



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
Adjudication Department

No. 1(63) SMD/ADJ/LHR/2019

June 10, 2019

Zafar Securities (Pvt.) Limited
Through its Chief Executive Officer -
Room No. 519, LSE Building,
Lahore.

SUBJECT: Order in respect of Show Cause Notice No. 1(63) SMD/ADJ/LHR/2019, dated May 03, 2019

Please find enclosed herewith a copy of Order dated June 10, 2019 in the title matter for your record and necessary action.



Muhammad Akram Farooka
Assistant Director



Securities and Exchange Commission of Pakistan
Securities Market Division

Through Courier

Before the Commissioner (SMD)

In the matter of Show Cause Notice issued to Zafar Securities (Pvt.) Limited

Date of Hearing	May 10, 2019
Present at the Hearing	
Representing Zafar Securities (Pvt.) Limited	Mr. Omar Junaid (Authorized Representative)

ORDER

This Order shall dispose of the proceedings initiated against the Zafar Securities (Pvt.) Limited (the "Respondent") through Show Cause Notice No. 1(63) SMD/ADJ/LHR/2019, dated May 03, 2019 (the "SCN") under Section 40A of the Securities and Exchange Commission of Pakistan Act 1997 (the "Act").

2. Brief facts of the case are that
 - a. The Respondent is a Trading Rights Entitlement Certificate holder of the Pakistan Stock Exchange Limited ("PSX") and licensed as a securities broker with the Securities and Exchange Commission of Pakistan (the "Commission"). The Commission, in exercise of the powers conferred under Section 137 of the Securities Act 2015, vide its Order dated October 29, 2018 conducted follow-up review of compliance status in consonance with the regulatory requirements contained in Securities and Exchange Commission of Pakistan (Anti Money Laundering and Countering Financing of Terrorism) Regulations, 2018 ("AML Regulations") and Guidelines on AML, Countering Financing of Terrorism, and Proliferation Financing ("AML Guidelines"). The team submitted its Report on April 19, 2019 ("Review Report") after receiving comments on the letter of finding dated April 03, 2019.
 - b. The Review Report revealed that the Respondent was found non-compliant with the AML Regulations; which are detailed as under:
 - i. The internal auditor failed to identify the missing information/documentation with regard to its clients and issued report without qualification. It appeared that no proper tests and checks were applied by the internal auditor.
 - ii. The information provided regarding the client risk profiling was incomplete. In the list; names of the clients, nature of income and source of funding were not available.
 - iii. Most of the clients of the Respondent were considered low risk without recording reasons for the decision.





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- iv. The Respondent had not obtained sources of funds, nature of business of 02 clients that were categorized as high risk. Further, the instances were observed wherein the high risk clients deposited high amounts in their accounts but no EDD was conducted regarding these amounts.
- v. No periodic review and ongoing monitoring of clients were conducted to ensure compliance with the AML Regulations citing, lack of documentation/ information with regard to clients such as sources of income or details of nominees. Further, during the Review, it was observed that the Respondent had not developed any system with regard to the Automatic Alert Generation system regarding ML/TF warning signs/red flags.
- vi. Review Report stated that one pager compliance reports for the months of November & December 2018 & January 2019 was issued. The Compliance officer failed to identify any non-compliances with reference to the aforementioned instances.
- vii. The Respondent had not provided any annual plan of training program of employees with regard to AML/CFT which has been approved by its BOD.

3. In view of the aforesaid, the Respondent *prima facie* acted in contravention of the AML Regulations. The Commission therefore took cognizance of the aforesaid violations, issued SCN dated May 03, 2019 to the Respondent. The Respondent vide its letters dated May 07, 2019 submitted reply to the SCN, which is reproduced below:

“You are requested to note that AML/KYC/CDD are relatively new concepts in our capital markets and we are all going through a learning phase.

