities Regulations, 2008 (the "**NBFC & NE Regulations**");
- The Non-Banking Finance Companies (Establishment and Regulations) Rules, 2003 (the "**NBFC Rules**"); and
- Section 17 (vii) of Guidelines on AML and CFT Regulations 2018 (the "**Guidelines**").

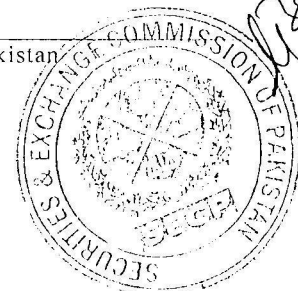
In this regard, as the personal liability of our Clients is purportedly being made out under Section 282J(1) of the Ordinance, it is essential to discuss the same at the first instance. The same is being reproduced below for ease of reference:

"282J(1) Penalty for failure, refusal to comply, with, or contravention of any provision of this Part. (1) Notwithstanding anything contained in any other provision of this Ordinance, if a NBFC or a notified entity, or its officers (including auditors) **fails or refuses to comply with, or contravenes any provision contained in this part or of any of the provisions of the rules or regulations made under section 282B or regulations, circular or directive or any direction or order passed by the Commission under the provisions contained in this Part** or knowingly and wilfully authorizes or permits such failure, refusal or contravention, shall, in addition to any other liability under this Ordinance, be also punishable with fine the amount the amount of which shall not exceed fifty million rupees;

Provided that if the failure, refusal, default, contravention is committed by NBFC or a notified entity, every director, manager, or other officer, or person responsible for the conduct of its affairs shall, unless he proves that the failure or contravention or default took place or committed without his knowledge, or that he exercised all diligence to prevent its commission, be deemed to be guilty of the offence. "

From a bare reading of Section 282J(1) of the Ordinance, it is evident that the same applies in respect of the contravention of any of the provision of the relevant Part of the Ordinance or contravention of any of the provisions of the rules or the regulations made under Section 282B or regulations, circular or directive or any direction or order passed by the Commission under the provisions contained in this Part of the Ordinance.

It is submitted that the AML & CFT Regulations and the Guidelines are neither incorporated nor notified under Section 282 B of the Ordinance. Hence, the provisions of Section 282J or the relevant Part of the



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Ordinance are not applicable per se. Consequently, invocation of the said provision of the Ordinance against our Clients is misconceived and illegal.

4) That, without prejudice to the above, it is a fundamental principle of jurisprudence that in order to substantiate or make out the commission of an offence attracting a punishment as contemplated in the Sections mentioned in the SCN, specifically Section 282J of the Ordinance, it is imperative that the requisite mens-rea has to be established. As such, the element of 'willful' default has to be demonstrated before any offence is made out. The word willful has been used in several enactments and has been judicially interpreted on numerous occasions. The Superior Courts have defined the term willful as "In the ordinary dictionary sense, it means the intentional or deliberate. The term, as used in different statutes and judicial precedents, means deliberate or intentional and not accidental or by inadvertence. It connotes a conscious act signifying something more than mere omission, default or inaction on the part of a person who is under a legal obligation to do or not to do a particular thing. In other words, an act done intentionally, knowingly or distinct from the one done carelessly, thoughtlessly, heedlessly or inadvertently". It is clear from the above definition that a person can only be punished under the Ordinance if he commits the default with the intention to do so. In the present case and from material available on record, it is evident that our Clients and/or the Company had no intention to contravene any of the provisions mentioned in the SCN. It is against the principles established by the Superior Courts to conclude, that too on a supposition, that our Clients were required to be well aware of their legal obligations under law, hence, they have violated the provision mentioned in the SCN knowingly and willfully.

5) That absolutely without prejudice to other grounds taken herein, the penalty provided under Section 282J of the Ordinance is only attracted provided the directors/officers of the company have 'knowingly and willfully' committed the default. In case the default by the directors/officers of the company is not committed knowingly and willfully, then the same may not entail any penalty and may be condoned. In the present case, in the absence of any 'knowing or willful' default on the part of Our Clients, they cannot be held liable for the penalty provided under the provisions mentioned in the SCN. Therefore, the penalty is liable to be condoned.....

