



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Adjudication Department-I
Adjudication Division

Through Courier

Before the Executive Director (Adjudication I)

Disposal of Show Cause Notice under Section 282J(1) read with Section 282M (1) of the Companies Ordinance 1984 for violations of inter-alia Regulation 38(1)(a) and Regulation 66A(c) and (d) of the Non-Banking Finance Companies and Notified Entities Regulations, 2008 along with Circular 23 of 2013.

Date of hearing:

January 17, 2020

Present (on behalf of NBP Fund
Management Limited)

- i. Dr. Amjad Waheed, CEO
- ii. Mr. Raheel Rehman, Head of Compliance

ORDER

This Order shall dispose of the proceedings against NBP Fund Management Limited ("NBP Funds", the "Company" or the "AMC"), which is a public limited company licensed to undertake the business of Asset Management and Investment Advisory Services initiated through Show Cause Notice (the "SCN") bearing No. SCD/ADJ/NBPF/44/2019/35 dated September 16, 2019 under Section 282M (1) of the Companies Ordinance, 1984 (the "Ordinance").

2. The brief facts of the case are that a "Complainant" approached the Securities and Exchange Commission of Pakistan (SECP or the Commission) with her complaint via the complaint management system on May 27, 2019 (Complaint No. 67883). The complainant has alleged that while persuading her to invest in the mutual fund, the relationship manager - NBP funds, at National Bank of Pakistan (the Distributor of NBP Funds), Rawalpindi Branch assured her that a profit of 12.5% (Rs.71,000 monthly) could be earned on her investment while keeping the principal amount intact/protected. Therefore, she invested an amount of Rs.5.7 million in NBP Islamic Sarmaya Izafa Fund (formerly, NAFA Islamic Asset Allocation Fund-NIAAF), in an asset allocation fund, on July 04, 2017. The complainant received monthly payments regardless of the performance of the fund under the impression that the monthly payment was actually the profit earned on her investment.

3. During the tenor of investment, an amount of Rs.1.286 million was paid to her in the form of monthly redemptions. The value of her investment at the time of redemption as on June 29, 2018 was Rs.3.81 million, which makes a total aggregate of Rs.5.096 million that was paid to the complainant as the redemption amount. The complainant has requested for recovery of a loss of



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around Rs.0.6 million on her principal investment along with the opportunity cost/profit which could have been earned during the period.

Further, the complainant also alleged that she was charged front-end load (FEL) of Rs.187,602 despite the fact that she was a walk-in customer.

4. The Company was called upon to show cause in writing as to why penal action should not be taken against the Company under Section 282J(1) read with Section 282M(1) of the Companies Ordinance 1984, for violations of inter-alia Regulation 38(1)(a) and Regulation 66A(c) and (d) of the Non-Banking Finance Companies and Notified Entities Regulations, 2008 ("the NBFC Regulations"). The regulations stipulate the following;

Regulation 38(1): Fiduciary responsibilities, - An Asset Management Company shall as applicable:

a) act in good faith and in the best interest of its unit/certificate holders without taking advantage for itself or any of its related parties, group companies or employees at the expense of its unit holders;

Regulation 66A: c) An Asset Management Company and distributor shall not:

i. involve either directly or indirectly in the mis-selling of Collective investment schemes;

ii. sell units of Collective Investment Scheme directly or indirectly by making a false or misleading statement;

iii. sell units of Collective Investment Scheme directly or indirectly by concealing or omitting material facts of the scheme; and

iv. sell units of Collective Investment Scheme directly or indirectly by concealing the risk factors associated with the scheme.

d) An Asset Management Company or distributor shall take reasonable care to ensure suitability of the scheme to the investor.

