

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

In the matter of Show Cause Notice Dated November 14, 2012 issued to M/s. AZEE Securities (Private) Limited, TREC holder Karachi Stock Exchange Limited

Date of Hearing: December 7, 2012

Present at the Hearing: Mr. Ghazi Naseem Authorized Representative of AZEE Securities (Private) Limited

Representing (BR&ICW): Mr. Murtaza Abbas (Deputy Director (BR&ICW))

ORDER

This Order shall dispose of the proceedings initiated through a Show Cause Notice No. 4/BRK-62/SE/SMD/01 dated November 14, 2012 (**“the SCN”**) issued to M/s. AZEE Securities (Private) Limited (**“the Respondent”**) under section 22 of the Securities and Exchange Ordinance, 1969 (**“the Ordinance”**).

2. Brief facts of the case are that the Respondent is a Trading Right Entitlement Certificate holder (**“TREC”**) holder of the Karachi Stock Exchange Limited (**“the exchange”**) and is registered with the Securities & Exchange Commission of Pakistan (**“the Commission”**) as a broker under the Brokers and Agents Registration Rules, 2001 (**“the Rules”**). 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 (**the “Inspection Rules”**) ordered an inspection of the books and records required to be maintained by the Respondent. The report dated June 22, 2012 submitted by the inspection team highlighted violations of the existing regulatory framework governing the brokerage business. The findings of the report were duly forwarded to the Respondent on July 5, 2012 and an opportunity of hearing in terms of rule 7(i) of the Inspection Rules was also provided to the Respondent on December 7, 2012.

3. Given the violations highlighted in the inspection report a SCN dated November 14, 2012 was issued to the Respondent, the contents of which are reproduced below:-


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

WHEREAS, the Securities and Exchange Commission of Pakistan (“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. SECP/SMD-MS&CID-C&IW10-1(40)/2012 dated April 10, 2012 of the books and record required to be maintained by M/s. AZEE Securities (Private) Limited (“AZSL”). The inspection team submitted the inspection report to the Commission on June 22, 2012 which was forwarded to AZSL in accordance with rule 7 of the Inspection Rules on July 5, 2012.

2. *AND WHEREAS, on review of the inspection report, the Commission has observed a number of irregularities in the Net Capital Balance (“NCB”) for the period ended December 31, 2011, required to be calculated in accordance with Third Schedule read with Rule 2(d) of the Securities and Exchange Rules, 1971 (“SECP Rules”) and submitted by AZSL to Karachi Stock Exchange Limited (“the exchange”) under regulation 2.1 of the Regulations Governing Risk Management of the Karachi Stock Exchange Limited. Details of the irregularities are as under.*

i) Cash in hand or Bank

An amount of Rs.3,919,912 was reported under the head of cash and bank balance whereas, as per trial balance as on December 31, 2011 of AZSL the said figure was appearing as Rs. 4,057,792 (Rs.148,580 as cash in hand and Rs. 3,909,212 as cash at banks). Thus cash and bank balances were understated by Rs. 138,580.

ii) Trade Receivables

An amount of Rs. 112,306,031 was reported under this head. However, as per aging schedule provided by AZSL, the trade receivables after adjusting those receivables which were overdue by more than fourteen days were calculated by the inspection team as Rs. 2,338,785, thus trade receivables based on aging provided by AZSL were



overstated by Rs. 109,967,246. Moreover, the trade receivables included late payment charges that are not allowable to be included for the purpose of calculation of NCB.

iii) Investment in Listed Securities in the Name of the Broker

An amount of Rs. 16,749,554 was reported as investment in listed securities whereas shares worth Rs. 68,204,081 were appearing in CDC House Account. Upon enquiry, AZSL informed that the excess shares were the property of the AZSL. In this regard it was observed that a ledger account titled as "**AZEE Securities (Private) Limited**" was showing debit balance of Rs.61,566,207.64 as on December 31, 2011 but this account was shown as trade receivable. For the purpose of NCB, investment in listed securities in the name of broker, the shares appearing in House Account as on that date amounting to Rs. 68,204,081 should have been reported after discounting @ of 15% as required under the SECP Rules i.e. Rs. 57,973,469. Thus amount reported under this head in NCB was understated by Rs. 41,223,915.

iv) Securities Purchased for Clients

An amount of Rs. 28,353,660 was reported under this head. However, as per working carried out by the inspection team, securities valuing Rs. 41,231,992 were available against clients' debit balances. The figure under this head was understated by Rs. 12,878,332.

v) Trade Payables

An amount of Rs. 14,397,518 was reported under this head, however, as per aging schedule provided by AZSL the said amount after adjusting overdue balance for more than 30 days was Rs. 9,075,034. Thus trade payables on the basis of aging schedule of AZSL were overstated by Rs. 5,322,484.

vi) Other Liabilities

An amount of Rs. 126,159,579 was reported as other liabilities. However, as per working of the inspection team the said figure should have been Rs.132,256,496. Thus, other liabilities were understated by Rs. 6,096,917.

