



Securities and Exchange Commission of Pakistan
Securities Market Division

Through Courier

Before the Commissioner (SMD)

In the matter of Show Cause Notice issued to Next Capital Limited

Date of Hearing	<i>June 26, 2019</i>
Present at the Hearing	i. <i>Dr. Ali Akhtar Ali (MD Equity Sales)</i>
	ii. <i>Mr. Nadeem Ul Haq (CFO)</i>
<i>Representing Next Capital Limited</i>	iii. <i>Mr. Yousuf</i>

ORDER

This Order shall dispose of the proceedings initiated through the Show Cause Notice bearing No. 1(167) SMD/ADJ/KHI/2019 dated June 17, 2019 (“SCN”) issued to Next Capital Limited (“Respondent”) by the Securities and Exchange Commission of Pakistan (“Commission”) under section 40A of the Securities and Exchange Commission of Pakistan Act, 1997 (the “Act”) and section 150 of the Securities Act, 2015.

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 (“PSX”) and licensed as a securities broker under the Securities Act, 2015.
- (b) An inspection conducted by the Commission revealed that the Respondent was non-compliant with the Securities and Exchange Commission of Pakistan (Anti Money Laundering and Countering Financing of Terrorism) Regulations, 2018 (“AML Regulations”). Keeping in view that the AML Regulations were new at the time of inspection, Commission decided to conduct a follow up review (“Review”) to assess the Respondent’s compliance with the AML Regulations.
- (c) The Review, *inter alia*, revealed the following:

- i. The Anti Money Laundering/Know Your Customer (AML/KYC) policy was not updated so as to meet the requirements of the AML Regulations in contravention of Regulation 4(a) of the AML Regulations which requires that a regulated person shall develop and implement policies, procedures





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- and controls, which are approved by its board of directors, to enable the regulated person to effectively manage and mitigate the risks that are identified in the risk assessment of ML/TF or notified to it by the Commission.
- ii. The Respondent had failed to perform Customer Due Diligence of fifteen (15) clients i.e. information relating to income, source of funds etc. was not obtained or identity documents were not validated through NADRA verisys in violation of Regulation 6 which requires that a regulated person shall apply Customer Due Diligence measures when establishing business relationship with a customer.
 - iii. The Respondent has not categorized one of its clients as political exposed person ("PEP") in violation of Regulation 10.
 - iv. The Respondent did not have a system that generated alerts one month before the expiry CNICs of its customers as required under Regulation 6 (Annexure I). Moreover, CNICs of five (5) of its clients were expired.
 - v. Circular 10 of 2017 required the Respondent to maintain record of its clients who had traded in excess of threshold of Rs. 5 million in case of individual and Rs. 25 million in case of corporate. However, the Respondent has not maintained record of six (6) of its clients whose net traded value exceeded the thresholds.
 - vi. The Respondent failed to provide AML training to its employees in contravention of Regulation 20(b) of the Act which requires that a regulated person shall chalk out and implement suitable training program for relevant employees on annual basis, in order to effectively implement the regulatory requirements and regulated person own policies and procedures relating to AML/ CFT.
 - vii. As per Circular 20 of 2017, a securities broker is prohibited from accepting any money or deposit or borrowing from any person including an individual or any segment of public or directors and sponsors of a securities broker. During the Review, it was observed that amount of Rs. 4.9 million and Rs. 2.4 million were credited in to the accounts of two of its clients as adjustment of short term loan.





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3. It appeared from the preceding that the Respondent *prima facie* acted in contravention of the AML Regulations and Section 150 of the Securities Act, 2015. Accordingly, the Commission took cognizance of the aforementioned facts and served the SCN requiring the Respondent to explain its stance in person on June 26, 2019.

4. The Respondent was accorded an opportunity of personal hearing dated June 26, 2019. Dr. Ali Akhtar Ali, Mr. Nadeem Ul Haq, and Mr. Yousuf (the “**Representatives**”) appeared for and on behalf of the Respondent and made the following submissions verbally and through written reply.

- i. *Copy of the Anti Money Laundering and Know Your Customer (AML/KYC) Policy updated and approved by the Board of the Directors of Next Capital Limited on October 29, 2018 was submitted with our response to SECP. Prior to this up dated version the Policy was updated in the light of guidelines issued by SECP and approved many times to reach this version. These policies are developed, implemented to meet the requirements of AML Regulations and approved by the Board of Directors many times hence, it may not be regarded as contravention of Regulations. For example Section 5(3h) of our AML Policy states that the AML/CFT review shall be conducted to assess the AML/CFT systems including the adequacy of Next Capital's process of identifying suspicious activity including screening sanctions lists from UN Security Council. Therefore, no relationship ever established with any proscribed entity/individual and regular monitoring is being made on receipt of every update of the list. Policy document on AML discusses nature of clients based on Risk Levels (High, Medium and Low) rather than Categories (Individuals, Companies, Trust, etc.) hence, specific wording on various categories has not been discussed in the policy but its inherent in risk categories has been focused. For example as a standard CDD policy Trusts are classified as 'High Risk' Clients therefore, all relevant sections are applied thereon automatically. Though it is mentioned that Next Capital is allowed to rely on third party for verifying identity in case of lower risk clients but in no case we relied on third party verification. Section I I(3a) of our AML Policy Refers to the Annexure-I of AML/CFT Regulations for verification of Customers Identification based on information / documents / data obtained.*
- ii. *Complete detail of Due Diligence performed relating to eighteen Customers was provided with our response along with information and documentary evidences obtained relating to their identification and pertaining to their occupation / source of income. Risk profiling of every such Customer was mentioned in our comments with the risk assessment and any change therein i.e. from low to high with the basis of such change.*
- iii. *The Report identified that Mr. Usman Ijaz Bajwa (Account number 30745) is a Superintendent at Punjab Police but his risk category has not been categorized in the list of PEPS and has not been classified as high risk. Our understanding about the position of Superintendent of Police is that this is not a very high level position as far as decision making is concern therefore, risk profile of Mr. Bajwa was kept low.*



Back office system doesn't provide generating alerts facility for Expiry of CNICs therefore, we have developed in-house mechanism of regularly downloading expiry detail of all



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Customers' CNICs from CDC System. The information is being utilized for identifying CNICs expiring within a couple of months. Out of five expired CNICs, copies of two renewed CNICs were submitted with our response whereas, three clients were abroad. Back Office Software Vendor is working on flag generating facility in the system and promised to provide the same in near future. Copy of a few search reports of expiring CNICs is attached herewith.

