



THE KARACHI STOCK EXCHANGE (GUARANTEE) LIMITED

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KSE/N- 1388

March 16, 2012

NOTICE

Karachi Stock Exchange

**EXPLANATORY NOTE/
COMMENTARY**

on

KNOW YOUR CUSTOMER

&

**CUSTOMER DUE DILEGENCE
GUIDELINES**

for

**Members/Brokers &
their Agents/Employees**

COMMENTARY on Guidelines for Brokers for developing effective Know Your Customer (KYC) and Customer Due Diligence (CDD) policies and procedures

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 policies 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, Apex capital market regulator, the SECP have provided comprehensive guidelines for 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 to monitor and remain alert regarding suspicious transactions and /or parties 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 Karachi Stock Exchange, being the frontline regulator of the brokerage industry in Karachi, 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.**

2. THE KYC/CDD Policy Outline

This document will help stock brokers/ members / employees of stock brokerage houses to design effective and practical KYC / CDD policies and procedures that are easy to understand, implement and monitor.

It is important to highlight that money laundering and financing of criminal activities is a very serious offense and the brokerage community must always remain vigilant that their good offices are not used for any such activity. This is important for the growth and development of individual brokerage houses and the securities industry in Pakistan.

Key areas that the KYC/CDD policy should cover 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

The brokers should 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, brokers 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 has been prescribed by the SECP. To be prudent, brokers are advised to obtain any other document from the account opener if they 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 brokers 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 has to be 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. Brokers should 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.
- 3.4
- 3.5 Brokers have to make sure and be 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 brokers 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 brokerage account with you, 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 which 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. This, along with customer's other information such as age, gender, occupation, knowledge of market, etc.
- 3.7

will help you 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, brokers 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 KSE regulations, brokers must follow the regulations that the all receipts/payments above Rs25,000/= are made through cross – cheques, bank drafts, pay-orders 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 Exchange 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. In the case of non-resident/overseas customers or customers in other cities where the broker does not have a branch/office, more strong identity verification procedures should be applied. These include verification by a reliable third party, reference of an existing customer of the broker, 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, that brokers 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 We have discussed assessment and categorization of customers as low, medium or high risk profile above. This risk assessment by brokers has to be done on the basis of information obtained at the time of brokerage account opening and has to be updated on the basis of information obtained during the relationship and doing business with the customer. It should be based on customer'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**:

- 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. However, prudence requires brokers to be careful.

4.3 In general, please note that Brokers should conduct 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 brokers need to assess the risk of potential money laundering / terrorism financing and the guidelines and this commentary will help in documenting such risk if the broker assesses that it exists.

5. ENHANCED DUE DILIGENCE

5.1 Once a customer has been categorized as HIGH RISK, it is necessary for the broker 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) either the Exchange member himself (in case of individual members) or nominee director/senior management of the corporate brokerage house, has to approve the opening of brokerage account. In the case of HIGH RISK CATEGORY customers, it is all the more important for brokers to determine the source of wealth and funds invested.

It should be noted that this exercise of categorizing customers in LOW, MEDIUM, HIGH RISK category applies to all customers, including existing customers, Thus, once the broker 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 (s)

- 5.3 If the above requirements can not be fulfilled by the broker than they should not open the brokerage account of such person(s) and file a Suspicious Transaction Report (STR).** In case an existing customer falls into HIGH RISK CATEGORY and the broker is unable to fulfill the above mentioned requirements, such account should be closed and a Suspicious Transaction Report filed.
6. Similarly, brokerage account should not be opened if the broker 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. If there are any such existing accounts they should be closed and a Suspicious Transaction Report (STR) filed.

