



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

Date of Hearing:

May 28, 2014

Present at the Hearing:

Representing Standard Capital Securities (Private) Limited

(i) Mr. Naushad H. Chamdia

Chief Executive Officer

(ii) Mr. Muhammad Zubair

Head of Department

(iii) Mr. M. Hanif Razzak

Consultant

Assisting the Director/HOD (MSRD)

(i) Mr. Muhammad Tanveer Alam

Joint Director

ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice bearing No. 1(25) SMD/MSRD/C&IW/2014 dated April 29, 2014 ("SCN") served to Standard 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 December 31, 2013:

- | | |
|-------------------------|-----------------|
| a) Mr. Muhammad Tanweer | Deputy Director |
| b) Mian Muhammad Imran | Deputy Director |





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3. The Inspection Team submitted the report ("Inspection Report") on March 4, 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 on 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 highlights that the Respondent, did not have Know Your Customer ("KYC") and Customer Due Diligence ("CDD") Policy duly approved from the Board of Directors of the Respondent; failed to maintain segregations of clients' assets; failed to maintain proper books of accounts and was involved in imposing late payment charges to its clients.

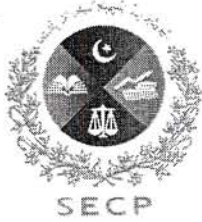
4. In light of the Inspection Report and the comments received from the Respondent, the Commission served a Show Cause Notice ("SCN") dated April 29, 2014 to the Respondent under Section 22 of the Ordinance and Rule 8 of the Brokers Rules. Hearing in the matter of aforesaid SCN was scheduled for May 13, 2014 at the Commission's Head Office in Islamabad. The Respondent vide letter dated May 7, 2014 requested that hearing be rescheduled for some other date and be fixed in Karachi. Acceding to the Respondent's request, hearing was rescheduled to May 28, 2014 at the Commission's Karachi office.

5. The Respondent submitted its written response to the SCN vide letter dated May 17, 2014. Mr. Naushad H. Chamdia, Chief Executive Officer of the Respondent; Mr. Muhammad Zubair, Head of Department of the Respondent and Mr. M. Hanif Razzak, FCA Consultant ("Representatives"), attended the hearing on behalf of the Respondent. The key arguments put forward by the Respondent in its written response are reproduced here as under:

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

"It is evident from the Inspection report under Trade Receivables "14 days" you noted understatement of Rs. 37.946 million while under "Securities Purchased for Client" the report shows overstatement of Rs. 29.396 million which shows same clients name both in Annexure II and Annexure III of the Inspection Report is attached for your perusal. Normal financial cycle of stock broking revolves between payable to clients (upon receipt of exposures) and conversion into trade receivables, investments/securities, bank balances. In the existing situation the inspection team observed over/understatement of identical amount and between Trade Receivables versus Securities Purchased for client and in both





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the cases it is admittedly accepted that no benefit of NCB accrued/enjoyed by the SCS. This assertion itself transform the observation from the clutches of non-compliance to academic discussion and SCS since had always desired to maintain the accuracy in the NCB calculation, inquired from the inspection team the apparent reason for identical difference in groupings of these two heads and came to now with the following reason, namely:-

Lump sum amount received by SCS from its clients have been set off from the amounts receivables falling under the category of 14 days first and remaining one from the category after 14 days. The situation obtaining is not addressed in any Rules and Regulations except for Sale of Goods Act, 1913 which are not applicable in the instant case. Hence this is not the situation where conclusion is drawn that NCB as on June 30, 2013 was not calculated in accordance with the Third Schedule of SEC Rules 1971 as there is no overall difference in calculation and confronted difference is in the sub-categories and that again due to some accounting assumption followed by SCS and suggested by the inspection team.

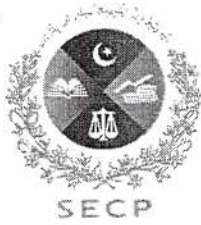
Once again in respect of Trade Payables, liabilities exceeding for 30 days period aggregating to Rs. 62,921,942 has been deducted from the Trade Payables and added to "Other Liabilities" after disclosing this in the NCB Certificate which is the classification difference and there is no under or over statement issue on overall basis. The reported difference is related to the classification of categories which is on the basis of requirements of Third Schedule."

b) Improper Books of Accounts:

"Financial statements are prepared based upon the applicable accounting framework and notified IAS/IFRS are followed in our jurisdiction for the preparation of financial statements of Listed Companies while SCS is a family owned Private Limited Company for which separate AFRS are applied and even for disclosure requirements Fifth Schedule is applied which is slightly less exhaustive.