5. A written reply was received from the Company vide letter dated September 25, 2019, wherein the contentions made in the SCN were categorically addressed. The following arguments were provided in the reply:

2(a.) The investor was briefed about various products (Collective Investment Schemes) offered by the NBP Fund Management Limited (NBP Funds) along with the risks and returns associated with each CIS. After a detailed Risk Profiling of the investor, the investor decided

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to invest in NAFA Islamic Asset Allocation Fund — NIAAF (Current Name of the Fund: NBP Islamic Sarmaya Izafa Fund). Verbally and through our brochure, the investor was made aware of the fact that the subject fund invests in the Stock Market, which is volatile in nature. She was also made aware of the fact that the past performance of the fund is not necessarily indicative of the future results of the fund and the same disclaimer is mentioned in our marketing brochures as well.

2(b). You will appraise the fact that obtaining loan (RF Facility) by the investor from the National Bank of Pakistan and its utilization is the sole discretion of the investor. We did not facilitate or encourage the investor to take the loan.

2(c). Please note that no monthly fixed profit was committed or paid to the investor and when the investor requested for fixed payment of Rs.71,000 per month as per her requirements, she was informed by our sales facilitator that in case of fixed payment, the payment will be made by redemption of units which may deplete the principal amount invested. Knowing this, the investor submitted a special instruction form on July 10, 2017 whereby the fixed payment option was replaced with the growth option. In addition to this, the investor redeemed her investment through redemption forms from time to time in order to meet her personal needs. Further, our sales facilitator did not guarantee investment amount or any fixed return on the investment amount.

2(d). Please note that the investor used to redeem her investment as per her personal needs after signing the redemption form. It is pertinent to mention that the amounts redeemed by the investor by submitting duly signed redemption forms are of variable nature and not fixed as can be seen from the redemption forms. Further, please also note that the investor had selected "Cash Requirement" as reason for redemption in the duly signed form whereas the redemption form also included 'profitability of the fund' as an option. Had the investor intended to redeem profit only, she would have selected the option of "profitability of the fund" rather than "Cash Requirement".

3. As per SECP Circular 26 of 2015, the load charged on an investment shall not exceed 3% of the NAV per unit. Please note that as per the applicable tax laws; the Asset Management Company is required to withhold 13% SST on the amount of the Front End Sales Load charged. You will appraise the fact that how a client could invest Rs.5.7 million as a walk-in customer without obtaining the necessary information and understanding of the products. As stated in point 2(a), detailed discussions were made with the investor where features including the risk and returns of various products (CISs) were deliberated with the investor and the investment made was as a result of continuous efforts made by our sales facilitator. This fact is also admitted by the investor at point 2(c) of the show cause notice that the investment was made after detailed discussion with the sales facilitator where she was convinced for the said

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investment. Therefore, this investment cannot be treated as a walk-in customer and hence, there is no violation of SECP circular 26 of 2015.

4. As per Circular 26 of 2015, issuance of investment details to the investors are dependent upon the realization of investment proceeds. The investment was marked realized in our system on July 07, 2019 and the initial Statement of Accounts was issued to the investor within 48 hours of the realization of the funds in compliance with the SECP Circular. In addition to this, as per the SECP Directive 31 of 2016, the investor is entitled to exercise Cooling off rights on her investment within three (3) working days of the receipt of the initial account statement. This information is clearly mentioned on our redemption forms. Therefore, the investor's plea of not being able to exercise the Cooling off right seems inappropriate. Further, when the investor has the knowledge of Cooling off rights, how can it be established that the investor is not aware of the investments in mutual funds and its related risks and return criteria.

5. Although the investor was not considered as a walk-in customer, but as a matter of good will gesture the management of NBP Funds reimbursed the front-end load deducted on the investment of the subject investor. The Company did this on its own and not under any compulsion or instruction of any regulatory body. This is evident from the fact that the front-end sales load was reimbursed to the investor on May 16, 2019 while the NBP Funds received the notice issued by the Banking Mohtasib on September 12, 2019. Further, it is also mentioned in the Show Cause Notice that the complaint of the investor was received at SECP on May 27, 2019. Considering the above factors, it is clearly evident that the reimbursement of Front End Sales Load was made by the management on its own and not under any compulsion.