- v. *Before revocation of Circular 10 of 2017 by SECP in April 2019, Next Capital was actively monitoring clients who had traded in excess of threshold of Rs.5 million in case of individuals and Rs.25 million in case of corporate clients through Reports Generated from our back office system. The Reports were submitted with our earlier responses and as mentioned earlier Risk Categories of many Customers were changed on the basis of these reports. Six accounts mentioned in the Report were already in High level of risk category.*
- vi. *Trainings provided to employees / staff members were part of our annual plan for AML/CFT training. Compliance team is regularly attending seminars / meetings / other programs to be able to effectively implement / manage AML/CFT policies. Head of Compliance is responsible to conduct inhouse employees training program at least once in six months. Responsibilities relating to AML / CFT are assigned to various persons after training. In due course Head of Compliance and some employees are held responsible to understand new developments, money laundering and financing of terrorism techniques to counter, methods and trends.*
- vii. *SECP Circular No. 20 of 2017 captioned "Unauthorized Deposits Taking by Securities Brokers including their Representatives and Agents" posted clear understanding that it is about some of the Securities Brokers who were involved in unauthorized deposits taking activities which is not permitted and indicated that the purpose of the Circular was to refrain Brokers from fund raising through Ponzi schemes or profit sharing arrangements, in order to avoid frauds with customers or general public but was not to restrict funds raising for day to day activities. Generally Directors/Sponsors provide loans to their own Company for various purposes e.g. occasional working capital requirement, enhancing business capacity, efficiently running business, etc. and even Companies acquire loan from third parties for temporary phases. Nevertheless, all the long term loans from Directors and individuals were repaid during Financial Year 2017 and remaining short term loans were returned before year end 2018 to avoid any violation of the Circular. Transaction of Rs. 4.9 million and Rs. 2.4 million were made to bring balances to and to close loan accounts.*

5. I have examined the written as well as oral submissions of the Respondent and its Representatives. The Respondent did not contend missing aspect of correspondent relationship in AML/CFT policy. Further, the Respondent argued that although it was allowed to rely on third party for verification of identity of low risk clients, however, it had not relied on any third party. Given that no specific case of violation has been observed during the Review, the Respondent is not held accountable on this count.

6. In regard to failure to conduct CDD of its clients, the Respondent contended that it has an in-house mechanism for identifying expiring CNICs. It was also argued that out of 5 clients,





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three clients were abroad. Analysis of the documents submitted by the Respondent suggests that it had a mechanism to generate alerts regarding expiring CNICs. Moreover, it had sent e-mails to such clients which established that the Respondent had taken reasonable steps to obtain renewed CNICs, therefore, Respondent is not held accountable on this count.

7. The Respondent did not provide any justification or evidence regarding its failure to validate photocopies of identity documents of 12 (twelve) clients through NADRA verisys. Rather it was argued that it was in process of implementing verisys facility when introduction of centralized KYC was announced. Therefore, in order to avoid double cost, rather than going for verisys, it started working on finger scan. In this regard, Annexure I under regulation 6 of AML Regulations reproduced as under:

"The photocopies of identity documents shall be validated through NADRA verisys"

It is mandatory under AML Regulations to verify the customer's/beneficial owner's identity through NADRA Verisys and cannot be avoided. Therefore, the response of the Respondent is not found satisfactory.

8. In regard to its failure to classify one of its customer as PEP, the Respondent contended that as per its understanding, its client (superintendent of police) was not in decision making position. The explanation of Respondent is accepted. In regard to observed noncompliance of Circular 10 of 2017 for six of its clients, the Respondent contended that it had submitted the said information. Given that the said circular has now been repealed, the matter is not being pressed further.

9. The Respondent contended that its compliance team is regularly attending seminars/meetings/other programs to effectively implement AML/CFT policies. In addition, the Respondent submitted that it has provided training to its employees on June 28, 2019 and attached contents of the training. Therefore, Respondent is not held accountable on this count.

10. In regard to failure of compliance of Circular 20 of 2017, the Respondent argued that long term loan repaid during the year 2017 and short term loans were returned before end of the year 2018. Further, it was informed that transactions of Rs. 4.9 million and Rs. 2.4 million had reduced the loan balances to nil in order to close the loan accounts. Given that the loan accounts were settled prior to Review and no outstanding balance has been identified, the matter is not being pressed any further at this stage.

11. In view of para 7 above, contravention of the provisions of AML Regulations have been established. Therefore, in terms of powers conferred under section 40A of the Act and 150 of the Securities Act, 2015 a penalty of **Rs. 200,000/- (Rupees two hundred thousand)** is hereby imposed on the Respondent. The Respondent is advised to examine accounts of its clients to ensure that the requirements contained in the AML Regulations are met in letter and spirit. A





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report in this regard shall be submitted to the Commission within sixty (60) days of the date of this order.

12. 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 the date of this Order and furnish Original Deposit Challan to this office.

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

Announced on 3-9-2019
Islamabad




Shauzab Ali
Commissioner (SMD)