7) Furthermore, by way of background it is also to be noted that an inspection of the Company was ordered by the Commission which culminated into passing of an alleged inspection order dated 02.08.2019. However, before passing of the said order neither any hearing was granted to the Company nor the same was shared with the Company.



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- 8) Pursuant to the same, the Company received the letter of findings dated 16 September 2019 (the "LOF") from Specialized Companies Division, Supervision & Enforcement Department, Securities and Exchange Commission of Pakistan which was duly replied by the Company through letter dated 30 September 2019.
- 9) After filing the reply to the LOF, neither any personal hearing on LOF was provided to the Company nor was any follow up in this regard made by the Commission. However, without offering any opportunity of hearing or explanation, the Commission initially issued the Previous SCN to the Company and now it has issued the SCN to our Clients on the same matter. The issuance of the SCN in such manner violates basic constitutional rights of the Company.
- 10) Without prejudice to aforesaid, the Company has already duly replied to all observations / findings stated in the LOF with all explanations and justifications and additionally stated in the Previous SCN. In light of the Company's reply to LOF and the Previous SCN, the matter stood closed as no communication was further made on the same with the Company.

REPLY ON MERITS

Without prejudice to the contents of the Preliminary Submissions/Objection above, our Clients' response to the observations stated in the SCN is as follows:

(a).....The Contents of Preliminary Submissions/ Objections are reiterated. Furthermore, the Company has already responded to the allegation of violation of Regulation 6(5a) of the AML & CFT Regulations in response to the Previous SCN. The insertion of Regulation 13(7) of the AML & CFT Regulations appears to be an afterthought and the same amounts to misuse of law. It is pointed out that the Regulation 6(3) (a) of the AML & CFT Regulations provides for the identification of the customer or beneficial owner and verification of the customer's/beneficial owner's identity. In light of the referred regulation, the Company has obtained identification documents in respect of all the customers/beneficial owners, data of all customers is screened against all lists of proscribed persons. Furthermore, for the verification of beneficiaries, the list of proscribed persons is also shared with all field area offices for verification. The record of beneficiaries is also maintained at the area office(s) of the Company. Furthermore, the Company employs, inter alia, social scrutiny measures to identify the risks of terrorism financing ("TF") and money laundering ("ML"). Moreover, the Company regularly screens the names of the proscribed persons to eliminate the risk of TF. Keeping in view the measure adopted by the Company, the risk of designated / proscribed persons obtaining financing facilities is negligible.



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In terms of Regulation 6(5a) of the AML & CFT Regulations, the same does not provide that the co-borrowers and nominees of borrowers (husband/brother) are to be considered as associates. Therefore, there is no violation of said provision by the Company.

Furthermore, the requirements of the Regulation 9(2)(a) of Non-Banking Finance Companies and Notified Entities Regulations, 2008 (the "NBFC & NE Regulations") are also fulfilled by the Company as the Company always determines the true identity of its customer. It is pointed out that the aforesaid Regulation defines the "customer" in following terms:

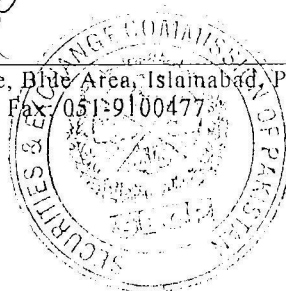
"For the purpose this regulation, customer means a person who has placed a Deposit with the Lending NBFC or has invested in the units or certificates of a Notified Entity or has obtained Finance from a Lending NBFC or has any business relationship with the NBFC or Notified Entity. Therefore, in terms of afore-quoted regulation, the Company is in compliance with the provisions of Regulation 9(2) (a) of NBFC & NE Regulations.

Without prejudice to the aforesaid, the Company, under instructions from the Commission, has completed the screening of the names of the beneficial owners against the proscribed persons list. Moreover, the details pertaining to the beneficial owners has already been incorporated in the MIS System.

b).....The contents of the Preliminary Submissions / Objections are reiterated. Furthermore, the Company has already responded to the aforesaid observation in response to the Previous SCN. The Company only forms a business relationship after reviewing the original CNICs of the customers and a copy of the said CNIC of the customer is placed in the record of the Company. The same was informed by the Company to the Commission in response to the Previous SCN and the issuing the SCN again on the same matter is unwarranted and unlawful.