6 & 11. In order to ensure compliance of the SECP Circular 26 of 2015, the investor was forwarded with the Initial Statement of Accounts within 48 hours of the realization of the Funds. Subsequently, on July 10, 2017 the investor submitted Special Instruction Form (Form-7) where it was requested to mark the correspondence on Hold. Since, the correspondence was marked on Hold, therefore, no correspondence was made with the investor.

With regards to the authenticity of the Special Instruction Form, please note that the signatures of the investors were duly verified from the record before processing the instructions and the signatures of the investors were found legitimate.

With regards to the issue raised that the Special Instruction Form was processed in a different date than the Account Opening date, please be informed that the purpose of the Special Instruction Form (Form 7) is to update / change the details of investor's information provided



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at the time of Account Opening. Therefore, in all cases, the said form will be submitted by the investor after the date of the Account Opening.

7. The investor approached the Chief Executive Officer of NBP Funds and the matter was scrutinized in details. Although the deduction of Front-End Sales Load was legitimate, but the Chief Executive Officer instructed for the reimbursement of Front-End Sales Load as a good gesture to the investor.

8, 9 & 10. As mentioned in response to Point I above, please note that detailed discussion was made with the investor with regards to the risks and returns mechanism of various products being offered to the investor. As per the Risk Profiling Questionnaire duly signed by the investor [attached as Annexure 'K'], please note that the investor has mentioned "good knowledge of investments" and she has marked accepting of "Moderate Risk", therefore, the fund selected by the investor was exactly in accordance with the risk appetite of the investor. Therefore, there is no violation of SECP Circular 23 of 2013.

Further, there is no clause in the Account Opening or the investment form signed by the investor where the return is guaranteed or where the capital protection is assured, therefore, there is no violation of Regulation 66A(d) of the NBFC Regulations.

12. The submissions above clearly demonstrated that we have not violated Regulations 38(1) Regulation 66A(c) and (d) of the NBFC Regulations 2008 along with Circular 23 of 2013.

13. Finally, we humbly submit that Section 282J of the Companies Ordinance, 1984 imposes a penalty for any failure or refusal to comply with or contravention of the rules and directives of SECP in relation to Asset Management Companies. NBP Funds, as submitted above, has been enforcing the said Regulations both in letter and true spirit and with due vigilance. Therefore, it cannot be said that there has been any institutional lapse of compliance with the Regulations. Furthermore, the customer always has the option of claiming redress from NBP Funds, which it promptly gives for lawful claims, so no harm is done to the investors in any case.

6. The hearing in the matter took place on January 17, 2019 wherein Dr. Amjad Waheed, CEO, and Mr. Raheel Rehman, Head of Compliance appeared on behalf of the Company. They reiterated their assertions contained in the written reply.

7. I have analyzed the facts of the case, considered the documentary evidence placed on record, and the arguments put forth by the Respondent Company. I am of the considered view that the submissions by NBP Funds are not plausible on the following grounds:





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- a. It is the key responsibility of an Asset Management Company or distributor to carry out adequate diligence while assessing the risk profile of an investor. It could not be demonstrated by the arguments furnished by the company whether the risk assessment was done accurately and whether the scheme offered was in conformity with the assessment. The above justifications fail to indicate what procedures have been adopted by NBP funds to check incidence of mis-selling by the sales representative. Moreover, the above contentions of NBP funds also do not substantiate whether risk disclosures in the requisite forms are adequate vis-à-vis content and language, which leaves much room for the sales team to mis-sell the products. All the above mentioned indicate that the AMC is susceptible to violate Regulation 66A(d) of the NBFC and NE Regulations 2008.
- b. It is a generally understood fact that for an investor it is challenging to understand the dynamics of mutual funds without adequate support and guidance from the seller. This is adequately demonstrated by the statutory provisions making it incumbent on the AMC to take due care in their selling practices. It is, therefore, the responsibility of the AMC that members of its sales team have the capacity to evaluate the level of awareness of the customers with the dynamics of the mutual funds/capital market and the associated risks. In the instant case the fact that the complainant was a housewife, was just a graduate and her only source of income were the DSCs, was completely ignored. It is apparent from the aforesaid that the complainant was wrongly placed in moderate category vis-s-vis the risk profile. Furthermore, the respondent has been unable to demonstrate that its sales representative explained the product and elaborated upon the associated risks before having the form filled out. However, in the instant case it appears that the sales representative did not explain the product to the complainant adequately and sold the units of the scheme by concealing material facts and risk factors associated with it, thereby violating Regulation 66A(c)(ii)(iii) and (iv) of the NBFC and NE Regulations 2008.
- c. NAFA Islamic Asset Allocation Fund-NIAAF remained largely invested in equity funds since the average investment by NIAAF in equity funds from July 2017 to July 2019 was 53.88% indicating it to be an aggressive allocation fund. It has been submitted that the complainant's risk tolerance, as assessed by the AMC, was 'Moderate' while the recommended investment solution for such a moderate risk tolerant customer, as per NBP Fund's risk profiling criteria is NAFA Islamic Asset Allocation Fund. It has already been elaborated that the profile of the customer matched low risk profiling hence a scheme invested in equity funds to extent of 53.88% for a period of two years, offered to a customer did not match her risk profile. It is apparent that the fact that the fund had aggressive allocation rather than conservative or moderate allocation, was deliberately





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ignored. I am of the considered view that suitability of the plan offered to the complainant had not been assessed appropriately, as an asset allocation plan with aggressive allocation towards equity securities was offered to the complainant, despite the fact that NBP Funds had assessed the risk tolerance level of the complainant to be moderate. This clearly shows the AMC failed to take reasonable care to ensure suitability of the scheme for the complainant, hence constituting violation of Regulation 66A (d) of the NBFC and NE Regulations 2008.

- d. Compensating the loss as a result of deduction of the front-end load incurred by the complainant, does not imply that the incidence of mis-selling did not occur. In order to lock in the sale, the practice of some sales agents to highlight the returns more without highlighting the associated risks and explaining potential downside of investing in mutual funds would be a case of mis-selling. In the instant case, the complainant had invested an amount through a Relationship Manager - NBP funds, who had assured her a monthly profit of Rs.71,000/- along with principal protection which constitutes mis-selling in violation of Regulation 66A (c) (i) of the NBFC and NE Regulations 2008.
- e. The contention, of the AMC that no monthly profit or fixed periodic payments were made to the investor and whatever, payments she received were redemptions duly authorized by her, is not plausible. It has been observed from the account statement of the complainant that for ten months, starting from August 2017 to May 2018, amounts of Rs.71,000/- tabulated below, has been paid regularly, until she redeemed the entire investment:

Sr. No.	Month	Amount Rupees
1	May 2017	71,000
2	August 2017	20,000
3	August 2017	71,000
4	September 2017	71,000
5	September 2017	120,000
6	November 2017	71,000
7	December 2017	125,000
8	April 2018	71,000
9	May 2018	0
10	June 2018	120,000
11	June 2018	All units



- f. The pattern of redemption payment adequately reflects that these payouts could be assumed as profit payments in line with sales pitch made to her. As regards the signature on redemption forms the respondents could not demonstrate that the complainant was explained the meaning redemption and furthermore, the redemption forms also lack the

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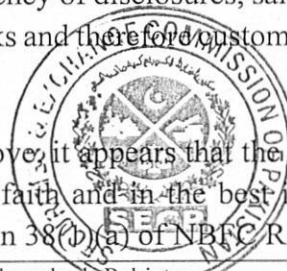
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clarity that payment as a result of submission of the said form would result into payment out of the principal invested. As regards the contention that the complainant could have selected "profitability of the fund" rather than "Cash Requirement", I would again emphasize that the language used is ambiguous and its interpretation would depend upon the sales pitch made to the complainant. In these circumstances, I am compelled to look at the larger picture in the backdrop of a sales pitch of risk-free investment with fixed monthly returns and the customer authorizing redemption without understanding the meaning thereof. Furthermore, the monthly payouts also maintained a facade that the complainant had been earning profit for all those months.

