

**Before the Director (Market Supervision & Registration Department)
Securities Market Division
Securities and Exchange Commission of Pakistan**

**In the matter of Show Cause Notice dated April 24, 2013 issued to
M/s. Zafar Moti Capital Securities (Pvt.) Limited under Section 22 of the
Securities and Exchange Ordinance, 1969**

Date of Hearing: May 15, 2013

Present at the Hearing: Authorized Representatives of M/s. Zafar Moti Capital Securities (Pvt.) Limited
1. Mr. Mohammad Javed Mohammad Ibrahim
2. Mr. Naveed Yaqoob

Representing (MSRD): Mr. Murtaza Abbas (Deputy Director – MSRD)

ORDER

This Order shall dispose of the proceedings initiated through a Show Cause Notice No. 4/BRK-14/SE/SMD/01 dated April 24, 2013 (**“the SCN”**) issued to M/s. Zafar Moti Capital Securities (Pvt.) Limited (**“the Respondent”**) under Section 22 of the Securities and Exchange Ordinance, 1969 (**“the Ordinance”**).

2. **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 No. SMD-MS&CID-C&IW10-1/(182)/2012 dated October 23, 2012 of the books and records required to be maintained by the Respondent. On review of the inspection report various *prima facie* violations regarding calculation of Net Capital Balance (**“NCB”**), charging of late payment charges and segregation of client’s account were observed and accordingly the subject SCN was issued, the contents of which are reproduced below.



“SUBJECT: SHOW CAUSE NOTICE IN THE MATTER OF INSPECTION OF BOOKS AND RECORD OF M/S. ZAFAR MOTI CAPITAL SECURITIES (PVT.) LIMITED, – TREC HOLDER OF KARACHI STOCK EXCHANGE LIMITED.”

THAT M/s. Zafar Moti Capital Securities (Pvt.) Limited, (“ZMC”) is a Trading Right Entitlement Certificate (“TREC”) holder of the Karachi Stock Exchange Limited (“the 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 Rules”).

2. 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 No. SMD-MS&CID-C&IW10-1/(182)/2012 dated October 23, 2012 of the books and records required to be maintained by ZMC.

3. WHEREAS, on review of the inspection report it has come to the notice of the Commission that the calculation of Net Capital Balance (“NCB”) of ZMC as on June 30, 2012 certified by M/s. Mansoor Aslam Seraj Shahid, Chartered Accountants, has various irregularities and consequently after incorporating the adjustments, in trade receivables, trade creditors and other liabilities the NCB shows negative balance of Rs. 111.42 million and is overstated by Rs. 191,160,996. Revised calculation of the NCB is tabulated below.

Particulars	Amount In Rs.			
	As per ZMC		Adjusted by SECP	
Cash in Hand & Bank Balances		2,450,098		2,528,290
Trade Receivables				
Book Value	130,348,508		233,922,555	
Less: Overdue for more than 14 days	(5,060,201)	125,288,307	(232,881,935)	1,040,619
Investment in Listed Securities in the name of Broker				
Securities on the exposure list marked to market				
Less: 15% Discount				
Securities held for clients				25,645,126
Total Current Assets		127,738,405		29,214,035



<i>Current Liabilities</i>				
<i>Trade Payable</i>				
<i>Book Value</i>	82,315		56,894,035	
<i>Less: Overdue For More Than 30 Days</i>		82,315	(55,478,238)	1,415,797
<i>Other Liabilities</i>		47,915,561		139,218,705
<i>Total Current Liabilities</i>		47,997,876		140,634,502
<i>Net Capital Balance</i>		79,740,529		(111,420,467)

4. **WHEREAS**, Regulation 41(1)(a) of the general regulation of the Exchange obligates brokers to maintain separate bank account which will include all the fund deposits of their clients along with record/breakdown of clients' balances. Perusal of the books of accounts has revealed that ZMC has been maintaining separate bank account in Summit Bank Limited with the title of client account, wherein all clients' assets could be deposited. Further, review of ledger account of the said bank account has revealed that no such transaction has been carried through this account. This practice neglects the essence of subject Regulation. Accordingly, ZMC can be construed to be in default of the said requirement.

