



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
ADJUDICATION DEPARTMENT I
ADJUDICATION DIVISION

Through Courier

Before the Executive Director (Adj-I)

In the matter of Show Cause Notice under Section 282J (1) read with Section 282M (1) of the Companies Ordinance, 1984 for violations of Rule 7(1)(g) of the NBFC (Establishment and Regulation) Rules 2003 and Section 40A of the Securities and Exchange Commission of Pakistan Act, 1997 for violations of inter-alia, Regulation 6(4), Regulation 6(5a) read with Regulation 6(3)(a), Regulation 6(8) and Regulation 13(7) of the Securities and Exchange Commission of Pakistan (Anti-Money Laundering and Countering Financing of Terrorism) Regulations, 2018.

Date of hearing:

December 20, 2019

Present (on behalf of Kashf Foundation)

- i. Ms. Shehla Sattar, Chief Risk Officer*
- ii. Ms. Saira Soofi, Legal Head/ Company Secretary*

ORDER

This Order shall dispose of proceedings against Kashf Foundation (“KF”, the “Company”), an NBFC licensed to undertake investment finance services to perform micro financing business, initiated through Show Cause Notice (the “SCN”) bearing No. SCD/ADJ/KF/68/2019/ dated November 28, 2019 under Section 40A of the Securities and Exchange Commission of Pakistan Act, 1997 and Section 282J (1) read with Section 282M (1) of the Companies Ordinance, 1984 (the “Ordinance”).

2. An inspection of KASHF Foundation was ordered under powers conferred upon Securities and Exchange Commission of Pakistan under Section 282I of the Companies Ordinance, 1984 vide inspection order bearing number SCD/S&ED/KF/2019/26 dated October 11, 2019. The scope of the inspection comprised ensuring compliance with the Securities and Exchange Commission of Pakistan (Anti Money Laundering and Countering Financing of Terrorism) Regulations 2018 (hereinafter referred to as the AML and CFT Regulations) and relevant regulatory framework.

3. During the course of inspection, various violations/non-compliances were observed. The inspection team indicated instances where violation of Regulation 6 (4), Regulation 6 (5a) read with Regulation 6 (3) (a), Regulation 6(8), and Regulation 13 (7) of AML and CFT Regulations and violations of Rule 7(1)(g) of the NBFC (Establishment and Regulation) Rules 2003 were observed.

4. The Company through Show cause notice dated November 29, 2019 (“SCN”) was called upon to show cause in writing as to why penal action should not be taken against the Company, under Section 40A

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of the Securities and Exchange Commission of Pakistan Act, 1997 for the aforementioned violations of Regulation 6 (4), Regulation 6 (5a) read with Regulation 6 (3) (a) and Regulation 13 (7) and Regulation 6(8) of AML and CFT Regulations and under Section 282J (1) read with Section 282M (1) of the Companies Ordinance, 1984 for violations of Rule 7(1)(g) of the NBFC (Establishment and Regulation) Rules 2003.

5. The inspection team highlighted some observations which constituted violation of several provisions of AML and CFT Regulations 2018. The inspection team indicated the following instances where violation of Regulation 6 (4), Regulation 6 (5a) read with Regulation 6 (3) (a) Regulation 6(8) and Regulation 13 (7) of AML and CFT Regulations were observed, which are being elaborated to indicate the nature of violations;

