



Securities and Exchange Commission of Pakistan

Securities Market Division
Market Supervision and Registration Department

Before the Director (MSRD)

In the matter of Show Cause Notice issued to Apex Capital Securities (Pvt.) Ltd. (APEX)

Date of Hearing:

September 30, 2013

Present at the Hearing:

Representing APEX:

- | | | |
|------|------------------------|------------------|
| i. | Mr. Rao Naseem Tehsin | Chairman, APEX |
| ii. | Mr. Naveed Godil | Director, APEX |
| iii. | Mr. Saifullah Farooqui | Accountant, APEX |

Assisting the Director (MSRD):

- | | | |
|----|----------------------|-----------------|
| i. | Ms. Saima Shafi Rana | Deputy Director |
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ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice No. 4(BRK-178) SE/SMD/2009 dated July 30, 2013 (the “**SCN**”) under Section 22 of the Securities and Exchange Ordinance, 1969 (the “**Ordinance**”) read with section 28 of the Central Depositories Act, 1997 (the “**CD Act**”) issued to M/s. Apex Capital Securities (Private) Limited (the “**Respondent**”), Trading Right Entitlement Certificate Holder of Karachi Stock Exchange Limited (the “**KSE**”) and a broker registered with the Securities & Exchange Commission of Pakistan (the “**Commission**”) under the Brokers and Agents Registration Rules, 2001 (the “**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 (the “**Inspection Rules**”) ordered an inspection of the books and records required to be maintained by the Respondent.

3. The report dated April 30, 2013 submitted by the Inspection Team disclosed that the Respondent was mishandling the securities of its clients. Moreover, major irregularities in calculation of Net Capital Balance (“**NCB**”) as on December 31, 2012 were also observed and it appeared that NCB was not in accordance with the Third Schedule of Securities and Exchange Rules, 1971 (the “**SE Rules**”). Thereafter, the Commission served a SCN to the Respondent, the contents of which are reproduced below:-

SUBJECT: SHOW CAUSE NOTICE IN THE MATTER OF INSPECTION OF BOOKS AND RECORD OF M/S. APEX CAPITAL SECURITIES (PVT.) LIMITED- TREC HOLDER KARACHI STOCK EXCHANGE LIMITED.

WHEREAS, M/s. Apex Capital Securities (Private) Limited ('APEX') is a Trading Right Entitlement Certificate (TREC) Holder of the Karachi Stock Exchange and registered as a broker with the Securities and Exchange Commission of Pakistan (the "Commission") under the Brokers and Agents Registration Rules, 2001 (the "Brokers Rules").

2. **AND WHEREAS**, the Commission in exercise of its powers under sub-section (1) of section 6 of the Securities and Exchange Ordinance, 1969 (the "Ordinance") read with Rule 3 and Rule 4 of the Stock Exchange Members (Inspection of Books and Record) Rules, 2001 (the "Inspection Rules") ordered an inspection vide order dated March 6, 2013 of the books and record required to be maintained by APEX. The Inspection Team submitted the inspection report to the Commission on April 30, 2013 which was forwarded to APEX in accordance with rule 7 of the Inspection Rules.

3. **AND WHEREAS**, on review of the inspection report, prima facie it appears that APEX is mishandling the securities of its clients. The detail of such mishandling is given as under:-

a. The Trial Balance of APEX as at December 31, 2012 disclosed "Nil" investments in listed securities by APEX. Further certified Net Capital Balance as at December 31, 2012 disclosed "Nil" proprietary investments in listed securities. Whereas, CDC statement balance of APEX's House Account reflected 217,666 shares of various companies amounting to Rs. 10.686 million as at December 31, 2012 Keeping clients' securities in House Account is in violation of Central Depository Company of Pakistan Limited Regulations whereby House Account has been defined as an account maintained on the Central Depository Register ("CDR") by an account holder for recording book-entry securities beneficially owned by the said account holder.

b. Instances of CDS Intra Account Transfers were observed, wherein clients' securities were routed from APEX's House Account in favor of Bank Alfalah Limited against running finance facility availed by APEX. It was pointed out that shares from sub-accounts were initially moved into House Account by describing them as off-market trades. On transfer, those shares were immediately pledged with Bank Alfalah Limited against financing availed by APEX. On release of pledge, those shares were again transferred to client's sub-accounts by describing as off-market trades. It was also observed and pointed out that those transactions were not recorded into ledgers of the respective clients.