Without prejudice to the aforesaid, it is submitted that the Company has entered into an Agreement with National Database and Registration Authority ("NADRA") in order to avail the services of NADRA Verisys. It is pertinent to mention here that NADRA has only entered into the aforesaid agreement with the Company after the Commission has requested NADRA to provide access to CNIC verification for various Non-Banking Microfinance Companies, including the Company. The said letter of the Commission is attached herewith as Annexure-A.

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(c).....The contents of the Preliminary Submissions / Objections are reiterated. Furthermore, the Company has already responded to the aforesaid observation in response to the Previous SCN. It is submitted that the AML & CFT Regulations does not provide for the criteria of rating the customers. The same appears to be determined by the regulated person. The Company has in place criteria for the customer due diligence which includes, inter alia, verification of customers through social scrutiny measures. Furthermore, the AML & CFT Regulations also provides that the where low risk is identified through adequate analysis of risk or where adequate checks and control exist, regulated person may apply simplified or reduced Customer Due Diligence. Furthermore, in respect to the aforementioned observation Regulation 9 of the AML & CFT Regulation is relevant, which is reproduced below:

"9. Enhanced Due Diligence (EDD).- (1) Regulated person shall implement appropriate internal risk management systems, policies, procedures and controls to determine if any customer presents high risk of ML/TF.

(2) For the purpose of sub-regulation (1), circumstances where a customer presents high risk of ML/TF include but are not limited to the following:-

(a) customers/policy holders belonging to countries which are non-compliant with anti-money laundering regulations according to FATF;

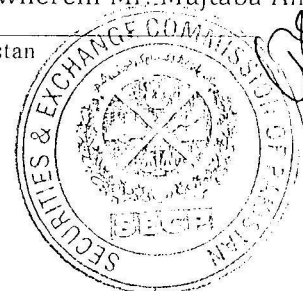
(b) such body corporate, partnerships, associations and legal arrangements including non-governmental organizations or not for profit organizations which receive donations; and

(c) legal persons or arrangements with complex ownership structure. "

It is submitted that in absence of any rating criteria the Regulation 9 appears to provide guidance in respect of customers which pose high risk. It is submitted that none of the customers of the Company falls within the list provided under Regulation 9(2) of the AML & CFT Regulations. Therefore, the risk classification of the Company's customers as low risk is justified and in accordance with law.

5. The hearing to the SCN addressed to the Company was initially scheduled on December 27, 2019, which was then rescheduled on January 02, 2020 on the request of the legal counsel representing AIM. However, on January 02, 2020 the legal counsel appeared before the adjudicating authority and requested to consult with his client and revert for further information and clarity, required in the matter. Subsequently, the hearing was re-fixed and it finally took place on January 07, 2020. Similarly, the hearing to the SCN addressed to the Respondents was scheduled for February 04, 2020. However, it was rescheduled for February 13, 2020 and subsequently for March 13, 2020 on the request of the counsel. It eventually took place on March 18, 2020 wherein Mr. Mujtaba Ali

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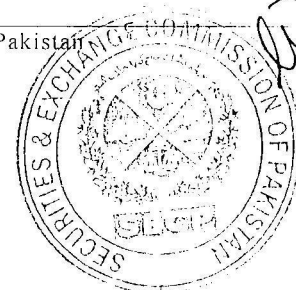
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Kazmi (Legal Representative of AIM) appeared on behalf of the CLM before the undersigned. The Legal Representative reiterated the facts stated in the written reply. The Respondent submitted that the Company had not contravened any provision of law as alleged in the SCN, and has always strived to abide by all the rules and regulations and all the instructions issued by the Commission from time to time. The legal counsel further mentioned that upon instructions of the Commission screening against the names of the proscribed person lists was completed and STRs were duly reported to Financial Monitoring Unit and the Commission. He further asserted that there was a lack of understanding of the AML Regulations, due to which only the immediate customer was being screened from the UNSCR and NACTA lists while the beneficial owners were being ignored. However, remedial work in that direction had already been initiated and the lists of proscribed persons were being disseminated to the field area offices for the verification of the beneficiaries.

