



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 Darson Securities (Pvt) Limited
under Section 22 of the Securities and Exchange Ordinance, 1969

Date of Hearing:

December 27, 2013

Present at the Hearing:

Representing Darson Securities (Private) Limited

(i) Mr. Dil-Awayz Ahmed

Manager

Assisting the Director/HOD (MSRD)

(i) Ms. Najia Ubaid

Deputy Director

ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice bearing No. 1(10) SMD/MSRD/C&IW/2013 dated December 16, 2013 ("SCN") served to Darson 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 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 June 24, 2013:

- | | |
|---------------------------|--------------------|
| a) Mr. Mohammad Tanweer | Deputy Director |
| b) Mr. Moizuddin Siddiqui | Assistant Director |

SECURITIES & EXCHANGE
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SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Supervision & Registration Department)

Continuation Sheet - 1 -

3. The Inspection Team submitted the report ("Inspection Report") on September 06, 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 October 3, 2013. Upon evaluation of the Inspection Report, irregularities in calculation of Net Capital Balance ("NCB") as on December 31, 2012 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"). Moreover, the Inspection Report further highlighted that the Respondent failed to provide requisite information, maintain segregation of client's assets and was involved in imposition of late payment charges to its clients.

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 December 27, 2013 at the Commission's Head Office in Islamabad.

5. The Respondent submitted its written response to the SCN vide letter dated December 18, 2013. Mr. Dil-Awayz Ahmed, Manager of the Respondent attended the hearing on behalf of the Respondent ("Representative"). 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 December 27, 2013:

a) **Cash in hand:** The Respondent in its written response communicated that:

"With reference to calculation of our NCB we would like to explain that understatement of cash in hand by Rs. 1.081 million is mainly due to inadvertent exclusion of amounts deposited at KSE as deposits/margins. We shall incorporate such deposits in calculation of our subsequent NCB. We would like to draw your kind attention that this has a positive impact on our final NCB amount but we inadvertently missed this positive factor on our NCB. In light of this explanation we request your good self to please don't initiate any action under Section 22 of the Ordinance and Rule 8 of Brokers Rules because it is an inadvertent mistake and is not a deliberate move."

The Representative of the Respondent asserted the above stance and ensured that they shall prepare NCB in light of the guidelines issued by the Commission in future.





SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Supervision & Registration Department)

Continuation Sheet - 2 -

- b) **Trade Receivables:** The Respondent while explaining the difference in calculation of trade receivable in its written response stated that:

"Whereas the referred overstatement of Trade Receivables by Rs. 79.421 million is concerned we would like to state that it is purely matter of interpretation while calculating trade receivables and overdue receivables. We classified trade receivables as overdue if they didn't have any movement in their account and trade receivables having any movement in their account are classified as trade receivables for the purpose of NCB. Adoption of different interpretations by us and respected inspection is a reason of this overstatement. Further we would like to draw your kind attention towards the guidelines/clarifications of your good office and stock exchange for submission of NCB certification to respective exchanges, extension for submission of NCB and finally the deferment of these guidelines with respect to NCB because we think that all the TREC holders classified their trade receivables and over dues as we did. In this regard we would also like to request your good self to please accept our interpretation for calculation of overdue trade receivables."

The Representative of the Respondent communicated that the overstatement was mainly because of aging methodology adopted by them. They further added that it was a market norm to use this methodology for accounting for the receivables.

- c) **Securities purchased for clients:** With regard to securities purchased for clients, the Respondent in its written response stated that:

"The non-inclusion of securities purchased for clients inadvertently missed by us in arriving at NCB amount. We shall incorporate such securities purchased for clients in our subsequent calculation of NCB amount. Please note that inclusion of such securities has positive impact on our NCB amount but we just missed such securities inadvertently in our NCB calculation. So we would like to request your good self to please don't initiate any action under Section 22 of the Ordinance and/or Rule 8 of Brokers Rules."

The Representative of the Respondent accepted that the value for securities purchased for clients was inadvertently missed by them in the calculation of NCB. Moreover, they added that it appeared to them as duplication of receivables.

