



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
Adjudication Department

No. 1(51)SMD/ADJ/PMEX/2019

June 19, 2019

Pakistan Mercantile Exchange
Through its Chief Executive Officer,
3B, 3rd Floor,
Bahria Complex IV,
Chaudhry Khaliq Uz Zaman Road, Gizri,
Karachi.

SUBJECT: Order in Respect of Show Cause Notice dated May 02, 2019 Bearing Number No. 1(51) SMD/ADJ/PMEX/2019

Please find enclosed herewith a copy of order dated June 18, 2019 the title matter for your record and necessary action.



Muhammad Faisal
Management Executive



Securities and Exchange Commission of Pakistan
Securities Market Division

Through Courier

Before the Commissioner (SMD)

In the matter of Show Cause Notice issued to Pakistan Mercantile Exchange Limited
under Section 16 read with Section 94 of the Futures Market Act, 2016

Date of Hearing

May 28, 2019

Present at the hearing representing
Pakistan Mercantile Exchange Limited

- I. Mr. Ejaz Ali Shah
(Managing Director),
II. Mr. Muhammad Irfan
(Branch In-charge Islamabad)

ORDER

This Order shall dispose of the proceedings initiated pursuant to Show Cause Notice No. 1(51) SMD/ADJ/PMEX/2019, dated May 02, 2019 (the "SCN"), issued by Securities and Exchange Commission of Pakistan (the "Commission") to Pakistan Mercantile Exchange Limited (the "Respondent") for *prima facie* violations under Section 16 read with Section 94 of the Futures Market Act, 2016 (the "Act").

2. Brief facts of the case are that the Respondent is a demutualized commodity futures exchange, licensed and regulated under the Act and the Futures Brokers (Licensing and Operations) Regulations, 2018 ("Licensing Regulations").

3. It was informed by Policy, Regulation and Development Department of the Securities Market Division that the Respondent had initially proposed new regulations in the name of a "Rule Book". In this regard, Department provided its detailed feedback to the Respondent. However, the Respondent had not submitted its final Rule Book approved by its Board of Directors. Therefore, the Respondent, *prima facie*, failed to comply with the requirements of Section 6 (4) & (5) of the Act.

4. Furthermore, the Respondent forwarded renewal applications of 83 brokers for obtaining licenses under the new regulatory regime to the Commission without adhering the requirements stipulated in Regulation 6 of the Licensing Regulations as it failed to:

- i. Submit complete applications of futures brokers as required under Regulation 6 of the Licensing Regulations;
- ii. Submit letter of recommendation as per the prescribed in regulation 6;





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- iii. Obtain the requisite documents / information as prescribed in Annexure A-1 of the Licensing Regulations.

Therefore, the Respondent, *prima facie*, failed to comply with Regulation 6 of the Licensing Regulations.

5. Accordingly, the Commission took cognizance of the aforementioned facts and served SCN dated 02 May 2019 to the Respondent under Section 16 read with Section 94 of the Act. The Respondent submitted its response vide letter dated May 24, 2019. The submissions of the Respondent are reproduced hereunder:

I. Regulations for TRE Certificate holders under Section 6(4)&(5) of FMA

1.1 *We understand that PMEX General Regulations, 2007 (PMEX Regulations) fulfill the requirements of Section 6(4) & (5) of FMA. Although PMEX Regulations were approved by SECP under Section 34(1) of the repealed Securities and Exchange Ordinance, 1969, however, under Section 124(2)(a) of FMA, they shall have effect as if they have been approved under FMA. We would also like to submit that being a demutualized exchange since inception as well as a Clearinghouse, all the members of PMEX are only IRE Certificate holders and Clearing Members in substance, as they are only entitled to trading/clearing rights. This is unlike Pakistan Stock Exchange (PSX) where its members, before demutualization, had both trading/clearing rights as well as shareholding rights. It is further submitted that as directed by SECP lately, an amendment in the existing PMEX Regulations with regards to explicit incorporation of Trading Rights Entitlement Certificate (TREC), after consultation with PMEX legal advisor, has been approved by the Board, and the same is in the process of submission to the Commission for approval.*

1.2 *We would like to further submit that the revamping exercise of PMEX Regulations in the form of a Rule Book was started in 2016-17 due to the fact that the PMEX Regulations were developed over a decade ago in 2007 and the scope and manner of PMEX's conduct of business has evolved over time. The Rule Book approved by the Board was submitted to SECP for approval in August 2017 and a presentation was also made to the SECP team. Since then, various discussions were held between SECP and PMEX but unfortunately a single session exclusively for conclusion of Rule Book could not take place as agreed. Moreover, in last 8-10 months, some major regulatory and operational changes have taken place e.g. Brokers Licensing Regulations, Anti Money Laundering Regulations and Centralized Know-Your-Customer Organization Regulations along-with the introduction of Direct Fund Model by the Exchange. It is therefore requested to allow three months for revamp and submission of PMEX Rule Book to the Commission.*





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2. Submission of incomplete license renewal applications of 83 brokers under Regulation 6 of Brokers Licensing Regulations