6. I have examined the facts of the case, considered the written responses submitted along with documentary evidences placed on record and the arguments put forth by the Respondents. The following narrative examines the submission put forth by the Respondents in their written reply as well as verbal:

- a) In the preliminary objections, it has been pointed out, that the subject SCN is unwarranted and without any lawful authority. It is to be noted that the company is a legal person with its own specific and distinct rights and responsibilities. However, natural person(s) are required to steer the company and thus legal regulatory framework creates the scheme of BOD having its own rights and responsibilities distinct from that of the Company. The member of the BOD as individual directors of the Company have a fiduciary role clearly envisaged in the law. Accordingly, each person as member of the Board of Directors of the AIM has his/her own specific and distinct rights and responsibilities. These rights and responsibilities can further distinguish amongst each member of the BOD in line with additional roles they take on such as members of BOD committees etc. It is imperative to understand that the role and responsibilities of AIM and its BOD are neither overlapping nor interchangeable. The BOD is responsible to steer the company in such a way that in achieving its object the company operates within the applicable legal framework. The Directors do so by giving policies to the Company and by overseeing the implementation of these policies in their true spirit. In other words, the board makes the decisions.





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management carries them out, and subsequently the board is responsible for post implementation review. The company on the other hand is responsible to formulate and implement procedures to ensure implementation of the policies set by the Directors. The responsibilities of the Board of Directors and the Company are hence distinct in nature.

It is pertinent to mention that in the Show Cause Notice dated December 02, 2019 the Respondent was AIM, a legal person in its own right whereas in the Show Cause Notice dated January 21, 2020 the BOD i.e. the natural persons holding the fiduciary responsibility to steer the company. The proceedings conducted under the first SCN examined the role and responsibility and discharge thereof by the Company, and the hearing was limited to the Company only. Whereas, the second proceedings were initiated to examine the discharge of role and responsibility by the member of BOD of the Company. Hence, the action does not violate the principles of fairness and natural justice.

- b) Now, I would examine the argument submitted at para 4(3) above regarding the inapplicability of the provisions of Section 282J (1) of the Companies Ordinance 1984. Section 282B of the Companies Ordinance 1984 gives unambiguous powers to the Commission to make Regulations. For ease of reference Section 282B(2) is reproduced below:

*(2) The Commission may make **regulations**, for the establishment and regulation NBFCS and notified entities and their business and activities and such regulations may provide for any matter which the Commission deems fit for the effective regulation of NBFCS, and notified entities and their business and activities.*

- c) NBFC and NE Regulations 2008 have been made under Section 282B of the Companies Ordinance 1984. Regulation 9(1) contains a generic provision which makes it mandatory on the Company to **abide by such laws, directives and circulars as may be issued by the Federal Government or the Commission to safeguard the NBFC against involvement in money laundering activities.** Whereas, Regulation 9(2) without limit the generality of the Regulation 9(1) prescribe additional measures is more specific to the clients, as defined therein. It is incumbent upon the AIM abide by the AML Regulation issued by the Commission and its application is not limited or curtailed by the definition of client provided in the Regulation 9(2). So in terms of Regulation 9(1) of NBFC and NE





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Regulations 2008 AIM was bound to abide by the AML Regulations. By violating of AML Regulation, AIM has also violated Regulation 9(1) of NBFC and NE Regulations 2008. Accordingly, the enforceability of these regulations are invoked through Section 282J (1) of the Companies Ordinance 1984. Consequently, holding AIMs liable under the said provision of the Ordinance is within the legal parameters. Similarly, in the same para referred above, the argument submitted with regards to 'willful default has to be demonstrated before any offence is made out....." . I am of the view that it is incumbent on both the Company and the BOD to keep themselves abreast of the applicable legal and regulatory framework and ensure that the mandatory provisions are implemented in letter and spirit. The argument regarding mens-rea is without any lawful justification and contrary to the facts available on record.