3. **AND WHEREAS**, after incorporating the aforementioned adjustments, the NCB is showing a negative balance of Rs. 35.72 million as mentioned below:-

Current Asset	Submitted to KSE	Adjusted
	Amount in Rs.	
<i>Cash in hand or in bank</i>		
<i>In Hand</i>	54,580	148,580
<i>In Bank</i>	3,864,632	3,909,212
<i>Trade Receivables</i>	112,306,031	2,338,785
<i>Investment in Listed Securities (Broker)</i>	16,749,554	57,973,469
<i>Securities Purchased for Client</i>	28,353,660	41,231,992
Current Liabilities		
<i>Trade Payables</i>	(14,397,518)	(9,075,034)
<i>Other Liabilities</i>	(126,159,579)	(132,256,496)
<i>Net Capital Balance</i>	20,771,360	(35,729,492)

4. **AND WHEREAS**, in terms of rule 3 of the SECP Rules, it is the duty of every member/TREC holder of the Exchange to maintain at all time NCB as calculated in accordance with the Third Schedule of the said rules. Further, section 18 of the Ordinance provides that:-

“No person shall, in any document, paper, accounts, information or explanation which he is, by or under this Ordinance, required to furnish , or in any application made under this Ordinance, make any statement or give any information which he knows or has reasonable cause to believe to be false or incorrect in any material particular.”

5. **AND WHEREAS**, prima facie, it appears that the NCB as calculated by AZSL is not in accordance with the Third Schedule of the SECP Rules and that the AZSL by submission of overstated NCB has submitted a statement as well as given information which it had reasonable cause to believe false or incorrect in material particular in violation of Section 18 of the Ordinance.

6. **AND WHEREAS** during the course of inspection, it was revealed that AZSL was charging late payment charges to its clients. The details of some of these transactions are as under:

<i>Date</i>	<i>Client name</i>	<i>Late Payment Charges debited during the period</i>	<i>Amount (Rs.)</i>
31-07-2011	Asmara Saleem-asm (G 22)	01-07-11 - 31-07-11	4,427.11
31-08-2011	Asmara Saleem-asm (G 22)	01-08-11 - 31-08-11	4,495.00
30-09-2011	Asmara Saleem-asm (G 22)	01-09-11- 30-09-11	4,416.30
30-11-2011	Asmara Saleem-asm (G 22)	01-11-11 - 30-11-11	4,550.40
31-12-2011	Asmara Saleem-asm (G 22)	01-12-11 - 31-12-11	4,771.52
31-07-2011	Muhammad Rafique Anjum-001 (S 51843)	01-07-11 - 31-07-11	2,675.61
31-08-2011	Muhammad Rafique Anjum-001 (S 51843)	01-08-11 - 31-08-11	2,716.53
31-07-2011	Muhammad Ejaz Khan - M09 (G 22)	01-07-11 - 31-07-11	7,706.60
31-08-2011	Muhammad Ejaz Khan - M09 (G 22)	01-08-11 - 31-08-11	7,889.81
30-09-2011	Muhammad Ejaz Khan - M09 (G 22)	01-09-11- 30-09-11	7,816.80
31-10-2011	Muhammad Ejaz Khan - M09 (G 22)	01-10-11- 31-10-11	8,263.36
30-11-2011	Muhammad Ejaz Khan - M09 (G 22)	01-11-11 - 30-11-11	8,187.00
31-12-2011	Muhammad Ejaz Khan - M09 (G 22)	01-12-11 - 31-12-11	8,654.58
31-07-2011	Ghazi Naseem 's clients	01-07-11 - 31-07-11	431,715.49
30-09-2011	Ghazi Naseem 's clients	01-09-11- 30-09-11	533,556.87

7. **AND 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 security 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.”*

8. **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.



9. **AND WHEREAS** in light of the facts mentioned above, it appears that AZSL is prima facie in contravention of Section 16 of the Ordinance and Third Schedule of the SECP Rules, read with Section 18 of the Ordinance.

10. **AND 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.

11. **AND THEREFORE**, you are hereby called upon to show cause in writing by November 28, 2012, as to why action as provided in Section 22 of the Ordinance may not be initiated against AZSL 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 **November 30, 2012 at 11.00 a.m.** at the Commission's Head Office – Islamabad. You are advised to bring all relevant original records, which you may consider necessary for clarification/in defense of your stance. This notice sufficiently discharges the Commission's obligation to afford AZSL 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 AZSL has nothing to say in its defense and the matter will be decided on the basis of available record.

Hasnat Ahmad
Director

4. Thereafter, the hearing fixed for November 30, 2012 was adjourned till December 7, 2012 on the request of the Respondent. Pursuant to the subject SCN and the hearing in this regard, the Respondent submitted its written reply vide its letter dated December 17, 2012. In the said reply the Respondent provided the following statement with regards to the violations mentioned in the SCN.

a) Submission of overstated NCB – Violation of Third Schedule of the Securities and Exchange Rules, 1971.

In the said reply the Respondent admitted the violation pertaining to Net Capital Balance (“NCB”) and provided assurance to comply with the requirements of Third schedule of the Securities and Exchange Rules, 1971 (“the Rules”). In support of this

statement the Respondent also provided a copy its letter dated December 13, 2012 addressed to its Auditor i.e. M/s. Aslam Malik & Co, Chartered Accountants, whereby necessary instructions were issued for calculation of NCB as prescribed in the Rules.

b) Charging of liquidation damages from the clients – Violation of Section 16 of the Securities and Exchange Ordinance

Violation of Section 16 of the Securities and Exchange Ordinance, 1969 the Respondent did not offer any comment.

5. I have examined the facts, evidences and documents on record, in addition to the written and verbal submissions made on behalf of the Respondent and the documents submitted subsequent to the hearing. It is evident from perusal of the record that if NCB was calculated in strict compliance with the requirements of the 1971 Rules, the NCB of the Respondent would have been in negative. This implies that the Respondent by submitting false NCB has attained much higher trading exposure thereby increasing the systemic risk in the market. Therefore, it stands established that the NCB as calculated by the Respondent is not in accordance with the Third Schedule of the 1971 Rules and that Respondent by submission of overstated NCB has submitted a statement and given information which it had reasonable cause to believe to be false or incorrect in material particular in violation of Section 18 of the Ordinance.

6. As far as the issue of liquidation charges is concerned perusal of record transpires that the Respondent extended financing from private sources. This fact is substantiated from the "Late Payment Charges" that were charged by the Respondent and this contention was not denied by the Respondent. Since the Respondent did not offer any comments on the said violation therefore it implies to the admission of the offence.

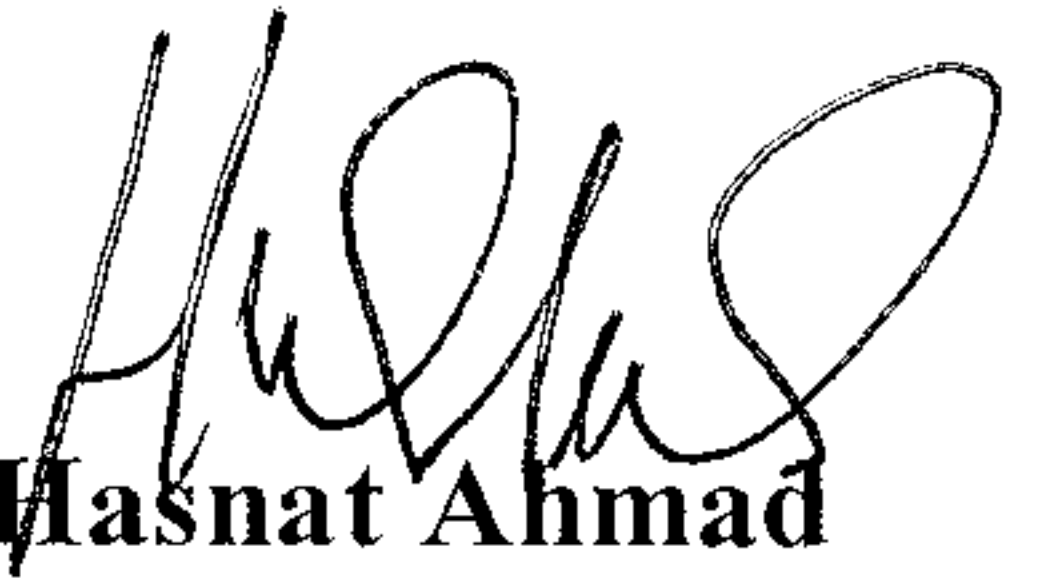
7. In view of the foregoing, I am of the considered opinion that the violations of Third Schedule of the SECP Rules, 1971 and Section 16 of the Ordinance stand established. In case any person contravenes or otherwise fails to comply with the provisions of this Ordinance, rules or regulations made thereunder, 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.

8. The violation of the Ordinance, rules and regulations is a serious matter and therefore I hereby direct the Respondent to pay the Commission by way of penalty a sum of Rs. 100,000/- (One Hundred Thousand Only) on account of violations of section 16 of the Ordinance and Third Schedule of the Securities and Exchange Rules, 1971. Further, the Respondent is directed to make necessary arrangements for compliance with the regulatory framework mentioned in the SCN and submit a comprehensive report in this regard to this office within sixty days of the date of this order.

9. This matter is disposed of and the Respondent is directed to deposit the amount of penalty as mentioned in paragraph 8 above in the account of the Commission being maintained

in the designated branches of the 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.

10. The order is issued without prejudice to any other action that the Commission may initiate against the Respondent in accordance with the law on matters subsequently taken up or investigated and/ or brought to the knowledge of the Commission.


Masnat Ahmad
Director (MSCID)

Announced on February 15, 2013
Islamabad.