



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 Elixir Securities Pakistan (Private)

Limited under Section 22 of the Securities and Exchange Ordinance, 1969

*Date of Hearing:*

August 29, 2014

*Present at the Hearing:*

*Representing Elixir Securities Pakistan (Private) Limited*

(i) Mr. Junaid Iqbal

Chief Executive Officer

(ii) Mr. Fahad Muslim

Company Secretary

*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(32) SMD/MSRD/C&IW/2013 dated July 24, 2014 ("SCN") served to Elixir Securities Pakistan (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 records 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 February 27, 2014:

a) Mr. Kashif Ali

Deputy Director

b) Mr. Mohammad Tanweer

Deputy Director





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3. The Inspection Team submitted the report ("**Inspection Report**") on May 5, 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 June 10, 2014. Upon evaluation of the Inspection Report, it was observed the Respondent failed to maintain segregation of clients' assets; involved in imposition of late payment charges to its clients; did not have duly approved Know Your Customer ("**KYC**") and Customer Due Diligence ("**CDD**") policy; and failed to maintain pre-trade and post-trade margins.

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 August 11, 2014 at the Commission's Head Office in Islamabad. However, the Respondent vide letter dated August 4, 2014 requested for extension in the date of hearing and change in venue to Karachi. Acceding to the Respondent's request, hearing date was rescheduled to August 29, 2014.

5. The Respondent submitted its written response to the SCN vide letter dated August 25, 2014. The arguments put forward by the Respondent in its written response are reproduced below:

a) **Segregation of Clients' assets:**

*"Clients' funds are recorded separately in the books of ESL who already maintains a separate bank account with Summit Bank for segregation of Clients' funds as the funds of all the Clients are held. The Law does not require maintenance of separate bank account in each city. Funds of Clients with Breakdown of balances are duly recorded in the books of ESL.*

*It is pertinent to mention that since ESL has Clients in many cities, payments are made by the Clients in ESL's bank accounts maintained with nearest banks and the funds are transferred to the main bank account with Summit Bank on daily basis. Furthermore, the accounts maintained in other cities are only collection accounts in which funds of Clients are received and thereafter immediately transferred to the main bank account with Summit Bank. This facilitated the Clients in other cities to make timely to make timely payments without any inconvenience. Furthermore, on sale of securities, the Clients demand immediate payment. Payments are made at times from bank accounts opened in the pertinent cities and the funds are thereafter transferred from the main account at Summit Bank to the bank account maintained with the bank in the pertinent cities to facilitate the clients. This is in the interest of the Clients.*







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Furthermore, separate CDC sub-accounts are maintained for each Client for custody margins deposited by the Clients. Hence, segregation of Client's assets is maintained as prescribed by the Regulations. We sincerely believe that it was not a requirement of Regulation 41 (1)(a) of the General Regulations which held the field at the appropriate time to maintain a separate bank account in each city for holding the funds of the Client and neither this would be possible since our main operations are in Karachi from where we monitor the activities of other branches.

It is incorrect that any deposits of Clients were transferred to ESL's running finance account. No running finance whatsoever was obtained against the funds of the Clients and there was no misuse of the Clients' fund whatsoever. Karachi Stock Exchange's Rule Book ("Rule Book") was published in the Gazette on June 18, 2014, whereas the inspection pertained to the period prior to that date. Therefore, as an academic point, SCN cannot be issued under the provisions of the Rule Book.

At any rate, no loss has been caused to any Client and neither there has been any complaint from any of the Clients. There is also an added factor that money is a fungible commodity and money belonging to different Clients cannot be identified by a simple bank statement. The cash balances of the Clients are always been reflected in their respective Sub-ledgers which are readily accessible to all the Clients."

b) **Late Payment Charges:**

"Liquidation damages are being recovered merely to cover cost of funds due to blockage of the funds remaining unpaid. It is not by way of mark-up or interest or profit and neither ESL had or has any intention to thrive on delays on part of the Clients in settling their accounts. Liquidated damages are permissible under Section 74 of the Contract Act, 1872. However, for the accounting purpose, the Accounts Department was using the terminology "Late Payment Charges". This has no bearing on sale of securities through Collateral Account, which is supposed to come into play when ESL decides to sell the securities. .... It is also pertinent to mention that due to pleasant working relations with prestigious clients, it is not desirable to immediately transfer the securities to the Collateral Account as it would not be in the interest of the broker and the capital market to do so. In this regard there are the following categories of Clients necessitating granting of time.

