



Securities and Exchange Commission of Pakistan
Securities Market Division

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Through Courier

Before The Director / HOD (MSRD)

In the matter of Show Cause Notice issued to Adam Securities (Private) Limited
under Section 22 of the Securities and Exchange Ordinance, 1969

Date of Hearing:

March 02, 2015

Present at the Hearing:

Representing Adam Securities (Pot.) Limited

(i) *Mr. Abdul Majeed Adam*

Chief Executive Officer

Assisting the Director/HOD (MSRD)

(i) *Mr. Muhammad Tanveer Alam*

Joint Director

(ii) *Ms. Najia Ubaid*

Deputy Director

ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice bearing No. 1(43) SMD/MSRD/C&IW/2014 dated January 14, 2014 ("SCN") served to Adam Securities (Private) Limited ("**Respondent**"), Trading Right Entitlement Certificate Holder/Broker of the Karachi Stock Exchange Limited ("**KSE**") by the Securities and Exchange Commission of Pakistan ("**Commission**") under Section 22 of the Securities and Exchange Ordinance, 1969 ("**Ordinance**") read with Rule 8 of the Brokers and Agents Registration Rules, 2001 ("**Brokers Rules**").

2. Brief facts of the case are that the Commission in exercise of its powers under Sub-section (1) of Section 6 of the Ordinance read with Rule 3 and Rule 4 of the Stock Exchange Members (Inspection of Books and Record) Rules, 2001 ("**Inspection Rules**") ordered an inspection of the books and record required to be maintained by the Respondent. The following officers of the Commission were appointed as inspectors ("**Inspection Team**") for the purpose vide order dated September 4, 2014:

a) *Mr. Adnan Ahmed*

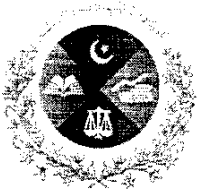
Deputy Director

b) *Mr. Kashif Ali*

Deputy Director

SECURITIES & EXCHANGE
COMMISSION OF PAKISTAN
NIC Building, 63 Jinnah Avenue,
Islamabad, Pakistan





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3. The Inspection Team submitted the report ("**Inspection Report**") on November 25, 2014 which was shared with the Respondent in accordance with Rule 7 of the Inspection Rules. The response of the Respondent in the context was received vide letter dated December 30, 2014. Upon evaluation of the Inspection Report, irregularities in calculation of Net Capital Balance ("**NCB**") as of June 30, 2014 were observed and it appeared that NCB certificate was not calculated in accordance with the Third Schedule of the Securities and Exchange Rules, 1971 ("**SEC Rules**"). The Inspection Report further highlighted that the Respondent failed to maintain segregation of clients' assets, did not have an effective Know Your Customer ("**KYC**") and Customer Due Diligence ("**CDD**") Policy; failed to be in compliance with Circular 34 of 2009 issued by Commission; and also failed to update Standardized Account Opening Form ("**SAOF**") as specified in the regulatory framework.

4. In light of the Inspection Report and the comments received from the Respondent, the Commission served a SCN to the Respondent under Section 22 of the Ordinance and Rule 8 of the Brokers Rules. Hearing in the matter of aforesaid SCN was scheduled for January 28, 2015 at the Commission's Head Office in Islamabad. However, the Respondent vide letter dated January 27, 2015 requested for extension in the date of hearing. Acceding to the Respondent's request, hearing was rescheduled for March 2, 2015 at the Commission's Karachi Office.

5. The arguments put forward by the Respondent in its written response to the SCN submitted vide letter dated February 6, 2015 are reproduced below:

a). **Improper Calculation of NCB:**

"As SECP observed related to Net Capital Balance as at June 30, 2014, we would like to bring it your knowledge that due to Pre-adjustment entry of Deposit losses through Karachi Stock Exchange (KSE) and closers of banks due to Ramzan Holidays and July 1, 2014, the confusion occurred and as we observed the correction we have made updated NCB and submitted within due time. (Copy Attached). We would like to bring it your knowledge that for the Calculation of Listed securities we use to verify this from Balance Inventory of National Clearing Company of Pakistan report as NCCPL is calculating ZELP amount that's why we apply the Rate of 0.44 to ZELP. As you inform us that this is not allowed we apply the 0 rate of that scrip. Due to non-finalization of Annual Account, the said liabilities were not recorded in our books."