- d) I have noted that AIM in its reply dated September 30, 2019 to the letter of findings issued by the Supervision and Enforcement Department of Specialized Companies Division, in context of violation of Regulation 6(3) (a) of the AML Regulations, has mentioned, *"The quoted regulation clearly specifies to scan either borrower or beneficiary. It is not required to scan both borrower and beneficiary separately."* The said Regulation has to be read in context. One of the foremost aims of the AML/CFT framework is to ensure the regulated person is not and should not be used as a vehicle of terror financing. Regulation 6(3)(a) requires scanning of all persons linked with the loan whether as a borrower or a beneficiary to that a proscribed individual is not financed. The statement of AIM indicates that the Regulation was misinterpreted by the company since the Regulation stipulates *"identifying the customer or beneficial owner and verifying the customer's beneficial owner's identity on the basis of documents....."*, meaning thereby that AIM has to identify the beneficial owner if he is other than the customer himself/herself.
- e) Moreover, the argument furnished by the legal counsel during the course of hearing and in the written reply, that upon instructions of the Commission screening against the names of the proscribed person lists was completed and the STRs were reported to Financial Monitoring Unit and the Commission, is not plausible. It is pertinent to mention that AIM is mentioning this in the backdrop of the email dated 19 July 2019 received from SECP's AML Department, which instructed the entities to scan their customer database for any matches with the specific lists of designated/proscribed persons, which were

NIC Building, 63-Jinnah Avenue, Blue Area, Islamabad, Pakistan
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attached with the email. Compliance with the subject regulation was not conditional upon receipt of emails/instructions from SECP since Regulation 6(5a) of the AML and CFT Regulations, clearly requires to refrain from forming business relationships with individuals that are proscribed under the Anti-Terrorism Act, 1997 and associates/facilitators of those person. The fact that even after positive identification of thirty-one (31) customers against the list of proscribed persons in the second half of year 2019 the Respondents did comprehend the risk they were carrying by not complying with requirements laid out in the AML Regulations. Had the realization set in, the Respondent would not have waited for the inspection findings and the resultant SCN to put in place remedial measure.

- f) The argument furnished in the reply dated March 18, 2020 that *"In terms of Regulation 6(5a) of the AML & CFT Regulations, the same does not provide that the co-borrowers and nominees of borrowers (husband/brother) are to be considered as associates. Therefore, there is no violation of said provision by the Company"* is not plausible. The wordings of the Regulations, use of generic terms such as associates and facilitators and the fact that these have not been defined to limit their scope is intentional rather than an oversight on part of the Regulator. Such drastic measures are in order in face of existential threat faced due to deep penetration of terror mongers in our society. The Regulator expects that the regulated entities go an extra mile to ensure that menace of terror financing is not further fed but is strangulated by drying all the financing channels and indicates that AIM could not grasp the implication of the subject Regulation. In my considered view AIM had failed to realize that screening was supposed to be a comprehensive and ongoing exercise to be carried out by the Company at all times and not dependent upon the instructions from the Regulator. It is also important to highlight AIM's argument as given at para 4(ii) above *"the Company is not in violation of this provision"*, is self-contradictory since AIM has admitted that only after instructions from the Commission had it started screening the names of the beneficial owners against the proscribed persons lists. Nevertheless, I have noted in the reply dated March 18, 2020 that AIM has stated that it has completed the screening of the names of the beneficial owners against the proscribed persons list and has incorporated the details pertaining to the beneficial owners in the MIS System.



