



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 First National Equities Limited under
Section 22 of the Securities and Exchange Ordinance, 1969

Date of Hearing:

January 21, 2015

Present at the Hearing:

Representing First National Equities Limited

(i) Mr. Ali A. Malik

Chief Executive Officer

(ii) Mr. Ali Raza

Head of Operations

Representing Karachi Stock Exchange Limited

(i) Mr. Abbas Mirza

General Manager & CCO

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(28) SMD/MSRD/C&IW/2014 dated November 28, 2014 ("SCN") served to First National Equities 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 KSE upon query submitted two Net Capital Balance ("NCB") Certificates of the Respondent dated June 30, 2014 and October 27, 2014 to the Commission vide email dated November 27, 2014. NCB Certificate as of June 30, 2014 depicted negative balance of Rs. 441 million and NCB Certificate of October 31, 2014 depicted a balance of Rs. 30 million with an observation/qualification with respect to current liabilities amounting to Rs. 394 million.

3. Analysis of the NCB Certificates revealed that the Respondent failed to maintain minimum NCB as required in terms of Rule 3 of the Securities and Exchange Rules, 1971 ("SEC Rules"). In light of the above, the Commission served a SCN to the Respondent under Section 22 of the Ordinance and Rule 8 of the Brokers Rules. Hearing matter





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

Continuation Sheet - 1 -

of aforesaid SCN was scheduled for December 8, 2014 at the Commission's Head Office in Islamabad. The Respondent vide letter dated December 5, 2014 submitted its written response to the SCN and requested for extension in the date of hearing, which was acceded to. Hearing in the matter was rescheduled at the Commission's Karachi office and was held on to January 21, 2015. The Chief Regulatory Officer of the KSE was also advised to attend the hearing in the said matter.

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

"In this regard it is respectfully stated that we submitted Net Capital Balance (NCB) Certificates of First National Equities Limited (FNEL) showing positions of NCB as on June 30, 2014 and as on October 27, 2014 to Karachi Stock Exchange Limited on October 31, 2014 based on number/figures duly audited by M/s Tariq Abdul Ghani Maqbool & Co Chartered Accountants.

The NCB Certificate of FNEL showing position as on October 27, 2014 of Rs. 30,407,686 along with the observation / qualification of auditor which states that the current liabilities amounting to Rs. 394,870,673 have not been included in Current Liabilities. Had it been included in Current Liabilities, the Net Capital Balance would have been negative Rs. 364,462,987. We submit here-under the breakup of Rs. 394, 870,673 along with the managements' stance for not including the same in the current Liabilities.

	Amounts (Rs)
1) Current Maturity of Bank Alfalah Ltd	115,210,000
2) Loan from Bank of Punjab	135,307,837
3) Payable to trade creditors	144,352,836
TOTAL	394,870,673

Reasons for not considering the above as Current Liabilities:

i) **Current Maturity of Bank Alfalah Limited (Rs. 115,210,000)**

The company entered into restructuring agreement with the Bank Alfalah Limited (BAF), vide its letter dated September 08, 2014, which stipulate mortgage of certain properties of FNEL valuing Rs. 115,210,000 with a right to acquire/purchase/sell these properties, as the BAF may deem fit, and the FNEL would relinquish its rights/privileges on these properties and would have no objection on this transaction, so executed. Hence, the loan shall be adjusted/settled against the fixed assets of FNEL pledged with BAF as reflected in non-current assets in the financial statements of FNEL. Due to specific NCB calculation format these fixed assets (properties) of the company, which are now adjustable against Current Liabilities, cannot be shown in the current assets in order to offset the impact of this current liability toward BAF. Therefore, management believes that this liability toward BAF is adjustable at the action available with the BAF and should be off set with the value of these properties and hence should not be considered as Current Liabilities.



