



# FIRST EQUITY MODARABA

## **KNOW YOUR CUSTOMER & CUSTOMER DUE DILEGENCE GUIDELINES**

### **1. INTRODUCTION**

In the last few years, across the world regulations have been put in place to discourage money laundering and financing of illegal/criminal activities. Furthermore, under the United Nations umbrella, several international agreements have been signed by U.N. member states under which member states are bound to implement policies that discourage money laundering and monitor financial transaction that are suspicious and raise concern about money laundering. Pakistan is a signatory to such agreement and is a member of relevant bodies such as Financial Action Task Force (FATF). As such, Pakistan has to abide by the recommendations of FATF and other relevant bodies and implement appropriate policies and procedures. If Pakistani polices are not in line with such recommendations, the image of the country is tarnished. Not only this, but Pakistani businesses and institutions (e.g. financial institutions, importers & exporters, investors, etc) can face difficulties in transacting business internationally with negative economic consequences for the country. Pakistan has enacted the ANTIMONEY LAUNDERING ACT 2010. Financial institutions and intermediaries must comply with the provisions of this Act.

In the above context, First Equity Modaraba (FEM) in line with Pakistan Stock Exchange (PSX), the SECP have develop a comprehensive guidelines for how to monitor and implement not only in FEM but the Pakistan capital market institutions regarding how to develop and implement policies and procedures that will help discourage money laundering and also allow capital market institutions and FEM to monitor and remain alert regarding suspicious transactions and /or parties and Clients who may be attempting to launder money.

In the case of the brokerage industry, the Securities and Exchange Commission of Pakistan, being its Apex regulator and the Pakistan Stock Exchange, being the frontline regulator of the brokerage industry in Pakistan, have formulated detailed set of guidelines for brokers to help them in developing KYC and CDD policies & procedures and implementing the same. This document will serve as a further explanation for brokers with the objective to enabling them to better understand the above mentioned Guidelines and facilitate in implementing the same.

FEM decided to adopt and implement the policy and regulation in letter and spirit as adopted, announced and implemented by PSX and SECP.

## **2. THE KYC/CDD Policy Outline**

It is important to highlight that money laundering and financing of criminal activities is a very serious offense and FEM concern department and staff must always remain vigilant that their good offices are not used for any such activity.

KYC/CDD policy include:

- a. Customer Identification
- b. Risk assessment of customer
- c. Circumstances where Enhanced Due Diligence is required
- d. On-going due Diligence
- e. Circumstances where simplified Due Diligence can be adopted
- f. Compliance function
- g. Data retention
- h. Training and employee screening

FEM also consider International best practices, recommendations from the relevant bodies such as Financial Action Task Force (FATF) while they develop their KYC/CDD policy

## **3. CUSTOMER IDENTIFICATION**

- 3.1 It is a basic tenet of any business to know who its customers are. This helps you to protect yourself from being used by unscrupulous and/or criminal elements. In this regard, FEM have to take all reasonable care to establish the true identity of customers. A minimum set of documents that need to be obtained from customers/potential customers at the time of opening their brokerage account that has been prescribed by the SECP. To be prudent, FEM obtain any other document from the account opener if we believe it will help in establishing the true identity of the customer and the real controlling person behind the account. The key point is that FEM must not open anonymous or obviously fictitious accounts.
- 3.2 It is important to recognize if a customer is acting on behalf of another person. If this is the case, then the identity of that person should be ascertained and relevant documents of that person needs to be obtained also.
- 3.3 For non-individual customers (e.g. companies, pension funds, government owned entities, non-profit organizations, foreign companies/ organizations) additional care is taken to establish the ownership and control structure of such an organization and who (i.e. person(s)) actually owns the organization and who manages it.
- 3.4 FEM verify that the person who represents himself as authorized signatory with powers to open and operate the brokerage account is actually authorized by the organization

- 3.5 FEM make sure and is careful that accounts of Institutions/ organizations / corporate bodies are not opened in the name of employee(s)/official(s). Because of sensitive nature of public sector (government) entities and risk of potential conflict of interest, it is critical for FEM and their representatives to ensure that accounts of Govt. Institutions are not opened in the individual name of any employee/official. Any such account, which is to be operated by an officer of a govt. owned entity, is to be operated by an officer of the Federal/Provincial/Local Government in his/her official capacity, shall be opened only on production of a special resolution/authority from the concerned administrative department, duly endorsed by the Ministry of Finance or Finance Department of the concerned Provincial or Local Government.
- 3.6 When an individual or an organization/institution opens account with FEM, it is important to find out and document in broad terms what does the customer intend to do. For example, are there any specific sectors or stocks that the customer does not wish to participate in; is the customer intending to invest for short-term only or is the customer intending to invest for longer term; will investment be only in liquid scrips or any scrip; or any other special needs or requirements of the customer.
- 3.7 Customer's other information such as age, gender, occupation, knowledge of market, etc. will help FEM develop a sense of the risk taking capacity and profile of the customer and thus guide the customer in more effective manner. At the same time, it will also help you to understand whether the customer should be classified as a low risk or a high risk customer from the KYC/CDD perspective. For example, a domestic customer working in a company with regular income would be low risk category; on the other hand, a government employee may be in a higher risk category because of the potential for conflict of interest; or a foreign organization having foreign currency sources would be in high risk category requiring more careful identification procedure and close monitoring of account operations.

