



PAKISTAN STOCK EXCHANGE LIMITED

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Ref. No. PSX/ RAD/O-3205

July 15, 2024

The Board of Directors

M/s. First Equity Modaraba
503-504, 5th Floor, Stock Exchange Building,
Stock Exchange Road
Karachi.

SUBJECT: DECISION IN THE MATTER OF NON-COMPLIANCES IDENTIFIED DURING THE THEMATIC REVIEW

Dear Sirs,

This is with reference to subject matter.

Please find enclosed herewith the Order dated July 15, 2024 in the matter of non-compliances identified during the thematic review.

The above is for your information and necessary compliance.

Yours truly,

M. Junaid Qayyoom

Senior Manager | Audit, Inspection, Default & Arbitration Unit
Regulatory Affairs Division

Cc:

1. The HOD/Director – SD, Licensed and Unlisted Companies Department, SECP
2. The Additional Director – SD, Licensed and Unlisted Companies Department, SECP
3. The Chief Regulatory Officer - PSX
4. The Chief Executive Officer – First Equity Modaraba
5. The Company Secretary – First Equity Modaraba (Ensure to circulate enclosed Order to the Board of Directors)

Encl: As Above



ORDER IN THE MATTER OF NON-COMPLIANCES HIGHLIGHTED
DURING THE THEMATIC REVIEW OF FIRST EQUITY MODARABA
(Trading and Self-Clearing Broker)

Hearing before:	Mr. Atif Islam Siddiqui Sr. Manager, RAD – PSX (Authorized by Chief Regulatory Officer –PSX)
Assisting Unit Head:	Ms. Beenish Mobin Manager, RAD – PSX Ms. Tuba Farooqui Manager, RAD – PSX
Representing Broker:	Mr. Adil Ghaffar Chief Executive Officer
Date of Hearing:	May 31, 2024

1. BACKGROUND:

Pakistan Stock Exchange Limited [PSX] initiated a thematic review [Review] of First Equity Modaraba [FEM] on January 01, 2024, under PSX Regulation 23.9 covering the period from September 01, 2023, to November 30, 2023. The scope of the review was to check the status of compliance of FEM with the following regulatory areas:

- (a) Financial Resource Requirements;
- (b) Distribution of profits to the customers on unutilized funds;
- (c) Mandatory Requirement of ICM Certification;
- (d) Execution of Customer Orders; and
- (e) Clients Assets Segregation.

2. OBSERVATIONS, BROKER RESPONSE DURING THE HEARING AND PSX COMMENTS:

During the review, PSX identified non-compliances pertaining to the Clients' Assets Segregation and calculation of Liquid Capital. In this regard, PSX provided an opportunity of being heard to FEM on May 31, 2024 to discuss the non-compliances and seek explanations along with any supporting documentary evidences.

The hearing was attended by Mr. Adil Ghaffar – Chief Executive Officer of FEM and the identified observations were discussed with at length during the hearing conducted by authorized officials of PSX. The observations along with FEM's responses and comments of PSX are mentioned below:

2.1 Client Assets Segregation:

PSX Regulation 4.17 requires brokers to keep assets belonging to their clients segregated from their assets. In order to verify compliance with this regulatory requirement above, the inspection team selected the following three dates to verify the segregation of clients' assets:

- September 8, 2023 (random date)
- October 25, 2023 (random date)
- November 15, 2023 (fortnightly reporting date)



While reviewing the records provided by FEM, a difference was observed in the clients' funds to the tune of PKR 5.7 million in comparison with the clients' trade payables of PKR 8.2 million as on October 25, 2023. The details are tabulated below:

Description	Ref.	Amount in PKR
Clients' Trade Payables	A	8,249,773
Clients' funds as per Back Office Ledger	B	1,792,744
Cash Margin deposited with NCCPL	C	751,050
Excess / (Shortfall) in Client's Funds	(B+C)-A	(5,705,978)

It is relevant to mention that FEM maintains two client-titled bank accounts (current accounts) and the balances maintained in such bank accounts are mentioned hereunder:

Bank Name / Bank Account No.	Bank Statement (A)	Ledger Balance (B)	Lower of (A) or (B)
Bank Islami Limited/ 101000073150003	4,017,723	1,792,723	1,792,723
Bank Al Habib Limited/ 0120081005347012	21	141	21
Total	4,017,744	1,792,864	1,792,744

The inspection team considered the lower balance of bank statements or bank ledger for the assessment of clients' funds segregation. As per bank reconciliation, FEM made two payments from Bank Islami Limited amounting to PKR 2.22 Million on October 23 and 25, 2023, which were not cleared on the selected date.

RESPONSE OF FEM DURING THE HEARING:

PSX inquired about a difference of PKR 5.7 million highlighted in clients' funds on a selected date. In response, FEM agreed with the highlighted observation and stated that the team had inadvertently overlooked the funds' deficiency in the client's titled bank account on the selected date. FEM informed that certain customers had executed trades that exceeded their available funds on the highlighted date. Had the deficiency of funds been identified on the same day, FEM would have ensured the collection of funds from the respective clients who had executed trades beyond their credit balance.

Furthermore, FEM stated that it had no shortfall in clients' funds on any other date or in subsequent dates because it always maintains proper segregation.

