

Before the Director (Market Supervision & Registration Department)
Securities Market Division
Securities and Exchange Commission of Pakistan

In the matter of Show Cause Notice Dated November 13, 2012 issued to
Axis Global Limited, Broker Karachi Stock Exchange Limited

Date of Hearing: December 19, 2012

Present at the Hearing: 1. Mr. Raj Kumar (Chief Executive Officer)
2. Mr. Hamid Nazir Kehar (Company Secretary)

Representing SECP (SMD): Ms. Saima Shafi Rana (Deputy Director-MSRD)

ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice No. 4(BRK-204)SMD/BR/06 dated November 13, 2012 (**“the SCN”**) under Section 22 of the Securities and Exchange Ordinance, 1969 (**“the Ordinance”**) and Section 28 of the Central Depositories Act, 1997 (the **“CDC Act”**) issued to M/s. Axis Global Limited (**“the Respondent”**), TREC Holder of Karachi Stock Exchange Limited (the **“KSE”**) and a broker registered under the Brokers and Agents Registration Rules, 2001 (**“Brokers Rules”**).

2. Brief facts of the case are that the Securities & Exchange Commission of Pakistan (**“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 (the **“Inspection Rules”**) ordered an inspection of the books and records required to be maintained by the Respondent.

3. The report dated April 24, 2012 submitted by the Inspection Team disclosed that the Respondent was mishandling the securities of its clients and was involved in imposing late payment charges to the clients. Moreover, major irregularities in calculation of Net Capital Balance (‘NCB’) as on June 30, 2011 were also observed and it appeared that NCB was not in accordance with the Third Schedule of Securities and Exchange Rules, 1971 (the **“SE Rules”**). Thereafter, the Commission served a SCN to the Respondent, the contents of which are reproduced below:-

SUBJECT: SHOW CAUSE NOTICE IN THE MATTER OF INSPECTION OF BOOKS AND RECORD OF M/S. AXIS GLOBAL LIMITED – TREC HOLDER OF KARACHI STOCK EXCHANGE.

WHEREAS, M/s. Axis Global Limited (‘AGL’) is a Trading Rights Entitlement Certificate (TREC) Holder of the Karachi Stock Exchange and registered as a broker with the Securities and Exchange Commission of Pakistan (the “Commission”) under the Brokers and Agents Registration Rules, 2001 (the “Brokers Rules”).



2. **AND WHEREAS**, the Commission in exercise of its powers under Sub-section (1) of Section 6 of the Securities and Exchange Ordinance, 1969 (the "**Ordinance**") read with Rule 3 and Rule 4 of the Stock Exchange Members (Inspection of Books and Record) Rules, 2001 (the "**Inspection Rules**") ordered an inspection vide order No. SMD/MS&CID-C&IW/10-1(10)/2012 dated February 6, 2012 of the books and record required to be maintained by AGL. The Inspection Team submitted the inspection report to the Commission on April 24, 2012 which was forwarded to AGL in accordance with rule 7 of the Inspection Rules on May 3, 2012 and response thereof was received on May 29, 2012.

3. **AND WHEREAS**, on review of the inspection report, prima facie it appears that AGL is mishandling the securities of its clients. The detail of such mishandling is given as under:-

- a. The Audited Financial Statements of AGL for the year ended June 30, 2011, disclosed "Nil" investments. Whereas, CDC statements balance of AGL's house account reflected 5.242 million shares of various companies amounting to Rs. 70.124 million as at June 30, 2011. On query, AGL responded that the said shares were inherited, when the new management took over AGL and they are opening sub accounts to transfer the shares. Said response implies that aforesaid shares belong to the clients and were transferred without clients' authorization.
- b. Shares of certain clients were pledged, directly from their respective sub accounts, in favor of Bank Alfalah Limited in respect of running finance facility availed by AGL. AGL was advised by the Inspection Team to provide specific authority for pledging the said shares, however, AGL failed to provide authority from 30 clients, and only few authorities were provided in this regard.
- c. Few instances of CDS Intra Account Transfers were observed, wherein clients' securities were routed from AGL's House Account in favor of Bank Alfalah Limited while being pledged against running finance facility availed by AGL. Details of the instances, as reported by the Inspection Team, are as follows:

| SHARES | SHARES MOVEMENT REFLECTS IN | | | REMARKS |
|-----------------------|-----------------------------|--------------------------|--------------------|--|
| | CDC RECORD | OFF MARKET RECORD OF KSE | BACK OFFICE RECORD | |
| 42,000 shares of AKBL | YES | YES | NO | 8,000 shares from Ratan Kumar while 34,000 shares from Hamayoon Siddiq's sub-accounts were moved into main account on March 24, 2011 and on the same date these shares were transferred to House Account and then pledged with the Bank. |
| 90,000 shares of AKBL | YES | YES | NO | 90,000 shares moved into Main-Account on July 07, 2011 from Sub Account of Nizamuddin and then transferred to House Account and pledged with the Bank. |

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| | | | | |
|------------------------|-----|-----|----|--|
| 48,000 shares of ATRL | YES | YES | NO | 48,000 shares were transferred into Main-Account on February 09, 2011 from Sub Account of Highlink, then moved into House account and pledged with the Bank. |
| 275,000 shares of BOP | YES | NO | NO | 275,000 shares were first moved into Main Account /House Account on February 24, 2011 from Sub Account of Nizamuddin and ultimately pledged with the Bank. |
| 800,000 shares of PIAA | | | | On February 24, 2011, 800,000 shares of PIAA were transferred to Main Account from Sub Account of Nayab Tariq from where these shares were transferred to House Account and pledged with the Bank. |
| 325,000 shares of NML | YES | YES | NO | Shares were found in client sub-account on October 18, 2011 which were transferred to Main Account / House Account on the same date and pledged with the Bank. |
| 75,000 shares of PTC | YES | NO | NO | 75,000 shares first moved into Main Account / House Account from Sub Account of Khawaja Adil Razzaq and ultimately pledged with the Bank. |

4. **AND WHEREAS**, prima facie it appears that AGL moved and/or pledged the shares with the Banks/others without authorization in sheer violation of Section 24 of the Central Depositories Act, 1997 (the "CDC Act) which reads as follows:

"(1) A Participant shall not handle or authorize or permit any handling of book-entry securities entered in the sub-accounts maintained under his account without authority of sub-account holder (2) A participant shall not expect with the authority of his clients, handle or authorize or permit any handling of book- entry securities beneficially owned by such clients and entered in his account."

5. **AND WHEREAS**, during the course of inspection, it was observed that AGL has been imposing late payment charges ranging from 18% to 22% p.a. to its clients, who do not clear their dues in time, and resultantly have earned Rs. 10.545 million as per audited financial statements of AGL for the year ended June 30, 2011 in contravention of Section 16 of the Securities & Exchange Ordinance, 1969, which is reproduced below for convenience.

"No member or associate shall, in contravention of any rules made under this Ordinance, directly or indirectly extend or maintain credit, or arrange for the extension or maintenance of credit, to or for any person for the purpose of purchasing or carrying any security."

6. **AND WHEREAS**, on review of the inspection report it has further come to the notice of the Commission that calculation of Net Capital Balance ("NCB") of AGL as on June 30, 2011 has the following irregularities:-

- a. Understatement of trade receivables by Rs. 71,955,822
- b. Overstatement of securities purchased for clients by Rs. 101,180,636
- c. Understatement of other liabilities by Rs. 1,114,750



d. *Overstatement of NCB by Rs. 30,339,564*

7. *AND WHEREAS, prima facie, it appears that the NCB as calculated by AGL is not in accordance with the Third Schedule of the 1971 Rules and that AGL by submission of overstated NCB has given information which it had reasonable cause to believe to be false or incorrect in material particular in violation of Section 18 of the Ordinance, which reads as follows:-*

“No person shall, in any document, paper, accounts, information or explanation which he is, by or under this Ordinance, required to furnish, or in any application made under this Ordinance, make any statement or give any information which he knows or has reasonable cause to believe to be false or incorrect in any material particular.”

8. *AND WHEREAS, in light of the facts mentioned above, prima facie it appears that AGL is in contravention of Section 24 of the CDC Act, Section 16 of the Ordinance and Third Schedule of the 1971 Rules read with Section 18 of the Ordinance, the contravention of which invokes penalty and/or punishment under Section 22 of the Ordinance and Section 28 of the CDC Act.*

9. *AND WHEREAS, Sub-section (1) of Section 22 of the Ordinance provides that:*

“ If any person refuses or fails to furnish any document, paper or information which he is required to furnish by or under this Ordinance; or refuses or fails to comply with any order or direction of the Commission made or issued under this Ordinance; or contravenes or otherwise fails to comply with the provisions of this Ordinance or any rules or regulations made thereunder, the Commission may if it is satisfied after giving the person an opportunity of being heard that the refusal, failure or contravention was willful, by order direct that such person shall pay to the Commission by way of penalty such sum not exceeding fifty million rupees as may be specified in the order and in the case of continuing default, a further sum calculated at the rate of two hundred thousand rupees for every day after the issue of such order during which the refusal, failure or contravention continues.”

10. *AND WHEREAS, Section 28 of the CDC Act provides that:*

“... whoever knowingly and willfully contravenes or attempts to contravene or abets the contravention of the provisions of Section 24 shall be punishable with a fine which may extend to one million rupees and to a further fine not exceeding twenty thousand rupees for every day after the first contravention during which the contravention continues or with imprisonment for a term which may extend to five years, or with both...”

11. *NOW THEREFORE, you are hereby called upon to show cause in writing by November 21, 2012, as to why action as provided under Section 22 of the Ordinance*


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and Section 28 of the CDC Act may not be initiated against AGL for violation as indicated above. You are further directed to appear in person or through an authorized representative (with documentary proof of such authorization), on November 27, 2012 at 11:00 a.m. at the SECP Headquarters – Islamabad. You are advised to bring all relevant record in original, which you may consider necessary for clarification/defense of your stance. This notice sufficiently discharges the Commission’s obligation to afford AGL an opportunity of hearing in terms of Section 22 of the Ordinance and in case of failure to appear on the stated date of hearing it will be deemed that AGL has nothing to say in its defense and the matter will be decided on the basis of available record.

Sd/-
Hasnat Ahmad
Director

4. Thereafter, the hearing fixed for November 27, 2012 was adjourned on the request of the Respondent. The Respondent submitted a written response to the SCN dated November 27, 2012. The following arguments were put forward by the Respondent in its written response and during the hearing held on December 19, 2012:

(a) Mishandling of Client’s Securities:

i. *Disparity in financial statements and CDC balance:* In this connection, the Respondent in its written response dated November 27, 2012 stated as follows:

“Said shares were inherited when the new management took over AGL. These shares were from the period of when the group accounts were in place and the new management is trying to contact clients so that their CDC sub-account is opened and their respective shares transferred to their accounts. The ones that have completed the required information there shares have been shifted to their respective accounts.”

During hearing the Respondent stated that when the new management took over AGL, there were only 20 sub-accounts whereas there were almost 400 clients at that time. From there onward, it started sorting out the issue and initiated sending letters to the clients. The Respondent explained that till now 76 clients have contacted it and their shares have duly been transferred after scrutiny. The Respondent also provided the courier slips of those clients that have been contacted but not responded to as yet.

ii. *Pledging directly from sub-accounts and CDC intra account transfers:* The Respondent in its written statement stated as under:

“ The 275,000 shares of BOP and 75,000 shares of PTC on February 24, 2011 and November 30, 2011 respectively for ultimately to be pledged with the bank from Nizamuddin and Khawaja Aadil Razzak were erroneously moved and returned the same day, hence, not pledged with the bank. This can be verified by the CDC Activity report of those particular dates. We would also like to mention that the 90,000 shares of AKBL mentioned by the team on July 07, 2011 from sub-account of Nizamuddin to Main-Account does not exist in the CDC report

as can be clearly seen from the attached CDC report. Furthermore, AGL's account opening form clearly states under its Terms and Conditions of Brokerage Agreement Section 15 that AGL shall have a lien over all securities carried, maintained, or held by it for the Client. The client hereby authorizes AGL to utilize or pledge, as permitted by law, all the Client's securities carried, maintained or held by AGL for the purpose of compliance with KSE regulations governing members' exposure"

During the hearing the Respondent informed that out of 7 reported CDC Intra Account Transfers, 3 were erroneous and because the transactions were made by mistake, therefore were not reported in off market.