4. **AND WHEREAS**, prima facie it appears that APEX moved and/or pledged the shares with the Banks/others without authorization in sheer violation of Section 24 of the Central Depositories Act, 1997 (the "CDC Act") which reads as follows:

"(1) A Participant shall not handle or authorize or permit any handling of book-entry securities entered in the sub-accounts maintained under his account without authority of sub-account holder (2) A participant shall not expect with the authority of his clients, handle or authorize or permit any handling of book-entry securities beneficially owned by such clients and entered in his account."

5. **AND WHEREAS**, on review of the inspection report it came to the notice of the Commission that calculation of Net Capital Balance ("NCB") of APEX as on December 31, 2012 had the following irregularities:-

a. Overstatement of Trade Receivables by Rs. 17,421,182

- b. *Understatement of Securities Purchased for Clients by Rs. 8,660,567*
- c. *Understatement of Trade Payable by Rs. 3,494,000*
- d. *Understatement of Other Liabilities by Rs. 6,143,452*
- e. *Overstatement of NCB by Rs. 18,398,467*

6. **AND WHEREAS**, *prima facie*, it appears that the NCB as calculated by APEX is not in accordance with the Third Schedule of the 1971 Rules and that APEX by submission of overstated NCB has given information which it had reasonable cause to believe to be false or incorrect in material particular in violation of section 18 of the Ordinance, which reads as follows:-

“No person shall, in any document, paper, accounts, information or explanation which he is, by or under this Ordinance, required to furnish, or in any application made under this Ordinance, make any statement or give any information which he knows or has reasonable cause to believe to be false or incorrect in any material particular.”

7. **AND WHEREAS**, in light of the facts mentioned above, *prima facie* it appears that APEX is in contravention of Section 24 of the CDC Act and Third Schedule of the 1971 Rules read with Section 18 of the Ordinance, the contravention of which invokes penalty and/or punishment under section 22 of the Ordinance and section 28 of the CDC Act.

8. **AND WHEREAS**, sub-section (1) of section 22 of the Ordinance provides that:

“ If any person refuses or fails to furnish any document, paper or information which he is required to furnish by or under this Ordinance; or refuses or fails to comply with any order or direction of the Commission made or issued under this Ordinance; or contravenes or otherwise fails to comply with the provisions of this Ordinance or any rules or regulations made thereunder, the Commission may if it is satisfied after giving the person an opportunity of being heard that the refusal, failure or contravention was willful, by order direct that such person shall pay to the Commission by way of penalty such sum not exceeding fifty million rupees as may be specified in the order and in the case of continuing default, a further sum calculated at the rate of two hundred thousand rupees for every day after the issue of such order during which the refusal, failure or contravention continues.”

9. **AND WHEREAS**, Section 28 of the CDC Act provides that:

“... whoever knowingly and willfully contravenes or attempts to contravene or abets the contravention of the provisions of section 24 shall be punishable with a fine which may extend to one million rupees and to a further fine not exceeding twenty thousand rupees for every day after the first contravention during which the contravention continues or with imprisonment for a term which may extend to five years, or with both...”

10. **NOW THEREFORE**, you are hereby called upon to show cause in writing by August 5, 2013, as to why action as provided under section 22 of the Ordinance and section 28 of the CDC Act may not be initiated against APEX for violation as indicated above. You are further directed to appear in person or through an authorized representative (with documentary proof of such authorization), on August 6, 2013 at 11:00 a.m. at the SECP Headquarters – Islamabad. You are advised to bring all relevant record in original, which you may consider necessary for clarification/defense of your stance.

11. This notice sufficiently discharges the Commission's obligation to afford APEX an opportunity of hearing in terms of section 22 of the Ordinance and in case of failure to appear on the stated date of hearing it will be deemed that APEX has nothing to say in its defense and the matter will be decided on the basis of available record.

Sd/-
Hasnat Ahmad
Director

4. Thereafter, the hearing fixed for August 6, 2013 was adjourned on the request of the Respondent. The Respondent submitted a written response to the SCN vide its letter dated October 23, 2013. The following arguments were put forward by the Respondent in its written response and during the hearing held on September 30, 2013:

(a) Mishandling Securities of Clients:

In this regard, the Respondent stated that:-

- i). Disclosure of investment in listed Securities and unauthorized Pledge: Please note that, while doing business for clients, at some point of time, the house need to settle its clearance whereas amount against trade is receivable from clients. In such cases, although authority of pledge is not available but to settle the clearance in bank against nonpayment of client, the house is left with no option but to pledge such client's shares with bank for facility.. The bank does not accept direct pledge in such cases and we had to route it through house's account and for that reason, investments are shown in CDC which are not company's investments in actual.
- ii). CDC Intra account transfers: In some cases of non-payment from the clients, just for the sake of timely settlement the house need to acquire bank facility and for that purpose uses client' securities. Whereas, the bank did not accept direct pledge and in such situation we had to route it through house's account and clients are aware of this practice.

