Through Courier

Before The Director / HOD (MSRD)

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

Date of Hearing:	*August 8, 2014*
Present at the Hearing:	
Representing Sunrise Capital (Private) Limited	
(i) Mr. Azam Khan	*Chief Executive Officer*
(ii) Mr. Aslam Khan	*Director*
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(26) SMD/MSRD/C&IW/2013 dated May 23, 2014 ("**SCN**") served to Sunrise Capital (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 record 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 December 31, 2013:

a) Mr. Adnan Ahmed — Deputy Director
b) Mr. Kashif Ali — Deputy Director

3. The Inspection Team submitted the report (**"Inspection Report"**) on March 5, 2014 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 March 20, 2014. Upon evaluation of the Inspection Report, irregularities in calculation of Net Capital Balance (**"NCB"**) as of June 30, 2013 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"**). Moreover, the Inspection Report further highlighted that the Respondent:

a) failed to maintain proper books of accounts;
b) failed to maintain segregation of clients' assets;
c) did not have Know Your Customer (**"KYC"**) and Customer Due Diligence (**"CDD"**) policy;
d) failed to classify account of its directors and employee as proprietary;
e) failed to maintain pre-trade and post-trade margins.

4. In light of the findings 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 June 10, 2014 at the Commission's Head Office in Islamabad. However, the Respondent vide letter dated May 28, 2014 requested for extension in the date of hearing and change in venue to Karachi. Acceding to the Respondent's request, hearing date was rescheduled to August 8, 2014.

5. The Respondent submitted its written response to the SCN vide letter dated June 25, 2014. The arguments put forward by the Respondent in its written response are reproduced below:

a) **Overstatement of cash in hand:**

"We would like to point out and for clarify submit there was no in principle no overstatement of cash as of the date of September 2, 2013 of net capital balance report since Muniff Ziauddin & CO Chartered Accountants carried out verification of the NCB statement on the basis of book balances of the relevant head of account that as of date of their report stood in the book of account at Rs.33,805. This is evident also from the basis of valuation of cash was book value

that was disclosed therein in the statement of net capital balance annexed to the certificate. The book value as of that date was Rs.33,805/-.

It is further submitted humbly that after audit was conducted and report was issued in December 2013 the amount of cash used in payment of expenses for which it was drawn was accounted for in the audited financial statement of the company as of 30th June 2013. This should therefore be seen in proper perspective as an adjustment incorporated by the management in the final audited accounts annexed to the audit report issued in December 2013 which by any standard is to be treated as a routine matter for any entity and this cannot be categorized as a misstatement but rather an error of omission of amount that is not even material. We trust that your authority will take a just and equitable view in this respect and drop proceeding in this respect. We are taking this opportunity to show that the payments made subsequently in cash considered as an adjustable event and recorded in the bold accordingly."

b) **Understatement of other liabilities:**

"We draw attention to the observation made by the team that there was a long term loan from directors amounting to Rs.5.332 million appearing in Trial Balance as at June 30, 2013 which is indeed the correct position of the company as well. This was intended to be long term as at the balance sheet date and this was at the very start booked as long term loan and appeared accordingly in the Trial Balance of 30th June 2013 which was also observed by the team. This was also reflected in the audited financial statement of the company as long term loan in line with the management's representation made as of that date that was in line with its intension. In view of the above, as per the Third Schedule it was not required to be included for determination of net capital balance and there was no intent to overstate the same as a result of classification. The matter is required to be considered accordingly in the light of fair representation made by the management as of the balance sheet date. The company is a private limited company that took decision in the said matter as a result of its risk assessment made subsequently that led it to withdraw and pay back the loans which is allegedly viewed by the team as a misclassification and hence an overstatement without taking cognizance of the fact that it within the doctrine of indoor management to take decision in the best interest of the company.

In view of the above, as per we request your kind authority to drop further proceedings in the above in the light of our above submissions. We calculate the NCB certificate as of 31st December 2013 where the net capital balance after the settlement of long term loan did not change negatively as compared with the NCB of Rs.8,757,365 as at 30th June 2013, which further supports the submissions of the management."

c) **Improper books of accounts:**

"As regard 5(i) we submit that we use the same software system that is commonly in use by other brokerage houses in KSE and as such we understand that except for the observation on recording of certain transactions on net basis and lack of control like reconciliation of ledger account balances, which was mainly due to the inefficiency of the former CFO who was since been replaced, proper books of accounts are being regularly maintained by the company. We have already taken note of the matter highlighted in sub paragraph (i) of the SCN about recording of proprietary investment on gross basis accordingly.