- (i) It was observed through screening of entity's database that in eight instances, the CNICs of co-borrowers of KF's microfinance borrowers or nominees of borrowers matched with NACTA list of proscribed persons. All these loans were granted to women borrowers and the proscribed persons were either the brother or husband of the borrower and were declared in the application forms as co-borrowers or nominees.
- (ii) The inspection team noted that out of eight loan cases, the proscribed person was the person running the business (user of funds) in five cases, in two cases the proscribed person was the co-borrower while in one case, the proscribed person was declared as a nominee.
- (iii) In terms of sub-regulation 5a of Regulation 6 of the AML and CFT Regulations, KF was required to refrain from forming business relationships with individuals that were proscribed under the Anti-Terrorism Act, 1997 and associates/ facilitators of those persons. In this instance, the co-borrowers and nominees of borrowers (husband/ brother) were considered associates.
- (iv) In this regard, KF had also violated Regulation 6(3)(a) of the AML and CFT Regulations, which stipulates the requirement of customer due diligence (CDD), i.e., 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.
- (v) Further in terms of regulation 13 (7) of the AML and CFT Regulations, KF was required to monitor its relationships with the entities/individuals mentioned in sub-regulation (5a) of regulation 6, on a continuous basis. KF was required to ensure that no such relationship existed directly or indirectly, through ultimate control of an account and where any such relationship was found, it was required to take immediate action as per the Commission's





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freezing the funds and assets of such proscribed entity/individual and reporting to the Commission.

- (vi) Prior to onsite inspection, KF informed vide email dated August 30, 2019 that it had screened its customer database against the list of proscribed persons and no matches were found. Nevertheless, contrary to this statement, the inspection team found matches with proscribed persons in KF's database, indicating the KF's screening system was not working effectively.
- (vii) During the course of inspection, it was also observed that KF did not have the facility of NADRA Verisys for verification of CNICs, hence CNICs of customers was not being verified through NADRA. In this regard, Regulation 6(4), Annexure I (i) of the AML and CFT Regulations requires that CNICs of all customers should be verified through NADRA Verisys.
- (viii) There was no evidence that KF had assessed the AML/CFT risk of customers during CDD process to categorize them among high and low risk, depending upon the outcome of the CDD process, as required in terms of Regulation 6(8) of the AML and CFT Regulations.

6. A written reply was received vide letter dated December 06, 2019 from the Company, wherein the contentions made in the SCN were replied. The following arguments were provided in the reply;

i. Names of borrowers/ Co borrowers of KF were appearing in the NACTA list of proscribed persons:

The inspection team during the course of its onsite inspection highlighted certain observations which KF needed to look into under the relevant provisions of law and in pursuance thereof also issued a letter of findings dated November 06, 2019 to KF in which it noted down its findings. KF vide its reply dated November 14, 2019, addressed all the observations affirmatively raised in the letter of findings. KF stated that in terms of Regulation 6(3)(a) and 6(5a), the Suspicious Transaction Report ("STR) of the eight individuals whose CNICs appeared to have matched with the NACTA list was filed on November 8, 2019 and vide email dated November 8, 2019 the STR numbers were also shared with the inspection team.

ii. Non screening of Associates / facilitators:

While responding to violation of Regulation 6(5a) and 6(3)(a) KF emphasized that on basis of lack of clarity and ambiguity present in the understanding of the term 'associates/facilitators' as the definition of associates/ facilitators has not been provided in the AML / CFT Regulations, 2018, KF was not able to detect the proscribed persons. KF asserted that the definition of associates/facilitators' has not been





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given under the AML/CFT Regulations, 2018. However, as and when the same was made clear by the inspection team, KF filed their STRs. KF also stated that it had also tagged the said persons in its customer database to guarantee that no future loan is issued to these persons and has also written loan recall letters to the said individuals to return the loan on immediate basis.

iii. Non verification through NADRA Verisys:

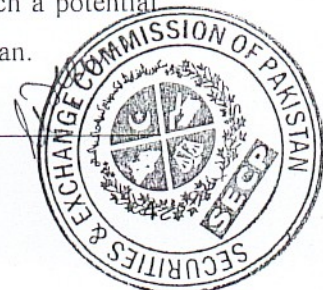
KF also stated that in terms of Regulation 6 (4) of the AML/CFT Regulations, the CNICs of all the clients have been obtained. However, with respect to verifying the copies with the NADRA verisys, it is a matter, which is currently outstanding. This matter has been taken up by Pakistan Microfinance Network ("PMN") on behalf of the micro finance sector with the SECP as incorporating the verisys system in the structure involves substantial cost. As soon as clarity is received from SECP in terms of either an exemption to be given to section 42/MFI's companies on this condition or a reduced cost be given to section 42/MFI, KF intends to move forward accordingly and integrate the verisys system in its structure.

