



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 Rahat Securities Limited under
Section 22 of the Securities and Exchange Ordinance, 1969 read with Rule 8 of
the Brokers and Agents Registration Rules, 2001

Date of Hearing:

March 04, 2015

Present at the Hearing:

Representing Rahat Securities Limited

(i) Mr. Ch. Muhammad Afzal

Chief Executive Officer

(ii) Mr. M. Sajid Yousaf

Manager Accounts

Assisting the Director/HOD (MSRD)

(i) Ms. Najia Ubaid

Deputy Director

ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice bearing No. 1(1) SMD/MSRD/C&IW/INS-LSE/2015 dated February 19, 2015 ("SCN") served to Rahat Securities Limited ("Respondent"), Trading Right Entitlement Certificate Holder/Broker of the Lahore Stock Exchange Limited ("LSE") 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 October 22, 2014:

a) Mr. Muhammad Ali

Deputy Director

b) Mr. Adnan Ahmed

Deputy Director

3. The Inspection Team submitted the report ("Inspection Report") on December 26, 2014 which was shared with the Respondent in accordance with Rule 7 of the Inspection





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

Continuation Sheet - 1 -

Rules. The response of the Respondent in the context was received vide letter dated January 20, 2015. Upon evaluation of the Inspection Report, irregularities in calculation of Net Capital Balance ("NCB") as of June 30, 2014 were observed and it appeared that NCB certificate was not prepared in accordance with the Third Schedule of the Securities and Exchange Rules, 1971 ("SEC Rules"). The Inspection Report further highlighted that the Respondent failed to maintain segregation of clients' assets, did not have an effective Know Your Customer ("KYC") and Customer Due Diligence ("CDD") Policy; failed to be in compliance with Internet Trading Guidelines of March 2005 ("IT Guidelines"); failed to maintain proper books of accounts; and also failed to update Standardized Account Opening Form ("SAOF") as specified in the regulatory framework.

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 March 3, 2015 at the Commission's Head Office in Islamabad. However, the Respondent vide letter dated February 23, 2015 requested for change in the venue of hearing to Lahore. Acceding to the Respondent's request, hearing was rescheduled for March 4, 2015 at the Commission's Lahore Office.

5. The arguments put forward by the Respondent in its written response to the SCN submitted vide letter dated February 27, 2015 are reproduced below:

a). Irregularities in NCB:

i) *Loan/Advances are recorded in Trade receivable amount: These loans/advances are very immaterial and recorded in trade receivables only for better control purposes for management. Employee's loans/advances are recorded in trade receivable.... We would like to state that client code G124 (Rs 1483/=) & 2345 (Rs. 99,791/=),.....are trade receivables, not advances/loans to employees.*

ii) *Liabilities pertaining to PMEX: RSL is working on prudent concept. PMEX receivable are not booked until they are received from PMEX as per basic accountancy concepts of prudent..... RSL would follow inspection team's guidelines in recording PMEX receivable in future.*

iii) *Understatement of securities purchased for clients by 3.929M: These clients were active clients during the last 14 days of June having sufficient margin of 9.913M in their respective accounts. They were actively trading in their accounts.... However, RSL would ensure calculating December NCB as per inspection team's instructions.*

b) Improper Books of Accounts:

i) *Defaulter account and Sialkot defaulter account appear in Tribal Balance: It is a simple oversight/omission. These balances are never taken in NCB before or after 30th*





SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Securities Market Division
(Market Supervision & Registration Department)