COMMENTS OF PSX:

It is a fiduciary obligation of every broker to ensure proper segregation of clients' assets and maintain sufficient funds in client title bank account(s). Further, Compliance Officer must exercise due care and diligence by regularly checking that the broker fulfills the above duty in the best interests of the customers.

2.2 Liquid Capital Statement:

During the review, the inspection team reviewed the audited Liquid Capital [LC] statement as of June 30, 2023 and the monthly LC statement as of November 30, 2023, and noted that



the LC was overstated by PKR 5.7 Million and PKR 11.82 Million on respective dates due to the inclusion of advance tax in the computation of LC.

In accordance with point 1.15 of Schedule III of Securities Brokers (Licensing and Operations) Regulations, 2016, the amount of advance tax permitted to be included in the computation of LC is limited to the extent it is netted with the provision for taxation. However, as per the trial balance of the above-mentioned selected dates, no provision for taxation existed. Therefore, a 100% haircut was required to be applied on the amount of advance tax.

If the advance tax is not included in the calculation, the FEM's LC would reduce from PKR 20 million to PKR 9.2 million on June 30, 2023 and from PKR 23.7 to PKR 17.96 on November 30, 2023.

RESPONSE OF FEM DURING THE HEARING:

FEM stated that it had submitted previous LCs in accordance with the auditor's comprehension of LC computation. However, FEM rectified it after notification of observation by the inspection team and LC computed subsequently did not include the advance tax. Furthermore, FEM apprised that it withdrew shares of PSX held by FEM and pledged in BMC in order to take its impact in LC computation and hence enhance the LC balance.

COMMENTS OF PSX:

FEM was advised to compute the applicable financial resources requirement in the manner prescribed in the regulations and exercise due care in the preparation and submission of information and documents to PSX. PSX advised FEM to submit LC as of May 31, 2024, along with all supporting documentary evidences in order for PSX to reassess the LC computation.

3. SUBSEQUENT TO THE HEARING:

FEM vide email dated June 24, 2024 submitted the BMC and LC statements as on April 30, 2024, and as on May 31, 2024 along with the following response:

As discussed during the hearing, please find attached the Liquid Capital Statement for the months of April and May 2024.

Our LCB calculation remains same except we withdrawal 1,000,000 share of PSX from the pledge under BMC requirement and placed additional ISE REIT Management Ltd share in the pledge under BMC. (Copy of April and May 2024 BMC report attached)

As at June 30 2023 or December 31 2023, the LCB was above the required threshold, we did not considered replacing the PSX share with ISE REIT share and once the ambiguity in the calculation of LCB appeared and we accepted the stance of the current auditors, as such action became inevitable.

You are once again requested to confirm that shall we start submitting the Net Worth and Liquid Capital on the basis of brokerage house books of accounts rather a consolidated book of accounts of FEM.

In addition to the above, FEM vide an email dated July 03, 2024 shared the clients' assets segregation as of October 31, 2023, and stated that the difference highlighted on October 25, 2023, had been rectified on October 31, 2023.

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4. **PSX ASSESSMENT:**

While assessing the documents submitted by FEM relating to LC, it was noted that LC computation did not include the advance tax amount. Furthermore, BMC documents demonstrate that FEM withdrew 1 million PSX shares from the BMC obligation on April 25, 2024, and additional 0.6 million shares on June 5, 2024. Therefore, the withdrawal of PSX shares from BMC were included in the LC computation under the head of 'investment in listed securities'.

Further, considering the response of FEM relating to the rectification of identified deficiency in clients' funds, PSX performed verification of clients' funds segregation on November 02, 2023. Based on the provided information, PSX did not find any deficiency in clients' funds.

5. **DECISION:**

Having considered all relevant facts and aspects in light of the above proceedings, it is established that FEM had insufficient funds in the client-titled bank account on a reviewed date of October 25, 2023 which is a violation of PSX Regulation 4.17.1(a). PSX also noted that no shortfall in clients' funds was observed on subsequently reviewed dates.

Furthermore, it is also established that FEM was unduly including the advance tax amount in the LC computation though it was removed subsequently by taking adequate remedial actions.

In view of the foregoing, PSX hereby directs FEM to comply with the following:

- (a) Pay a fine of PKR 50,000 within 30 days from the date of this Order.
- (b) Ensure to maintain sufficient funds in client-titled bank account(s) in fulfillment of the fiduciary obligation to maintain proper segregation of clients' assets at all times.
- (c) Ensure that LC is computed correctly in the manner prescribed in Schedule III of Securities Brokers (Licensing and Operations) Regulations, 2016.

This Order shall dispose-off the above-discussed matter. It may be noted that the said Order is issued without prejudice to the right of PSX to initiate any inquiry or special audit with expanded, restricted, or different scope to take any punitive action against FEM in accordance with the relevant Regulations on matters subsequently investigated or otherwise brought to the knowledge of PSX including but not limited to the aforesaid direction issued in this Order.

A handwritten signature in blue ink, appearing to read 'AJEEET KUMAR', is written over a horizontal line.

AJEET KUMAR
CHIEF REGULATORY OFFICER

Date: July 15, 2024