



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

Date of Hearing:

February 27, 2014

Present at the Hearing:

Representing WE Financial Service Limited

(i) Mr. Humayun Javed

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(17) SMD/MSRD/C&IW/2013 dated February 6, 2014 ("SCN") served to WE Financial Service 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 September 27, 2013:

a) Mr. Mohammad Tanweer

Deputy Director

b) Mian Muhammad Imran

Deputy Director





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3. The Inspection Team submitted the report ("**Inspection Report**") on December 3, 2013 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 January 20, 2014. On review of the Inspection Report, irregularities in calculation of Net Capital Balance ("**NCB**") as on June 30, 2013 were observed. The NCB resulted in negative figure of Rs. 5 million after adjustment. From the Inspection Report and subsequent comments of the Respondent, it appeared that NCB certificate was not calculated and prepared 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 proper books of accounts; failed to provide complete information; and failed to maintain collateral account.

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 February 20, 2014 at the Commission's Head Office in Islamabad. The Respondent vide email dated February 11, 2014 requested for change in venue to the Commission's Karachi Office. Acceding to the request of the Respondent, the hearing was rescheduled to February 19, 2014. However, the Respondent again vide email dated February 18, 2014 communicated its inability to attend the hearing and requested for change in the hearing date. Again, acceding to the Respondent's request, hearing was rescheduled for February 27, 2014 at the Commission's Head Office in Islamabad.

5. Mr. Humayun Javed, Chief Executive Officer ("**Representative**") of the Respondent attended the hearing on behalf of the Respondent and submitted written response of the Respondent on the date of hearing. The following arguments were put forward by the Respondent in its written response and by the Representative of the Respondent during the hearing held on February 27, 2014:

- a) **Overstatement of Trade Receivables:** The Respondent in its written response communicated that:

"As stated that Trade Receivables have been overstated it is clarified that due to inadvertence of excluding weekends in the ambit of 14 days this mistake crept in as we under perception that the 14 days represents 14 working days. However, we have now made the notation of the

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clarification which we observed from the observation and since this was due to inadvertence and not deliberate, this may please be condoned."

The Representative of the Respondent asserted its above stance and assured that in future they will prepare NCB in accordance with the Rules 1971 and the Guidelines issued by the Commission in this regard.

- b) **Overstatement of Trade Payables:** The Respondent in its written response stated that:

"As stated that Trade Payables were overstated, it is admitted that no benefit accrues to the brokerage house and that alone established the inadvertence and acts not deliberate, and hope to be condoned."

The Representative of the Respondent communicated that the overstatement was mainly because of the error as mentioned in the response by the Respondent.

- c) **Understatement of Other Liabilities:** The Respondent in its written response stated that:

"As stated that Other Liabilities has been understated, here comes the intention of the management of the company which come into action as the confronted amounts were classified in the books of the brokerage house and the company decided to make repayment at its convenience, hence the confronted amounts in question were accordingly classified. Moreover, scope and ambits of Other Liabilities were not interpreted/implemented till the time of issuance of NCB of June 13, 2013. It is however, ensured that all NCB preparations of ensuing period shall reflect the implementation guidelines of the Commission. We hope the difference so confronted under Other Liabilities is once again was due to interpretations and management intentions and since not deliberate action for non-compliance and humbly requested to be condoned."

The Representative during the course of hearing communicated that the difference is because of the loans given by the directors of the Respondent and for that purpose were not included in the calculation of NCB.

- d) **Adjusting entries and clients' accounts depicting only receivable and payable:** The Respondent in the written response submitted that:

"it is clarified that the referred account is of our regular client and unfortunately during the period of inspection that account reflected low trades. Furthermore our brokerage house, unlike others, not indulged in charging for late payments and follows the prohibition in respect thereto."





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The Representative of the Respondent asserted its above stance, however, the Representative failed to make any suitable argument for supporting its claim that the clients' account showing only receipts and payments are its regular clients' account. Furthermore, the Representative also failed to explain the logic of ledger account titled 'Adjustment for Net Capital Dec -2013' appearing in its books of accounts.

e) **Non-provision of information:** The Respondent in this context, communicated that:

"It is clarified that the long term loans were obtained from related parties comprising of Sponsors and their family members and their names and particulars were part and parcel of the books and records furnished to the Inspection team. The loan pertaining to financial institutions was fully documented and copies whereof has duly been furnished. Since the sponsors and related party loans were not supported with any formal agreements and were backed with only confirmations that these are un-secured, and interest free and repayable at the convenience of the company which is usual feature of such loans, hence what other documents are expected to be furnished on the context. This fact may also be referred from the annual financial statement of past many years and are reconcilable there-from."

In this context, the Representative of the Respondent informed that the loan accounts should have been cancelled as the loan has already been paid. It was some accounting error which they failed to rectify.

f) **Collateral Account:** With regard to collateral account, the Respondent in its written response communicated that:

"the brokerage house is not maintaining collateral account under its Participant Account as required under Regulation 41(1)(c) of General Regulations of the KSE. In this respect it is stated that the requirement to maintain collateral account till June 30, 2013 has not arisen and the company has managed well on this account. However as identified the Company has now is in the process to open collateral account in compliance of KSE General Regulation. It is further stated that the KSE has never sought compliance earlier on the context otherwise this observation would never has arisen at this point of time."

