Securities and Exchange Commission of Pakistan

BEFORE THE APPELLATE BENCH

In the matter of

Appeal No. 126 of 2020

UBL Fund Managers Limited

..... Appellant

versus

1. Mr. Tariq Hussain
2. Mr. Muhammad Younas
3. The Securities and Exchange Commission of Pakistan

.....Respondents

Date of hearing: May 16, 2024

Present:

For the Appellant:

1. Mr. Yasir Qadri (CEO)
2. Mr. Hadi Hassan Mukhi (Head of Risk & Compliance)

For the Respondents:

1. Mr. Mahboob Ahmed, Additional Director, Adjudication -I, SECP
2. Ms. Asima Wajid, Additional Joint Director (Adjudication-I), SECP

ORDER

1. This Order shall dispose of Appeal No. 126 of 2020 filed by UBL Fund Management Limited (the Appellant) against the Order dated September 4, 2020 (the Impugned Order) passed by the Executive Director, Adjudication Department-I, Adjudication Division, SECP (the Respondent No. 3) under Section 282J(l) read with Section 282(M)(l) of the Companies Ordinance, 1984 (the Ordinance), for contravention of Regulations 66A(c)(i), 66A(c)(iv), 66A(d) and 66A(f) of the Non-Banking Finance Companies and Notified Entities Regulations, 2008 (the Regulations).

2. The brief facts of the appeal are that the Appellant is an unlisted public limited company licensed to undertake the business of asset management and investment advisory services. The Respondents

No. 1 and 2 lodged complaints against the Appellant through the complaint management system (SDMS) of the Securities and Exchange Commission of Pakistan (SECP) which were referred to the Supervision and Enforcement Department, Specialized Companies Division of SECP for detailed scrutiny. After initial examination of the complaints, the Appellant was found to have incurred several violations of the Regulations.

3. In light of the aforementioned violations of the requirements of the Ordinance and Regulations, the Show-Cause Notice (the 'SCN') dated January 23, 2020 was issued to the Appellant, requiring the Appellant to explain its stance. Subsequently, the Appellant submitted its written response to the SCN vide its letter dated February 03, 2020. Hearing on the matter was held on February 06, 2020, and after hearing the Appellant, the Respondent in exercise of powers delegated, held that the Appellant has violated Regulation 38(2)(b), 66A(c)(i), 66A(c)(iv), 66A(d) and 66A(f) of the Regulations and therefore imposed a penalty of Rs. 400,000/- under section 282J(1) read with section 282(M)(1) of the Ordinance, through the order dated September 04, 2020 (the Impugned Order).

4. The Appellant has challenged the Impugned Order *Inter alia* on the grounds that there was no fault whatsoever on the part of the Appellant or its Relationship Manager. The Appellant further stated that it had tried to contact each of the Respondents No. 1 and 2 by voice call for the 'welcome call' which would have dissipated any misconceptions, however, despite repeated attempts no contact was established. The Appellant stated that the Respondents No.1 and 2 had duly signed the initial investment form and account opening forms (AOF) which contained adequate disclosures of investment synergies, advantages and risk factors involved in the investment. The Appellant stated that, according to the risk assessment, the risk score of Respondents No. 1 and 2 was deemed as moderate, which is why they were suggested to invest in the plan(s) which best matched their risk assessment. The Appellant stated that risk profiling was entirely based on the information provided by the Respondents No. 1 and 2 and it was performed in line with the legal framework existing at the time of investment, therefore, the Appellant had not violated the requirements of the applicable law. The Appellant stated that Respondents No. 1 and 2 also signed an undertaking acknowledging the risks of investment, therefore, in the presence of documentary evidence and

signed investment forms, it cannot be assumed that Respondents No. 1 and 2 were compelled by the Appellant's Relationship Manager to invest in the Plan unsuitable to their requirements.

5. The Appellant submitted that its efforts to ensure compliance with SECP's Circular 23 of 2013 along with Regulations 66A of the Regulations were entirely ignored in the Impugned Order, despite the fact that adequate risk profiling of Respondents No. 1 and 2 was carried out before investment. The Appellant stated that the allegation regarding misleading investment and verbal assurances in respect of the guaranteed returns is without any evidence. The Appellant submitted that imposition of penalties on the Appellant merely on the basis of allegations by the investors will open floodgates for claims against the asset management companies and all investors will seek to get out of their unprofitable investments by alleging mis-selling.

6. The Appellant stated that the 'Debit Authority Form', which was also signed by the Appellant as part of the investment procedure, clearly describes and refutes the claim that mutual funds (Plan) are sold as banking products. The Appellant stated that Respondent No. 3 erred in law by not acknowledging and applying the doctrine of "Caveat Emptor" (buyer beware) which requires that the Respondent No.1 and 2 should have acted with due care while investing in the Plan.

7. The Appellant has further stated that at the relevant time, due to the absence of any specific mandatory risk assessment mechanism, the Appellant prepared its own need/ risk assessment mechanism, therefore, it cannot be alleged that the risk assessment mechanism of the Appellant was inadequate. The Appellant also stated that although it was not required by law, however, risk disclaimers in the AOF and initial investment form contained the requirements laid down by SECP's Circular 16 of 2014. Furthermore, the Appellant stated that, for the first time, Respondent No. 3 provided risk assessment guidelines vide Circular No. 2 of 2020 dated February 6, 2020, and since then it has been complying with such guidelines. The Appellant argued that the term sheet of each investment plan opted by Respondents No. 1 and 2, very clearly and explicitly states that it will invest in Pakistan Stock Exchange Limited and in equity investments. The Appellant denied the allegations of mis-selling [Regulation 66A(c)(i)], suitability of the Plan

[Regulation 66A(d)], concealment of risk factors [Regulation 66A(c)(iv)], and vague promotional material [Regulation 66A(f)] are baseless and without any proof.

8. Respondent No.3 rebutted the grounds of appeal and stated that the Appellant's Relationship Manager failed to offer a suitable investment plan to Respondents No.1 and 2, therefore, it should not take refuge behind the fact that the Respondents No. 1 and 2 did not receive the 'welcome call' in which terms of the investment were to be explained. Respondent No. 3 stated that investors only adhere to what the sales representative is pitching and seldom read what is written on the forms, therefore, it was the responsibility of the Appellant to actually make the investors understand what their investment decision entails and to ensure that they have fully understood the 'pros and cons' of the investment. Respondent No. 3 admitted that although no evidence was provided by Respondents No. 1 and 2 regarding mis-selling and guaranteed returns on investment, however, the allegation that the sales representative had guaranteed profit and preservation of capital, cannot be completely overlooked. Respondent No. 3 contended that, as a common phenomenon in the mutual fund industry, invariably sales agents highlight the returns without explaining the associated risks and potential downside of investing in mutual funds. Respondent No. 3 stated that the sales representative persuaded the Appellant to sign the relevant forms by concealing the associated risks of investment. Respondent No. 3 further stated that the Impugned Order has been passed after considering the written and oral submissions made by the Appellant in addition to the available documentary evidence.

9. Respondent No. 3 stated that, in this case, as per the Appellant's own assessment, Respondents' No. 1 and 2 investment knowledge was basic since both of them were only graduates/undergraduates and they had no experience of investment in the capital market. