



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 26 of 2015

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" / the Respondent), 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/46/2019/55** dated **October 25, 2019** under Section 282J (1) and 282M (1) of the Companies Ordinance, 1984 (the "Ordinance").

2. The brief facts of the case are that a "Complainant" approached the Banking Mohtasib with her complaint dated **August 21, 2019**, which was also forwarded to SECP and was registered on Service Desk Management System (SDMS) as **Complaint No 75154**. The complaint was referred to Supervision and Enforcement Department, Specialized Companies Division (SCD) of the Securities and Exchange Commission of Pakistan (SECP or the Commission) on **August 21, 2019** for detailed scrutiny, after initial examination of the complaint by the Policy, Regulation and Development Department of SCD. SCD-S&ED observed violations of Regulation 38(1) (a) and Regulation 66A(c) and (d) of the Non-Banking Finance Companies and Notified Entities Regulations, 2008 (the NBFCE Regulations) and referred the matter to the Adjudication Division for necessary enforcement action.

3. The complainant invested an amount of **Rs. 500,000/-** in **NBP Islamic Active Allocation Plan VIII (NIAAP-VIII)**, an asset allocation plan, during its pre-IPO period on **October 07, 2017**. The plan started its operation in **November 2017**. The investment was made through a sales representative of NBP Funds at National Bank of Pakistan, Rawalpindi, (a distributor of NBP Funds).

4. The complainant was a graduate, a housewife and was interested in investing her meagre savings. The complainant has alleged that while convincing her for investment, the sales representative assured her that a profit of **Rs. 5,400/-** would be paid on her investment on monthly basis while the principal amount will remain intact/protected. However, she was charged Front End Load (FEL) of **Rs.16,950/-** despite the fact that the subject investment transaction was conducted by the complainant as a walk-in customer. The periodic payments were made to the Complainant in the following manner, by obtaining signatures on redemption forms from the Complainant.





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Date of payment	Amount paid as profit (Rs)	Tenure of profit payment
20 November 2017	5400	1 month
27 February 2018	16200	3 months
1 June 2018	10800	2 months
31 October 2018	27000	5 months

5. The complainant incurred a loss of around **Rs.116,325/-** on her principal investment along with the opportunity cost/profit which could be earned during the period. A summary of her account statement is as under:

Description	Amount (Rs.)	Date
Investment Amount	500,000	07/10/2017
Redemptions as periodic payments	5,400	20/11/2017
	16,200	02/03/2018
	10,800	04/06/2018
	27,000	31/10/2018
Complete redemption from the fund	244,045	17/7/2019
Total redemptions	303,445	-
Investment value on Aug 19, 2019	80,230	19/8/2019
Net Loss on August 19, 2019 (Investment - Redemptions - Existing investment value)	116,325	-

6. 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 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;

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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

7. 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). Initially, 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 on October 09, 2017. After convincing the investor for the investment, the investor intended to invest Rs. 500,000 in NBP Funds. Subsequently, a detailed Risk Profiling of the investor was carried. The Investor decided to invest in NAFA Islamic Active Allocation Plan VIII — NIAAP VIII. Verbally and through the term sheet of NIAAP VIII, 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 related plans is not necessarily indicative of the future results of the plans.

2(b). Since the investor decided to take moderate level of risk and the Stock Market declined during her investment period, she experienced a loss, along with our several other investors who had invested in the 'Moderate' or 'High' Risk categories.

2(c)&(d). Please note that no capital protection or monthly fixed profit was committed or paid to the investor during the tenure of her investment. The investor redeemed her investment through redemption forms from time to time in order to meet her personal needs. At the time of making an investment with NBP Funds, the Investor selected the option for Unit Type as "Growth Unit" in the Investment Form which signifies that the investor herself agreed not to receive any fixed sum of money at regular intervals.

2(e). No periodic payments were made by NBP Funds as the investor had marked 'Growth Units'. The investor herself made some redemption transactions of various amounts as per her needs. Further, please note that the investor has selected "Cash Requirement" as reason for redemption in the form duly signed. It is pertinent to mention that the reasons on the redemption form also include the "Profitability of the Fund". If the investor was redeeming just profit, she would have selected the option of "profitability of the Fund" rather than "Cash Requirement". This explicitly implies that the investor was making redemptions from the principal invested.



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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. It is notable that in order to approach investors for convincing them to make investments with NBP Funds, as a general market practice, lists of potential investors together with their contact numbers to be targeted are obtained from various sources by our Sales Staff all over Pakistan. In the subject matter, the investor was approached by our Sales Staff and was briefed about various products (Collective Investment Schemes) offered by the NBP Fund Management Limited (NBP Funds). She showed interest to invest Rs. 500,000. She was asked to visit the branch on October 09, 2017 where the meeting was conducted. Since, the investor was approached by our sales staff, this investor was not classified as "Direct Approach / Walk In Customer" in accordance with SECP Circular 26 of 2015. Therefore, there is no violation of the said circular.

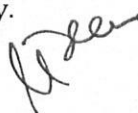
4. We will reiterate that no Capital Protection or monthly Fixed Profit was committed or paid to the investor during the tenure of her investment. By providing the term sheet of the Plan, no concealment of the material facts of the scheme and the related risk factors was made and hence, there is no violation of Regulation 66A(c) of the NBFC Regulations.

5. As stated earlier, appropriate risk profiling was carried out prior to the selection of Fund for investment. The Investor was asked various questions in order to assess her risk sphere. The answers of the investor were noted in the Risk Profiling Questionnaire. As per the risk profiling questionnaire, please note that the investor has mentioned "average knowledge of the investments" and she has marked accepting of "Moderate Risk". However, the investor selected "Low to Moderate Risk" Category Fund for her investment. This is evident of the fact that the investor has not crossed her risk sphere as determined by the Risk Profiling Questionnaire 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.

6. The submissions above clearly demonstrate that we have not violated Regulations 38(1) (a), Regulation 66A(c) and (d) of the NBFC Regulations 2008 along with Circular 26 of 2015.

7. 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 spirit strictly and with 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.

8. 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.



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9. 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:

- 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. The company was unable to demonstrate through its arguments 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 increases the probability for the sales team to mis-sell the products. All the above mentioned indicate that the AMC is susceptible to violate Regulation 66A(c)(ii) 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 with little knowledge of the capital market, 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. The average investment by NIAAP-VIII in equity funds from July 2017 to July 2019 was 38% indicating it to be a moderate 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 38% for a period of two years, offered to a customer did not match her risk profile. 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. 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

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monthly profit of Rs.5400/- 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 is not plausible. It has been observed from the account statement of the complainant that starting from November 2017 to October 2018, amount of **Rs.5,400/-** has been paid periodically, until she redeemed the entire investment. The redemption forms and the account statements are enough evidence to ascertain that payments were made to the complainant according to what had been pitched to her while investing her funds. The argument furnished by the AMC at para 2(c&d) above, that no monthly fixed profit was committed or paid to the investor, is hence refuted.
- 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. Moreover, the respondents could not demonstrate that the complainant was explained the meaning redemption and furthermore, the redemption forms also lack the 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 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. 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.
- h. 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 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.



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10. To conclude, it is important to take into account that the complainant was merely a housewife, oblivious to the dynamics of the capital market and mutual funds/plans, and had invested her savings for the purpose of growth. In pursuance of instances referred above, I am of the considered view that NBP Funds is responsible for selling such a product to the complainant, which was neither suitable nor in consonance with her risk assessment. NBP Funds has not acted in the best interest of the complainant and is hence responsible for the losses incurred to the Complainant in violation of above-mentioned NBFC Regulations.

11. The AMC needs to ensure that the investor understands the decision he/she is taking in choosing a high-risk product and to this effect, should take proper acknowledgment from investor for his/her selection. Fact of the matter is that investors only listen to what the sales representative is pitching and seldom read what is written on the forms. Question is what steps are taken by the AMC to actually make the investors understand what their investment decision entails and to ensure that they have fully understood the upside and downside of the investment along with the associated risks. The complainant's claim that the sales representative had guaranteed profit and preservation of capital cannot be completely overlooked. Some instances have come to the knowledge of SECP with similar assertions against NBP Funds and warrants that NBP Funds makes extra efforts to curtail the instances of mis-selling. The AMCs should consider to modify and explicitly indicate risk levels of all the plans while placing asset allocation funds /plans in the moderate-risk category.

12. In view of the foregoing, I hereby impose a fine of **Rs. 750,000/- (Rupees Seven Hundred and Fifty 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. The aforesaid fine must be deposited in the designated bank account maintained with MCB Bank Limited in the name of SECP within seven days from the receipt of the order. The receipt or bank challan is to be furnished to SECP.

13. 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 process and 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.

14. 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

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has been done prior to their investment. The respondent should be proactive and make efforts that instances of mis-selling by its employees are minimized and should take concrete measure to that effect such as: -

- Sales materials/forms in language understood by investors;
- Customer verification call mechanism.

15. 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.

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

(Ali Azeem Ikram)
Authorized Officer/
Executive Director (Adjudication-I)



Announced on
February 28, 2020