Netting of some income against the Old Bad Debts which were unlikely to be realized has been explained in detail with supported copies of tax assessment orders wherein the claim has been disallowed and that resulted into enhanced tax liability to SCS for which it is not obliged under the law. Under this situation where the tax assessments are framed on whims and conjectures always cause loss to the taxpayers. You will appreciate that we duly explained this to the Inspection Team and have nothing in mind to conceal anything or defraud any person, while defending the SCS against any unwarranted tax liability for which it is not obliged to pay under the law."





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c) **KYC & CDD Policy:**

"Though we have provided KYC and CDD Policy in written form to the Inspection Team along with the reply, which was formulated and implemented under the directions of our Chief Executive and upon information that this is also needed to be approved by the Board of Directors, has duly been tabled in the BOD meeting date May 5, 2014 and accordingly approved by our Board of Directors."

d) **Segregation of Clients' Assets:**

"As asserted above, brokers need to always keep the availability of funds to meet settlement requirements. In the instant case, even bank finance of Rs. 57.681 have been availed on the cutoff date while Clients shareholding amount to Rs. 83.39 million. On overall basis, the client segregation of funds is made in separate accounts; however there will be occasions when the settlements are made for client purchases of securities from the clients funds and corresponding record keeping lags results in mismatches at micro levels of fund keeping. It is however, ensured that the instances of such mismatched be mitigated by effective monitoring in future."

e) **Late Payment Charges:**

"Our assertion is reiterated that re-imbursement of finance cost adjustment where there was delay in settlement by the clients has been discontinued w.e.f 14-November-2013 and copies of relevant ledger account has also been provided in soft form to the Inspection team during the Inspection carried out at our office on 16-Januray-2014 which confirms our assertion. We have instead introduced Margin Financing (MFS) and that fact was also evident from the records which have been examined by the Inspection Team. In order to dispel any confusion, copies of relevant ledgers and MFS documents retched from NCCPL terminal are furnished to confirm the stance."

f) **Collateral Account:**

"Collateral account has been opened on 20-March-2014 and evidence whereof is attached."

g) **Registration of employees in UIN database:**

"UIN database of certain employees identified by the Inspection Team has been updated. Evidence is attached for your perusal."

h) **Internet Trading Regulations:**

"Audit Report relating to the compliance of Internet Trading Regulations has been attached. That report was also forwarded to the Inspection Team vide our letter dated 20-March-2014 which might have not drawn attention earlier."





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

- a) With regard to calculation of NCB, the Representatives assured future compliance by the Respondent and further added that the next NCB of the Respondent shall be prepared in light of the Rules and the Guidelines issued by the Commission.
- b) While explaining netting of net income with old receivables, the Representatives accepted that the Respondent did not properly follow the accounting principles in the matter highlighted by the Commission. The Representatives further assured that, in future, the Respondent shall follow the accounting principles in letter and spirit.
- c) The Representatives asserted the response of the Respondent with regard to KYC and CDD Policy and communicated that the same has duly been approved by the Board of Directors of the Respondent.
- d) The Representatives in response to the maintenance of segregation of clients' assets communicated that it shall provide reconciliation of the payables as on June 30, 2013 with that of bank balance and other funds position within a weeks' time. The Representatives asserted that it maintains segregation of clients' funds.
- e) With regard to imposition of late payment charges, the Representatives accepted that the Respondent was involved in imposing late payment charges to its clients; however, it has stopped the said practice after November 2013.

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 communicated that the difference in the NCB calculation was mainly because of accounting methodology adopted in the calculation of receivables and payables for the purpose of NCB. However, even after the adjustments to NCB, the Respondent met the specified capital adequacy requirements. Moreover, the Respondent assured that it shall prepare the NCB in accordance with the SEC Rules and the guidelines issued by the Commission.
- b) The Representatives of the Respondent during the course of hearing accepted that by netting its net income against old receivables, the Respondent did not follow





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proper accounting treatment in accordance with the accounting principles. The Representative asserted that there was no intent to conceal anything or defraud any person and assured that it shall properly follow the accounting principles and maintain its books of accounts, in future, in accordance with Rule 8 of SEC Rules.