We at Zafar Securities (Pvt.) Ltd always try to keep a hands on positions on any improvements related to the capitals market. We have attended all the related seminars conducted by SECP and are fully aware of the requirements related to Financial Action Task Force. However we have also proposed that KYC/CDD should be under the NCCL what should do their due diligence at the time of issuing the UIN. Once the UIN has been issued than the broker should not have to do further KYC/CDD. Further as a matter of policy we do not receive cash which is more than 25,000 and all money is received through banking channels. It is the banker's duty to verify the source of funds rather than the broker who is only transferring one asset class into another asset.

All the record of the custody is available under the single UIN with CDC and everything is documented. All trading activity is available with under the single UIN with NCCL. Going forward now that the KYC/CDD and EDD are to be centralized under one entity KYC/CDD will be much effective and better managed freeing the brokers of undue burden and allowing them to concentrate on the businesses.

Para wise reply to your letter dated May 03, 2019 your reference 1(63)SMD/ADJ/LHR/2019

- a. *Qualification of Internal auditor was shared with the auditors. Internal audit report is being attached herewith.
The information required was sent to the auditors.*





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- c. *All clients are considered low risk initially as they fulfill all the requirements under the law at the time of account opening; unless some suspicion arises thereof. Further risk categorization is a dynamic process. Reason for change is based upon the high volumes, levels of investment, politically exposed person, assets beyond known income, lawyer/government servants, fundamentalist groups and pending trials. Lacking any centralized data to match our clients against, it becomes impossible to keep a dynamic categorization list. Clients are marked in High Risk Category on the basis of Circular No 10 where Net Traded Amount for an individual when exceeds Rs. 5 Million shall be due for CDD/EDD.*
- d. *EDD of the High-Risk Clients are done on monthly basis and then the report is sent to senior management for approval regarding to establish/continue business relations with the client. Proof of income is obtained from clients which is then matched with their respective risk profiles.*
- e. *We are in contact with our software vendor Softech Pvt. Ltd, who are the approved vendors as per SECP /PSX list. They are working on the automation of the AML/CFT EDD Risk profiling etc. They have promised the automations of alerts in the next version of the software. Once implemented the said reports/information will be readily available. Expiry of CNIC alert generation is in place and was sent earlier. All the points mentioned in Annexure 3 of AML Guidelines are subjective and are under process of automation. Further, Clients having expired CNIC are contacted and are requested to submit their renewed CNIC.*
- f. *Comprehensive monthly compliance report is sent to senior management which is a one-page summarized report. However, a collective set of reports include reports on trading activities with remarks from CO, cash deposit reports, watch list compliance reports (as per circular no 10), CDD/ EDD reports. A quarterly detailed report is also shared with senior management which was earlier sent to you.*
- g. *We have meeting every 60 days in one of the branch offices by rotation where the latest information regarding the brokerage Industry is discussed which includes any updates in KYC/CDD/AML/CFT policies. The relevant staff is trained and guided by the senior management.*

4. The Respondent was accorded hearing opportunity on May 10, 2019. Mr. Omer Junaid; Authorized Representative attended the hearing on behalf of the Respondent. During the hearing proceedings, the Authorized Representative reiterated the argument as submitted in response to the SCN.

5. I have examined the submission of the Respondent and its Representative. In this regard I have observed the followings:

- a. The primary justification extended by the Respondent was that the AML Regulations are new and reasonable time was not available to become fully compliant, does not hold merit. I would like to point out that although the AML Regulations were issued in 2018 but the requirement contained therein are not new. These AML requirements were introduced in 2012 by Karachi Stock Exchange Limited (presently PSX). Regulation 4.18 of the Rule





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Book made it mandatory for the securities broker to formulate and implement an effective KYC and CDD policy in accordance with the Know Your Customer and Customer Due Diligence Guidelines issued by the Exchange. A comparison of the regulatory framework of 2012 with AML Regulations does not reflect any material difference in term of the requirements. Therefore the stance of the Respondent is not tenable.

