



Securities and Exchange Commission of Pakistan  
Securities Market Division

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Through Courier

Before The Director / HOD (MSRD)

In the matter of Show Cause Notice issued to Fairtrade Capital Securities (Pvt) Limited  
under Section 22 of the Securities and Exchange Ordinance, 1969

*Date of Hearing:*

May 22, 2014

*Present at the Hearing:*

*Representing Fairtrade Capital Securities (Private) Limited*

(i) Mr. Kamran Shahzad

Director

(ii) Mr. Muhammad Faisal

Manager Operations

*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(27) SMD/MSRD/C&IW/2014 dated April 29, 2014 ("SCN") served to Fairtrade Capital 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 November 27, 2012:

- a) Mr. Muhammad Tanveer      Deputy Director
- b) Mr. Kashif Ali              Deputy Director

3. The Inspection Team submitted the report ("Inspection Report") on January 28, 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





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February 14, 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 ("SEC Rules"). The Inspection Report further highlighted that the Respondent:

- a) was involved in imposition of late payment charges to its clients;
- b) failed to maintain segregation of clients' assets;
- c) failed to devise Know Your Customer ("KYC") and Customer Due Diligence ("CDD") Policy;
- d) failed to maintain Standardized Account Opening Form ("SAOF"); and
- e) failed to classify its directors and employees as proprietary in the UIN database maintained by National Clearing Company of Pakistan Limited.

4. The Commission vide letter dated March 21, 2014 sought clarification on the issues highlighted in the inspection report and required the Respondent to provide requisite information by March 31, 2014. The Respondent vide letter dated April 7, 2014 shared its comments along with the information except for the trial balance as of March 31, 2013 and the bank statement of the account tagged as clients' account for the period July 1, 2012 till March 31, 2013, as was required vide above referred letter. Subsequently Respondent vide emails dated April 23, 2014 and April 24, 2014 provided the requisite information.

5. In light of the Inspection Report and 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 was scheduled for May 13, 2014 at the Commission's Head Office in Islamabad, which was subsequently rescheduled to May 22, 2014.

6. The Respondent submitted its written response to the SCN vide letter dated May 21, 2014. Mr. Kamran Shahzad, Director of the Respondent and Mr. Muhammad Faisal, Manager Operations of the Respondent ("Representatives"), attended the hearing on behalf of the Respondent. The following arguments were put forward by the Respondent in its written response:

a) **Calculation of Net Capital Balance:**

*"Net Capital Balance was prepared according to the routine practice prevalent at that time but when exchange intimated us we began to migrate on new practice and started following the guidelines issued to prepare NCB."*







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According to our observations on NCB as on June 30, 2012, Trade Receivables, Investments in Listed Securities & Securities held for clients were understated by Rs. 5.256 mn, Rs. 3.573 mn and Rs. 5.206 mn respectively. And trade payables were overstated by Rs. 1.4 mn. These observations of SECP have been noted. Had NCB been prepared according to the above mentioned observations the NCB of our company would have been increased by 12.6 mn, having positive impact on our NCB. So there was no willful intention in calculation of the figures mentioned above. SECP also observed that in calculation of the NCB, Other Liabilities have been understated by Rs. 59.45 mn. In this regard we clarify that Long term - Interest Free Loan of Rs. 60.14 mn from MAHA had been erroneously included by us in the trial balance as current liability. It was actually a long term loan; therefore it was not included in the calculation of NCB. Corrections had been made in the trial balance accordingly."

b) Segregation of Clients' assets:

"We have more than one bank account for the clients and separate bank account for company's expenses. Amount against trade payable was in bank accounts mentioned above and in cash deposited as margin with the Karachi Stock Exchange. Although we have opened a separate bank account which was tagged as client account but other account of the company are also used as client' accounts."

c) KYC & CDD Policy :

"We have attached separate pages for KYC and CDD of the clients with our account opening form."

d) Updating UIN database :

"We have updated UIN list of our employees, evidence of which is attached with this letter. However we are still in updating process and exchange will be updated soon with regard to the employees mention in para 5.5.4 of the inspection report."

e) Standardized Account Opening Form ("SAOF"):

"We have updated most of the SAOFs mentioned in para 5.5.5 of the inspection report. And we have adopted a strict policy for opening new accounts after the said inspection report. Few percentages of old SAOFs still remain to be updated as we are unable to contact those clients."

f) Undertaking from employees:

"We have allowed and given written authorization to certain employees to trade and we have also taken undertaking from those employees to abide by the rules and regulations as well."





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g) **Late payment charges and Collateral Account:**

*"We have stopped imposing late payment charges/liquidation damages to our clients and we have opened a Collateral Account for this purpose. Evidence is also attached with this letter. However, the hear appearing in the trial balance of March 31, 2013 with the name of "Markup Recovered" is basically a "Premium Service Charges Account" from some of our clients for providing premium services. But name of that account head has mistakenly mentioned as Markup Recovered account which has now rectified."*

7. The arguments put forward by Representatives of the Respondent during the course of hearing are summarized below:

- a) The Representatives apprised that NCB of June 30, 2012, as calculated by the inspection team was negative because of non-inclusion of Loan term loan of Rs. 59.154 million from MAHA Securities (Private) Limited ("MAHA"). However, the same has now been accounted for and as of the date of the latest NCB i.e. December 31, 2013 this loan amount has almost been paid. Only liability outstanding in this context is of Rs. 2.3 million, which the Respondent is planning to pay this year.
- b) With regard to segregation of clients' assets, the Representatives of the Respondent asserted that the Respondent has six bank accounts for clients' funds and a separate bank account for the Respondent to meet day to day expenses of the business. The Representatives agreed to provide reconciliation in this context with in a week's time.
- c) The Representatives informed that KYC and CDD Policy has not yet been approved by the Board of Directors of the Respondent. The Representatives assured that they shall get the Policy approved from the Respondent's Board of Directors as required under the General Regulations of the KSE ("KSE Regulations").
- d) With regard to updating the UIN database maintained by the National Clearing Company of Pakistan Limited, the Representatives apprised that they have updated the database and all the employees and directors of the Respondent are properly classified in the data.
- e) The Representatives stated that the Respondent has updated the SAOFs in accordance with the requirements of KSE Regulations and are now compliant with the specific requirements.







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f) The Representatives confirmed the stance of the Respondent with regard to imposition of late payment charges and obtaining undertaking by the employees. The Representatives further added that the ledger account with the nomenclature of 'markup recovered' in the trial balance as of March 31, 2013 is actually the premium service charges, charged to the clients of the Respondent. The Representatives added that we have now rectified the nomenclature of the specific ledger to depict the nature of transactions accounted for in that ledger account.

8. 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 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 Representatives of the Respondent during the course of hearing informed that they have accounted for the loan from MAHA and, in future, shall prepare the NCB in accordance with the SEC Rules and the guidelines issued by the Commission.
- b) The Respondent in its written response to the inspection report dated February 14, 2013 communicated that it has opened a separate account for handling of clients' funds and further assured that it shall comply with the Regulations in full spirit. However, it has been noted that the bank account which was opened for the purpose, depicted a balance of only Rs. 1,957 as of March 31, 2013 in comparison to trade payable position of Rs. 18.102 communicated in the NCB of the same date. Moreover, evaluation of the bank account no. 000515-03-07 tagged as clients' account revealed that no activity took place during the period December 31, 2012 till March 31, 2013.
- c) In order to substantiate their stance of segregation of clients' assets, the Representatives agreed to provide reconciliation of the payables and funds position as of June 30, 2012 and March 31, 2013 within a week's time; however, no information was received till June 11, 2014. Subsequent to the reminder issued through email dated June 12, 2014, the Respondent vide letter dated June 13, 2014 provided reconciliation of the payables and fund position as of June 30, 2012. Moreover, the Respondent communicated that it will provide the reconciliation of the position of March 31, 2013 subsequently. The Respondent in the reconciliation





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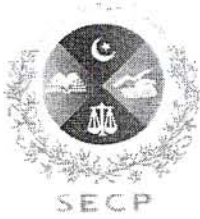
of payables and bank account position as of June 30, 2012 communicated that it had Rs. 14.782 million as deposits against ready and future market with the KSE and Rs. 5.360 million to Client Control Account. Further, the Respondent in the explanation communicated that it was previously using Account No. 0031-0081-0005151-01-5 at Bank Al Habib for both clearing purpose and for managing clients' funds, however, after the Commission's directions will use this account for clearing purpose only. However, the Respondent did not refer to the details in its comments on the Inspection Report and written response to the SCN.

- d) The Representatives' and the Respondent's stance, that they have multiple bank accounts for the purpose and they strictly maintain segregation of clients' assets cannot be accepted. Moreover, the Respondent depicted laid back attitude towards the observations highlighted in the inspection report by not complying with the requirements of segregation of clients' assets, as the same was communicated to the Respondent almost one and a half year ago.
- e) The Respondent and the Representatives accepted that the Respondent was involved in imposition of late payment charges, however, they informed that immediately after the inspection the practice of imposition of late payment charges was stopped.
- f) Till the date of hearing, the Respondent had no KYC and CDD Policy approved by its Board of Directors despite of highlighting the discrepancy through inspection report. The Respondent in its comments on the Inspection Report in 2013 communicated that it shall get the KYC and CDD Policy approved. The Respondent after the serving of SCN and after the date of hearing, prepared a Policy and subsequently got it approved from the Board of Directors of the Respondent. The Respondent shared copy of KYC and CDD Policy vide letter dated June 13, 2014.

9. 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 failed to properly maintain segregation of clients' assets; failed to prepare KYC and CDD policy in a timely manner; and was involved in the imposition of late payment charges (as per the Respondent this practice has been subsequently stopped). I am of the considered view that segregation of clients' assets is of paramount importance for the protection of investors'







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interest. The Respondent being the custodian of clients' assets is expected to comply with the applicable regulatory framework in letter and spirit.


10. The violation of the Rules and Regulations is a serious matter. Therefore, in exercises of the powers under Section 22 of the Ordinance, I hereby impose on the Respondent a penalty of Rs. 25,000/- (Rupees Twenty Five Thousand Only). The Respondent is further directed to:

- a) Comply with the Rules 1971 and the guidelines issued in letter and spirit;
- b) Ensure segregation of clients' assets, maintain separate bank account for the clients' funds and use that one account solely for the purpose of clients' funds.

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 June 18, 2014  
Islamabad.