7. ON-GOING DUE DILIGENCE

- 7.1 It is important for brokers and their agents to 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 brokers need to be vigilant at all the times, and keep monitoring transactions of their 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 broker has to become alert and be satisfied that no suspicious reportable activity is taking place. Similarly, if a regular domestic customer, all of a sudden shows foreign sources of funds, this is likely to require further the investigation by the broker.
- 7.2 In the above context, brokers should 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 DELIGENCE

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

8.1 it is acceptable for Brokers 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 must be 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 brokers and their agents understand the processes involved in KYC/CDD, it is important that a system be developed at the brokers' end to implement these guidelines. This will help brokers to monitor customer transactions and report any suspicious activity in a timely manner. In order to achieve this objective two key elements have to be instituted at the brokers' end: (i) Compliance Function with suitable human resource (ii) MIS reporting capability

- 9.2 In this context, the person responsible for compliance should be designated and he/she should have sufficient skills and experience to effectively perform the compliance function. In case of individual members of the Exchange, they should identify the person who will be responsible for compliance. In the case of corporate members of the Exchange the individual identified to ensure compliance should report to the Board of Directors of the Corporate Brokerage House.
- 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 Board of Directors. Any such record has to be available for inspection by SECP and KSE as and when required.

10 DATA RETENTION

All data relating to KYC/CDD guidelines & procedures have to be 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 has to be on-going training of brokers, their 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 their own safety, that unscrupulous elements do not become employees/agents, brokers should have 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 brokers' own safety and reputation but the reputation of the Capital Market.

13. It should be noted that brokers (like other financial institutions) are 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

14. CONCLUDING REMARKS

As the global economy becomes increasingly inter - connected and the ease of cross-border financial transactions increases, every country, including Pakistan, becomes more exposed to the potential of illegal money transfers and money laundering. It is to guard the Capital Market of Pakistan and its participants that the guidelines prescribed by SECP and this explanatory statement are being issued, as is already the case for other segments of the financial sector such as banks and asset management companies.

It is expected that Brokers will take serious note of the guidelines and this commentary and implement the same for the sake of their individual safety and reputation as well for ensuring the reputation, growth and future development of the country's Capital Market.

ANNEXURE A – Specimen suggested KYC / CDD Checklist for brokers

ANNEXURE B – SECP GUIDELINES for the brokers for developing effective Know Your Customer (KYC) and Customer due Diligence (CDD) policies and procedures.

SPECIMEN

Annexure A

FOR INTERNAL USE ONLY

KYC / CDD Checklist

Date	Account Title	Account / UIN #
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SECTION A

Minimum Information / Documents to be provided by Investor				
	Pls tick		Pls tick	
1. Individuals/Sole Proprietorships	<input type="checkbox"/>	2. Partnerships	<input type="checkbox"/>	3. Institutions/Corporates
CNIC of Principal and Joint Holders / Passport for Foreign Nationals / NICOP for non-resident Pakistanis	<input type="checkbox"/>	CNICs/NICOP of all partners, as applicable	<input type="checkbox"/>	CNIC / NICOP of Authorized Signatories and Directors
Proof of Employment/Business	<input type="checkbox"/>	Partnership Deed	<input type="checkbox"/>	List of Directors and Officers
NTN Certificate, where available	<input type="checkbox"/>	Latest financial statements	<input type="checkbox"/>	NTN Certificate
	<input type="checkbox"/>	Certificate of Registration (in case of registered partnership firm)	<input type="checkbox"/>	Documentary evidence of Tax Exemption (if applicable)
	<input type="checkbox"/>	NTN Certificate	<input type="checkbox"/>	Certificate of Incorporation
	<input type="checkbox"/>		<input type="checkbox"/>	Certificate of Commencement of Business
	<input type="checkbox"/>		<input type="checkbox"/>	Certified Copy of Board Resolution
	<input type="checkbox"/>		<input type="checkbox"/>	Memorandum & Articles of Association/ Bye Laws/ Trust Deed
	<input type="checkbox"/>		<input type="checkbox"/>	Audited Accounts of the Company
4. Trusts	<input type="checkbox"/>	5. Clubs Societies and Associations	<input type="checkbox"/>	6. Executors/Administrators
CNICs of all trustees	<input type="checkbox"/>	Certified copy of certificate of Registration	<input type="checkbox"/>	CNICs of all Executors/Administrators
Certified copy of the Trust Deed	<input type="checkbox"/>	List of members	<input type="checkbox"/>	Certified copy of Letter of Administration
Latest financials of the trust	<input type="checkbox"/>	CNIC/NICOP of members of Governing Board	<input type="checkbox"/>	
Documentary Evidence of Tax Exemption (if applicable)	<input type="checkbox"/>	Certified copy of bylaws/rules and regulations	<input type="checkbox"/>	
Trustee/Governing Body Resolution	<input type="checkbox"/>	Copy of latest financials of Society/Association	<input type="checkbox"/>	
	<input type="checkbox"/>	Board/Governing Body Resolution	<input type="checkbox"/>	
If documents / information is complete, proceed to Section B				
List any missing documents / information below:				
1				
2				
If ANY document or information is missing, proceed to Section G.4				