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b). **Capital Adequacy Requirements:**

As you aware that our Rs. 85.5 Million were invested in Book building of Pakistan Petroleum and as per the Third Schedule of SECP rules 1971, brokers are not allowed to use this investment in calculation of NCB, so we have submitted new NCB as at September 02, 2014 of date after receiving the share of Pakistan Petroleum in due time (Copy Attached).

Net Capital Balance:	154.9869 Million
Karachi Stock Exchange	148.4869 Million
Lahore Stock Exchange	4.00 Million
Pakistan Mercantile Exchange	2.5 Million."

c). **Segregation of clients' assets:**

"As per mutual understanding with our familiar clients, they are allowed us to use their funds as we have taken written agreement from those clients for using their credit balances in favor of Adam Securities (PVT) Limited (Copy Attached)."

d). **Irregularities in SAOFs:**

"As per Clause 4.17 of Rule Book we have updated SAOF and duly signed by our client to remove said non-compliance as mentioned in your above letter (Attached filled SAOF)."

e). **KYC & CDD Policy:**

Further, as per Clause 4.18 our Board of Directors pass the resolution for implementation of requirement as specified in guidelines of Know Your Customer ("KYC") and Customer Due Diligence ("CDD") to aware our clients (Copy of Board Resolution & New AOF is attached)."

f). **Credit Risk Assessment Methodology:**

"As per clause 4.21 & 4.21.3 of Rule Book we have amend Margin Trading Agreement in our Account Opening form to fulfill the requirement of the said regulation (AOF is attached)."

g). **Branch Office Regulations:**

"As you mention in paragraph 10 of SCN, we have pasted the awareness notices for our clients that

- No cash transactions are allowed on our Branch.
- We are not dealing in Fix return policies.
- Letter of Authorized person to deal with clients.
- Copy of Certificate of Branch by SECP.
- Copy of Registered Agent by KSE."

h). **ICM Certification:**

"We are registered with the Institute of Capital Markets and assure you that as soon as possible we will be qualified by the said Certification (Copy of Registrations are attached)."





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6. Mr. Abdul Majeed Adam, Chief Executive Officer of the Respondent, ("Representative") attended the hearing on behalf of the Respondent on March 02, 2015 at the Commission's Karachi office through video conference. The arguments put forth by the Representative of the Respondent during the course hearing are summarized below:

- a) With regard to NCB calculation the Representative stated that the irregularities identified by the inspection team in the NCB of June 30, 2014 amounting to Rs. 5.889 million were rectified and the Respondent accordingly on October 21, 2014 submitted revised NCB as of June 30, 2014 depicting the NCB of Rs. 2.97 million. The Representative while explaining inadequate NCB, being a TREC Holder of both the KSE and the Lahore Stock Exchange Limited ("LSE"), informed that the NCB turned negative because of non-inclusion of the advance payment made for the purchase of Pakistan Petroleum Limited ("PPL") shares, as the same were not allowed under the guidelines issued by the Commission. The Representative added that as soon as the payments was received back, the Respondent prepared a new NCB certificate and submitted revised NCB of Rs. 154.98 million as of September 2, 2014.
- b) The Representative in respect of segregation of clients' assets accepted that the Respondent has around 500 active clients and the difference in trade payables and client's bank balances identified in the inspection report pertains only to seven clients. The Representative further communicated that the Respondent has obtained authority from the referred seven clients and stated that copies of the authority letters were provided to the Commission along with written response of the Respondent.
- c) Regarding the irregularities in SAOFs, the Representative apprised that the same have been rectified and the Respondent has provided copies of SAOFs duly signed by the clients.
- d) The Representative accepted that an automated system was not in place for identification of suspicious transactions as the Respondent has around 500 clients and it is very difficult to develop such a system for large number of clients. However, the Respondent is trying to develop an automated system as per the KYC and CDD requirements.
- e) The Representative during the hearing informed that the Respondent has submitted the required fee and completed registration of two of its employees for obtaining the





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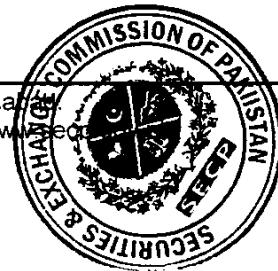
required certification. The Representative emphasized that evidence of the same has been provided along with written response of the Respondent.