- d) **Trade Creditors and Other Liabilities :** The Respondent in the written response communicated that:

"Understatement of other liabilities must be seen in conjunction of point (v) of show cause notice because as per inspection team it is matter of classification of trade payables and other liabilities because if one part is understated the other would be overstated. Because according





SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Supervision & Registration Department)

Continuation Sheet - 3 -

to inspection team one of our clients should be classified under other liabilities, whereas we counted that client as a trade payable. Overall it has neutral impact on calculation of NCB, so we request your good self to please don't initiate any action under Section 22 of the Ordinance and/or Rule 8 of Brokers Rules."

The Representative of the Respondent stated that the difference was because of aging methodology.

- e) **Late Payment Charges:** With reference to the imposition of late payment charges, the Respondent communicated that:

"With reference to clause 4 of said show cause notice we would like to explain that pointed charges should be considered as commission on clients availing margin financing. Because the formal implementation of margin financing as approved by the National Clearing Company of Pakistan was pending these commissions were directly posted in clients' accounts instead of prescribed mechanism of margin financing rules."

In this context, the Representative of the Respondent stated that these charges relate to margin financing and not to late payment charges. He further added that they shall provide client's ledgers depicting margin financing charges.

- f) **Non-provision of information:** In this context, the Respondent in its written response stated that:

"Whereas the provision of information/explanation to inspection team as mentioned in point 6 is concerned we had never failed and will never refuse or fail to comply with this Rule 5 of Inspection Rules and clause D (2) of the Code of Conduct contained in the Third Schedule of Brokers Rules. If some information/explanation were missed or not properly delivered to inspection team as mentioned in point 6 of the said show cause notice, we are once again providing you the same along with this reply."

The Representative of the Respondent communicated that they have provided all information and shall provide copy of acknowledgement letter through which the information was submitted to the Commission.

- g) **Transmission of trade confirmations:** The Respondent in its written response stated that:

"So far as the transmission of trade confirmation to clients as required under Rule 4(4) of SEC Rules and the terms and conditions contained in SAOF is concerned, we would like to explain your good office that we are properly transmitting trade confirmation within 24 hours to





SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Supervision & Registration Department)

Continuation Sheet - 4 -

respected clients as per the hierarchy: 1) official email IDs of clients having email accounts, 2) Through TCS courier, 3) Through post office, 4) by hand delivery to easily accessed accounts. In support of this we are enclosing herewith some reports in support of this observation and to the satisfaction of your food office."

The Representative of the Respondent during the course of hearing asserted the stance taken by the Respondent in its written response.

- h) **Segregation of Client's assets and Collateral Account:** With regard to maintenance of separate bank account for handling of clients' assets and collateral account, the Respondent in its written response communicated that:

"We would like to inform your good self that we are maintaining client bank account for segregation of clients' assets as required under Regulation 41 (1)(a) of the KSE Regulations, the same was also shown and provided to respected Inspector. Further we have opened a collateral account in our Participant as required under Regulation 41 (1)(c) of KSE Regulations. We are enclosing herewith statements of bank and CDC for your satisfaction."

The Representative of the Respondent communicated that they are maintaining separate bank accounts and shall provide evidence of the same. He further added that the Respondent has now opened the collateral account.

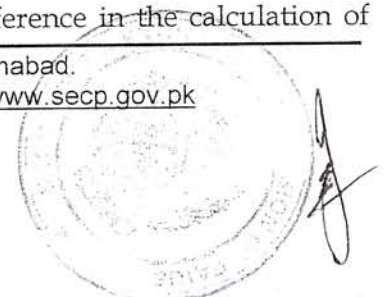
- i) **Non recording of pledged securities:** The Respondent stated that:

"We would like to explain that referred shares are part of proprietary investment but the auditor excluded these shares while calculating our NCB because these shares were pledged. Upon our inquiry the respected auditor explained that it adopted a conservative approach regarding these shares and excluded these pledged shares from the calculation of NCB."

The Representative of the Respondent stated they shall provide copy of the trial balance as evidence that pledged securities have been accounted for and shall also provide the copy of auditor's letter in this context.

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



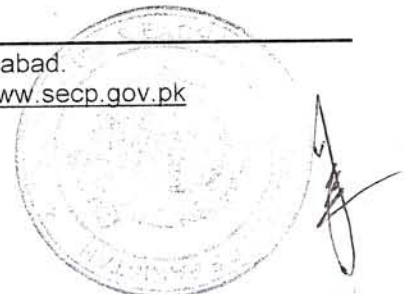


SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Supervision & Registration Department)

Continuation Sheet - 5 -

trade receivables and payables was because of aging methodology applied by them and further assured that in future the aging of receivables shall be made on actual basis and not on the basis of movement in the clients' account in compliance with the guidelines issued by the Commission.