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- g) The Regulation 6(4), Annexure I of the AML and CFT Regulations clearly states that CNICs of all customers should be verified through NADRA Verisys. AIM had only obtained the CNICs of its customers and not their beneficial owners. AIM declared that NADRA Verisys of CNICs was not being conducted due to the reason that incorporating the verisys system in the structure involved substantial cost. AIM mentioned that the matter has been taken up by Pakistan Microfinance Network ("PMN") on behalf of the micro finance sector with the SECP. Moreover, I have noted that it is submitted in the reply dated March 18, 2020 that the Company has entered into an Agreement with National Database and Registration Authority ("NADRA") in order to avail the services of NADRA Verisys.
- h) The argument of AIM that it has obtained requisite identification documents in respect of all the customers as per the requirement, strongly indicates that the Company was not carrying out adequate customer due diligence (CDD), in contravention of Regulation 6(3)(a) of the AML & CFT Regulations. The due diligence carried out by AIM is oriented to cover the business risks. AML Regulation expects companies to seamlessly incorporate such CDD policies and procedures so as to enable it to effectively mitigate AML/CFT risks. The laxity displayed by the Respondents in ensuring the compliance with the screening requirements, be it the ensuring completeness of the database or screening the same against the various proscribed list is a matter of serious concern. The Respondents need to sensitize themselves to the importance of the adopting AML/CFT measures. The Regulators expects complete compliance of the AML Regulations and has adopted a zero tolerance for any violation in this respect. The fact the AML/TF activities pose a huge threat to the economy of the country and it is imperative on every constituent of the economy to act responsibly and fully apprehend the perform their mandatory obligations. The submission vide reply dated January 7, 2020,(Para 4(i) and (iv) above) that *"the Company has, under instructions from the Commission, started screening the names of the beneficial owners against the proscribed persons lists. The said screening is expected to be completed by 20 February 2020. Moreover, the details pertaining to the beneficial owners are being incorporated in the MIS System."* Does not depict the level of understanding and responsiveness on part of the Respondents.





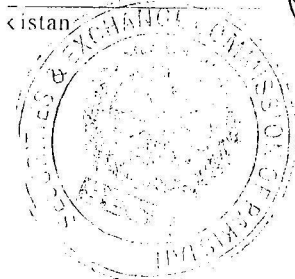
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- i) The argument of AIM in regards to non-compliance with Regulation 6(8) of the AML Regulations is acceptable to the extent that the AML & CFT Regulations do not provide for the criteria of rating the customers and the same has to be determined by the regulated person depending upon the outcome of the CDD process. However, guidance in this regard is available in form of National Risk Assessment (NRA) regarding AML, FAQs on AML. The Respondents do not have the choice to assume that each of its customer is low risk without duly carrying out the risk assessment. During the hearing, AIM put forth an argument that all its customers were considered/categorized as low risk, since micro loans were being disbursed to small households for small businesses, which in my considered view is not plausible. Risk Based Approach means that financial institutions identify, assess, and understand the money laundering and terrorist financing risks to which the financial institution is exposed. AIM cannot categorize its customers as low risk merely on the basis of the size of the loan.
- j) I am of the firm view that the failure of AIM to match the CNICs of beneficial owners of AIM's microfinance borrowers with NAC/FA list of proscribed persons is considered as a serious oversight. Moreover, the argument furnished by the legal counsel during the course of hearing and in the written reply, that upon instructions of the Commission screening against the names of the proscribed person lists was completed and the STRs were reported to Financial Monitoring Unit and the Commission, is not plausible. It is pertinent to mention that AIM is mentioning this in the backdrop of the email dated 19 July 2019 received from SECP's AML Department, which instructed the entities to scan their customer database for any matches with the specific lists of designated/proscribed persons, which were attached with the email. Compliance with the subject regulation was not conditional upon receipt of emails/instructions from SECP since Regulation 6(5a) of the AML and CFT Regulations, clearly requires to refrain from forming business relationships with individuals that are proscribed under the Anti-Terrorism Act, 1997 and associates/ facilitators of those person.
- k) The argument furnished in the reply dated March 18, 2020 that *in terms of Regulation 6(5a) of the AML & CFT Regulations, the same does not provide that the co-borrowers and nominees of borrowers (husband/brother) are to be considered as associates. Therefore,*



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there is no violation of said provision by the Company” is not plausible. The wordings of the Regulations, use of generic terms such as associates and facilitators and the fact that these have not been defined to limit their scope is intentional rather than an oversight on part of the Regulator. Such drastic measures are in order in face of the existential threat faced due to deep penetration of terror mongers in our society. The Regulator expects that the regulated entities go an extra mile to ensure that menace of terror financing is not further fed but is strangulated by drying all the financing channels. and indicates that AIM could not grasp the implication of the subject Regulation. It would have been feasible for AIM to seek clarification from SECP by correspondence in the matter rather than violating the law. In my considered view AIM had failed to realize that screening was supposed to be a comprehensive and ongoing exercise to be carried out by the Company at all times and not dependent upon the instructions from the Regulator. It is also important to highlight AIM’s argument as given at para 4(ii) above” *the Company is not in violation of this provision*”, is self-contradictory since AIM has admitted that only after instructions from the Commission had it started screening the names of the beneficial owners against the proscribed persons lists. Nevertheless, I have noted in the reply dated March 18, 2020 that AIM has stated that it has completed the screening of the names of the beneficial owners against the proscribed persons list and has incorporated the details pertaining to the beneficial owners in the MIS System.

