



Securities and Exchange Commission of Pakistan  
Adjudication Division

Through Courier

Before the Commissioner (SMD)

In the matter of Show Cause Notice issued to First Equity Modaraba

Date of Hearing

December 04, 2019

Present at the Hearing

i. Mr. Adil A. Ghaffar  
(Chief Executive)

Representing M/s. First Equity Modaraba

ii. Mr. Qazi Obaid Ullah  
(Chief Financial Officer)

**ORDER**

This Order shall dispose of the proceedings initiated against First Equity Modaraba (the “Respondent”) through Show Cause Notice No. 1(174) SMD/ADJ/KHI/2019, dated October 25, 2019 (the “SCN”) issued under Section 40A of the Securities and Exchange Commission of Pakistan Act 1997 (the “Act”) and Section 150 of the Securities Act, 2015 (“Securities Act”)

2. Brief facts of the case are as follows:

- (a) The Respondent is a Trading Rights Entitlement Certificate (TREC) holder of the Pakistan Stock Exchange Limited (the “PSX”) and licensed as a securities broker under the Securities Act, 2015.
- (b) Thematic review (the “Review”) of the Respondent was conducted by 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”). Subsequently, findings of the Review were shared with the respondent vide letter dated July 13, 2019. The Respondent’s reply was received vide letter dated July 22, 2019.

3. The findings of the aforesaid Review indicated that, the Respondent had, *prima facie* acted in contravention of the AML Regulations & Licensing Regulations. The Commission therefore took cognizance of the aforesaid violations, issued SCN dated October 25, 2019 to the Respondent.) The allegations against the Respondents are detailed as under:

- a. Following deficiencies were noted in the AML/CFT Policy of the Respondent:
- Enhanced Due Diligence
  - Employees training

The above reflects that the Respondent was noncompliant with Regulation 4(a), 9(4), 18(c)(iii) and 20(b) of AML Regulations.





**Securities and Exchange Commission of Pakistan**  
**Adjudication Division**

- b. The compliance reports of the Respondent were reviewed by the Head of Internal Audit and submitted to Chief Executive Officer in contravention of Regulation 18 of AML Regulations that requires a regulated person to have an independent compliance function with direct reporting to the Board of Directors. Further, it had not prepared and shared monthly compliance reports in contravention of Regulation 29(5) of Securities Brokers (Licensing and Operations) Regulations, 2016 (the "**Licensing Regulations**").
- c. The internal audit report has been submitted to the Chief Executive Officer, in addition to the Audit Committee of the Respondent, and does not cover the aspects detailed in clause 15(a) of the AML/CFT Guidelines that reflects that the Respondent had not developed an effective independent audit function in violation of Regulation 4(d) of AML Regulations and Regulation 16(9)(e) of Licensing Regulations
- d. The Respondent had failed to perform Enhanced Due Diligence (the "EDD") of three (3) of its clients that were categorized as high risk in violation of Regulation 9 of AML Regulations that requires that Regulated person shall perform appropriate EDD measures with customers that are identified as high risk by the regulated person.
4. The Respondent vide its letter dated December 04, 2019 submitted reply to the SCN, which is reproduced below:

**"Point 3(a) of the SCN:**

*It is respectfully denied that FEM has not updated its AML/K.YC Policy. FEM has been continuously updating its policies to meet the requirements of AML Regulations and the ECP Guidelines made thereunder as and when updated by the SECP. FEM got its AML/KYC policies duly approved by its Board of Director and kept updated as required under the AML Regulations and the SECP Guidelines and further also Pakistan National Risk Assessment.*

*Further, please note that FEM has developed and implemented its policies, procedures and controls, which are approved by its Board of Directors to enable the FEM to effectively manage and mitigate the risk that are identified in the risk assessment of ML/TF or notified to it by the Commission. Our replies to the observations highlighted by the Commission are given below:*