- f) With regard to issues raised by inspection team relating to branch offices, the Representative communicated that the Respondent is now compliant with the regulatory requirements in the context.

7. I have heard the arguments presented by the Representative at length during the hearing. Additionally, I have perused the available record and the written reply filed by the Respondent. Accordingly, my findings on the arguments and assertions made by the Respondent to the issues raised in the SCN are as follows:

- a). For NCB calculation, the Representative explained the circumstances which caused differences in NCB and asserted that the identified discrepancies were rectified and revised NCBs were submitted in the context. The chronology of the NCB certificates in accordance with the date of submission to KSE is summarized below:

NCB as on	Amount (Rs in million)	Date of the Certificate	Auditor Certifying the NCB	Date of submission with KSE	Remarks
June 30, 2014	5.889	September 4, 2014	Nasir Javaid Maqsood Ibrahim, Chartered Accountants	September 11, 2014	NCB was overstated because of overstating the amount of deposits with the exchange by Rs. 3.59 million as identified in the Inspection report.
June 30, 2014	2.978	October 21, 2014	Nasir Javaid Maqsood Ibrahim, Chartered Accountants	October 22, 2014	NCB was revised and adjusted by the amount of overstated deposits as referred to above.
September 2, 2014	219.599	September 8, 2014	Zahid Jamil & Company, Chartered Accountants	September 11, 2014	This NCB certificate was not submitted to the inspection team and came to the notice of the Commission subsequent to the SCN.
September 2, 2014	154.987	September 8, 2014	Zahid Jamil & Company, Chartered Accountants	October 24, 2014	As per the Respondent, this NCB was prepared after the receipt of PPL shares by the Respondent and the same was submitted to the inspection team





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The Respondent by submitting the revised NCB as on October 22, 2014 accepted the fact that the NCB submitted on September 11, 2014 was overstated, thereby accepting the observation of the inspection team.

- b) The Respondent is the TREC holder of KSE and LSE and also a member of Pakistan Mercantile Exchange Limited (PMEX). From the above details, it appeared that the NCB of June 30, 2014 amounting to Rs. 2.978 million was far much below the required minimum NCB. Therefore, in order to meet the regulatory requirements pertaining to NCB, the Respondent submitted its revised NCB Certificate as of September 2, 2014 showing balance of Rs. 154.987 million as referred to at Annexure II of the Inspection Report. However, the certificate depicting NCB of September 8, 2014 was issued by the Auditor on September 8, 2014 and submitted to KSE and LSE on October 24, 2014. Moreover, on query with the KSE, it was revealed that the Respondent submitted two different NCB Certificates depicting NCB as of September 2, 2014 signed by M/s. Zahid Jamil & Co. with different balances and both signed on September 8, 2014.
- c) The Respondent did not provide any information about the submission of two different certificates depicting two different NCB position neither to the inspection team during the course of inspection nor did the Representative communicate any such thing during the course of hearing.
- d) The Respondent's NCB as of June 30, 2014 did not meet the minimum required balance. The Respondent is allowed trading exposure at the KSE and LSE on the basis of NCB, which actually was below the required balance as of June 30, 2014. The Respondent at first trading day of each week before commencement of trading is required to submit its status by clicking "Yes/No", as the case may be, regarding maintenance of minimum required NCB during the week at the functionality at the National Clearing House System ("NCHS"). The said functionality stops the brokers to proceed with trading, if he does not report under the functionality. However, the Respondent despite being aware of the fact that it failed to meet the required minimum balance kept on clicking the "YES" option of the functionality. Although the Representative during the course of hearing assured that it shall ensure adherence to the regulatory requirements in future but the same does not absolve the Respondent



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from complying with the NCB requirements as envisaged in the regulatory framework.