- c) The Representatives of the Respondent during the course of hearing provided copy of the minutes of the meeting of Board of Directors' of the Respondent regarding formulation of KYC and CDD Policy to substantiate the claim of compliance with the regulatory framework.
- d) The Respondent, as was agreed by the Representative during the course of hearing, provided reconciliation of its assets with payable position for June 25, June 26, June 27, June 30, 2013, July 1, July 2, July 3, July 4 and July 5, 2013 vide email dated June 19, 2014. The Respondent for June 30, 2013 communicated the following:

Bank Balance - SCS	6,876,551	
Bank Balance - Clients	5,534,923	
Deposits - KSE/NCCPL	3,050,000	
Cash in hand	183,332	
	<u>15,644,806</u>	
Trade Receivables	152,516,399	
Less: SPC	(83,839,348)	
	<u>68,677,051</u>	
Net Assets	<u>84,321,857</u>	84,321,857
<u>Represented by</u>		
SCS Funds	20,416,702	
Less: Own Investments	(27,418,950)	
	<u>(7,002,248)</u>	
Bank O/D	57,261,319	
Trade Payables	95,094,092	95,094,092
	<u>145,353,163</u>	2,187,311

From the above calculation, it is evident that the Respondent had Rs. 5.5 million in the bank account tagged as clients' account and Rs. 3.050 million in deposits with KSE/NCCPL as on June 30, 2013 against the trade payables position of the same date of Rs. 95.094 million. From the above, it is evident that the Respondent was involved in using client's funds for either financing the debtors from the money of other clients or for its own investments and/or other purposes being in violation of the KSE Regulations which specifically requires the Respondent to maintain





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separate bank account for clients and ensure that the funds deposited by the clients (appearing as trade payables) in its books are available in the bank account tagged for clients' funds.

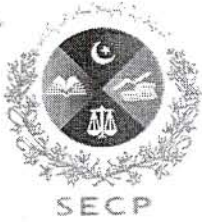
The Respondent vide email dated June 20, 2014 while clarifying SCS Funds communicated that it is the amount funded by the Respondent to meet clients' settlement on day to day basis. From analysis of the information provided by the Respondent and tabulated above it is clear that the Respondent invested Rs. 20.416 million for settlement and made investments on the same day of Rs. 27.418 million for its ownself, thereby funding investments worth Rs. 7 million from clients' funds and implying that the Respondent was involved in misuse of clients' assets. From the above analysis it is established that the Respondent failed to maintain segregation of clients' assets.

- e) With regard to imposing late payment charges to its clients, the Respondent and its Representatives communicated that after November 2013, no such charges are imposed on the clients and the Respondent has now opened a collateral account for the purpose of handling the transactions for which its clients fail to make settlement.

8. After a detailed and thorough perusal of the facts, evidence and 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 maintain segregation of clients' assets; failed to maintain proper books of accounts and was involved in imposing late payment charges. The use of clients' funds to either finance other clients (receivables) or to make own investments of the Respondent is prohibited under the regulatory framework.

9. I am of the considered view that segregation of clients' assets is vital for the protection of investors' assets and to promote market integrity and transparency. The failure of the Respondent to maintain segregation of clients' assets is harmful and detrimental for the interest of its clients. The Respondent being registered as a Broker with the Commission under the Brokers Rules is required to abide by all the provisions of the laws, rules and regulations issued by the Commission and the Stock Exchanges from time to time.





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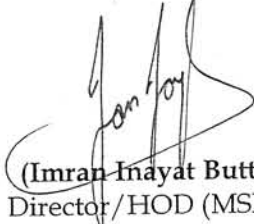
10. The violation of the rules and regulations is a serious matter. Therefore, in exercises of the powers under Section 22 of the Ordinance, I hereby impose on the Respondent a penalty of Rs. 100,000/- (Rupees One Hundred Thousand Only). The Respondent is further directed to:

- a) Comply with the Rules 1971 and the guidelines issued in letter and spirit;
- b) Ensure segregation of clients' assets;

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 July 7, 2014
Islamabad.