



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 Topline Securities (Private) Limited
under Section 22 of the Securities and Exchange Ordinance, 1969

Date of Hearing:

January 20, 2015

Present at the Hearing:

Representing Topline Securities (Private) Limited

(i) Mr. Muhammad Sohail

Chief Executive Officer

(ii) Mr. Khalid Mehmood

Compliance 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(41) SMD/MSRD/C&IW/2014 dated December 26, 2014 ("SCN") served to Topline 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 August 7, 2014:

a) Mr. Kashif Ali

Deputy Director

b) Mr. Mian Muhammad Imran

Deputy Director





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3. The Inspection Team submitted the report ("Inspection Report") on October 17, 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 November 4, 2014. Upon evaluation of the Inspection Report, irregularities in calculation of Net Capital Balance ("NCB") as on December 31, 2013 were observed and it appeared that NCB certificate was not in accordance with the Third Schedule of the Securities and Exchange Rules, 1971 ("Rules 1971"). The Inspection Report further highlighted that the Respondent failed to maintain proper segregation of clients' assets and books of accounts; did not have collateral account and duly approved Know Your Customer ("KYC") & Customer Due Diligence ("CDD") policy; was imposing late payment charges to its clients and failed to comply with the requirements as specified in 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 January 12, 2015 at the Commission's Head Office in Islamabad. However, upon the request of the Respondent made vide letter dated January 6, 2015, hearing was rescheduled for January 20, 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 January 23, 2015 are reproduced below:

a) Improper calculation of NCB:

"With reference to point 3(i) of the said letter we want to clarify that we have no intention to overstate net capital balance as our net capital balance is adequate for our business.

NCB was computed as per our understanding of regulations and same was also certified by Chartered Accountant Firm (SBP A Category Firm). On September 23, 2013 Karachi Stock Exchange issued a notice Ref. No KSE/N-5049 which states that Commission receivable that was previously disallowed by the SECP guidelines issued on July 03, 2013 has now been allowed. The guideline issued by the SECP did not mention aging of Commission receivables. Further, this is normal practice that broker receive commission after few weeks from institutions.

Regarding Point No. 3 (ii), we thought that "Exposure list" and "margin eligible security" as defined in the KSE regulations governing risk management are two different concepts.





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Further, NIT Government Bond Fund is less risky than shares and this fund can be redeemed in same day (T+0) so we considered this in NCB calculations."

b) Imposing late payment charges:

"Regarding point No. 4 of your said letter for charging late payments to our client, we have abolished this practice from July 01, 2014 and are focusing on available products for leverage. Documents supporting this are enclosed."

c) Collateral Account:

"Collateral account has been opened. Supporting documents are enclosed."

d) KYC and CDD Policy:

"In response to Point No.8 we are enclosing extract of BOD approval."

e) Segregation of clients assets:

"As explained to Inspection Team and clarified during hearing on January 20, 2015 we did not consider Rs. 10 million un-credited cheques due to which balance was higher. Moreover there are few operational issues due to which matching exact amount is impossible. For instance few clients requested to issue cheques from their banks for getting instant payments through online banking. Due to this we need to have extra balance a times"

f) Telephone recording:

"We have provided 22 recordings out of 36 to the Inspection Team. We do recordings of our office telephones and maintain all records of those recording. However in few cases clients come to our office and give orders to traders, few clients email us the orders and few clients call traders at their cell or house phone after office hours and give orders. However, if the Commission desired, we can provide written instruction of our client that they have placed those orders."

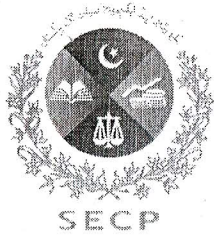
h) Certification from Institute of Capital Markets ("ICM"):

"We are enclosing evidence of new registration with ICM of 5 staff members engaged in activities mentioned in SECP circular No. 34 of 2009."

6. Mr. Muhammad Sohail, Chief Executive Officer and Mr. Khalid Mehmood, Compliance Officer ("Representatives") attended the hearing on January 20, 2015. The arguments put forth by the Representatives of the Respondent during the course of hearing are summarized below:

- a) With regard to improper calculation of NCB, the Representatives stated that the difference was because of non-inclusion of commission receivable and the auditor at that time also did not point out anything in this context. The Representatives communicated that the auditor who certified the NCB was category A auditor as





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specified in the list of State Bank of Pakistan. The Representatives assured that the Respondent shall prepare the NCB in accordance with the regulatory requirements. With regard to inclusion of NIT units in NCB calculation, the Representatives stated that the Respondent considered NIT as less risky investment and thought that it was allowed to be included. The Representatives communicated that it is now clear that investment in NIT units is not allowed as per the guidelines issued by the Commission, the Respondent shall not account it for in future for calculation of NCB. Moreover, the Respondent in its written response stated that it never had any negative intention to overstate the NCB and that the Respondent always had sufficient funds available with it.

- b) The Representatives communicated that since imposing late payment charges to clients was a business practice, the Respondent was also doing that. The Representatives informed that during last year the Respondent decided to completely discontinue the practice; accordingly it has stopped imposing it from June 30, 2014. The Representatives agreed to provide copy of trial balance and relevant ledgers to substantiate their stance of discontinuance of late payment charges from June 30, 2014.
- c) The Representatives apprised that the Respondent has now opened collateral account and evidence of the same shall be provided to the Commission.
- d) With reference to recording of late payment charges of all the clients in a single clients' ledger, the Representatives explained that miscellaneous expenses were recorded in the referred clients' ledger account, however, the said practice has now been stopped. The Representatives agreed to provide copy of the referred ledger to the Commission to substantiate their stance.
- e) While explaining compliance with the regulatory requirements regarding segregation of clients' funds, the Representatives communicated that specific reconciliation in the context as of December 31, 2013 and June 30, 2014 shall be provided to the Commission. The Representatives informed that in case of non-payment on due date, the Respondent transfer funds from its own account to make settlements. The Representatives further assured future compliance of the regulatory requirements in letter and spirit.