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

Continuation Sheet - 2 -

ii) Loan from Bank of Punjab Rs. 135,307,837:

The matter is under litigation in Sind High Court since 2009 and the company has also filed a counter claim against the bank. Based on the status of the case and the opinion of the legal counsel, the company feels for all practical purposes and on ground realities that this liability is not payable in near future, at least within next twelve (12) months, as the claim of the bank has to be adjudicated upon by the honorable court. Pending such determination, there is no obligation upon the Company to make payment and since it is not possible to determine what and when decision will eventually be passed by the honorable court, the liability cannot be classified as current. It may be noted that a liability becomes payable on demand which is to be classified as current. Since recovery suite of the bank is pending litigation and since no demand has yet been raised, it is not payable on demand and hence cannot be treated as current.

Thus, the management believes that neither the Company has the obligation to settle the liability within next twelve months nor any demand has yet been raised in the light of the court decisions, or expected to be raised in near future (or within normal operating cycle) justifying to treat this liability as current. Furthermore, it may please be noted that any judgment pronounced by the courts of first instance are also subject to appellate remedies. Hence, management believes that it would be fair not to treat this liability as current for the purpose of calculating NCB of the company.

However, the company is in the process of negotiating/out of court settlement with the Bank of Punjab to restructure its liabilities towards the bank through long term restructuring arrangement. Many different options are under consideration/negotiation for the settlement of this liability and one of the options under consideration is the debt equity swap. We are hopeful that negotiation will be successful and completed very soon.

iii) Payable to trade creditor (Rs. 144,352,836)

The company is in process of long term settlement/restructuring, arrangement with the creditor; both parties are determined to resolve this matter on permanent basis. We are hopeful to settle the matter on mutually agreed terms and conditions. However no payment is expected to be made in next 12 months, therefore this amount has not been included in current liabilities while preparing NCB. Furthermore, the company is also trying to negotiate with the Creditor by offering fresh issue of shares of the company.

Efforts of Management for the Revival of the Company:

The management of the company has taken concrete steps in the past and trying its utmost presently to take measures which is return have positive impact on the financial position of the company.

- The management efforts resulted in reducing the negative equity from Rs. 725 million to Rs. 397 million in last 2-3 year.
- As per the restructuring agreement with Bank Alfalah Limited there will be huge positive impact on the profitability and equity of the following amounting to Rs.442 million approximately in very near future.





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

Continuation Sheet - 3 -

- *There is no single complaint in SECP or KSE from investor/clients as we are diligently trying to ensure compliance with the all the applicable rules and regulation of Karachi Stock Exchange as well as Securities & Exchange Commission of Pakistan."*

5. Mr. Ali A. Malik, Chief Executive Officer and Mr. Ali Raza, Head of Operations ("Representatives") attended the hearing on January 21, 2015. Mr. Abbas Mirza, Chief Compliance Officer of KSE ("CCO KSE") also participated in the proceedings of the hearing. The arguments put forth by the Representatives of the Respondent during the course of hearing are summarized below:

- a) The Representatives communicated that the Respondent is in the process of inducing equity in the business. The Representatives further added that they managed through tougher times and has made all possible efforts to revive the company. The CCO KSE asserted that the Respondent has strived hard to sustain its operations but it has to expedite the settlement of liabilities in the context. The CCO KSE informed that the Respondent, under close supervision of KSE, has made significant improvement with regard to maintenance of segregation of clients' funds, however, that does not absolve the Respondent from compliance of other mandatory requirements of the regulatory framework.
- b) With regard to liability outstanding against Bank of Punjab ("BOP"), the Representatives explaining its intent towards settlement of liabilities towards banks informed that the Respondent has settled its liability with Summit Bank Limited and nothing in the context is outstanding as of December 31, 2014. They further apprised that all the remaining issues which include liability outstanding against BOP shall be resolved by March 31, 2015 and for the purpose they are in constant liaison with the bank. The Representatives assented to provide copy of the agreement evidencing settlement phase in the context.
- c) In reference to the complaint of Abundant Properties Organization ("APO") outstanding against the Respondent, the Representatives apprised that they have reached an agreement with the complainant and the same shall be resolved by March 2015. The Representatives further added that they shall provide copy of the agreement in the context.
- d) The Representatives informed that it has resolved number of issues with the cooperation and support of the KSE and the Commission. They further requested that a little more time is required to settle the remaining issues and ensure smooth



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

Continuation Sheet - 4 -

running of its operations. The Representatives informed that the Respondent as of now is settling half of its outstanding daily settlement on T+1 basis and the remaining half on T+2 basis and is also not dealing in futures market and margin financing. The CCO KSE confirmed their response.