<b>Observation</b>	<b>FEM Responses</b>
<i>Enhanced Due Diligence not incorporated in the Policies</i>	<i>EDD identification and procedure were and are adopted in the Policy and Procedures. EDD measures have been incorporated and adopted in the policy of risk management, monitoring, etc. Please refer to Clause 9.1 of the old policy, wherein it was written as mention above. However, we do not wish to debate in the generality of the policies adopted and therefore, as an abundant precaution updated our policy in line with suggestions.</i>
<i>Employees Training</i>	<i>We respectfully denied that FEM had not arranged staff training on AML/CFT regime. Head of Internal Audit and Compliance Officer have been attending all training sessions pertaining to AML/CFT conducted by SECP, PSX and Modaraba Association.</i>



**Securities and Exchange Commission of Pakistan**  
Adjudication Division

Please refer to FEM old Policy no 2 which clearly spell the need and requirement of the training of the staff Furthermore, the Head of Internal Audit and the Compliance Officer are continuously attending training session pertaining to the AML & CFT and checking the internationally adopted policies and procedures relating effective monitoring of money laundering and terrorist financing by the criminals.

Even the Chief Financial Officer attended the PNRA training session. In-house presentation on PNRA was also given to the relevant staff. Furthermore, as per the Policy and Procedure "training will be provided once in a year or as and when required or where there are changes in the relevant laws.

The dilemma is that none of them provide the certificate of attendance, for which we have requested many times. In house training of the staff pertaining to the AML, KYC, CFT and PNRA are conducted.

**Point 3(b) of the SCN:**

FEM is a listed company and adopted Code of Corporate Governance (CCG), which requires that Head of Internal Audit ("HIA") will report to Audit Committee of the Board. The Compliance Officer has been appointed for brokerage business and transaction including continuous monitoring of AML/CFT requirements as defined in the AML Regulations and the SECP Guidelines.

Normally the Board meetings and Audit Committee meetings are held on quarterly basis, which are also mandatory under CCG. All findings of the Compliance Officer and HIA are used in details by Audit Committee and the Board in their respective meetings. As per instruction of the Board, all major findings are rectified within the targeted time.

HIA operationally and administratively report to the management of FEM and functionally to the Board Audit Committee.

Therefore, it is respectfully denied that same functions were performed by two individuals interdependently. The Compliance Officer (CO) have commenced submitting monthly report to HIA and Audit Committee of the Board of Director. Presently Board of Directors consist of 4 directors including the CEO, whereas the audit committee have three excluding the CEO. Although, the Regulation allows the Compliance Officer can report to equivalent executive position and it is deemed that CEO is the executive position but the CO report to the Board Audit Committee. For any non-compliance reported by CO, the Audit Committee will refer the matter accordingly.

FEM, the internal audit and Compliance are continuous process and all the transaction are monitor at different level and authority to bring up unusual transaction. However, we do not wish to debate in the generality of the policies adopted and therefore, as an abundant precaution updated our policy in line with suggestion

**Point 3(C) of the SCN:**

It is respectfully denied that as FEM is a listed company, which is mandatorily required to opt CCG. As CCG requirement, FEM requires to have Head internal Audit with specific qualification and experience.

Therefore, FEM have duly qualified Head of Internal Audit who reports to the Audit Committee of the Board as required under CCG. A comprehensive Audit Reports with audit findings are discussed in the Audit Committee then with the Board with recommendations of the Audit Committee on





## Securities and Exchange Commission of Pakistan Adjudication Division

quarterly basis. Therefore, we respectfully submit that Commission's finding relating to non-compliance of regulations 4(d) of AML Regulations and clause 16(9)(e) of the Licensing Regulations might be misunderstood and misinterpreted. However, we do not wish to debate in the generality of the policies adopted and therefore, as an abundant precaution updated our policy in line with suggestion The TOR of HIA has been revised so that it should specifically mention the KYC/CFT matters.

The HIA administratively report to the CEO and functionally to Internal Audit Committee of Board of Directors. Merely on the basis of reporting structure, concluding that the HIA is not independent and effective audit function does not exist is incorrect.