As regards 5 (ii) and 5 (iii), the company has now introduced proper controls of periodic reconciliation so that such errors of omission and erroneous posting do not recur in future which has created apprehension in the eyes of the inspection team."

d) **Segregation of clients' assets:**

"In this regard it is submitted that as a matter of policy company maintains two separate bank accounts mentioned hereunder for the above said compliance

i. Account No.0012 -01002434-003288041- Clearing Account

ii. Account No. 0012 -01002551 –(1003288041)- Client Account

The payment made from the above bank accounts are related to house liability which is permitted under the regulation and there is hence company is not in violation of any regulation. The company deposits all receipts and payments from and to clients from the bank account for the client exclusively. The funds belonging to clients are exclusively applied as per client's instructions for client's purpose. We make sure that two bank accounts remain separate and no funds of clients are used by company for its needs. This observation should be accordingly dropped."

e) **KYC & CDD Policy :**

"SCL encourage face to face Meeting with individual and corporate clients are schedule before opening. Further, SCL encourage only well reputed persons for investment, however if someone refer to anyone we check market credibility and discussed face to face. SCL determined carefully the sources of funds of its client, if any client's source of fund is in doubt, SCL clearly refused the application. In-addition, SCL does not deal with risky client. Risk assessment has to be done at the time of the Account Opening and updated on the basis of the information obtained during the relationship and doing business with the customer."

f) **Separate trading account for proprietary trades:**

"SCL has following proprietary trading accounts:

i. ID0780 – Sunrise Capital (Private) Limited – Prop

ii. ID0781 – Sunrise Capital (Private) Limited - Prop

iii. *ID0782 – Sunrise Capital (Private) Limited - Prop*
iv. *ID0783 – Sunrise Capital (Private) Limited - Prop*
v. *ID0784 – Sunrise Capital (Private) Limited - Prop*
vi. *ID0786 – Sunrise Capital (Private) Limited – Prop*

The ledger of the same proprietary accounts was provided to inspection team during inspection. Further, as per the discrepancy highlighted by the inspection team we have added word 'prop' to the accounts."

g) **Absence of pre-trade and post-trade margins:**

"We make sure to maintain pre trade and post trade margins balances before and after execution of trades. However, in case of shortfall in margins during trade, we request our client to make shortfall in margin either by making payment or transfer of shares to the CDC sub account. As you are already aware that the settlement of transaction is done on T+2 basis so the brought position is settled before the clearance date by receiving payment from client or sold position is settled by transferring of shares to CDC sub account before the clearance date."

6. Mr. Azam Khan, Chief Executive Officer of the Respondent and Mr. Aslam Khan, Director, (**"Representatives"**) attended the hearing on behalf of the Respondent. The Representatives of the Respondent during the course of hearing communicated that:

a) Due to resignation of Chief Financial Officer (**"CFO"**) of the Respondent some mistakes were made by the staff in calculation of NCB, however those were unintentional. In respect of difference in cash in hand balance, the Representatives further stated that those mistakes were identified by the auditor and as per auditors' recommendation the rectifications were done while calculating NCB. They also agreed to provide necessary evidence in respect of difference in the cash ledger. The Representative communicated that the Respondent followed old method for NCB calculation and did not include the loan amount in NCB calculation as of June 30, 2013. They further asserted that the Respondent has now followed the guidelines issued by the Commission in letter and spirit and shall submit NCB Certificate of the Respondent as of June 30, 2014 within few days.

b) With regard to improper books of accounts, the Representatives admitted the mistakes and apprised that the Respondent has now rectified everything and is preparing books of accounts in accordance with the rules and regulations. The Representatives agreed to provide copies of rectified ledger subsequent to the hearing within few days.

c) With regard to segregation of clients' assets, the Representatives of the Respondent asserted that after 2013, the Respondent is strictly maintaining segregation of clients' assets. The Representatives agreed to provide reconciliation of the payables position as of June 30, 2014 with the fund available in the bank account tagged as clients' bank account.

d) The Representatives assured that they shall provide the duly approved KYC and CDD policy subsequent to the hearing.

e) In the context of acceptance of pre-trade and post-trade margins, the Representative asserted that they are now complying with the applicable regulatory framework and the Commission can verify the same.

7. 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 admitted that there was an interim period when the financial transactions were not recorded properly because of the inefficiency of the former CFO of the Respondent who later resigned. The Representatives communicated that subsequent to that period, the Respondent is in compliance with the applicable regulatory framework.

b) In order to substantiate its claim of maintenance of proper books of account, the Respondent submitted copies of rectified ledgers as was agreed during the course of hearing by the Representatives vide letter dated August 20, 2014.

c) The Respondent vide above dated letter also provided copy of its trial balance as of June 30, 2014 depicting the trade payables as Rs. 799,982/- and the bank balance in the account tagged for clients as Rs. 2,503,602/- evidencing that it is maintaining segregation of clients' assets and is in compliance with the regulatory framework.

d) The Respondent through its written response dated August 18, 2014 provided copy of duly approved KYC and CDD Policy along with updated ledger records, evidencing maintenance of proper books of accounts.

e) The Respondent through above mentioned letter also provided copy of NCB Certificate as of June 30, 2014; where in the NCB of the Respondent is reflected as Rs. 14.49 million.

8. 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 in the inspection period failed to maintain proper segregation of clients' assets; proper books of accounts; and KYC & CDD Policy. However, subsequently the Respondent rectified the discrepancies and submitted evidences of its compliance with the applicable regulatory framework.

9. The violation of the Rules and Regulations is a serious matter, however, taking a lenient view and in exercise of the powers under Section 22 of the Ordinance, I hereby impose a penalty of Rs. 25,000/- (Rupees Twenty Five Thousand Only) on the Respondent. Moreover, the Respondent is directed to:

i). comply with the Rules 1971 and the guidelines issued in letter and spirit; and

ii). ensure segregation of clients' assets and maintain separate bank account for the clients' funds.

10. The matter is disposed of in the above manner. 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.

SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
SECP

(Imran Inayat Butt)
Director/HOD (MSRD)

Announced on September 4, 2014
Islamabad.