5. **WHEREAS**, it has been observed that ZMC has been charging late payments charges to its clients at the rate of 24% p.a. on monthly basis, who do not clear their dues. Such instances are quoted below for your reference.

<i>Sr #</i>	<i>Date</i>	<i>Account Code</i>	<i>Title of Account</i>	<i>Particulars</i>	<i>Amount</i>
1	13-Mar-12	7001	M.WAMIQ M.YOUSUF	L/P CHARGES FROM 08-03-2012 - 13-03-2012	42,889
2	6-Apr-12			L/P CHARGES FROM 01-04-2012 - 06-04-2012	49,877
3	27-Apr-12			L/P CHARGES FROM 21-04-2012 - 27-04-2012	69,678
4	6-May-12			L/P CHARGES FROM 28-04-2012 - 06-05-2012	85,742
5	18-May-12			L/P CHARGES FROM 12-05-2012 - 18-05-2012	70,657
6	26-Mar-12	65108	MUHAMME D YOUSUF	L/P CHARGES FROM 21-03-2012 - 26-03-2012	6,863
7	18-May-12			L/P CHARGES FROM 12-05-2012 - 18-05-2012	10,075
8	8-Jun-12			L/P CHARGES FROM 02-06-2012 - 08-06-2012	14,987
9	26-Mar-12	66082	ABDUL RASHEED	L/P CHARGES FROM 21-03-2012 - 26-03-2012	2,550
10	6-Apr-12			L/P CHARGES FROM 01-04-2012 - 06-04-2012	2,345
11	8-Jun-12	66083	ZAINAB ASHFAQ	L/P CHARGES FROM 02-06-2012 - 08-06-2012	3,107
12	27-Jun-12			L/P CHARGES FROM 23-06-2012 - 27-06-2012	2,255



13	8-Jun-12	66088	SHAHBAZ UD DIN	L/P CHARGES FROM 02-06-2012 - 08-06-2012	2,093
14	11-May-12	66095	SYED EJAZ AHMED	L/P CHARGES FROM 07-05-2012 - 11-05-2012	15,579
15	18-May-12			L/P CHARGES FROM 12-05-2012 - 18-05-2012	19,326
16	22-Jun-12			L/P CHARGES FROM 19-06-2012 - 22-06-2012	17,077
17	8-Jun-12	95001	M.SHAFIQ	L/P CHARGES FROM 02-06-2012 - 08-06-2012	16,715

6. **WHEREAS**, Section 16 of the Ordinance provides that:

“No member or associate shall, in contravention of any rules made under this Ordinance, directly or indirectly,-

- a) Extend or maintain credit, or arrange for the extension or maintenance of credit, to or for any person for the purpose of purchasing or carrying any security; or
- b) Borrow on any security or lend or arrange for the lending of any carried for the account of a customer; or
- c) Pledge or arrange for the pledging of any security carried for the account of any customer.”

7. **WHEREAS** it has been observed that shares of certain clients have been pledged, directly from their respective sub accounts, in favor of financial institutions in respect of running finance facility availed by ZMC:

- i. Sajjad Mehdi
- ii. Tariq Yaqoob
- iii. Zafar Moti
- iv. Najeeb Shuja
- v. Skandar Ali Memon

In respect of the above, ZMC was advised to provide specific authority for said pledge, where against, ZMC responded that authority to get said pledge is covered under the terms and conditions of the SAOF, hence no specific authorities have been obtained from respective clients. Section 12 (6) of the CDC Act, 1997 stipulates that a participant shall not create a pledge over any book-entry securities entered in any sub-accounts maintained under his account with the central depository without authorization of the sub-account holder concerned. In line with that Section 24 of the CDC Act, 1997 also prohibits handling of book entry securities entered in the sub accounts without the authority of the sub account holders. It has also been observed that the securities balances of selected clients appearing in the back office record were different from their CDC balance reports. Rule 8 of SEC Rules binds every TREC holder to maintain books of account, in a manner



that will disclose a true, accurate and up-to-date position of his business, whereas, the said differences reflect noncompliance of the said Rule. Whereas, above instances imply that ZMC has prima facie contravened the requirements of Section 12 (6) and 24 of the CDC Act, 1997.