(b) Late Payment Charges

Regarding Late Payment Charges, the Respondent in its written statement stated as under:

"The settlement charges that the company imposed were for the financing facility availed from the bank, No Directors of the Company or the Company itself was directly financing the clients. The financing facility during that time which was availed from the bank for our clients incurred 16% financial charges and a nominal charge to bear the burden of handling and maintaining this facility at our end which consisted of 4-5 staff members. This tedious work involved of shares in and out of CDC maintaining and sending margin calls to clients and collecting cheques from clients to meet these margin calls or shortage either in shares or cheque. Furthermore, it is imperative to mention that the majority of financing extended was during the period when there was no leverage available in the market and this was industry broker norm to provide such services to the clients and was a question of survival. However, once the MTS/MFS products have been launched the company has shifted its efforts on focusing these products for its clients. Furthermore, the Company was one of the top brokers of MTS in order to provide service to its clients when this product was launched."

(c) Overstatement of Net Capital Balance

- i. *Understatement of Trade Receivables:* In respect of this, the Respondent in its written statement stated as under:

"The Company has calculated trade Debtors within 14 days on the basis of overall position of debtors. When a particular customer is outstanding for more than 14 days then full amount is excluded from trade debtors within 14 days; whereas inspection team has bifurcated transactions with particulars customers between 14 days and more than 14 days."

- ii. *Overstatement of Securities Purchased for Clients:* The Respondent in its written statement stated as under:



“Clause 4 of Rule 2(d) of and Third Schedule to the Securities and Exchange Rules, 1971 requires disclosure of amount of securities purchased for client. This Section requires valuation of securities purchased for the clients and held by the member where the payment has not been received within fourteen days. The company has calculated amount of trade debtors above 14 days on the basis of overall debtors’ position and not on the basis of each transaction. Therefore remaining balance worked out at Rs. 109.815 million. Against the said balances of Rs. 109.815 million the securities purchased for the client and held by the member with market rate as on June 30, 2011 was Rs. 147 million. Valuation and CDC reports were provided for verification purpose at the time of inspection. We are unable to trace the calculation of Rs. 8.6 million from Show Cause Notice as well as Inspection Report. We are of the view that the company has calculated NCB according to the Rule 2(d) of Third Schedule to the Securities and Exchange Rules, 1971 and no misstatement or untrue statement made by the company as envisaged by Inspection team Show Cause Notice”

- iii. *Understatement of Other liabilities:* The Respondent in its written statement stated as under:

“Net Capital Balance statement was prepared and submitted in Stock Exchange on September 9th, 2011 while the audit was completed on October 31, 2011. The difference was the adjustments as required in audited accounts and was not available at the time of issue of NCB certificate”

5. The arguments raised by the Respondent are discussed and appraised hereunder in seriatim:

(a) Mishandling Client’s Securities

Regarding pledging directly from CDS account without any authorization, the Respondent provided the authority letters of few clients whereas the authority letters of 10 reported clients were not provided by the Respondent. It is further emphasized that the blanket authorities as provided by the clients in their SAOF are not sufficient to enable the broker to transfer the clients’ securities for purposes other than those based on market based transactions. The Brokers, in general, are required to obtain specific authorities on every occasion of transfer of securities other than market based transactions. It is further emphasized that all the brokers (CDC participants) vide Commission direction dated June 4, 2009 were abstained from obtaining general purpose/blanket authority from the sub-account holders. Therefore, movement/pledging of securities of the clients was a clear violation of Section 24 of the CDC Act.

Regarding the CDC intra Account Transfers, although the Respondent claimed that it had explicit authority but on scrutiny of the transactions, it has been observed that even with the claimed explicit authority, the Respondent chose to follow a pattern rather than directly pledging from the sub-accounts and more importantly did not maintain proper audit trail. As a result, only the shares were moved from the sub-accounts of investors



without reflecting that movement in the back office record. Therefore, the clients were not aware about the movement from/to their sub-accounts.

Moreover, it has also been noted that the provision of Group Accounts was abolished in the year 2005 and even after lapse of seven years, the Respondent failed to transfer the funds to the sub-accounts of the investors implying that no serious efforts have been made by the Respondent.