(b) Irregularities in Calculation of Net Capital Balance

The arguments submitted by the Respondent are as under:-


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- i). Overstatement of Trade Receivables: “We have reviewed our data and found that Trade Receivables outstanding for more than 14 days are Rs. 59.022 million”
- ii). Understatement of Securities held for clients: “ We have reviewed our data and found that the amount shown as securities held for clients is correctly shown at Rs. 16.501 million”
- iii). Understatement of Trade Payables: “We have reviewed our data and found that the reported figure is correct”
- iv). Understatement of Other Liabilities: “Please note that account titled as long term loan and future profit withheld are not in the nature of current liabilities”

5. I have examined the facts, evidences and documents on record, in addition to the written and verbal submissions made on behalf of the Respondent. The arguments raised by the Respondent are discussed and appraised hereunder in seriatim:

(a) Mishandling Securities of Clients:

The Respondent contended that shares of various clients were kept in its House Account as the said clients failed to clear their outstanding balances and the said shares were pledged to settle the trades of the clients. The Respondent further accepted that it had no authority to pledge the said shares but it was left with no option other than keeping the shares in House Account for utilizing the same for pledging.

Moreover, with regard to the issue relating to unauthorized movement and unauthorized pledging of clients' securities; it is pertinent to mention that using client's funds/shares without proper authorization is a violation under CD Act. Section 12 (6) of the CD Act stipulates that a participant shall not create a pledge over any book-entry securities entered in any sub-accounts maintained under its account with the Central Depository without the authorization of the sub-account holder concerned. In line with that Section 24 of the CD Act also prohibits handling of book entry securities entered in the sub-accounts without the authority of the sub-account holder. Moreover, as per Part (G) of the Standardized Account Opening Form, the Respondent was required to obtain specific authority from the sub-account holder(s) for transfer, pledge and withdrawal of book-entry securities. However, the Respondent failed to provide any documentary evidence to substantiate its stance.

(b) Irregularities in Calculation of Net Capital Balance

It is observed that the aging methodology of the Respondent is not correct. It is apparent that the Respondent calculated the amount of Trade Receivables and Trade Payables above 14 days on the basis of overall debtors' and creditors position and not on the basis of each transaction. However, the Third Schedule of SE Rules states that *Book Value less those overdue for more than 14 days* and clearly indicates that transactions outstanding for more than 14 days must be considered as overdue. It is also a well-established principle that general payments against receivables and vice versa should first be adjusted against older balances. All of these arguments clearly indicate that the treatment of receivables and payables shall be on individual transactions basis rather than collective basis. It is also observed that incorrect aging methodology resulted in overstatement of Trade Receivables and understatement of Trade Payables and Securities held for Clients.

Moreover, the contention of the Respondent with regards to understatement of Other Receivables cannot be accepted as 'Future Profits withheld' are current in nature and have to be settled prior to the inception of next future contracts; which in, any case, should be settled within one year from the date of reporting. Hence, these are bound to be included under Current Liabilities.

6. After a detailed and thorough perusal of the facts, evidence/information available on record, contentions and averments made by the Respondent during the course of the hearing, it is observed that the Respondent misinterpreted the aging methodology; which resulted in overstatement of NCB. Moreover, it is also observed that current liabilities were wrongly calculated as a result NCB submitted by the Respondent was overstated. If the NCB of the Respondent was calculated in strict compliance with the requirements of the SE Rules; it would have been negative.

7. It is further established that in many instances the Respondent has moved/pledged the shares without proper authority of the sub-account holders. Moreover, the Respondent was holding the shares of its clients in its House Account. Such mishandling of clients' securities is a clear violation of Section 24 of the CD Act, which is punishable under Section 28 of the CD Act.

8. The violation of the Ordinance, rules and regulations is a serious matter and in view of the regulatory violations as discussed above, through this Order, the Respondent is directed to deposit a sum of Rs. 300,000 (Rupees Three Hundred Thousand Only) under Section 22 of the Ordinance and Section 28 of the CD Act to the Commission by way of penalty. The Respondent is directed to ensure that the shares of the investors be transferred to the respective sub-accounts of the clients at the earliest. Moreover, the practice of keeping shares in House

Account be immediately discontinued. The Respondent is further directed to ensure full compliance with the Ordinance, rules, regulations and directives of the Commission in future.

9. The matter is disposed of in the above manner and the Respondent is directed to deposit the penalty 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 copy of the deposit challan to the undersigned.

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

**Announced on December 10, 2013
Islamabad.**




(Hasnat Ahmad)
Director (MSRD)