8. **WHEREAS**, Section 28 of the CDC Act, 1997 provides that:

“Notwithstanding anything contained in sub-section (1), 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.”

9. **AND WHEREAS**, Section 22 of the Ordinance provides that:

“if any person contravenes or otherwise fails to comply with the provisions of the Ordinance or any rules or regulations made there under; 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 a 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.

10. **WHEREAS** in light of the facts mentioned above, it appears that ZMC is prima facie in contravention of, Third Schedule of the SEC Rules, 1971, rule 8 of the SEC Rules 1971, regulation 41 (1) (a) of the general regulations of the Exchange, Section 16 of the Ordinance, and Section 12 (6) read with Section 24 of the Central Depositories Act, 1997.

11. **WHEREAS**, if any person contravenes or otherwise fails to comply with the provisions of the Ordinance or any rules or regulations made thereunder, the Commission may by order direct such person to pay the Commission by way of penalty such sum in accordance with Section 22 of the Ordinance and Section 28 of the CDC Act 1997.

12. **THEREFORE**, you are hereby called upon to show cause in writing by May 3, 2013, as to why action as provided in Section 22 of the Ordinance and Section 28 of the CDC Act, 1997 may not be initiated against ZMC 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 May 8, 2013 at 11.00 a.m. at the SECP Headquarters – Islamabad. You are advised to bring all relevant original records, which you may consider necessary for



[Handwritten Signature]
Page 5 of 9

clarification/in defense of your stance. This notice sufficiently discharges the Commission's obligation to afford ZMC an opportunity of hearing in terms of Section 22 of the Ordinance and in case of failure to appear on the above stated date of hearing, it will be deemed that ZMC has nothing to say in its defense and the matter will be decided on the basis of available record.

Hasnat Ahmad

Director

3. Pursuant to the said SCN, the Respondent requested the Commission to adjourn the hearing and accordingly the hearing was rescheduled for May 15, 2013. The Respondent appeared on May 15, 2013 for hearing and also submitted its written comments before the undersigned. The comments of the Respondent are reproduced below:-

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- i. According to our statement, Rs. 190 million are outstanding against Siddiq Moti and are reflecting as Receivables in our accounts. This statement was forwarded by us to our Auditor's and they also treated this amount as Receivables.
- ii. According to SECP Show Cause Notice, they have shown the amount as liability separately, however, we have already deducted the same from total debtors accounts and it does not has any effect on Net Capital.
- iii. Due to very choppy situation of stock market, many of our clients to whom we were debtor have now become our debtors and their financial position have also depleted in this situation. Due to this reason, we obtained financing facility from bank and transferred markup charges to those customers who have been unable to clear their outstanding for long. They are the reason due to which we have to avail financing facilities from the bank.
- iv. As reflected in the Account Opening Form, we have been given authority to manage/transfer shares/securities of clients. Therefore, the shares of the Clients under CD are in the account of ZMCS, which is why there is inconsistency in the balances between CDS and Back Office Records. Please note that this has been done with authorization from the client.”

4. I have examined the facts, evidences and documents on record, in addition to written and verbal submissions made on behalf of the Respondent. Looking into the facts of the case the following four issues are framed to decide the matter:-

- 1) Overstatement of Rs. 191.161 million in NCB submitted by the Respondent;
- 2) Non-maintenance of separate bank accounts for the clients;
- 3) Charging of late payment charges from the clients; and



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4) Pledging of client's shares without authority.

5. With regard to the first issue of overstatement of Rs. 191.161 million in NCB is concerned, the representatives of the Respondent acknowledged the overstatement during the hearing. The representatives further admitted this fact that amount of Rs. 190 million was entered through a Journal Voucher and no actual transaction took place. Since no actual transaction took place for Rs. 190 million, therefore, this amount is a cosmetic change made by the Respondent to make that amount receivable within 14 days to include it in the calculation of NCB. With regard to other liabilities the Respondent failed to give any satisfactory explanation. Therefore, it stands established that the NCB has been overstated by an amount of Rs. 191.161 million. In this regard it has been observed that the ledger of Mr. Siddiq Moti as presented during hearing (printed on September 13, 2012) JV of Rs.190 million was appearing, whereas the ledger provided to the inspection team during inspection also showing the same closing balance but the said JV was not appearing rather other transactions were appearing. It is further observed that the Respondent has accepted in its written comments that the aforesaid statement dated September 13, 2012 was provided by it to its auditor.