The Representative of the Respondent communicated that they have now opened the collateral account and shall provide evidence of the same.

g) **Risk Management Regulations and Account Opening Forms:** The Respondent in this context stated that:

"Previously, we were manually placing hair-cuts as per circuit breaker rules. Now we have updated our back-office software and hair-cuts are now applied on all clients (evidence enclosed). Our account opening forms are now updated as per KSE format."





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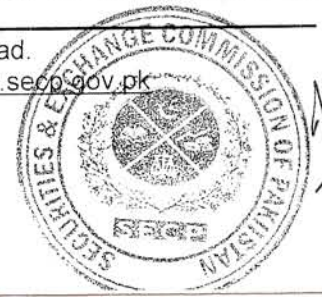
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The Representatives of the Respondent asserted the stance taken by the Respondent in its written response.

- h) **Negative NCB:** The Representative during the course of hearing communicated that it will submit the revised NCB to the Commission within next week after meeting the capital requirements. However, after a week the Respondent requested for further one week extension and subsequently submitted its NCB, along with certificate from auditors M/s 'Aslam Malik & Co, Chartered Accountants' depicting NCB of Rs. 7.365 million as of March 7, 2014.

6. I have heard the arguments presented by the Representative 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) The Respondent in its written response and the Representative of the Respondent during the course of hearing communicated that the difference in the calculation of trade receivables and trade payables was because of different ways of calculation and in future the Respondent will strictly comply with the applicable regulatory framework and the guidelines issued by the Commission.
- b) With regard to the adjusting entries made by the Respondent to adjust the value of NCB, the Respondent failed to provide ample argument/evidence. Through the adjusting entries made in the books of accounts, the Respondent incorrectly managed to have high NCB and capital adequacy, which lead to excess exposure than the Respondent was being able to manage. This could have resulted in default by the Respondent in meeting the settlement requirement and subsequently a cost to the small investors and general public.
- c) The Inspection Report was shared with Respondent, vide Commission's letter dated January 20, 2014, which depicted the negative NCB of Rs 5 million. The Respondent neither in its comments on the inspection report nor in its written response to SCN addresses the issue of negative NCB. It was during the course of hearing, when the Representative of the Respondent was enquired, he requested for time to meet the





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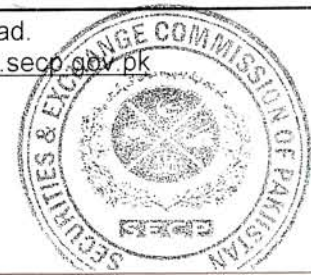
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NCB requirement and capital adequacy. The Respondent is allowed trading exposure at the KSE on the basis of NCB, which actually was negative. The Respondent at first trading day of week before commencement of trading is required to submit its status 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 its NCB was negative not only kept on clicking the "YES" option of the functionality but also did not even try to increase its NCB.

- d) The Representative of the Respondent with regard to negative NCB provided revised NCB Certificate as of March 7, 2014 depicting the NCB of Rs. 7.365 million; however, the calculation of NCB provided by the Respondent indicated adjustment in the loan amount. The Respondent vide email dated March 28, 2014 provided copy of the journal voucher through which the loan amount has been adjusted. However, the email does not provide any detail as to why the amount of Rs. 69.235 million was credited to "Providence Modaraba Limited" and an amount of Rs. 24 million being credited to "Dawood Family Takaful Limited".
- e) The Representative of the Respondent during the course of hearing time and again asserted that they will ensure that the observations highlighted in the inspection report are properly addressed and ensured compliance with the applicable regulatory framework in future.

7. 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 prepare the NCB in accordance with the SEC Rules and the guidelines issued by the Commission and failed to maintain proper books of accounts as required under the SEC Rules.

8. Moreover, the Respondent being aware of the fact of its negative NCB, kept on reporting its NCB and/or capital adequacy requirement as met in the NCHS. The Respondent used the information in NCHS for continuity of its business which it had reasonable cause to





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believe to be false. From the above it is evident that the Respondent failed to act with honesty and due diligence. The Respondent is expected not to engage in such business conduct that compromise the market transparency; clients' interest; systemic risk of the stock market and increase the default risk at the cost of Respondent's own interest.

9. It is the 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. The violation of the Rules and Regulations is a serious matter. Accordingly, in exercise of the powers under Section 22 of the Ordinance, I hereby impose on the Respondent a penalty of Rs. 500,000/- (Rupees Five Hundred Thousand Only). The Respondent is further directed to:

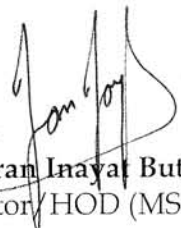
- a) Comply with the Rules 1971 and the guidelines issued by the Commission;
- b) Ensure compliance with the capital adequacy requirements. In this context, submit its certified NCB after every three months starting from March 31, 2014 till December 31, 2014 along with the copy of its trial balance of the same date, within 15 days of the end of each three months period; and
- c) Maintain proper books of accounts.

10. 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.

11. 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 17, 2014
Islamabad.




(Imran Inayat Butt)
Director/HOD (MSRD)