Continuation Sheet - 2 -

- June, 2014. (Copy attached). This is an inadvertent oversight/omission due to fact that new default amount of Rs. 4,287/= was added in defaulter account and it became active in our in our software system. This is purely inadvertent oversight/omission and even it accounted for These amounts are taken in account receivable for Taxation purposes and RSL is still trying hard to recover the amount involved. ii) Loan/advances to employees. ...iii) CDC Charges credited to employees of RSL: CDC charges are not just credited to Irshad Ahmad in fact it is credited to 3 different persons. a) Akhtar Hussain b) Arif Mehmood c) Irshad Ahmad...RSL doesn't intend to earn income from transfer of shares in CDC as this would result in hiring of a complete new team for this purpose and transfers of shares to CDC generate a very immaterial income.would result in increase of fixed expense. Above 3 persons work on behalf of RSL to facilitate its clients. This practice is adopted for taxation purpose. iv) Adjustment in client's account: This transaction doesn't have an effect on Company's NCB. Said transactions were made on written requests of clients on both days..... RSL has no financial benefit of these transactions nor do these transactions have any effect on company's NCB and Capital Adequacy.... state said transaction doesn't has direct impact on calculation of NCB.
- c). Segregation of Client's Asset by broker: Commission would appreciate the effect of that all shares of client's were reconciled...during the inspection. All share holdings of client's are properly maintained in their respected CDC sub account. Bank Accounts: RSL is maintaining 17 bank accounts out of which 4 banks accounts are maintained for client's assets....balances in these 4 accounts are available than it is payable to our clients on any single given day during the year. The client's funds and securities are never used by the company for any purpose other than as authorized by the client.....Expense payments are made against commission income or capital gain in bank accounts maintained for clients as commission and capital gain are generated in the settlement account. RSL has stopped these expense payments from accountsThere always more funds available in bank accounts maintained for clients' assets because sometimes clients are given margin for trading purpose.
- d). Standardized Account Opening Form:
- i) Clause 1(a) related to dispute resolution...is available in new SAOF. ii) Clause 2(a) regarding segregation of client's fund....is available in new SAOF. iii) Clause 7(a) delivery of physical shares...is available in all SAOF. iv) Clause 7(b) related to transfer of securities to collateral account is now added in SAOF. v) Clause 8 with specific reference to maximum limit on cash base transactions.... is revised in all SAOF. vi) Clause 9 with reference to all payments above Rs. 25,000/= to be made through cheques... is available in SAOF. vii) Clause 17 regarding modes of communication for providing trade confirmation... is available in SAOF. viii) Clause 18 related to telephonic recordings.. is available in SAOF. ix). RSL, from time to time, is trying to update all old account opening forms and old accounts are mostly updated. RSL recently has sent email to all old account holders updating them on all changing in SAOF.
- e). Cash received/payments made from/to clients.
There are very few instances in which RSL fail to report such transactions. Cash payment transactions are only made where client have some urgent need and done on their personal request. RSL has started reporting all such cash receipt to LSE.



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

Continuation Sheet - 3 -

f). Telephone Recording

RSL always telephone recording but lost its data when its telephonic recording server broke down due to leakage of LSE roof top ...We have again maintaining all telephonic recordingthat there is no dispute with any one in day to day business as of today.

g). KYC & CDD

RSL is very careful in selecting its clients and always do due diligence before opening accounts. All clients are personally met by authorized persons of company. ... RSL has now prepared its own KYC Form which is made part of SAOF.

h). Internet Trading and Audit.

A proper form (copy attached) is required to be filled by clients before trading terminal is given to them. RSL has inquired from LSE about IT GUIDELINES OF MARCH, 2005. LSE as of today have not adopted Internet Trading Guidelines of March, 2005. There is no such compulsion on its broker to submit such Internet Trading audit report."

6. Mr. Ch. Muhammad Afzal, Chief Executive Officer ("CEO") of the Respondent, and Mr. M. Sajid Yousaf, Manager Accounts of the Respondent ("Representatives") attended the hearing on behalf of the Respondent on March 4, 2015 at the Commission's Lahore office through video conferencing. The arguments put forth by the Representatives of the Respondent during the course of hearing are summarized below:

- a) With regard to inclusion of loans/advances given to employees of the Respondent in NCB calculation, the Representatives stated that the CEO used to review the receivables twice a week and receivables of all nature were accumulated for better control. The Representatives communicated that the Respondent has now updated its records and the loans/advances are properly classified. The Representatives with regard to inclusion of the payables pertaining to Pakistan Mercantile Exchange Limited ("PMEX") explained that the Respondent shall be careful in future, however if adjustments are made as referred to by the inspection team, it would have positive impact on the NCB.
- b) The Representatives with regard to defaulter account and inclusion of few very old receivables in the NCB calculation narrated that the Respondent has a small amount of receivables pertaining to the years 1995 and 2007 and the Respondent expects to recover some of the amount, accordingly it has not categorized them as bad debts. The Representatives further explained that an amount of Rs. 4,000 pertaining to the old receivables was received and credited in the client account, as a result of which the system classified it as an active receivable. The Representatives avowed that the Respondent did not have any malafide intent of overstating the trade receivables for NCB calculation.

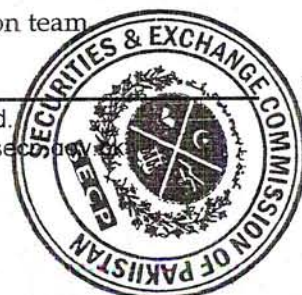




SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Supervision & Registration Department)