SECTION B**Assessment of information provided in section A**

Based on information provided in A,

1. Is the investor also the ultimate beneficiary of the funds to be invested If NO, joint account should be opened or power of attorney be provided by ultimate beneficiary with relevant documentary details of the beneficiary	YES	NO
2. In case the Investor is a private company , IS the latest shareholders' list available	YES	NO
3. In case of Government Accounts , Mark YES if the account is not in the personal name of the government official A resolution / authority letter (duly endorsed by Ministry of Finance or Finance Department of concerned government) is available, which authorizes the opening and operating of this account by an officer of federal / provincial / local government in his / her official capacity	YES	NO
If the answer to any of the above questions was 'NO', go to section G.3 or G.4, otherwise go to Section C		

SECTION C

Risk Category of Investor	Please tick box		
1. Government Department / Entity	<input type="checkbox"/>	LOW RISK	<i>Go to Section G.1</i>
2. Public listed company	<input type="checkbox"/>	LOW RISK	<i>Go to Section G.1</i>
3. Private limited company	<input type="checkbox"/>	MEDIUM RISK	<i>Go to Section G.2</i>
4. Non-Governmental Organization (NGO)	<input type="checkbox"/>	HIGH RISK	<i>Go to Section G.3</i>
5. Trust / Charity	<input type="checkbox"/>	HIGH RISK	<i>Go to Section G.3</i>
6. Unlisted Financial institution	<input type="checkbox"/>		<i>Go to Section D</i>
7. Individual	<input type="checkbox"/>		<i>Go to Section E</i>

SECTION D

Unlisted Private Financial Institution (NBFI)		
Is the unlisted private financial institution domiciled in Pakistan and is regulated by the SECP/State Bank of Pakistan (SBP)	YES	NO
OR Is it domiciled in a FATF member country that is satisfactorily following the FATF recommendations and is supervised by a regulatory body	YES	NO
If YES, proceed to Section G.1	If NO, proceed to Section G.3	

SECTION E

Individual		
1. Is the person a non-resident Pakistani	YES	NO
2. Is the person a high net worth individual with no identifiable source of income or his/her profile/source of income doesn't match with size & quantum of investments/	YES	NO
3. Is the person involved in dealing in high value items (<i>based on declared occupation</i>)	YES	NO
4. Is the person a foreign national	YES	NO
5. Does the person appear to have links or money transfer to/from offshore tax havens or belongs to country(s) where KYC/CDD and anti money laundering regulations are lax (in terms of not sufficiently applying FATF recommendations)	YES	NO
6. Is there any reason to believe that the person has been refused account opening by another financial institution / brokerage house	YES	NO
7. Is the person opening the brokerage account on a non-face-to-face basis/on-line	YES	NO
If the response to any question (1-7) above was 'YES', proceed to Section G.3		
8. Is the person a holder of a senior level public (government) office i.e. a politically exposed person (PEP) or a family member of PEP.	YES	NO
9. Is the person a holder of high profile position (e.g. senior politician)	YES	NO
If the response to any question (8-9) above was 'YES', proceed to Section F, else proceed to Section G.1		

SECTION F

Politically Exposed Person / Foreign National / Holders of High Profile Position		
Is the brokerage account relationship with this high risk category person including politically exposed person / foreign national / holder of high profile position, approved by the Nominee Director, CEO / COO of the brokerage house (<i>approval shall be provided by management through signing the respective Account Opening Form</i>)	YES	NO
If YES, proceed to Section G.3	If NO, proceed to Section G.4	

SECTION G

Investor Risk Profile		
	Risk Classification	KYC Requirements
G.1	LOW RISK	Reduced KYC Requirements shall be applicable: Investor account can be opened once information / documents mentioned in section A have been provided.
G.2	MEDIUM RISK	Greater care required and documents listed in Section A should be obtained before opening of account.
G.3	HIGH RISK	Enhanced KYC Requirements shall be applicable: Investor account can be opened once information / documents mentioned in section A have been provided. Transactions shall be monitored to ensure that the funds used for investments are from an account under the Investor's own name in a financial institution (e.g. bank) subject to high due diligence standards and the amount and frequency of investments are not unusual given the nature and financial strength of the Investor
G.4	HIGH RISK	Account cannot be opened as KYC Requirements have not been fulfilled.

