



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 Friendly Securities (Private) Limited
under Section 22 of the Securities and Exchange Ordinance, 1969

Date of Hearing:

August 6, 2014

Present at the Hearing:

Representing Friendly Securities (Private) Limited

(i) *Mr. Hasan Mehmood*

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(30) SMD/MSRD/C&IW/2014 dated June 27, 2014 ("SCN") served to Friendly 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 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 February 27, 2014:

a) Mr. Mian Muhammad Imran

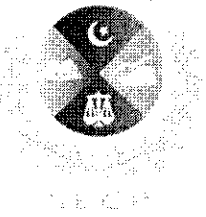
Deputy Director

b) Mr. Adnan Ahmed

Deputy Director



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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 May 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 June 9, 2014. Upon evaluation of the Inspection Report, irregularities in calculation of Net Capital Balance ("**NCB**") as of December 31, 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) was involved in imposing late payment charges to its clients;
- d) did not have Know Your Customer ("**KYC**") and Customer Due Diligence ("**CDD**") policy;
- e) failed to classify account of its director as proprietary;
- f) failed to comply with Circular 34 of 2009 issued by the Commission.

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 July 11, 2014 at the Commission's Head Office in Islamabad. However, the Respondent vide letter dated July 8, 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 6, 2014.

5. The arguments put forward by the Respondent in its written response to the SCN submitted vide letter dated August 8, 2014 are reproduced below:

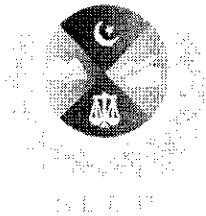
a) **Overstatement of trade receivables:**

"Overstatement of trade receivables by Rs. 3.42 million in this regard we want to inform you that overstatement of trade receivables by Rs. 0.83 million is unintentional due to late payment charges booked by us and accrual of these charges are stopped by December 31, 2013 and evidence of the same is also provided by us."

b) **Understatement of trade payables:**

"Understatement of trade payables by Rs. 4.466 million in this regards we want to inform you that trade payables were fully disclosed and no understatement was found by us."





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

Continuation Sheet - 2 -

c) **Payment of personal nature from client account of the director :**

"Payment of personal nature to one of the director of FSL was made from the account classified as trade debt/receivables in this regard we want to inform you that it was a one off transaction and adequate measures are taken to prevent any personal nature payment from trading accounts."

d) **Trading account in the name of the peon:**

"Account of our employee is being used for welfare of employees and any gain from the trade is distributed among all employees of FSL and that this account is being managed by the directors of FSL. We want to inform you that the account has been closed and adequate measures are taken to ensure that in future account is not managed/used by the director."

e) **Improper books of accounts:**

"Provision for bad debts is shown as miscellaneous expense in this regard we are inform you that name of account head in our management system is wrong and also corrected in our system.

Accrued markup nil amounts is shown in financial statement, we want to inform that accrued markup are clubbed in accrued expense head and the amount is properly recorded.

Ledger of proprietary account as of June 2013 depicted and adjustment of Rs. 161,072.76 as bad debts and a provision for bad debts Rs. 395,621 in this regard we want to inform you that total bad debts of miscellaneous clients are only Rs. 395,621 therefore recorded as miscellaneous expense in our books.

Offset commission expense against commission income in this regards we have inform you that this presentation is followed only for management accounts, but in our financial statements expense and income are separately presented as per the requirement of IAS and IFRS."

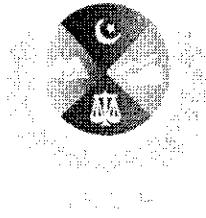
f) **Late payment charges:**

"FSL involved in imposition of late payment charges to its clients, who do not clear dues in this regard we are inform you that we impose a late payment charges due to cover financial loss but this practice has been discontinued from January 1, 2014."

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

"Segregation of funds in this regards we are inform you that we start segregation of funds starts from November 2013 after system audit due to this reason only few transaction were appearing during period January 2013 till December 31, 2013."





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

Continuation Sheet - 3 -

h) **KYC and CDD Policy:**

"KYC and CDD Policy in this regards we want to clarify that we already follow KYC and CDD Policy after system audit in November 2013 and a proof of KYC and CDD are attached."

i) **UIN database:**

"FSL failed to classify the account of Mr. Jawwad Janoo, the director of FSL, as proprietary in this regards we want to inform you that we already have updated in NCCPL system."

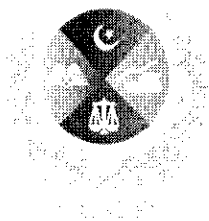
j) **Circular 34 of 2009:**

"the circular 34 of 2009 required that at least two individuals or 20% of the employees (whichever is high) shall have relevant certification from ICM by June 30, 2011 in this regards we would like to inform you that as point out by SECP we contact ICM but ICM representative communicated that any person whose age is above 35 years was exempted from this circular but now a days this facility are not available but our management is in discussion with SECP regarding exemption of those persons who ages above 35 years and have decade experience."

6. Mr. Hasan Mehmood, Manager - Operations of the Respondent ("**Representative**") attended the hearing on behalf of the Respondent on August 6, 2014. Following arguments were put forth by the Representative of the Respondent during the course of hearing:

- a) With regard to overstatement of trade receivables with the amount of markup, the Representative informed that only Rs. 830,000 is included in NCB and the same was outstanding as on December 31, 2013. He, further, stated that the remaining amount charged on account of markup/late payment was received from the clients during the period. The Representative agreed to provide client wise breakup of the markup included in the trade receivables for calculation of NCB.
- b) The Representative informed that the Respondent has now stopped imposing late payment charges and shall provide evidence of the same to the Commission.
- c) The Representative, with regard to payment of Rs. 4.46 million to the director of the Respondent and its inclusion in trade debts calculation, accepted that this should have not been done from the trading account. The Representative further added that they are now acting more consciously and have stopped making such payments from the trade receivables and payables account of the director.