- l) The argument that *“the insertion of Regulation 13(7) of the AML & CFT Regulations appears to be an afterthought and the same amounts to misuse of law”* is refuted. The AML and CFT Regulations, 2018 were applicable immediately after their issuance in June 2018 and warranted that AIM initiate the process of verification of customers /beneficial owners, at its earliest and monitor the business relation with them on an ongoing basis in terms of Regulation 13(7). Failure to do so thus exhibits weakness on part of both the management for not implementing the AML and CFT Regulations adequately and the BoD for not ensuring implementation of the same.
- m) It is a matter of grave concern that the Board of directors did not play their due role or applied their knowledge in the matter pertaining to compliance with AML related obligations, which resulted in default or non-compliance as stated in the SCN. The Board needs to stay informed of how the organization is being managed to protect its legal

NIC Building, 63-Jinnah Avenue, Blue Area, Islamabad, Pakistan
Ph: 051-9207091, Fax: 051-9100477



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responsibilities at the same time the board should maintain the balance and be careful not cross over into performing management duties. However, the Respondents could not furnish any evidence regarding efforts to perform oversight of the policy implementation. I am of the considered view that the Respondents on their part had a fiduciary responsibility for oversight of AIM, to ensure compliance of the mandatory legal framework. This indicates laxity on part of the BOD towards their responsibilities.

7. In view of the aforesaid it is my considered view that AIM prior to inspection and the proceedings at hand did not comprehend the gravity of issues being addressed by the AML/CFT regime. Their approach towards screening of their customers focused more on the business risk. The laxity shown by the Respondent has exposed it to breach of mandatory provision and which is liable to penalty. However, I have observed that the Respondent has been very responsive and forthcoming in efforts to rectify the deficiencies observed in the inspection, after the same were brought to its' notice.

8. Based on my observations above, non-compliance of AML and CFT Regulation 6(4), Regulation 6(5a) read with Regulation 6(3)(a) and Regulation 13(7), and Regulation 6(8) is established. However, non-compliances are mitigated to some extent by the remedial actions taken by the respondent. I hereby conclude the proceedings initiated under section 40A of the SECP Act, 1997 and Section 282J(1) read with Section 282M(1) of the Companies Ordinance, 1984, by imposing an aggregate fine of Rs 2,500,000/- (Rupees two million five hundred thousand only) on the AIM. Furthermore, the BOD is hereby strictly warned to enhance its oversight regarding the implementation of AML/CFT policies and ensure that the Company and its employees are sensitized to importance of compliance with AML/CFT Regulatory Regime. The BOD is further, directed to undertake a comprehensive review of the AML/CFT policies and procedure to align the same the regulatory requirements within 3 months of the date of this order. I also hereby direct the AIM to report within 3 months of the date of this order and provide documentary evidence to SCD Supervision & Enforcement Department that:

- screening of all clients, their associates, facilitators and beneficial owners has been completed; and
- risk based categorization of all the clients has been completed.



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I am well aware of the exceptional role that the Respondents are playing for poverty alleviation and self-empowerment in Pakistan. The penalty imposed should not be construed as to undermine these efforts. However, as a regulator SECP is committed itself to be on the forefront to fight the AML/TF. The magnitude risk that AML/TF pose to Pakistan's economy cannot be overstated. The Respondent as responsible constituent of the micro finance sector are expected to play their part in the cause to fight this menace.

9. The aforesaid fine must be deposited by AIM in the designated bank account maintained with MCB Bank Limited in the name of SECP within **30 days** from the receipt of the order. The receipt or bank challan is to be furnished to SECP. In case of non-deposit of penalty within the given time, proceedings for recovery of the fine as arrears will be initiated.

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



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

Announced on:
April 21, 2020 Islamabad.

