



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 Adam Securities Limited

Date of Hearing

January 2, 2020

Present at the Hearing
Representing the Respondents

Mr. Noman, chief executive
Mr. Muhammad Rizwan, chief
financial officer
Mr. Ali Lakhani

ORDER

This Order shall dispose of the proceedings initiated against **Adam Securities Limited** (the "Company") and its Board of Directors through Show Cause Notice No. 1(137)SMD/Adj-1/KHI/2018 dated December 18, 2019 (the "SCN") issued under Securities and Exchange Commission of Pakistan (Anti Money Laundering and Countering Financing of Terrorism) Regulations, 2018 (the "Regulations") and section 40A of the Securities and Exchange Commission of Pakistan Act, 1997 (the "Act"). The Company and its Board of Directors are collectively referred to as the Respondents.

2. Brief facts of the case are as follows:

- (a) The Company is a Trading Rights Entitlement Certificate holder of the Pakistan Stock Exchange Limited (the "PSX") and member of Pakistan Mercantile Exchange Limited ("PMEX").
- (b) An inspection of the Company was conducted by Joint Investigation Team (JIT), in pursuance of Notice No. T027 dated November 1, 2019, and also an inspection was carried by PMEX through its order number PMEX/RAD/822/2019 dated November 1, 2019 with a scope to review and check compliance with applicable AML/CFT regulatory framework including the Regulations and other related circulars, notifications and directives.

3. The inspection teams observed a number of instances where the Company, *prima facie*, failed to comply with the applicable provisions of the Regulations, which are summarized as under:

The Company did not have a database of board of directors/trustees/office bearers/associates of its clients. The Company in its reply dated November 12, 2019



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responded that vendor had been requested to provide such database. In absence of the said database, the screening of forward (beneficiary) or backward (parent, husband) of its clients on continuous basis was not being conducted, in absence of provision of any evidence, by the Company and adequate controls and procedures were not in place to mitigate ML/TF risks. The Company in its reply has informed that it was acquiring the declaration letters from clients for identification of beneficial owners. Therefore, in absence of the aforesaid, the screening at the time of establishment of relationship with customers and periodic screening of associated persons, was not being performed, which reflected that the Company failed, to put in place adequate procedures and controls, to mitigate the ML/TF risks, and mechanism in place to periodically monitor their relationships of its clients with the entities and individuals mentioned in sub-regulation (5a) of regulation (6), on continuous basis, in violation of regulation 4(a) and regulation 13(7) of the Regulations.

- ii. As per organogram provided by the Company, its internal auditor had reporting line to its chief executive, which indicated that Company did not have independent audit function. The above is violation of regulation 4(d) of the Regulations.
- iii. The Company did not validate the copies of the identity documents of its sample, consisting of 15 cases of PSX clients and 12 cases of PMEX clients, through NADRA verisys, in violation of requirements given in clause (i) of Annexure-I as per regulation 6(4) of the Regulations.
- iv. The Company did not update the record of its clients relating to knowledge about the business and profession and source of income of the customer, business and risk profile including source of funds and updating records and data. The report highlighted instance of a client, who was house wife, having trading in her account, however, the Company did not identify or document monitoring of account/transactions, on continuous basis nor updated record, in violation of regulation 6(3)(c) of the Regulations.
- v. In case of a client, who was student and declared himself as ultimate beneficial owner. The Company stated that an undertaking dated October 5, 2018 and affidavit dated February 20, 2018 received from the client was on record. The above, however, revealed that the Company did not identify or verify the beneficial ownership of its mentioned client and had just relied on the aforesaid documents. In absence of identification and verification of beneficial ownership of client, the Company had violated regulation 6(3)(a) and regulation (6)(5)(a) of the Regulations.

The bank statement of a client revealed transactions including remittances of millions of rupees. The Company, however, classified its client, who is a student





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and declared himself as ultimate beneficial owner, as "medium" risk. The above indicated presence of high risk of ML/TF, and the Company has failed to determine, identify and document presence of high risk of its clients, to implement internal risk management systems, policies, procedures, controls to determine, if any customer presented high risk of ML/TF, and to perform enhanced measures to manage high risks, in violation of regulation 9(1) and regulation 4(c) of the Regulations.

- vii. In case of four high risk clients, the Company did not provide approval of senior management to establish or continue business relationships with such high risk customers, in violation of regulation 9(4)(a) of the Regulations.
- viii. In case of a high risk corporate client, having trading transactions in its accounts during relevant period, the Company, however, did not provide evidence of source of funds or income of shareholders/beneficial owners of the corporate client, in violation of regulation 9(4)(b) of the Regulations.
- ix. The Company did not retain the records of screening performed of its clients as the Company did not provide documentary evidence of screening performed of its clients. Pursuant to inspections carried, the Company, however, has initiated the process to retain copy of screening results. Hence, in the absence of relevant record, it has failed to demonstrate that it kept record of its verifications in respect of the period prior to the inspection, in violation of regulation 15(3) of the Regulations.
- x. As per organogram of the Company, its compliance officer reports to chief executive instead of reporting directly to the board of directors or another equivalent executive position or committee. Moreover, the Company informed that its compliance officer used to prepare and present compliance reports to the chief executive. The above is violation of Regulation 18(a) of the AML Regulations.