- b. With regard to the internal audit function, I would like to mention here that the provisions of Regulation 4(d) of the AML Regulations are explicit, with objective to have independent internal audit function to test the AML/CFT systems. The Respondent submitted that it had shared detailed internal audit report with the inspector and same are also submitted with reply to the SCN. It is pointed out that the broker shared the same report on both the occasions. I have reviewed the internal audit report and hereby concur with the observations of the inspector that the said report does not disclose any qualifications and does not suffice the purpose of the AML Regulations. In view of the above, I hereby find the Respondent non-compliant with Regulation 4(d) of the AML Regulations.
- c. With regard to the incomplete risk profiling of its client, it may be noted that the said noncompliance has been observed after reviewing the document provided by the Respondent. This fact is also admitted by the Authorized Representative during the hearing proceedings that information regarding nature of income and source of funding was not available. The Respondent is therefore found non-compliant with the provisions of 6 (3) & (4) of the AML Regulations.
- d. The Respondent contented that all the clients are initially considered as low risk unless some suspicion arise thereof. It is however observed that the policy of the Respondent in this regard does not appear cogent. Firstly categorizing all the clients at initial stage at low risk without assigning any reason defeats the spirit of the AML Regulations. Regulation 11 of the AML Regulations requires a securities broker to conduct simplified due diligence for its low risk clients. The Respondent admitted that due to lack of centralized data, it becomes impossible to keep a dynamic categorization list. This depicts that the Respondent is non-compliant with the said provisions of the AML Regulations.
- e. With regard to EDD, the stance of the Respondent that EDD is carried out on monthly basis does not replicate the true compliance of the AML Regulations. It was reported by the inspector that the Respondent had not obtained sources of funds, nature of business of 2 clients that were categorized as high risk. The Respondent fail to satisfy about the EDD of high risk clients who deposited high amounts in their accounts. From this, it appears that the Respondent has failed to comply with the provisions of Regulation 9(4) of the AML Regulations.
- f. Respondent in its reply to the SCN and also during the hearing, admitted that it is in process of developing a software so that AML/CFT, EDD risk profiling will be automated. Currently the Respondent is deficient in performing the EDD of the high risk clients. Beside this no periodic review has been conducted by the Respondent for ongoing monitoring of clients to ensure compliance with the AML Regulations. This results in violation of Regulation 13 of the AML Regulations.

With regard to the compliance function in accordance with Regulation 18(c) of the AML Regulations, the Respondent provided that a comprehensive monthly compliance report is sent to the senior management which is one-page summarized report. Copy of the said





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report is provided along with reply to the SCN which was also submitted to the inspection team. The compliance report although cannot be termed as comprehensive but it shows that the Respondent has a compliance function. I therefore advise the Respondent to systematically develop the compliance function to ensure the compliance of AML Regulations, in letter and spirit.


- h. With regard to the annual training program, the Respondent has not provided evidence of annual training program for its employee. The Respondent is therefore found noncompliant with the provisions of Regulation 20 of the AML Regulations. The Respondent is however advised to prepare training plan and conduct trainings of its employees till June 30, 2019 to address the gap of compliance.

6. Before arriving at the decision, it is reiterated that the regulatory requirement relating to KYC/CDD and anti-money laundering have been implemented since the year 2012 considering the public interest, integrity of Pakistan capital market and the country's international commitments. Hence all licensed persons are expected to ensure strict compliance with this regime by remaining vigilant and putting in place requisite policies and procedures to curtail activities relating to money laundering and financing of terrorism.

7. In the view of the foregoing and admission of the Respondent, contravention of the provisions of AML Regulations have been established. Therefore, in term of the power conferred under Section 40A of the Act, a penalty of Rs 250,000/- (Rupees two hundred fifty thousand only) is hereby imposed on the Respondent. The Respondent is advised to enforce the AML Regulations in letter and spirit. 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 June 10, 2019
Islamabad