iv. Customer Due Diligence:

KF further emphasized that in terms of Regulation 6(8) of the AML/CFT Regulations, KF is a microfinance organization and gives micro-credit loans to individuals to support small businesses. KF has a strong due diligence criteria, which it follows diligently before giving loan to any individual. The business development officers of KF go from door to door to potential customers houses for verification before disbursement. The system does not allow disbursement if any of the following circumstances exist:

- a. Potential client or her husband/father does not have valid original CNIC
- b. Potential client is unable to show evidence of permanent residence
- c. Potential client is unable to show evidence for businesses for which credit is required
- d. Potential client is found in client exclusion list of KF
- e. Potential client business falls under business exclusion list of KF
- f. Potential client is a defaulter according to data falling under Credit Information Bureau
- g. Potential client name/CNIC found in NACTA or UNSCR list

KF affirmed that if during the due diligence process a potential client falls under any of the above risk category than KF as per its policy refrains from disbursing its micro-credit loans to such a potential client. Additionally, the clients are categorized on the basis of repayment pattern of the loan.





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v. Ongoing Monitoring:

In terms of Regulation 13(7) of the AML/CFT Regulations, KF stated that loan officers carry out a detailed business assessment of a potential/existing client during client loan application filling process. After the initial assessment by the loan officer, the KF branch manager then performs a physical screening of the residence and business place of the potential/existing client and after satisfactory verification then approves the loan. There are several monitoring circuits and multiple checks for the loan officers, branch managers, area managers and regional managers of KF. Furthermore, there are separate quarterly and annual visits from the Compliance and the Internal Audit departments of KF to independently assess the client verification and business authenticity. If during any of the monitoring visits, it is assessed and concluded that the loan was not utilized for the intended purposes for which it was availed, such clients are tagged in the KF system and are not disbursed further loan, until satisfactory response is received from the client.

vi. KF envisaged that the allegations that were raised in the letter of findings were rectified by immediately taking the following measures;

- tagging the individuals whose names and CNICs appeared in the NACTA list
- ensuring that any further disbursements to said individuals were restricted and disallowed
- recalling the loans from such persons
- reviewing its AML/CFT policy to strengthen and intensify its processes and procedures and keep it safeguarded and secured against any accidental and inadvertent lapse in the future.

7. KF pleaded that the lapses were completely unintended and was an inadvertent oversight, which now stands corrected.

8. The hearing in the matter took place on December 20, 2019 wherein Ms. Shehla Sattar, Chief Risk Officer and Ms. Saira Soofi, Legal Head/ Company Secretary appeared on behalf of the Company before the undersigned. They reiterated the facts stated in the written reply. The Respondents further submitted that KF did not disagree with the allegations made in the show cause notice. However, the Company fully realized that it had not been completely compliant with the AML and CFT Regulations, 2018 and was making its best possible effort to expedite remedial work in that direction. KF 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, and therefore the co-borrowers/nominees went undetected.





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KF further emphasized that there was no malafide intention and reiterated that Kashf Foundation is a mission oriented organization, aiming at poverty alleviation of Pakistan through social and economic empowerment of women and strictly believes that it can only achieve its vision and mission in letter and spirit by complete conformity and adherence to all the applicable laws, rules and regulations.