- e) Regarding segregation of clients' assets, the Representative communicated that the clients' funds of only few familiar clients were being used by the Respondent and that was on the basis of the authorities provided by them. Notwithstanding the authority letters obtained by the Respondent, the regulatory framework time and again provides very clear instructions to be followed by the brokers with regard to segregation of clients' funds. Relevant extracts, in this context, are reproduced below:

(i) Chapter 4.19.1 of KSE Rule Book:

"The broker shall ensure that the assets belonging to their clients are kept separated from the assets of the Broker. For this purpose the broker shall maintain

(a) a separate bank account which will include all the funds deposits of their clients along with record/breakdown of clients' balances;"

(ii) Chapter 4.19.2 of KSE Rule Book:

"Except as permitted above, the clients funds and securities shall not be used by the broker for any purpose other than as authorized by the client in writing in the manner and procedure prescribed by the Exchange and/or CDC..."

(iii) Condition 2(a) of Special Terms and Conditions contained in the Standardized Account Opening Form, Annexure - I of KSE Rule Book:

"The credit amount of the Account Holder(s) shall be kept by the broker in a separate bank account titled "Account Holder/Client Account" and shall not be used by the broker for his own business"

It is evident from the above that regulatory framework does not allow use of clients' assets other than for his/her own benefit. Irrespective of the status of clients i.e., being familiar or not, the Respondent cannot use the funds of its' clients even when authorized by the client him/herself. Under the existing regulatory requirements, the Respondent is expected to ensure proper segregation of clients' assets and should at all times have an amount equivalent to its trade payables/creditors in the bank account tagged as clients' account.

- f) Regarding SAOF, the Representative provided updated SAOFs and confirmed that the discrepancies identified by the inspection team have now been rectified.





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- g) With reference to implementation of KYC and CDD requirements, the Representative assured that it shall automate the system to meet the requirements as specified in the context.
- h) To substantiate compliance with the qualification requirements of its employees, the Respondent provided copies of cheque through which the fees were paid and the copies of registration form of two of its employees.

8. After a detailed and thorough perusal of the facts, evidence/information available on record, contentions and averments made by the Representative of the Respondent during the course of the hearing, it is evident that the Respondent failed to maintain NCB in accordance with the regulatory framework; did not provide complete information to the Commission and failed to fulfil its regulatory obligations by not maintaining proper segregation of clients' assets.

9. Brokers are required to maintain minimum NCB at all times of the year and are further required to submit NCB Certificate to the exchange as of June 30, 2014 and December 31, 2014 under the existing regulatory requirements. Submission of two different certificates both depicting two different NCBs of the same date depicts sheer laxity and negligence of the Respondent towards the compliance of regulatory requirements. The Commission has serious reservations on such conduct of the Respondent that can be termed as misrepresentation and deception and are performed only for the continuity of its business. The Respondent is required to demonstrate fairness in the conduct of its business and is not expected to make any false/misleading statement and to engage in such act that compromise the market transparency; clients' interest; systemic risk to the stock market and increase the default risk at the cost of Respondent's own interest.

10. The Respondent being registered with Commission as a broker is expected to exercise due skill, care and diligence in the conduct of its business and ensure full compliance of the laws and relevant rules and regulations. Additionally the Respondent takes the responsibility of the custodian of clients' assets and is required to act diligently, prudently and cautiously. The Respondent must follow all the regulatory provisions in letter and spirit. It is the





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responsibility of every market participant including the Respondent to maintain the integrity of capital market with the prime objective of the protection of clients' interest.

11. Violations of rules and regulations is a matter of serious concern, therefore, in exercise of the powers conferred upon under Section 22 of the Ordinance, I hereby impose on the Respondent a penalty of Rs. 300,000/- (Rupees Three Hundred Thousand Only). Moreover, the Respondent is directed to:

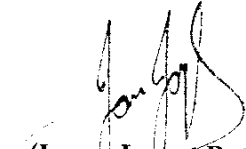
- i) comply with the Rules 1971 and the guidelines issued in letter and spirit; and
- ii) ensure segregation of clients' assets and maintain separate bank account for the clients' funds.

12. The matter is disposed of in the above manner and the Respondent is directed to deposit the fine in the account of the Commission being maintained in the designated branches of MCB Bank Limited not later than thirty (30) days from the date of this Order and furnish a copy of the deposit challan to the undersigned.

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 April 03, 2015
Islamabad.




(Imran Inayat Butt)
Director/HOD (MSRD)