- g. The enquiry team reviewed the 'Hold Mail' Form/Special Instruction form and it was observed that signatures of the investor showed stark differences on the hold mail form. The complainant has also vehemently denied signing any such form.
- h. I am of the view that NBP Funds could not demonstrate that as a usual course of business efforts are made by the sales teams to explain the products to the customers by giving out brochures/offering documents or explaining the terms and conditions or the disclaimers to the best satisfaction of the customers. Furthermore, since the distributor is also selling the products of the AMC, it is imperative to ensure that the sales representatives are fully equipped with complete information pertaining to all the products the AMC is offering. The sales representatives must be able to guide the investors regarding the suitability of the products being pitched, in line with the risk profile of that particular investor.
- i. Moreover, I have observed that the expression/language of the disclaimers lack transparency and are difficult for a customer to understand and need to either be reworded in simple English/Urdu or be fully explained by the sales team while selling the products, in order to curtail any probability of mis-selling. The risk disclosure on the risk profiling questionnaire form where the customer is required to sign off the allocated risk rating is indicative of the fact, where it is mentioned, "All investments in mutual funds are subject to market risks", without mentioning the probability of loss/depletion of the principal investment that could occur as a result of market volatility. The disclosure further advises to read the offering document to understand the investment policies and risks involved. Due to lack of transparency of disclosures, sales agents tend to highlight the returns more than the associated risks and therefore customers are unable to make informed decisions.

8. In pursuance of the details of instances referred to above, it appears that the Company has failed to perform its fiduciary responsibility to act in good faith and in the best interest of the unitholder, hence contravening the requirements of Regulation 38(b)(a) of NBFC Regulations.



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9. In view of the foregoing, I hereby impose a fine of Rs 500,000/- (Rupees Five hundred thousand only) on the Respondent Company who has been issued SCN under Section 282J(1) read with Section 282(M)(1) of the Companies Ordinance, 1984, for contravention of the Regulation 38(1)(a), Regulation 66A(c) and (d) of the NBFC Regulations.

10. Investor confidence is the key for flourishing of the mutual fund industry. An AMC can inspire this confidence by being fair and transparent in its dealing with its customers and ensuring that the fairness and transparency is demonstrated through its conduct. It is the right of the investor who has entrusted his/her funds with an AMC that their grievances, if any, would be analysed with the open mind for not only its redressal, but to identify weaknesses in the systems and processes and for improvement therein to avoid future misunderstandings. It is my considered opinion that redressal of investors' grievances is extremely important for the Regulator to regulate the capital market. If the grievances are not redressed amicably and within a reasonable time, it leads to frustration among the investors who may be demotivated and stop further investments in the capital market. Therefore, I hereby refer the matter to the Supervision and Enforcement Department of SCD, who may issue Direction to the AMC for making good the complainant's loss in exercise of powers conferred to them under Section 282D of the Companies Ordinance 1984.

11. NBP Funds should develop internal controls and procedures for supervising staff at the branch and head office to ensure that mis-selling does not occur and proper risk profiling of investors has been done prior to their investment.

12. This order is issued without prejudice to any other action that the Commission may initiate against the Company in accordance with the law on matter subsequently investigated or otherwise brought to the knowledge of the Commission.

13. In terms of the above, the instant SCN is disposed of.



(Ali Azeem Ikram)

Executive Director (Adjudication-I)

Announced on
February 12, 2020