9. 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 Respondent Company, I am of the view that the arguments submitted by KF do not justify as a reason for their non-compliance with the AML related obligations on the following grounds;

a. Regulation 6(5 a) 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 persons. The argument of KF that it had ambiguity about the term associates / facilitators in AML Regulations does not hold merit, as if it had any such ambiguity it should have taken up this with SECP at the time when AML regulations were issued for public comments in April 2018 and thereafter finally published in June 2018, rather than violating the law by allowing business relation with proscribed persons. Therefore, KF failed to consider the co-borrowers and nominees of borrowers (husband/ brother) as associates. Due to this lapse, KF failed to match the CNICs of co-borrowers and nominees of KF's microfinance borrowers with NACTA list of proscribed persons, which is considered as a serious oversight.

b. KF did not identify the customer and the beneficial owner and verify 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, thus violating Regulation 6(3) of the AML and CFT Regulations. Due to this negligence, KF failed to determine that the proscribed person was the person running the business (user of funds) in five cases, in two cases the proscribed person was the co-borrower while in one case, the proscribed person was declared as a nominee. Due to this weakness of the system, KF was potentially at a high risk of providing loans to proscribed persons who had the capability to use the money for wrongful intent.

c. KF was required to monitor its relationships with the entities/individuals on a continuous basis in accordance with Regulation 13(3) of the AML and CFT Regulations. It was the responsibility of KF to ensure that no such relationship existed directly or indirectly, through ultimate control of an account and where any such relationship was found, it was required to take immediate action as per law, including freezing the funds and assets of such proscribed entity/individual and reporting to the Commission.





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d. It is however, a matter of concern that prior to onsite inspection, KF informed vide email dated August 30, 2019 that it had screened its customer database against the list of proscribed persons and no matches were found. Despite being clearly laid out KF failed to appreciate that the database against which the list of proscribed persons is to be matched should include all associates and facilitators of the customers. Contrary to this statement, the inspection team found matches with proscribed persons in KF's database, further proving that KF's screening system was not working effectively, prima facie violating the requirements of Regulation 13(3) of the AML and CFT Regulations.

e. During the hearing, KF 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. KF cannot categorize its customers as low risk merely on the basis of the size of the loan. The use of the single parameter of loan size has in fact exposed KF to a serious breach of the mandatory provisions of law. This deficiency constituted contravention of Regulation 6(8) of the AML and CFT Regulations.

f. 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. KF had only obtained the CNICs of its customers and the nominees/co-borrowers. However, KF 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. KF's argument that the matter has been taken up by Pakistan Microfinance Network ("PMN") on behalf of the micro finance sector with the SECP, is not plausible. It is my firm view, until any conclusion is reached in the matter, KF should not risk itself to exposure of proscribed individuals and initiate the process of NADRA Verisys besides every odd. No cost can be high then the cost of providing loan to a proscribed person, only because NADRA verisys of his CNIC could not be done or his name was could not be adequately screened from the proscribed persons lists. Any such eventuality is likely to jeopardize the reputation of KF and may prove to be harmful for its business.

10. In view of the aforesaid it is my considered view that KF prior to inspection and the proceedings at hand did not grasp the severity and 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 accepted its shortcoming and has been very responsive and forthcoming in efforts to undo the same. I appreciate the efforts to comply with the provision of the





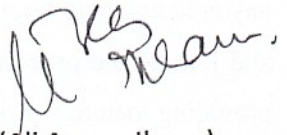
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AML/CFT Regulations. In my opinion, KF needs to undertake a self-review to identify any other shortcomings to improve and strengthen its operational procedures and systems with specific reference to AML/CFT.

11. Based on my observation above, non-compliance of AML and CFT Regulation 6 (4), Regulation 6 (5a) read with Regulation 6 (3) (a) Regulation 6(8) and Regulation 13 (7), and Rule 7(1)(g) of the NBFC (Establishment and Regulation) Rules 2003 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 40 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 1,000,000/- (Rupees One Million) on the Respondent.

12. The aforesaid fine must be deposited in the designated bank account maintained with MCB Bank Limited in the name of SECP within thirty days (30) 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.

13. 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 (Adj-I)

Announced on:
December 24, 2019 at Islamabad.