Continuation Sheet - 4 -

- c) Regarding CDC charges debited to clients' accounts and subsequently credited in the account of one of the employees of the Respondent, the Representatives elaborated that those CDC charges pertained to handling of physical shares and that the Respondent outsourced this assignment to three people one of whom is employee of the Respondent. The Representatives further added that the total of such payments made by the Respondent during the year was roughly Rs. 250,000 and was not significant and therefore it was not classified separately. However, since the inspection team has categorized it as an irregularity, the Respondent shall classify it properly in its books of accounts.
- d) The Representatives explained that the adjustments made in two of the clients' accounts, as identified by the inspection team, were based on formal authority from the referred clients and their requests. The Representatives agreed to provide the authority letter to the Commission.
- e) With reference to maintaining segregation of clients' assets, the Representatives informed that number of bank accounts were opened to facilitate its clients and that the Respondent since November 2014 is maintaining proper segregation of clients' assets to ensure compliance with the regulatory requirements.
- f) Regarding the irregularities in SAOFs, the Representatives apprised that the same have been rectified and the Respondent has also informed all of its clients' about the amendments.
- g) With regard to non-reporting of cash receipts from the Respondent's clients to the LSE, the Representatives agreed that this was not done by the Respondent prior to the inspection, subsequently the Respondent has started reporting the receipt of cash to the LSE and is now compliant with the requirements.
- h) The Representatives accepted that the telephone recording system broke down in 2012 and since then the Respondent failed to maintain telephone recording, but as of now the Respondent has installed a new system and at present is compliant with the regulatory requirement.
- i) With specific reference to non-provision of KYC and CDD Policy, the Representative communicated that the Respondent has developed a policy which shall be approved from the Respondent's board of directors in its next meeting.
- j) The Representatives further assured that the Respondent shall ensure future compliance with the IT Guidelines referred to by the inspection team.





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

Continuation Sheet - 5 -

7. 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). For NCB calculation, the Representatives explaining the reasons asserted that the identified discrepancies have now been rectified. The Representatives communicated that the loans/advances have properly been classified. They assured that the Respondent shall be careful in future with regard to inclusion of the receivables and payables pertaining to PMEX in NCB calculation.
- b). Explaining the instances of improper books of accounts as referred to in the SCN, the Respondent admitted that inclusion of old receivables was an inadvertent oversight/omission and that it shall be conscious of the fact for future reference. With specific reference to debit in the clients' accounts in the context of CDC charges and then making payment of the same to three persons, the Representatives informed that it was just an adjustment to avoid fixed expense, however, the Respondent agreed to make proper arrangements in the context.
- c). The Representatives during the course of hearing communicated that the transfer of funds from one clients' account to the other account was on clients' request and proper authority for the purpose was provided to the Respondent. The Respondent provided copies of the authority letters, as was agreed during the course of hearing, and communicated that this did not have any impact on NCB calculation. In this context, it is pertinent to mention here that debiting and/or crediting clients' accounts do affect the aging of the trades receivables and trade payables, which is an important consideration in NCB calculation.
- d). Regarding segregation of clients' assets, the Representatives communicated that the Respondent is now maintaining proper segregation of clients' assets and has immediately stopped making other operational payments from the bank accounts tagged as clients' account and further assured of future compliance.
- e). Regarding SAOF, the Respondent provided updated SAOF and apprised that all of the clients' have been informed about the changes in the forms.





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

Continuation Sheet - 6 -

- f). The Respondent in its written response specified that it is now maintaining proper telephone records as per the requirements and there is no dispute with anyone in the Respondent's day to day business.
- g). With reference to non-provision of KYC and CDD policy, the Representatives during the course of hearing assured that the Respondent shall get the KYC and CDD policy approved from its board of directors. Moreover, the Respondent in its written response informed that it has made KYC form part of the SAOF.
- h). With regard to IT Guidelines, the Representatives assured that the Respondent shall ensure compliance with the guidelines, however, the Respondent in its written response communicated that LSE has not adopted IT Guidelines and there is no compulsion on its brokers to submit internet trading audit report.

8. After a detailed and thorough perusal of the facts, evidence/information available on record, contentions and averments made by the Representative of the Respondent during the course of the hearing, it is evident that the Respondent failed to prepare NCB in accordance with the regulatory framework and failed to fulfil its regulatory obligations by not maintaining proper segregation of clients' assets. The Respondent, however, upon identification of irregularities pertaining to SAOFs, telephone recording system, reporting of cash transactions to the LSE, KYC & CDD policy, has rectified those and assured future compliance.

9. The Respondent being registered with 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. Additionally the Respondent takes the responsibility of the custodian of clients' assets and is required to act diligently, prudently and cautiously. 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.

10. In light of the violations of rules and regulations and considering the steps initiated by the Respondent to rectify and ensure compliance, I hereby impose on the Respondent a penalty of Rs. 25,000/- (Rupees Twenty Five Thousand Only) under Rule 8 of the Brokers Rules. The Respondent is further directed to comply with the applicable regulatory framework in letter and spirit at all times.





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

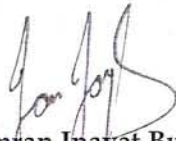
Continuation Sheet - 7 -

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.

Announced on
Islamabad.

April 6, 2013




(Imran Inayat Butt)
Director/HOD (MSRD)