4. In view of the aforesaid findings and based on recommendation on record, Securities and Exchange Commission of Pakistan (the "Commission") took cognizance of the matter by issuing show cause notice dated December 18, 2019 to the Respondents as they, *prima facie*, acted in contravention of the Regulations. The Respondents were advised to show cause in writing within seven (7) days from the date of the show cause notice as to why penalties may not be imposed upon them under section 40A of the Act for contravening the Regulations. The chief executive through his letter dated December 26, 2019, furnished reply to the SCN, which is summarized in the following manner:

i. Before establishing relation with any account holder, the Company ensures that the details of the clients (including the BOD/trustees/office bearers) are monitored with the entities and individuals mentioned in sub-regulation (5a) of regulation (6). The aforesaid observation relates to corporate accounts. At the





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advice of JIT, now in the client database, initiated the practice of also adding the details of BOD/trustees/office bearer/associates of the clients. Moreover, the Company has in place adequate procedures and controls to mitigate the ML/TF risks.

- ii. The internal audit function reports administratively to chief executive officer and functionally to the board of directors. Reporting line of the internal audit function is in compliance with the regulatory requirements and is independent and value adding function of the Company.
- iii. The Company initially ensured that the identity document i.e. CNIC of each client was validated either by requiring CNIC copy to be verified through original CNIC and by requiring attested copy of the CNIC. The Company faced difficulties in obtaining NADRA verisys system. As an alternate, an agreement with third party i.e. Background Checks Pvt. Limited was made for validation of identity documents and compliance reports of NADRA verisys of some clients.
- iv. The observation for non-updation of the record of clients about business and profession and source of income relates to a client (house wife). The inspection team has highlighted that the Company did not identify or document monitoring of account/transaction on continuous basis nor updated record. Profile of mentioned client was duly updated.
- v. A client, who is a student has declared himself as ultimate beneficial owner, the Company obtained undertaking and affidavit from him. The Company duly verified ultimate beneficial ownership.
- vi. A client, who is a student, was categorized as "medium" risk, his continuous due diligence was being made. No suspicious transaction was found in his account. The Company had rightly categorized the client as "medium" risk in compliance with regulatory requirements.
- vii. The Company has in practice of obtaining approval of senior management for establishing and or to continue business relationship with high risk customers. The Inspection Team in its letter of findings did not share such observation.
- viii. For observation that the Company did not provide source of funds of its corporate client, having trading transactions, relevant audited financial statements, know your customer details of directors of corporate client, form 29, memorandum and articles of associations, and Pakistan Credit Rating Agency reports were secured from the corporate client.
- ix. The Company is due cognizant of the requirement to perform due screening of the client in accordance with the regulatory requirements. The Company was also in the practice of documenting the results of such screenings, whereby the compliance officer reports the results of aforesaid screenings to the chief executive against each screening.

The compliance function reports administratively to the chief executive and functionally to the board of directors. Furthermore, the compliance function has been reporting directly to the board of directors of the Company since 2016,





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pursuant to section 29 of the Securities Brokers (Licensing and Operations) Regulations, 2016.

5. In order to afford the Respondents an opportunity of making personal representation, hearing in the matter was fixed for January 2, 2020. The hearing was attended by Mr. Noman, chief executive, Mr. Muhammad Rizwan, chief financial officer and Mr. Ali Lahkani, being Authorized Representatives. During the hearing proceedings, the Authorized Representatives were advised to explain the reasons for the alleged violations of the Regulations. Authorized Representatives discussed each alleged violation and reiterated their stance as given in writing. The Authorized Representatives were also advised to furnish supporting evidences, and through letter dated January 2, 2020, chief executive, provided additional details, which are summarized in the following manner:

- (i) With regard to updation of record of client, as highlighted, in respect of profession, source of income, and monitoring of account, the same are being done on continuous basis. Her profile was updated in back office. During CDD process, source of income of her husband was duly verified.
- (ii) For evidence of remittance from client's brother to client, the account statement of UAE Exchange and remittance slips annexed.
- (iii) Approval of senior management with regard to continuation of business relationships of two clients annexed.
- (iv) For source of funds of the shareholders/ beneficial ownerships of corporate client, the requisite documents were provided.

6. I have examined the submissions made in writing and during the hearing as well as issues highlighted in the show cause notice and requirements of the Regulations. The facts of the case may be summarized as under:

- (i) At the relevant time of inspection, the Company's internal controls and procedures were not sufficient due to absence of system in place to screen and identify proscribed persons or entities, to the extent of corporate clients on continuous basis. The Company has admitted that a system has been subsequently implemented and database was updated and it initiated the practice of also adding the details of BOD/trustees/office bearers/associates of the clients. This is violation of regulation (4a) and regulation 13(7) of the Regulations.
- (ii) In view of available organogram, the Company's internal audit function / internal auditor reports to chief executive and it has been stated by the Company in its written reply that internal audit function administratively reports to the chief executive. The Company through its letter dated January 2, 2020, furnished copy of minutes of directors meeting held on October 15, 2019, in terms whereof chief internal auditor presented audit report to board of





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directors. I am of the view that internal auditor should have direct and unrestricted access to senior management and the board. In this sense, organizational independence is achieved when the chief audit executive functionally reports on its work to the board, where functional reporting includes all the issues relating to the scope of internal audit, from planning to reporting on work results, including the quality control of internal audit activities. The independence of the internal auditor is questionable, which is violation of regulation 4(d) of the Regulations.

