

Securities and Exchange Commission of Pakistan  
Securities Market Division

Through Courier

Before The Director / HOD (MSRD)

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

*Date of Hearing:*

September 19, 2014

*Present at the Hearing:*

*Representing Alfa Adhi Securities (Private) Limited*

(i) Mr. Mohsin Adhi

Director

(ii) Mr. Ayaz Aman

Director

*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(35) SMD/MSRD/C&IW/2014 dated September 5, 2014 ("SCN") served to Alfa Adhi 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 March 31, 2014:

a) Mr. Kashif Ali

Deputy Director

b) Mr. Muhammad Tanweer

Deputy Director





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3. The Inspection Team submitted the report ("Inspection Report") on June 30, 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 August 5, 2014. Upon evaluation of the Inspection Report, irregularities in calculation of Net Capital Balance ("NCB") as of December 31, 2013 were observed and it appeared that NCB certificate was not prepared in accordance with 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 approved Know Your Customer ("KYC") and Customer Due Diligence ("CDD") Policy; failed to comply with requirements pertaining to internet trading and failed to comply with Circular 34 of 2009 issued by the Commission.

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 September 19, 2014 at the Commission's Head Office in Islamabad.

5. The arguments put forward by the Respondent in its written response to the SCN, submitted vide letter dated September 13, 2014 are reproduced below:

a) **Net Capital Balance:**

*"Based on IAS 32 (Para 45)*

*A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount due from the creditor. In unusual circumstance, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement between the three parties that clearly establishes the debtor's right of set-off. Because the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and the laws applicable to the relationships between the parties need to be considered."*

*Accordingly we have authority letter from Mr. Yaqoob Ali (12070176)(Debtor), Noor Jahan (12070178) Arfa Jawed (12070182) Khalid Ali (12070181) Yaqoob Ali (12070175) Farha Farhan (12070186) (creditors) in which they have agreed for netting off debit and credit balances and we also consented in writing to this arrangement. Further after 31<sup>st</sup> December*





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2013 these six accounts of clients have been finally settled on 11-March-2014 by paying net amount of debit and credit balances. The ledgers of these accounts are enclosed as evidence."

b) **Segregation of Clients' Assets:**

"As per KSE notice dated 26-March-2008

The client's cash deposit and margin securities shall not be used by the broker for any purpose other than as authorized by the client in writing.

Moreover in clause 4.19.2 Chapter -4 of 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. The broker shall be obliged to maintain and furnish documentary evidence to substantiate the compliance with the above regulations as and when required by the Exchange."

Based on the above text we have seek approval from few of our clients in writing the sample of which is attached (Annexure B). Whereas for others we have kept their balances in client Account.

c) **Standardized Account Opening Forms (SAOFs):**

"As per our comments we have drafted new SAOF the copy of which is attached for your approval (Annexure C). Once you approve it we will start its implementation."

d) **KYC and CDD:**

"The Board has made the decision to fill and complete checklist of KYC/CDD as suggested by Karachi Stock Exchange in Notice KSE/N-1388 dated 16-March-2102 copy of checklist is attached for your reference (Annexure D)."

e) **Online Trading:**

"Our company has outsourced online software which has online risk management capacity and it covers all the aspects as mentioned in clause 9-6 of the Chapter 9 of Rule Book. In relation to your observation regarding highlighting the risk associated with internet trading we are unable to extract such guideline from Rule Book, therefore we would like to seek appropriate guideline in this case from your good self."

f) **Institute of Capital Market:**

"We have intitiated registration process of two of our employees at this stage. As the examinations are conducted four times a year our respective candidates."