- i. A Client may come at times, under genuine financial difficulties, not foreseen or visualized by the Client or by ESL. For such Clients who believe in prompt discharge of their liabilities, it does not seem practicable or ethical to immediately transfer the securities to the collateral account.
- ii. A Client has substantial security custody position with us which is far greater than the outstanding invoice of ESL. How can ESL justify immediate transfer of his



*[Handwritten signature]*





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*securities in the collateral account when there is no exposure whatsoever for ESL who is overly secured.*

*However, since ESL believes in abiding by the all applicable laws, rules and regulations and the guidelines of the Hon'ble Commission, ESL had sought the Commission's guidance on this issue in its Comments, taking into account the market practice prevailing at the Karachi Stock Exchange. In particular, if the Client delays the payment under the above scenarios, how would ESL be compensated for being out of money for such period and especially when ESL like other brokers has financing arrangements with banks and has to pay mark-up to its banks? This issue is being confronted by the broker community and in the interest of capital market, the Hon'ble commission's guidance is solicited so as to save the broker from suffering such loses due to delayed payments, especially under situation where the Client has long standing relations and has all intentions to pay, but is in genuine difficulty and/or has a strong custody position with us and it is also not fair to transfer his securities immediately to Collateral Account and sell the same.....Furthermore Clause vi of ESL's AOF provides for payment of liquidated damages for delayed payments. Charging of liquidated damages with the consent of the client is lawful and permissible under Section 74 of the Contract Act, 1872. Additional conditions were permitted to be included under General Regulation 40 (1) that held the field at relevant time and are also now permissible under Chapter 4, Rule 4.17." of the Rule Book. .... If client fails to pay any amount on a date, ESL only claims liquidated damages, not by the way of financing or penalty, but as compensation for financial loss, which is a universally recognized principle of law of contract..... Thus if a Client of ESL does not pay up for purchases on settlement date, ESL can charge compensation by whatever name called, as per the contract, No Client has raised any issue in this respect. Furthermore, even Clause 7 (b) of the Terms and Conditions of SAOF does not specifically prohibit charging additional compensation in the event of breach of contract. It simply mentions that the broker may transfer such securities to the Collateral Account..... Section 16 of the Securities & Exchange ordinance 1969 undoubtedly prohibits direct or indirect extension or maintenance of credit or arranging for extension or maintenance of credit for any person for the purpose of purchasing or carrying any security. ESL does not extend or maintain any credit and neither ESL arranges for extension or maintenance of any credit for its Clients from other sources for the purpose of purchasing or carrying any security. .... The matter is pure and simple. If a Client commits default on the due date, ESL recovers compensation from the defaulting Client as per contract, since ESL has to meet its clearing obligation and remains out of money..... In recovery suits, the court proceedings drag on for years and years. It will be extremely unfair to ESL, if it is not allowed to recover compensation by way of late payment charges or mark-up or surcharge by whatever*





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name called. This is one of the major exposures for stock broker in the event of substantial front in the prices of securities."

c) **Standardized Account Opening Forms (SAOF's):**

All SAOF have been updated.

d) **Registration of certain employees in UIN Data Base:**

Name	Status	ESL's Submission
Muhammad Ali Ansari	Regular Customer	He was an employee, but he left the company, Subsequently, he became ESL's Client. Therefore, ESL had to change the status from employee to the Client.
Shoaib Bin Shahid	Regular Customer	He also was an employee and left the Company. Therefore, ESL had to change the status from employee to the Client.
Muhammad Shabbir		No trading has taken place in his account so far. Employee status has been updated.
Amir Ali	Not registered	It was our bonafide understanding that it was not mandatory to open a Contract employee's account. However, due to the objection raised by the Inspection Team, he has already been registered as ESL's employee.
Ali Raza	Not registered	NCCPL declined to open the account screen snap shot attached. He already had an account with another broker who did not change his status. This is not ESL's fault.

e) **Non- Classification of Employees' Accounts as Proprietary**

The position has been explained in ESL's Comments. ESPL marks "Employee" status of all associated persons in NCCPL database at the time opening of an account or at change. ESL also has a sophisticated back office system, through which ESPL segregation by branch and by the trader, which are properly marked Prop. after employee name. It may be noted that Prop. is always marked against the account of each employee. Furthermore, no directors have trading account with ESPL. You therefore appreciate that there has been no violation of Clause 7.5 of Chapter 7 of the Rule Book

f) **KYC & CDD Policy:**

According to the Inspection Team's observation, ESL was required to fill in a Checklist relating to KYC in order to determine its compliance status and duly filled in Checklist was not provided to the Inspection Team, which led them to believe that ESL was attached with







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ESL's Comments. ESL's Standard Operating Procedures for Equities also cover KYC requirements All the requirements of KSE's Notice on Know your Customer and Customer Due Diligence Guidelines dated March 16, 2012 were fully complied with, with the concurrence of the Directors of ESL as the same were presented to the Board on Tuesday November 26, 2013 and cleared by the Board.