CONFIRMATION of physical presence of customer when opening account	YES	NO
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Other Comments

Completed by:	<i>Name of Sales Person / Agent</i>	<i>Signature</i>	<i>Date</i>
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Checked by:	<i>Name of Compliance Person</i>	<i>Signature</i>	<i>Date</i>
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Annexure-B**Guidelines for the brokers for developing effective Know Your Customer (KYC) and Customer Due Diligence (CDD) policies and procedures**

1. While developing the KYC and CDD policies and framework, International best practices, recommendations from the relevant bodies such as Financial Action Task Force (FATF) must be taken into account.
2. The KYC/CDD policy, at minimum, must provide for the following:
 - 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

3. Customer identification

- 3.1 Brokers shall ensure that no anonymous accounts or accounts that are obviously in the name of fictitious persons are opened or maintained. Brokers must take all reasonable steps to confirm the true identity of the prospective client and to collect all relevant information to ascertain the identity of the real controlling party of the trading account. For this purpose, minimum set of documents as prescribed by SECP from time to time must be obtained. Brokers may obtain any additional documents where considered necessary.
- 3.2 The Brokers shall determine whether a customer is acting on behalf of another person. In such cases steps should be taken and all the relevant documents should be obtained to determine the true identity of that person.
- 3.3 For legal persons, Brokers must take reasonable measures to understand the beneficial ownership and control structure of the customer. For this purpose, Brokers shall seek to identify the natural persons with controlling interest and who constitute the mind and management of the legal person or arrangement.

Annexure-B**Guidelines for the brokers for developing effective Know Your Customer (KYC) and Customer Due Diligence (CDD) policies and procedures**

- 3.4 For legal persons, Brokers shall verify that person purporting to act on behalf of the customer is so authorized.
- 3.5 Broker must ensure that accounts of Institutions/ body corporate are not opened in the individual name of any employee/ official. Government accounts should not be opened in the personal names of Government officials. Any such account, which is to be operated by an officer of 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 Brokers should obtain and document sufficient information on the purpose and intended nature of the account to be opened/ maintained with them and develop a profile of the customer based on results of customer identification and the risk assessment. Information regarding the intended investment plan of the customer must also be obtained to the extent possible and should be documented.
- 3.7 Brokers must obtain sufficient information to determine the expected source of funding for the account, particularly whether the client shall be receiving/ remitting funds in foreign currency.
- 3.8 In addition to the requirements mentioned above, Brokers must ensure that all receipts and payments to the customers above the prescribed threshold must be through cross cheques, bank drafts, pay orders or other crossed banking instruments. For exceptional circumstances where it becomes necessary for a broker to accept cash from a customer, reporting of such instances with rationale should be made immediately to the exchanges.
- 3.9 The brokers shall ensure physical presence of the customer at the time of opening of account. In case of off-shore clients or clients in cities where the broker does not have a branch, Broker must apply appropriate procedures, such as verification by a reliable third party, confirmation from previous broker of the clients etc. When obtaining confirmation from the third parties in different jurisdictions the

Annexure-B

Guidelines for the brokers for developing effective Know Your Customer (KYC) and Customer Due Diligence (CDD) policies and procedures

brokerage house must consider whether that jurisdiction is following the FATF recommendations.