In the above context, FEM have to carefully determine the source of funding especially if the customer is expected to receive/send funds in foreign currency.

- 3.8 As is already the practice and part of PSE regulations, FEM is following the regulations that the all receipts/payments above Rs25,000/= are made through cross – cheques, bank drafts, payorders or other crossed banking instruments. Where any cash is accepted from a customer in an exceptional circumstance only, it has to be immediately reported to the PSX with clear reasons as to why the cash receipt was accepted by the broker.
- 3.9 In general, physical presence of the account opener/authorized representative is necessary at the time of opening a brokerage account. Or in other case the person referring him should be FEM Client and known to FEM. In the case of non-resident/overseas customers or customers in other cities where the FEM does not have a branch/office, more strong identity verification procedures have been applied. These include verification by a reliable third party, which should be a Crescent Group member, reference of an existing customer, confirmation from another broker with whom the customer had an account etc.

Furthermore, it is important when obtaining confirmation from third parties in other jurisdictions, especially foreign, FEM consider whether that foreign jurisdiction is following the Financial Action Task Force (FATF) recommendations. The list of jurisdictions following FATF recommendations is available.

#### **4. RISK ASSESSMENT**

- 4.1 FEM assessment and categorization of customers as low, medium or high risk profile. This risk assessment by FEM is done on the basis of information obtained at the time of brokerage account opening and is/will be updated on the basis of information obtained during the relationship and doing business with the Client. It should be based on Client's identity, nature of income, source of funding, location/domicile of customer, etc. SECP has provided the following broad outline of factors that will categorize the customer into HIGH RISK CATEGORY which are adopted by FEM:
- i. Non-resident customers;
  - ii. Legal persons or arrangements including non-governmental organizations; (NGOs)/ not-for-profit organizations (NPOs) and trusts / charities;
  - iii. Customers belonging to countries where CDD/KYC and anti money laundering regulations are lax or if funds originate or go to those countries;
  - iv. Customers whose business or activities present a higher risk of money laundering such as cash based business;
  - v. Customers with links to offshore tax havens;
  - vi. High net worth customers with no clearly identifiable source of income;
  - vii. There is reason to believe that the customer has been refused brokerage services by another brokerage house;
  - viii. Non-face-to face / on-line customers;
  - ix. Establishing business relationship or transactions with counterparts from or in countries not sufficiently applying FATF recommendations; and
  - x. Politically Exposed Persons (PEPs) or customers holding public or high profile positions
- 4.2 "Politically Exposed Persons" (PEPs'). PEP's also fall under HIGH RISK CATEGORY. These generally include individuals in prominent positions such as senior politicians, senior government, judicial or military officials; senior executives of State Corporations and their family members and close associates. These individuals present reputational risk and potential conflict of interest and extra caution is required when opening their brokerage account and monitoring their account activity. The above definition is not intended to cover middle ranking / junior officials in above noted categories.
- 4.3 In general, FEM conducts a self assessment for money laundering and terrorist financing risk, identifying and documenting the key risks presented by virtue of its business model, types of customers and geographical placement.
- 4.4 The bottom line is that FEM assess the risk of potential money laundering / terrorism financing and the guidelines and this commentary will help in documenting such risk assesses that it exists.