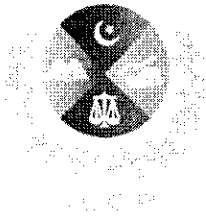


SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Supervision & Registration Department)

Continuation Sheet - 4 -

- d) The Representative with regard to buying of shares worth Rs. 6.98 million in the account of the peon accepted that the trading in the said account was executed by the directors of the Respondent and profit, if any, was distributed among employees of the Respondent. The Representative, however, admitted the fact that the trading account of peon should not be used by the directors. He apprised that the said practice has immediately been stopped and have also closed the said trading account. He agreed to provide evidence of the same.
- e) The Representative communicated that the provision for bad debts is included in miscellaneous expense only in management accounts and correctly accounted for in the ledgers and the balance sheet.
- f) With regard to payment from accrued expense account and adjustment of bad debts from the proprietary trading account, the Representative stated that it was done by mistake and the Respondent has now rectified it. He, further, added that this provision for bad debts was to be made from the various clients' trading accounts and the staff of the Respondent was not sure of where to record this transaction, charged the amount in the proprietary trading ledger.
- g) The Representative, with regard to offsetting of income and expense account, communicated that it is only done for management accounts. For the purpose of financial reporting, expenses and income are reported separately.
- h) The Representative communicated that the Respondent has now started maintaining segregation of clients' assets and shall provide reconciliation of the payables position as of the June 30, 2014 with the trade payables position of the same date. He stated that only few transactions were appearing in the bank account tagged as clients' account because the Respondent started to maintain segregation of clients' funds from November 2013 and afterwards is in compliance with the applicable regulatory framework.
- i) The Representative accepted that no KYC and CDD Policy has yet been approved. However, the Representative stated that the KYC and CDD Policy shall be approved from the board of directors of the Respondent and a copy of the same shall be provided to the Commission.





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

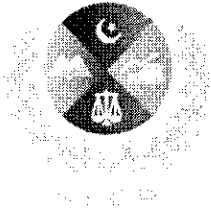
Continuation Sheet - 5 -

- j) With regard to classification of the account of Mr. Jawwad Janoo as proprietary, the Representative communicated that the same has been updated and evidence of the same shall be provided to the Commission.

7. 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 they have now stopped imposing late payment charges. Further, they stated that the difference in NCB calculation resulted firstly because of inclusion of late payment charges in receivables and secondly, recording of few payments (not relating to trading activity) in the ledger account (pertaining to trading activity) of the director. The Representative asserted that this practice has now been stopped. The Respondent and the Representative assured that in future NCB shall be calculated in light of the guidelines issued by the Commission.
- b) With regard to the trading account in the name of the peon of the Respondent, the Representative during the course of hearing and the Respondent in its written response accepted that it was managed by the directors of the Respondent and any gain in the account was distributed among the employees of the Respondent. The Representative agreed to provide copy of the statement depicting account closure, however, no evidence in the context was received till the date of issuance of this order.
- c) The Respondent vide letter dated August 8, 2014 provided copies of ledger accounts evidencing rectification of provision of bad debts expense and assured that in future, it shall ensure compliance with the applicable regulatory framework.
- d) Regarding segregation of clients' assets, the Respondent vide letter dated August 8, 2014 provided letters of Bank Alfalah Limited and JS Bank Limited verifying the balances as of June 30, 2014 as Rs. 2,010,000 and Rs. 5,320,500 respectively against trade payables of Rs. 6,122,262 of the same date. However, the Respondent during the course of inspection, in its written response and the Representative during the course





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

Continuation Sheet - 6 -

of hearing communicated that from November 2013 onwards, account with Bank Alfalah is being used for maintaining segregation of clients' funds.

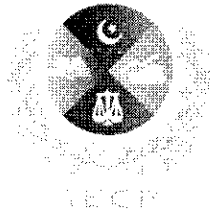
- e) The Rule Book of KSE clearly states that a separate bank account is to be maintained for segregation of clients' assets, meaning thereby that an amount equivalent to trade payables position as of the date should be available in the bank account tagged for the purpose as clients' account. In view of the above, the Respondent should have an amount equivalent to the trade payables of June 30, 2014 amounting to Rs. 6.12 million in the bank account with Bank Alfalah Limited (tagged as clients' account).
- f) The Respondent vide letter dated August 8, 2014 provided copy of duly approved KYC and CDD Policy.
- g) With regard to classification of the account of Mr. Jawwad Janoo as proprietary, the Respondent provided evidence of the same to the Commission during the course of hearing.

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 failed to comply with statutory requirements and did not fulfil its regulatory obligations by not maintaining proper segregation of clients' assets; not having KYC and CDD Policy and not maintaining proper books of account. 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 on the Respondent a penalty of Rs. 25,000/- (Rupees Twenty Five Thousand Only). Moreover, the Respondent is directed to:

- i) comply with the Rules 1971 and the guidelines issued in letter and spirit; and
- ii) ensure proper segregation of clients' assets and provide copy of bank statement of Bank Alfalah Limited (client account) as of September 30, 2014 along with copy of trial balance of the same date depicting gross trade payables and trade receivables position by October 15, 2014.





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

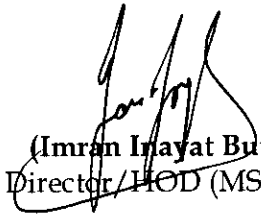
Continuation Sheet - 7 -

10. 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.

11. 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 September 11, 2014
Islamabad.




(Imran Inayat Butt)
Director/HOD (MSRD)