- e) With specific reference to the settlement of liability with Bank Alfalah Limited ("BAFL"), the Representatives communicated that the Respondent is planning to sell the property and settle the liability. They further apprised that an agreement has been reached between the parties and within 30 days the payment shall be made to BAFL to settle the liability. The Representatives agreed that once the liability is settled the Respondent shall provide updated status to the Commission.
 - f) The Representatives agreed to provide projected balance sheet of the Respondent as of March 31, 2015 by February 4, 2015 to substantiate the stance that all the liabilities shall be settled by March 2015. They further assented to update the Commission on stage by stage basis with specific reference to settlement of liabilities.
 - g) The Representatives during the course of hearing informed that the KSE is in possession of bank guarantee provided by the Respondent of worth Rs. 30 million to meet the worst situation if it may arise under any circumstance.
6. I have heard the arguments presented by the Representatives at length during the course of hearing. Additionally, I have perused the available record and the written response 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 vide letter dated February 4, 2015 provided its projected balance sheet as of March 31, 2015 along with comparatives as of June 30, 2014, as was agreed by the Representatives during the course of hearing.
 - b) Analysis of the information provided by the Respondent in comparison to the position as of June 30, 2014 revealed the following:
 - i) Reduction in non-current assets of the Respondent by Rs. 100 million approx;
 - ii) Increase in current assets by Rs. 150 million, out of which Rs. 79 million shall be because of increase in cash and bank balances;
 - iii) Reduction in non-current liabilities by Rs. 318 million, out of which Rs. 411 million is depicted as reduction in long term financing and Rs. 80 million as an increase in loan from sponsors;





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

Continuation Sheet - 5 -

- iv) Reduction in current liabilities by Rs. 370.299 million; depicted by reduction of Rs. 124 million in trade and other payables and reduction in current maturity of long term financing by Rs. 246 million; and
- v) Net increase in capital by Rs. 689 million.
- c) The Respondent incorporated all the settlement of liabilities as referred to by its Representatives during the course of hearing. The Respondent vide email dated February 13, 2015 communicated the following progress with regard to outstanding liabilities as referred to in the SCN served to the Respondent:

"Current Maturity of Bank Alfalah Limited (Rs 115,210,000):

We would like to inform you that the process of liquidating the company's property has been finalized with the parties and we are going to settle the outstanding loan of BAFL amounting to Rs. 100 Million by the end of this quarter ended March 2015 against the sale of said properties. All the required documents are already sent to the concerned parties for legal documentation and verification.

Loan from Bank of Punjab Rs. 135,307,837:

The company is still in the process of negotiation with the bank and the management of the company is confident for the settlement of the outstanding loan with the Bank of Punjab through debt equity swap positively by the end of this quarter.

Payable to trade creditor (Rs. 144,352,836):

With reference to the meetings of the Chief Executive Officer of (FNEL) and Chairman (APO) in which different options were considered to settle the outstanding balance through debt equity swap or deferment of the payment. The management of the company is hopeful to resolve the matter by the end of March 2015.

The management of the company is very much confident and doing vigorous and rigorous efforts to resolve and settle the all above said issues in an amicable manner suitable to all parties."