## **5. ENHANCED DUE DILIGENCE**

- 5.1 Once a customer has been categorized as HIGH RISK, it is necessary for FEM to have Enhanced Due Diligence (EDD) when dealing with such a customer. Policies and procedures should be put in place so that activities and transactions of HIGH RISK customers are monitored and any unusual transactions are reported in a Suspicious Transaction Report (STR).
  - 5.2 In the above context, when dealing with high-risk customers, including Politically Exposed Persons (PEP's), FEM avoid to entertain such persons and to open their brokerage accounts. In the case of High Risk Category customers, it is all the more important for FEM to determine the source of wealth and funds invested before any further entertainment. It should be noted that this exercise of categorizing customers in Low, Medium, and High Risk category applies to all customers, including existing customers. Thus, once FEM has carried out the above exercise, if an existing customer falls into the High Risk Category, the above requirements for monitoring and reporting suspicious transactions and senior management approval for continuing with the customer will also apply to such customer.
  - 5.3 If the above requirements cannot be fulfilled by the FEM will not open the brokerage account of such person and file a Suspicious Transaction Report (STR). In case an existing customer falls into High Risk Category and the FEM is unable to fulfill the above mentioned requirements, such account will be closed and a Suspicious Transaction Report filed.
6. Similarly, brokerage account will not be opened if the FEM is unable to verify the identity of the customer / beneficial owner of the account, or if it is unclear what the purpose and intention of customer is and should file an STR.

## **7. ON-GOING DUE DILIGENCE**

- 7.1 FEM realize that Customer Due Diligence (CDD) is not a one-time exercise at the time of account opening only. In order to guard against misuse of their good offices against criminal transactions FEM is vigilant at all the times, and keep monitoring transactions of customers to ensure that the transactions executed in any particular account are within the understanding of the Broker in terms of the customer's profile, risk category, historical pattern of the transactions and their historic funding source. For example, if a domestic individual customer orders a transaction that is significantly different from the average historical transaction size, the Trader of FEM has to become alert and be satisfied that no suspicious reportable activity to take place. Similarly, if a regular domestic customer, all of a sudden shows foreign sources of funds, this is likely to require further the investigation.
- 7.2 In the above context, FEM keep all customer records updated and have a policy of assessing any change in customer profile on regular basis, which change should be documented and sufficient information should be obtained regarding such change.

## **8. SIMPLIFIED DUE DILIGENCE**

The purpose of the KYC/CDD guidelines is not to make FEM operations unnecessarily cumbersome, but to help the FEM and broker community guard against their services from being used for money laundering by unscrupulous elements. In this regards:

- 8.1 It is acceptable for FEM to apply simplified or reduced CDD measures in the following circumstances:
- a) risk of money laundering or terrorist financing is lower
  - b) information on the identity of the customer and the beneficial owner of a customer is publicly available
  - c) adequate checks and controls exist
- 8.2 Accordingly, following customers may be considered for simplified or reduced CDD:
- Financial institutions which are subject to requirement to combat money laundering and terrorist financing consistent with the FATF Recommendations and are supervised for compliance with those controls
  - Public companies that are subject to regulatory disclosure requirements
  - Government administrations or enterprises
- 8.3 When opting for simplified or reduced due diligence, the FATF guidelines in this regard is consulted. Simplified CDD should not be followed when there is an identified risk of money laundering or terrorist financing.

## **9. COMPLIANCE FUNCTION**

- 9.1 While the above noted KYC/CDD guidelines are being provided to help FEM and its agents understand the processes involved in KYC/CDD. FEM is and will develop a process in this respect. This will help FEM to monitor customer transactions and report any suspicious activity in a timely manner. In order to achieve this objective two key elements is instituted:
- (i) Compliance Function with suitable human resource
  - (ii) MIS reporting capability
- 9.2 In this context, the person responsible for compliance is designated and he/she should have sufficient skills and experience to effectively perform the compliance function. The person ensure compliance is requires report to the Chief Executive Officer and Company Secretary
- 9.3 It is the responsibility of the compliance function to ensure that KYC/CDD guidelines are being complied with as well as with other regulatory requirements. This includes maintaining record of violations / non-compliance identified which has to be reported to the CEO and CS. Any such record has to be available for inspection by SECP and PSX as and when required.

## **10. DATA RETENTION**

All data relating to KYC/CDD guidelines & procedures are maintained for a minimum of five years, including identity of the customer(s), account files and correspondence exchanged with the customer(s).

**11 TRAINING**

There is an on-going training of the employees and agents to ensure that they understand their duties under KYC/CDD and are able to perform those duties satisfactorily.

**12 SCREENING**

In order to ensure, for FEM safety, unscrupulous elements do not become employees/agents, FEM has developed an appropriate screening procedures when hiring and also on an ongoing basis to ensure high standards of staff in terms of honesty, integrity, ethics and professionalism. This is important not just for the sake of FEM own safety and reputation but the reputation of the Capital Market.

13. FEM is bound by the requirements of Anti Money Laundering Act 2010, as applicable to them and must comply with the provisions of this Act. This includes filing of suspicious Transactions Reports and complying with any directives, circulars, guidelines with regard to KYC/CDD/Anti-Money Laundering/Terrorist Financing, issued by the Federal Government. This also means that brokers have to provide information concerning their customers and their transactions to the Stock Exchange, Financial Monitoring Unit and the SECP