6. Regarding the issue pertaining to non-maintenance of separate accounts for the clients, the Respondent has not submitted any comment, implying that the said violation has been accepted by the Respondent.

7. Charging late payment charges to the clients is a serious violation under the provisions of Section 16 of the Ordinance. Respondent's reply on this issue that due to choppy market situation the financial position of the clients deteriorated due to which it obtained financing from the banks is a confession of this violation. In the presence of margin trading and financing system which is duly regulated under Securities (Leveraged Markets and Pledging) Rules, 2011, opting for other financing mechanism is a clear cut violation of Section 16 of the Ordinance and therefore attracts penalty under Section 22 of the Ordinance.

8. With regard to the issue relating to unauthorized movement and unauthorized pledging of clients' securities, the Respondent claims that authority to manage and transfer the shares of clients was obtained under the Standardized Accounting Opening Form ("SAOF") and therefore it cannot be construed as violation. It is pertinent to mention here that the definition of House Account as provided in the Central Depository Company of Pakistan Limited Regulations means an account maintained on the Central Depository Register ("CDR") by an account holder for recording book-entry securities beneficially owned by the account holder. This definition clearly states that only those securities which are beneficially owned by the account holder can be placed in the House Account. In this case the Respondent failed to provide any evidence that the securities appearing in its House Account are beneficially owned by it. Moreover, Respondent's audited financial statements for the year ended June 30, 2012 do not show any investment made



by the Respondent in listed securities. Therefore, it is clear that shares appearing in House Account of the Respondent are not owned by it. Further Section 12 (6) of the CDC Act, 1997 stipulates that a participant shall not create a pledge over any book-entry securities entered in any sub-account 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 CDC Act, 1997 also prohibits handling of book entry securities entered in the sub accounts without the authority of the sub account holders. The Commission also vide letter dated September 22, 2010 addressed to all the stock exchanges circulated the circular issued by State Bank of Pakistan wherein the SBP provided brief guidelines for acceptance of pledge of clients' securities with Banks in line with the provision of the SAOF. According to the said circular reference was made to Part (G) of SAOF, in which participants were required to obtain specific authority from sub-account holder(s) for transfer, pledge and withdrawal of book-entry securities. In line with the requirements of the said circular the Respondent failed to provide any documentary evidence to substantiate its stance. The Respondent neither in its written comments nor during the hearing presented any documentary evidence before the undersigned to substantiate its response therefore, it has been established that violation of Section 24 has occurred.

9. In light of the written submission and explanation given by the Respondent mentioned at Para 3, I am of the considered opinion that Respondent's justification regarding NCB is not tenable. The Respondent has accepted the violations of charging late payment charges and non-maintenance of separate bank accounts for the clients. The Respondent has failed to provide any documentary evidence in support of pledging of clients' securities and therefore found guilty of the non-compliance. Therefore, in exercise of the powers under Section 22 of the Ordinance and Section 28 (2) of the CDC Act, 1997, through this Order, I hereby impose a penalty of Rs. 500,000/- (Rupees Five hundred thousand only) on the Respondent to be deposited 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. The Respondent is further directed to:-

- i. Discontinue the practice of keeping clients' securities in its House Account and transfer such securities from the House Account to the respective sub-accounts under the supervision of Central Depository Company of Pakistan Limited;
- ii. Discontinue the practice of transferring/pledging client's securities as per the authority provided along with the SAOF;
- iii. Properly maintain separate bank account for the clients and deposit the proceeds of client's trading in the same; and
- iv. Regularize its NCB in line with the requirements of Third Schedule of the 1971 Rules;
- v. Discontinue the practice of charging the late payment charges to the clients.



10. Moreover, through this Order the Karachi Stock Exchange Limited is directed to vigilantly monitor the trading positions and exposure of the Respondent and to curtail the capital adequacy/exposure limit of the Respondent, as deemed appropriate, till submission of the revised NCB.

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


Hasnat Ahmad
Director (MSRD)

Announced on June 26, 2013
Islamabad.