4. Risk Assessment

4.1 The Brokers must perform a risk assessment of all the existing and prospective customers on the basis of information obtained regarding their identity, nature of income, source of funding, location etc and based on the results of such assessment, categorize their customers among high risk, medium risk and low risk customers. Brokers should develop clear guidelines for identification of High Risk customers which include:

- 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 businesses;
- 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) are individuals who are or have been entrusted with prominent public functions for example senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials. Business relationships with family members or close associates of PEPs involve reputational risks similar to those with PEPs themselves. The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories

Annexure-B**Guidelines for the brokers for developing effective Know Your Customer (KYC) and Customer Due Diligence (CDD) policies and procedures**

- 4.3 Broker should conduct a self assessment for money laundering and terrorist financing risk, identifying and documenting the key risks presented to it by virtue of its business model, types of customers and geographical placement

5. Enhanced Due Diligence

- 5.1 Brokers should apply Enhanced Due Diligence (EDD) when dealing with high-risk customers. Appropriate policies and procedures must be developed and put in place to ensure that activities and transactions of High-risk customers are adequately monitored and any unusual transactions are reported.

- 5.2 While dealing with the high-risk customers including the PEPs, the Brokers should:

- a) Obtain senior management approval for establishing business relationships with such customers. The same shall also apply in case of an existing customer which is classified as High-risk pursuant to these guidelines or which is subsequently classified as a result of ongoing due diligence;
- b) Take reasonable measures to establish the source of wealth and source of funds.

- 5.3 If the Broker is unable to comply with the above requirements, it should not open the account, or should terminate the business relationship, as the case may be and should submit a Suspicious Transaction Report.

6. When a Broker is not able to identify and verify the identity of the customer and the beneficial owner or is not able to obtain adequate information regarding the purpose and intended nature of the customer relationship, it should not open the account, commence customer relationship or in the case of an existing customer should terminate the relationship and consider the filing of a Suspicious Transaction Report.

7. On-going Due Diligence

- 7.1 CDD is not a one-time exercise. Brokers should ensure that on-going Due Diligence on the customer relationship and scrutiny of transactions is undertaken to ensure that the transactions executed in a particular account are consistent with the Broker's knowledge of the

Annexure-B**Guidelines for the brokers for developing effective Know Your Customer (KYC) and Customer Due Diligence (CDD) policies and procedures**

Customer, its business and risk profile, historical pattern of transactions and the pattern and source of funding of the account.

7.2 Brokers shall ensure that the customer records are updated at regular intervals and sufficient information is obtained regarding any significant change in the customer profile.

8. Simplified Due Diligence

8.1 Brokers shall 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 requirements 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 must be consulted. Simplified CDD should not be followed when there is an identified risk of money laundering or terrorist financing.

9. Compliance function

9.1 Brokers should set up a compliance function with suitable human resource and MIS reporting capabilities, enabling it to effectively monitor the clients' transactions and make timely reports.

Annexure-B**Guidelines for the brokers for developing effective Know Your Customer (KYC) and Customer Due Diligence (CDD) policies and procedures**

- 9.2 The Head of Compliance function must have skills and experience necessary for satisfactory performance of functions assigned. Head of Compliance must be independent and report directly to the Board of Directors.
- 9.3 The Compliance function shall ensure compliance with the requirements of these guidelines as well as other regulatory requirements applicable on the Broker under the relevant legal framework. A record should be maintained of all violation/ non-compliance identified and reported to the BoD and must be available for the inspection of Commission as and when required.

10. Data Retention

Brokers shall maintain the relevant documents obtained through the application of KYC/CDD procedures, especially those pertaining to identification of the identity of a customer, account files and correspondence exchanged for a minimum period of five years.

11. Training

The Brokers should develop an on-going employee training program to ensure that the employees understand their duties and are able to perform the same on a satisfactory level.

12. Screening

- 12.1 Brokers shall develop and implement appropriate screening procedures to ensure high standards while hiring staff. However, the screening process must be an on-going exercise and must be applied consistently to ensure that employees, particularly those working at sensitive positions, meet and maintain high standards of integrity and professionalism.
- 12.2 Brokers must provide any information concerning its clients and their transactions to the exchanges, Financial Monitoring Unit or the Commission as and when required.

Annexure-B**Guidelines for the brokers for developing effective Know Your Customer (KYC) and Customer Due Diligence (CDD) policies and procedures**

13. Other requirements

Brokers must comply with the requirements of Anti Money Laundering Act, 2010 as applicable on them, including the requirement to file Suspicious Transaction Reports and any directives, circulars, guidelines issued in this regard by Federal Government, Financial Monitoring Unit and SECP.