- b) With regard to the non-inclusion of securities purchased for clients, the Respondent and the Representative of the Respondent admitted that it was inadvertently not included in NCB calculation and further added that it appeared to them as duplication. Here it is pertinent to note that Third Schedule of Rules 1971 clearly provides that securities purchased for the clients and held by the broker where payment has not been received within 14 days has to be included under the title in the calculation of NCB and leave no ambiguity in the context.
- c) The Respondent in its written response and the Representative of the Respondent during the course of hearing communicated that they were imposing charges related to margin financing and not the late payment. However, the Respondent failed to provide any document to support its stance, thereby leading the Commission to believe that the Respondent was in contravention of Section 16 of the Ordinance.
- d) The Representative of the Respondent during the course of hearing stated that they are maintaining separate bank account for clients' of the Respondent and collateral account to ensure compliance of the General Regulations of the KSE. However, the bank statement provided by the Respondent and available in record depicted number of payments not relating to the clients made from the bank account titled client's account.
- e) The Representative of the Respondent during the course of hearing communicated that it shall provide copy of trial balance evidencing that it has incorporated all the securities pledged in the books of accounts. However, the information provided by the Respondent included incomplete trial balance whose value of total debits does not even equal the value of total credits and hence failed to provide evidence of recording of value of pledged securities in the books of accounts maintained by the Respondent being in violation of Rule 8 of the Rules 1971.





SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Supervision & Registration Department)

Continuation Sheet - 6 -

- f) The Respondent with regard to non-provision of information, provided copies of emails dated August 23 and August 30, 2013 as an evidence that it has provided all the required information to the Inspection Team. The review of the emails and the available data revealed that:
- i). The Respondent vide above referred SCN was communicated that it failed to provide general ledgers/clients ledger for the period January 1, 2013 and as per the email dated August 23 and August 30, 2013, the Respondent provided general ledger of other than clients for the specified period and did not provide clients' ledger for the period.
 - ii). The Respondent was further communicated that it failed to provide margin deposit book/exposure margin report. However, the copy of email provided by the Respondent only explains what margin deposit book consists and it did not provide the required information.
 - iii). The Respondent failed to provide any evidence communicating that it has provided break up of excess shares appearing in its house account to the inspection team.

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 perform its responsibilities by

- a) not recording the securities pledged from house account in the books of accounts being in violation of Rules 1971
- b) not preparing the NCB Certificate in accordance with the Rules 1971 being in violation of Rules 1971;
- c) imposing late payment charges being in violation of Ordinance;
- d) not maintaining segregation of clients' assets being in violation of General Regulations of KSE; and
- e) not providing the information to the Commission being in violation of the Brokers Rules.





SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Supervision & Registration Department)

Continuation Sheet - 7 -

It is pivotal for maintenance of investors' confidence that the brokers should follow the rules, regulations and procedures formulated by the Commission in letter and spirit. A broker should be perceived as professional with high integrity that is beyond reproach and it should perform its functions in a fair, proficient and impartial manner.

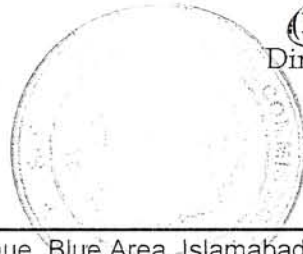
8. The violation of the Rules and Regulations is a serious matter. Therefore, in exercise of the powers under Section 22 of the Ordinance, I hereby impose on the Respondent a penalty of Rs. 100,000/- (Rupees One Hundred Thousand Only). The Respondent is further directed to:

- a) Comply with the Rules 1971 and the guidelines issued by the Commission;
- b) Discontinue the practice of imposing late payment charges immediately;
- c) Maintain proper books of accounts to record for the proprietary and clients' investments;
- d) Ensure segregation of clients' assets and maintain separate bank account for the clients' funds.

9. 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.

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 matter subsequently investigated or otherwise brought to the knowledge of the Commission.

Announced on January 29, 2014
Islamabad.




(Imran Inayat Butt)
Director/HOD (MSRD)