- (iii) The Company has furnished its correspondence with PSX and copy of agreement dated December 16, 2019 with third party for validation of identity documents through NADRA verisys. The inspection team highlighted 27 instances where documents were not validated through NADRA verisys. The Company through its aforesaid agreement has furnished evidence to implement NADRA verisys system through third party vendor.
- (iv) The Company has furnished documents in support that CDD of its client, who is a housewife was carried, and supporting documents of her source of income were secured. Scrutiny of relevant documents revealed that she was holding funds of Rs. 1,500,000 from rental income of property of her husband, however, supporting documents were not enough to prove that she could make investments of Rs. 1,500,000. There exists a disconnect in her source of income and the amount she made available for investments. In terms of regulation 6(3)(c) of the Regulations, CDD includes monitoring of accounts/transactions on ongoing basis to ensure that the transactions being conducted are consistent and knowledge of the customer, the customer's business and risk profile, the source of funds through regular matching with available information to take prompt action when there is a material departure. The Company therefore needs to comply with regulation 6(3)(c) of the Regulations by securing relevant documents from clients and diligence to be made making relevant available sources of income.
- (v) The Company has furnished details and supporting evidence of remittances sent to a client, who is a student, who stated himself as ultimate beneficial owner. However, as per relevant information provided, the brother of client, was sending him remittances from UAE, which was primarily being used by the client for trading transactions. The Company, however, did not substantiate that brother of the client was real owner of such funds, who remitted these funds in the account of client and the same funds were being utilized by the client for making transactions. The money trail of funds utilized by the client is not complete due to lack of supporting evidences of employment record of the brother of client and copies of financial instruments evidencing movement of funds, hence, the Company contravened the





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requirements prescribed in regulation 6(3)(a) and regulation 6(5)(a) of the Regulations in case of the mentioned client for identification and verification of the client's/beneficial owner's identity on the basis of documents, data or information obtained from customer and/or from reliable and independent sources.

- (vi) For a client, who is a student, and the bank statements of client revealed transactions of millions of rupees, however, he was categorized as "medium" risk. The Company, in support furnished relevant copies of bank statements revealing transfer of funds, however, the Company did not furnish trading activity reports of relevant periods of the said client, which could justify that amounts invested or utilized were as per declared sources. Moreover, as per relevant details, encashment of certificates of millions of rupees was noticed as unusual activity, however, the Company's internal system did not highlight the seriousness of risk and requirement of enhanced due diligence for the said client in violation of regulation 9(1) and 4(c) of the Regulations.
- (vii) The Company through its letter dated January 2, 2020 provided copies of approvals of chief executive dated October 30, 2018 of four of its high risk clients.
- (viii) For a high risk corporate client, in order to ascertain source of income of shareholders/beneficial owners, the Authorized Representatives were of the view that corporate clients keeps audited its financial statements, and its sponsors were directors in various companies, and remuneration of director, by virtue of his directorships in companies were being disclosed in respective financials statements where he was acting as director. As per relevant record, total trading in the client's account during the period from July to October 2019 was Rs. 68,465,729 buy and Rs. 5,192,070 sale. I am of the view that the Company in order to ascertain the source of income of shareholders/beneficial owners, needs to weigh other measures as securing copies of documents evidencing sources of income so that requirement given in regulation 9(4)(b) of the Regulations be complied with due to the reason that disclosure in financial statements about directors remuneration is made on aggregate basis.
- (ix) I am of the view that at the time of inspection the Company was not retaining the records of screening performed of its clients as relevant supporting evidence was not provided to the inspection team, which is violation of regulation 15(3) of the Regulations.
- (x) For reporting of compliance function administratively to chief executive, I am of the view that violation of regulation 18(a) of the Regulations is not attracted in view of submissions made by the Company.





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7. In view of the foregoing facts, I am of the view that the Company violated the requirements of the Regulations as narrated in above paras. However, I have also noted that Company has either rectified or in the process of rectifying the alleged defaults to comply with applicable framework. Therefore, in terms of powers conferred under section 40A of the Act, a penalty of **Rs. 300,000/- (Rupees Three Hundred Thousand)** is hereby imposed on the Company. The Respondents are hereby also directed to implement measures to manage risks of AML/CFT, which include but not limited to formulation and implementation of procedures and controls, truly independence of its audit function and procedures to be carried for enhanced due diligence, to ensure that the requirements contained in the Regulations are meticulously complied in true letter and spirit.

8. 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.

9. This Order is issued without prejudice to any other action that the Commission may initiate against the Respondents 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 January 24, 2020
Islamabad