- d) From the above, it is evident that the Respondent's status with regard to settlement of its outstanding liabilities towards BOP, BAFL and APO as of February 13, 2015 is the same as was communicated vide its letter dated December 5, 2014 and no documentary evidence to substantiate any kind of improvement in terms of settlement of liabilities was provided to the Commission till the date of this Order.
- e) The Respondent is allowed trading exposure at the KSE on the basis of NCB, which actually was negative as on June 30, 2014. The Respondent at the first trading day of each week before commencement of trading is required to submit its status by clicking "Yes/No", as the case may be, at the functionality at the National Clearing House System ("NCHS"), regarding maintenance of minimum required NCB as





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

Continuation Sheet - 6 -

specified in the SEC Rules and the KSE Rule Book, that allows the brokers to trade during the week. The said functionality stops the brokers to proceed with trading, if it does not report "Yes". However, the Respondent despite being aware of the fact that its NCB was negative kept on clicking the "YES" option of the functionality. Although, as communicated by CCO KSE the Respondent kept on providing weekly status of segregation of clients' funds and status of settlement of outstanding issues to the KSE but the same does not absolve the Respondent from complying with the NCB requirements as envisaged in the regulatory framework.

- f) The Respondent in its written response assured that it shall improve its financial position by March 2015 and shall update the Commission in the context, however no update in the context was reported to the Commission till the date of this Order.

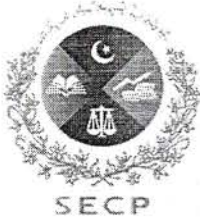
7. After a detailed and thorough perusal of the facts, evidence/information available on record, contentions and averments made by the Representatives of the Respondent during the course of the hearing, it is evident that the Respondent failed to maintain NCB in accordance with the regulatory framework.

8. The Respondent being registered with the Commission as a broker is expected to exercise due skill, care and diligence in the conduct of its business and ensure full compliance of the laws and relevant rules and regulations. Moreover, the Respondent being aware of the fact that its NCB is in negative, kept on reporting in the NCHS that it has maintained minimum NCB and/or capital adequacy requirements.

9. The Commission has serious reservations on such conduct of the Respondent that can be termed as misrepresentation and deception and are performed only for the continuity of its business. The Respondent is required to demonstrate fairness in the conduct of its business and is not expected to make any false/misleading statement and to engage in such act that compromise the market transparency; clients' interest; systemic risk to the stock market and increase the default risk at the cost of Respondent's own interest.

10. It is the responsibility of every market participant including the Respondent to maintain the integrity of capital market with the prime objective of the protection of clients' interest. The Respondent in its written response and the Representatives of the Respondent during the course of hearing assured compliance with the regulatory





SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Securities Market Division
(Market Supervision & Registration Department)

Continuation Sheet - 7 -

requirements and asserted that all the liabilities outstanding against it shall be settled by March 2015.

11. Violation of rules and regulation is a serious matter of concern, however, considering the assurance of the Respondent with regard to compliance with the regulatory requirements; settlement of outstanding liabilities; bank guarantee provided to KSE; settlement of obligations on T+1 basis in exercise of the powers conferred upon under Section 22 of the Ordinance, I hereby impose a penalty of Rs. 500,000/- (Rupees Five Hundred Thousand Only) on the Respondent. Moreover, the Respondent is directed to:

- i) submit its NCB Certificate as of March 10, 2015; and
- ii) provide documentary evidence regarding settlement of all the outstanding liabilities along with copy of trial balance as of March 10, 2015.

The Respondent is further directed to ensure that the above information is received in this office by March 15, 2015.

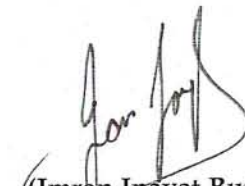
12. The matter is disposed of in the above manner and the Respondent is directed to deposit the fine in the account of the Commission being maintained in the designated branches of MCB Bank Limited not later than thirty (30) days from the date of this Order and furnish a copy of the deposit challan to the undersigned.

13. 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
Islamabad.

February 20, 2015


(Imran Inayat Butt)
Director/HOD (MSRD)