g) **Acceptance of Margin in Non-Margin Eligible Securities:**

Under Regulations Governing Risk Management of Karachi Stock Exchange (Risk Management Regulations"), there was no categorical condition or the acceptance of only Margin Eligible Securities, although securities were categorized into four categories. ESL accepted only liquid stocks as the margin securities. The liquid stocks are discounted @ 30% or as per KSE haircut list, whichever is higher and stock valued at less than Rs.5/- are discounted 100%. Clause 19.10.4 of the Rule Book also does not categorically bar a broker from accepting non-margin eligible securities. It simply obligates brokers to take margin from their respective clients in accordance with margin requirements as prescribed by KSE.

h) **Internet Trading Agreement:**

Clause C of Additional Terms and Conditions is self-contained and includes all requirements including risk disclosures for IBTS, as prescribed by Regulation 5 of the Internet Trading Regulations which held the field and is identical to Clause 9.5 of Chapter 9 of the Rule Book. Since this is a part of the Account Opening Form, it constitutes a valid and binding Agreement in relation to Internet Trading and there is no need for a separate agreement.

Regulation 6.a required appropriate disclosures highlighting the risks. This is adequately covered in Paras V and V11. of Clause C of Additional Terms and Conditions.

Regulation 6.b required a broker to provide access to the clients on all applicable rules, regulations, guidelines, information etc., which is being done and it cannot be the part of this contract. Regulation 6.d required disclosures to clients the Agreement and the infrastructure provided by third party vendor which is being done at ESL and is not required to be made as part of the agreement.

Regulation 6.e required retention of records for at least five years which is being done by ESL and this is not required to be made a part of the agreement. Most specifically, only agreement is required and the remaining conditions relate to the regulatory obligations of the broker which may not be the part of the contract. The above Regulations were analogous with Clauses 9.4.1 to 9.4.5 of the Chapter 9 of the Rule Book. Hence, there is no violation.

6. Mr. Junaid Iqbal, Chief Executive Officer and Mr. Fahad Muslim, Company Secretary of the Respondent, ("**Representatives**") attended the hearing on behalf of the Respondent. The Representatives of the Respondent during the course of hearing communicated that:





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- a). The Representatives regarding segregation of clients' funds apprised that the Respondent has opened number of bank accounts to facilitate its clients, however, the Representatives further informed that at the end of the day, all the payments received are transferred to the bank account tagged as clients' account. Referring to the instances highlighted in Annexure V of the Inspection Report, the Representatives contended that those cheques were of Habib Metro Bank submitted by the clients of the Respondent, which were subsequently transferred to the Summit Bank clients' account. The Representatives agreed to provide reconciliation of the same. The Representatives further added that no complaint against the Respondent has yet been received by the Commission.
- b). Regarding late payment charges, the Representatives asserted that the purpose of imposing late payment charges is to ensure recovery of the receivable balance and not to earn income. The Representatives further stated that if the situation is analysed in depth, the Commission shall come to know that the Respondent even after imposing late payment charges, actually have to bear extra cost. The Representatives contended that the Respondent is imposing late payment charges as per the market norms.
- c). With reference to the updated SAOFs the Representatives provided copies of the SAOFs to substantiate that the Respondent is now compliant with the regulatory framework in this context.
- d). Regarding classification of certain employees as referred to in para 9.3.5 of the Inspection Report, the Representatives informed that same has been updated and agreed to provide evidence, subsequent to the hearing.
- e). The Representatives agreed to provide duly approved KYC and CDD Policy subsequent to the hearing as the same was in the process of approval by the Board of Directors of the Respondent.
- f). The Representatives apprised that the Respondent is collecting complete margins from its clients. They agreed to provide script wise list of the haircuts applied by the Respondent.







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7. Hearing the Representatives at length during the course of hearing, perusal of the available record and evaluation of written reply filed by the Respondent, my findings to the issues raised in the SCN are as follows:

- a) To corroborate maintenance of segregation of clients' funds, the Respondent vide email dated September 10, 2014 provided reconciliation as to where the amounts as highlighted in Annexure V of the Inspection Report were deposited. The information provided by the Respondent is summarized below:

Sr. No	Particulars	Date	Amount	Total Payables	Client Bank Account Balance (as per ledger of the Respondent)	Bank Name
1	Saima Matloob	04/02/2013	3,000,000	90,967,434	134,798,057	Atlas Bank Limited - Client Account
2	Shahzad Gull	24/05/2013	3,000,000	111,625,190	130,277,235	Atlas Bank Limited - Client Account
3	Raymond	13/08/2013	1,530,000	72,389,320	75,766,138	Atlas Bank Limited - Client Account
4	Raymond	20/08/2013	4,175,000	59,529,900	87,929,484	Atlas Bank Limited - Client Account
5	Rukhsana	02/01/2013	2,500,000	50,208,819	106,955,458	Atlas Bank Limited - Client Account
6	Farhat Abbas	21/11/2013	3,255,000	74,276,700	85,846,729	Atlas Bank Limited - Client Account
7	Farhat Abbas	26/12/2013	1,400,000	90,796,100	106,191,504	Atlas Bank Limited - Client Account
8	Mujtaba Hassan	27/12/2013	850,000	76,928,813	106,191,514	Summit Bank Limited - Clients' Account