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- f) The Representatives during the course of hearing informed that the Respondent has approved KYC and CDD policy and relevant extracts of the policy were also provided to the inspection team. The Representatives agreed to provide copy of the approval of the Respondents' board of directors in this regard.
- g) In reference to transfer of funds from one of its clients' account "Mr. Haris" to his family members' client account, the Representatives apprised that he has given authority to the Respondent that whenever he gives verbal instructions, the amount be transferred to his wife's account. However, upon objection raised by the inspection team, the Respondent has contacted the client and he has agreed to provide specific transaction wise authority letter which shall be shared with the Commission once received.
- h) The Representatives communicated that they shall provide evidence of the registration of employees of the Respondent with the ICM to substantiate compliance with the Circular 34 of 2009 issued by 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 response subsequently 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 irregularities in the calculation of NCB, the Representatives took a plea that the differences as identified by the inspection team were because of not taking into account commission receivable in the same manner as was done for the trade receivables and including investments in NIT Units in NCB calculations. As per the Representatives, the auditors also did not point out anything with regard to these items, otherwise, the same would have not been included in the calculation. Moreover, the Respondent in its written response stated that it considered investments in NIT units less risky and accordingly included the same. However, the Representatives and the Respondent assured that in future the calculation shall strictly be made in accordance with the guidelines issued by the Commission.
- b) Regarding late payment charges, the Representatives claimed that the Respondent is now focusing on available leverage products and stopped imposition of the late



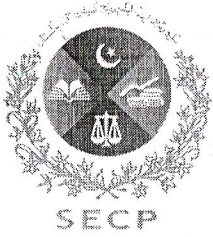


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- payment charges from July 2014 onwards to its clients. The Respondent as an evidence provided copy of client's ledger in which the amounts pertaining to late payments charges were earlier recorded by it. As per the information provided by the Respondent the said client's ledger depicted no activity during July 2014 till January 21, 2015.
- c) The Respondent along with its written response to the SCN provided evidence of the opening of collateral account.
- d) With regard to segregation of clients' assets, the Representatives during the course of hearing and the Respondent in its written response communicated that the difference was because of not mentioning uncredited cheques of worth Rs. 10 million and few operational issues due to which exact reconciliation was not possible. The Representative during the course of hearing agreed to provide reconciliation of the bank balance in clients' account with that of trade payables as of December 31, 2013 and December 31, 2014. The Respondent along with its written response dated January 23, 2015 provided Reconciliation of the bank accounts tagged as clients' account as of the dates and trade payables of December 31, 2014. Analysis of the information revealed that the Respondent had an amount of Rs. 66.562 million available in 11 bank accounts tagged as clients' account against trade payables of Rs. 66.698 million as of December 31, 2014.
- e) With reference to the KYC and CDD Policy, the Respondent provided approval of its board of directors as was agreed during the course of hearing by the Representatives. The Representatives during the hearing and the Respondent in its written response assured effective implementation of KYC and CDD Policy. Moreover, in order to effectively perform risk profiling of the clients and ensure compliance with the KYC and CDD requirements as specified in the guidelines issued by the KSE, the Respondent should have automated system for the purpose.
- f) The Respondent provided specific authority letters pertaining to its client "Haris" substantiating that the transfer of funds from his account to his wife's account were made upon receipt of specific written instruction from the client.
- g) With specific reference to maintaining telephonic recording, the Representatives during the course of hearing and the Respondent in its written response took the





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stance that it is strictly in compliance with the regulatory requirements and has provided 22 recordings out of the 36 recordings demanded by the inspection team. The Respondent further added that it can provide written instructions of its clients for the remaining recordings, if required by the Commission. The Respondent asserted that all the telephone calls received are properly recorded and are available in the form of record for a period more than made mandatory by the exchange. The Representatives further communicated that on number of instances the Respondent provided telephonic recordings of period older than a year to surveillance department of the Commission.

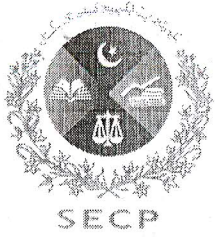
h) The Respondent, with regard to registration of its employees for obtaining desired certification from ICM, communicated that it has registered 4 of its employees and provided emails received from ICM confirming said registration.

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 fulfill its regulatory obligations by imposing late payment charges and not calculating NCB in accordance with the guidelines issued by the Commission.

9. The Representatives of the Respondent during the course of hearing and the Respondent in its written response communicated that they have stopped imposing late payment charges to its clients. They also ensured to follow the regulatory requirements regarding NCB calculation and segregation of clients' assets in letter and spirit and further assured compliance with the entire applicable regulatory framework in future.

10. Therefore, in exercise of the powers conferred upon under Section 22 of the Ordinance, I hereby impose a penalty of Rs. 25,000/- (Rupees Twenty Five Thousand Only) on the Respondent. Moreover, the Respondent is directed to comply with the requirements of Rules 1971 and the guidelines issued by the Commission in letter and spirit.



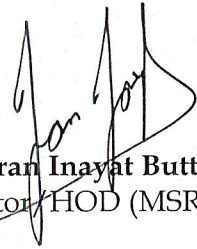


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11. The matter is disposed of in the above manner and the Respondent is directed to deposit the fine in the account of the Commission being maintained in the designated branches of MCB Bank Limited not later than thirty (30) days from the date of this 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 February 6, 2015
Islamabad.