### **Point 3(d) of the SCN:**

It is humbly submitted that our Policy and Procedures duly cover the evaluation and monitoring of clients' sources of funds, wealth, beneficiary ownership, etc. FEM has reported only 3 High Risk Clients and that too not on the basis of KYC due diligence but due to their default in trade settlement, so that the Commission can report them as high risk. Furthermore, their last trade was executed more than a decade back and that time such Regulations did not exist and their accounts are blocked not only at our BackOffice but at CDC also.

from those 3 High Risk Clients, none of the current active clients are categorized as High Risk. Therefore, in contrary to allegation leveled in the SCN, we have detailed procedures for performing EDD for all active clients based on which their risk categorizations "

5. The Respondent was accorded hearing opportunity on December 04, 2019. The hearing was attended by Mr. Adil A. Ghaffar (Chief Executive) & Mr. Qazi Ubaid Ullah (Chief Financial Officer) as Authorized Representatives. During the hearing proceedings, the Authorized Representatives reiterated the argument as submitted in response to the SCN.

6. I have examined the submissions of the Respondent and its Representatives. In this regard, I observe that:

(a) With regard to the deficiencies in AML/CFT Policy, the Respondent denied the allegation and provided that the two points as highlighted in the SCN were adequately addressed in their earlier policy which was also shared with the Commission. The need for Enhanced Due Diligence and employee trainings and controls and procedures thereof, were previously provided in Para 9.1 & 20 of the Respondent's AML/CFT Policy respectively. The viewpoint of the Respondent in this regard is tenable hence, it cannot be held accountable in the matter.

(b) With regard to the reporting of Compliance Officer to CEO and/ or head of internal audit/committee in contravention with the AML Regulations, it may be noted that Regulation 18 (a) of the AML Regulations provides room for the reporting of compliance function to Board of Directors or to another equivalent position or committee therefore, the Respondent cannot be held accountable in the matter. However, it was observed that monthly compliance reports were not being prepared by the compliance officer and no evidence in this regard was provided by the



**Securities and Exchange Commission of Pakistan**  
**Adjudication Division**

Respondent. Therefore, in absence of monthly compliance report, the Respondent was found non-compliant with Regulation 29(5) of the Licensing Regulations.

(c) With regard to observation regarding the independence of audit function, the Respondent provided that the effectiveness and independence of the audit function may not be questioned merely due to the reporting structure as the head of internal audit administratively report to the Chief Executive and functionally to the internal audit committee. The reply of the Respondent to this extent is tenable. However, it was observed that the internal audit report did not include independent assessment of its AML/CFT systems rather it relied on the observations made by the compliance officer and did not cover detailed aspects of AML/CFT as provided in the AML Guidelines. Therefore, the Respondent was found non-compliant with Regulation 4(d) of the AML Regulations & 16(9)(e) of the Licensing Regulations.

(d) With regard to the observation regarding the EDD of 3 high risk clients, the Respondent submitted that it had reported only 3 high risk clients on the basis of default on trade settlement and not on the issue of KYC/CDD. The Respondent further provided that last trade in these accounts was carried out more than a decade ago and currently these accounts have been marked as blocked not only in their back-office system but at CDC also. The Respondent's reply in this regard is tenable hence, it cannot be held accountable in the matter of violation of Regulation 9 of the AML Regulations.

7. In view of the foregoing and admission made by the Representatives, contraventions of the provisions of AML Regulations & Licensing Regulations have been established. Therefore, in terms of powers conferred under section 40A of the Act, a penalty of **Rs. 200,000/- (Rupees Two hundred thousand only)** is hereby imposed on the Respondent. Further, in terms of powers conferred under section 150 of the Securities Act 2015, a penalty of **Rs. 50,000- (Rupees Fifty thousand only)** is also imposed on the Respondent. The Respondent is directed to deposit the aforesaid penalty in the account of the Commission being maintained in the designated branches of MCB Bank Limited within 30 days of date this Order and furnish the original deposit challan to this Office.

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



(Shauzab Ali)  
Commissioner (SMD)

**Announced on April 24, 2020**  
Islamabad