- 2.1 It is submitted that Part IV of FMA was enacted on November 15, 2017, by virtue of which all the brokers who were granted broker registration under Commodity Exchange and Futures Contracts Rules, 2005 were considered deemed licensed for one year, i.e. till November 14, 2018. The Brokers Licensing Regulations were issued on September 25, 2018, i.e. only 50 days before expiry of deemed licenses.
- 2.2 Under Regulation 9(1) of the Brokers Licensing Regulations, brokers were to apply for renewal to SECP through PMEX at least 45 days before the expiry of their license. Moreover, under Regulation 9(3), PMEX was to submit the license renewal applications to the Commission one month prior to the date of expiry of licenses.
- 2.3 Due to insufficient time for renewal after promulgation of Broker Licensing Regulations, and in order to ensure continuity of operations after November 14, 2018, the Exchange in consultation with SECP submitted the minimum documents for renewal of license of 83 brokers, which included recommendation of PMEX, broker's application on letterhead, license renewal fee etc.
- 2.4 Under Regulation 9, for renewal of license only such documents were required to be submitted by a Broker which have not already been provided at the time of applying for license, or subsequent renewals. PMEX was only required to check compliance with any additional requirements as applicable under the FMA.
- 2.5 With regards to letter of recommendation, please note that there is no prescribed format for the letter of recommendation for PMEX. The letter of recommendation for the first time license application under Regulation 6 is required to include the areas mentioned in your notice. However, the letter of recommendation for renewal of license under Regulation 9(3) is not required to cover all areas again.
- 2.6 Please note that PMEX communicated its comments on the draft Broker Licensing Regulations on various occasions and market participants also provided their comments on the said regulations. Unfortunately, neither the comments submitted were discussed with the Exchange nor incorporated in the final Broker Licensing Regulations.
- 2.7 We would like to further submit that certain stringent and excessive requirements with reference to Broker Licensing Regulations have been highlighted by the Exchange on which consensus has been reached with the Commission recently. As all active brokers of the Exchange are unable to fully comply with the requirements even after a comprehensive follow up by the Exchange, we feel that it would not be prudent to take action against non-compliant brokers at the moment. However, once the Regulations are amended, the Exchange shall ensure that all the brokers comply with the licensing requirements in letter & spirit. In case of non-compliance, the Exchange will start disciplinary proceedings against non-compliant brokers”.





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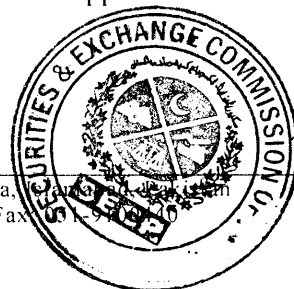
6. The Respondent was accorded hearing opportunity on May 28, 2019 wherein, Mr. Ejaz Ali Shah, Managing Director and Mr. Muhammad Irfan, Branch In-charge Islamabad (the “Representatives”) attended the hearing on behalf of the Respondent. During the hearing proceedings, the Respondent admitted the highlighted issues in the SCN. The Respondent committed to submit complete/missing information relating to license renewal applications of brokers by June 30, 2019. Further, the Respondent submitted that it would submit its Rulebook, duly approved by its Board of Directors, latest by July 15, 2019 for review and approval by the Commission.

7. I have examined the written as well as oral submissions of the Respondent and its Representative. The Respondent admitted its contraventions highlighted in the SCN regarding the license renewal applications of brokers.

8. In regard to the PMEX General Regulations, 2007, it has been observed and admitted by the Respondent that they are deficient in terms of the requirements stipulated under Section 7 of the Act and need to be catered in the new Rule Book. In particular, the deficient areas of Regulations include but not limited to the:

- i. Eligibility, admittance and conduct of TRE certificate holder (TREC). Prior to the Act, the concept of TREC did not exist. The Act envisages that only TREC can become a licensed broker. Therefore, PMEX is required to frame its regulations under Section 7 of the Act for issuance governing matters related to TREC;
- ii. Risk management system and matters connected therewith;
- iii. Appointment and functioning of internal auditors;
- iv. Conflict of interest between futures broker, its employees and its clients;
- v. Mechanism for inspection, audit and compliance of futures' brokers including cooperation with other licensed entities for violation of any requirement of this Act or any rules or regulations made thereunder;
- vi. Proprietary trading by futures broker; and
- vii. Know your customer and customer due diligence policies and procedures and other matters ancillary to anti-money laundering.

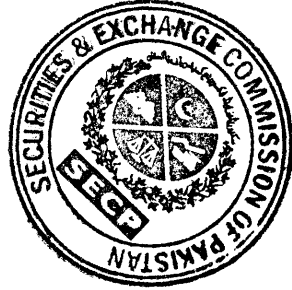
9. Since the Respondent has committed to submit (i) complete/missing documents required under Licensing Regulations relating to license renewal application of brokers, latest by June, 30 2019 and (ii) its Rulebook, duly approved by its Board of Directors, latest by July 15, 2019 for review and approval by the Commission. The SCN is concluded with a warning to the Respondent to ensure meticulous compliance with the applicable laws in future.





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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 the matter subsequently investigated or otherwise brought to the knowledge of the Commission.



Shauzab Ali
Commissioner (SMD)

Announced on June 18, 2019
Islamabad