6. Mr. Mohsin Adhi and Mr. Ayaz Aman, Directors of the Respondent ("Representatives") attended the hearing on behalf of the Respondent on September 19, 2014 at the Commission's Head Office. The arguments put forth by the Representatives of the Respondent during the course of hearing are summarized below:





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- a) With regard to calculation of NCB, the Representatives stated that the Respondent is strictly following the guidelines issued by the Commission. The Representatives informed that the difference identified by the Inspection Team was because of netting of few clients' accounts as those were family accounts. The Representatives added that this was only one time arrangement subsequently, those accounts have been settled and closed in March 2014. The Representatives provided copies of the clients' ledger accounts depicting settlement and subsequent closure. The Representatives further added that no accounting entry in the context was made in the books of accounts, it was just done in the preparation of NCB. The Representatives agreed to provide copy of the NCB Certificate as of June 30, 2014.
- b) The Representatives, in the context of segregation of clients' assets, ensured compliance with the regulatory framework in future and agreed to provide copy of bank statement of clients' account as of September 30, 2014 along with copy of the trial balance depicting payables of the same date.
- c) Regarding SAOFs, the Representatives stated that they shall remove the discrepancies as identified by the Inspection Team and shall ensure compliance of regulatory requirements in the future.
- d) The Representatives stated that they shall get the KYC and CDD Policy approved from the Board of Directors of the Respondent and shall subsequently share copy of the board resolution and the Policy document with the Commission.
- e) The Representatives apprised that in order to ensure compliance with Circular 34 of 2009, the Respondent has registered two of its employees with the Institute of Capital Markets. The Representatives further agreed to provide evidence of the same to the Commission.

7. I have heard the arguments presented by the Representatives of the Respondent 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) With regard to NCB, the Respondent in the written reply and its Representatives during the course of hearing communicated that the difference was only because of





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the netting of few clients' accounts, which were actually family accounts and had provided written authority in the context. The Respondent provided copies of the clients' ledgers identified by the Inspection Team depicting settlement and closure of those clients' accounts along with the written response to the SCN. The Respondent further vide letter dated September 30, 2014 provided copy of NCB Certificate as of June 30, 2014 depicting NCB of Rs. 37.401 million.

- b) Regarding segregation of clients' funds, the Representatives during the course of hearing and the Respondent in its written response ensured compliance of the same in future. As of June 30, 2014 as per the information provided in NCB Certificate, available balance in the clients' bank account was Rs. 1.431 million against trade payables of Rs. 48.123 million of the same date.

Notwithstanding the above, the regulatory framework 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"*

The Respondent as an evidence of future compliance to the requirements of segregation of clients' assets provided a letter from JS Bank depicting bank balance of





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Rs. 11.475 million as of September 30, 2014 in the account tagged as clients' account against trade payables of the same date of Rs. 9.151 million.

- c) In reference to SAOFs, the Respondent vide letter dated September 30, 2014 provided copy of the latest updated SAOF and communicated that the disclosure requirements as identified by the Inspection Team has been incorporated.
- d) Resolution of the Board of Directors regarding approval of the KYC and CDD Policy was provided by the Respondent vide letter dated September 30, 2014 as was agreed during the course of hearing.
- e) The Respondent vide letter dated September 30, 2014 provided copy of email confirming registration of two of its staff members with Institute of Capital Markets to substantiate compliance with Circular 34 of 2009 issued by the Commission.

8. 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 during the inspection period failed to fulfil its regulatory obligations by not maintaining proper segregation of clients' assets; not having updated SAOFs; not having approved KYC and CDD Policy and not ensuring compliance with Circular 34 of 2009.

9. Segregation of clients' assets is of quintessence to strengthen investors' confidence in the stock market and to avoid misuse of clients' assets by the brokers and probable default of the brokerage houses. The Respondent being custodian of clients' assets is expected to perform its business with due care and conscientiousness. In order to protect the interest of investors, the Commission has promulgated a set of rules and regulations which the Respondent is required to comply with.

10. The violation of the rules and regulations is a serious matter. However, the Representatives during the course of hearing and the Respondent in its written response communicated that it is now maintaining segregation of client's assets in letter and spirit. Moreover, the Respondent rectified the identified irregularities highlighted in the inspection report and assured compliance with the applicable regulatory framework in future. Therefore, taking a lenient view, in exercises of the powers under Section 22 of the Ordinance,





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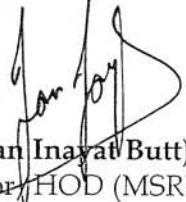
I hereby impose a penalty of Rs. 25,000/- (Rupees Twenty Five Thousand Only) on the Respondent. The Respondent is further directed to:

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

11. 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.

12. 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 October 22, 2014  
Islamabad.