(b) Late Payment Charges:

The Respondent has admitted the practice of charging late payment charges/liquidation damages @18% to 22%. This practice is identical to inhouse/ badla financing, which is prohibited under law and is a blatant violation of Section 16 of the Ordinance. It is clarified that Section 16 of the Ordinance clearly states that *no member or associate can directly or indirectly extend or maintain credit or arrange for the extension and maintenance of credit to or for any person for the purpose of purchasing or carrying any security.*

(c) Overstatement of Net Capital Balance

It is noteworthy that the amount payable to Mr. Usman Butt was being classified by the Respondent as Trade Creditor; however, pattern of transactions suggested that it was in fact a loan and therefore liable to be classified as other liability. The review of the inspection report duly shared with the Respondent reveals that if the amount payable to Mr. Usman Butt was to be considered as Loan; the NCB would have been in negative. The Inspection Team, however, chose to calculate NCB while considering the amount payable to Mr. Usman Butt as Trade Creditors.

It is apparent that the Respondent calculated the amount of Trade Receivables above 14 days on the basis of overall debtors' position and not on the basis of each transaction. However, the Third Schedule of SE Rules states that *Book Value less those overdue for more than 14 days* and clearly indicates that transactions outstanding for more than 14 days must be considered as overdue. It is also a well-established principle that general payments against receivables should first be adjusted against older balances. All of these arguments clearly indicate that the treatment of receivables shall be on individual transactions basis rather than collective basis.

With regards to 'Securities Purchased for Clients', it is apparent that since the aging was not done properly and 'amount pertaining to balance of Mr. Usman' was not excluded, the amount was overstated by an amount of Rs. 101.18 million. For the purposes of record, the working of actual amount i.e Rs. 8.633 is being reproduced as under:-

| <i>Particulars</i> | <i>Amount in Rs.</i> |
|--|----------------------|
| <i>Value of 'Securities Purchased for clients' as provided in Annexure VI of Inspection Report</i> | <i>44,445,199</i> |
| <i>Less 'Amount pertaining of balance of Mr. Usman Butt'</i> | <i>35,811,737</i> |
| Total | 8,633,462 |

Moreover, since the identified difference in other liabilities was the adjustment as required in the audited accounts and was not available at the time of issue of NCB Certificate, the comments of the Respondent are accepted.

6. I have examined the facts, evidences and documents on record, in addition to the written and verbal submissions made on behalf of the Respondent. It is established that in many instances the Respondent has moved/pledged the shares without proper authority of the sub-account holders. Moreover, although group accounts were abolished in 2005, the Respondent did not take serious measures to transfer the securities to the respective sub-accounts. Such mishandling of clients' securities is a clear violation of Section 24 of the CDC Act, which is punishable under Section 28 of the CDC Act.

7. It is established that the Respondent was imposing late payment charges in violation of Section 16 of the Ordinance. It is evident that the NCB as calculated by Respondent is not in accordance with the Third Schedule of the SE Rules. It is further evident that the Respondent by submission of overstated NCB has submitted a statement and given information which it had reasonable cause to believe to be false or incorrect in material particular in violation of Section 18 of the Ordinance.

8. The violation of the Ordinance, rules and regulations is a serious matter and in view of the regulatory violations as discussed above, through this Order, the Respondent is directed to deposit a sum of Rs. 100,000 (Rupees One Hundred Thousand Only) under Section 22 of the Ordinance and a further sum of Rs. 300,000 (Rupees Three Hundred Thousand Only) under Section 28 of the CDC Act to the Commission by way of penalty. The Respondent is directed to ensure that the shares of the investors be transferred to the respective sub-accounts at the earliest. The Respondent is further directed to ensure full compliance with the Ordinance, rules, regulations and directives of the Commission in future.

9. The matter is disposed of in the above manner and the Respondent is directed to deposit the penalty 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 copy of the deposit challan to the undersigned.

10. This Order is issued without prejudice to any other action that the Commission may initiate against the Respondent in accordance with the law on matters subsequently investigated or otherwise brought to the knowledge of the Commission.


Hasnat Ahmad
Director (MSRD)

Announced on April 11, 2013
Islamabad.