In this context, it is pertinent to note that the Respondent provided details of the bank balances in its ledgers account and did not provide copy of the bank statements of the referred dates. Moreover, as per the Inspection Report, the Respondent is maintaining bank account with Summit Bank Limited for ensuring segregation of clients' funds, however, as per the detail provided the Respondent deposited majority of the amounts in the Atlas Bank Limited. The Respondent with regard to non-utilization of the clients' funds for reducing/maintaining running finance facility, did not provide evidence to confirm that the same amount was not used for the referred purpose.







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Furthermore, the Respondent vide email dated September 25, 2014 submitted its NCB as of June 30, 2014 and a reconciliation of the trade payables the balance in the clients' bank account of the same date. As per the reconciliation provided by the Respondent, it has an amount of Rs. 162 million available in its clients' bank account against balance of trade payables amounting to Rs. 113 million, excluding the payable to IDS clients incorporated in the NCB. However, further clarifications provided by the Respondent to substantiate its stance of segregation of clients' assets did not support the calculation of trade payables of Rs. 113 million. The Respondent vide email dated September 30, 2014 provided break up/aging of trade payables included in the NCB calculation depicting an amount of Rs. 223 million overdue for more than 30 days from IDS clients. In light of the above, the Respondent failed to provide sufficient evidence to substantiate maintenance of proper segregation of clients' assets.

The regulatory framework regarding segregation of clients' assets clearly instructs the broker to maintain a single bank account. The framework further specifies that clients' funds cannot be used by the broker for his own business. Relevant extracts, in the 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) 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."*

From the above, it becomes very clear that the Respondent is expected to maintain a single bank account for maintaining segregation of clients' assets and the clients' funds should be deposited in the same bank account. The Respondent by not maintaining proper segregation of clients' assets is, prima facie, in violation of the requirements as laid down in the KSE Rule Book.





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- b) Regarding late payment charges, the Representatives during the course of hearing and the Respondent in its written response stated that the purpose is not to earn income. However, the Respondent by imposing late payment charges, as the same is not allowed in the regulatory framework, is prima facie, not compliant with the specified requirements.
- c) With reference to the update of the UIN database maintained by NCCPL, the Respondent vide email dated September 10, 2014 provided copies of the UIN Reports of the employees referred to in the Inspection Report and para 7 of the SCN.

8. It is important to note that all regulatory provisions have a specific purpose behind their enactment and enforcement. The objective of governing compliance of segregation of clients' assets is to ensure smooth and sound functioning of the securities market and to protect the interest of the investors. The Respondent being custodian of clients' assets is expected to ensure that clients' assets are kept segregated from the assets of the Respondent along with client wise traceable record of clients' assets.

9. After a detailed and thorough perusal of the facts, evidence/information available on record, contentions and averments made by the Representatives of the Respondent during the course of the hearing, it is evident that the Respondent failed to properly maintain segregation of clients' assets; did not have approved KYC and CDD Policy and was involved in imposition of late payment charges to its clients.

10. The violation of the Rules and Regulations is a serious matter, therefore, in exercise of the powers under Section 22 of the Ordinance, I hereby impose on the Respondent a penalty of Rs. 50,000/- (Rupees Fifty Thousand Only). Moreover, the Respondent is directed to:

- i) comply with the Rules 1971 and the guidelines issued in letter and spirit;
- ii) ensure proper segregation of clients' assets and maintain a separate bank account for the clients' funds;
- iii) provide bank statement of the bank account with Summit Bank Limited (meant for segregation of clients' assets) as of December 31, 2014 along with copy of trial balance of the same date evidencing gross trade receivables and trade payables; and
- iv) immediately stop imposing late payment charges.





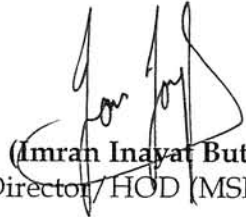


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11. The matter is disposed of in the above manner. This Order is issued without prejudice to any other action that the Commission may initiate against the Respondent in accordance with the law on matter subsequently investigated or otherwise brought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



  
(Imran Inayat Butt)  
Director/HOD (MSRD)

Announced on September 30, 2014  
Islamabad.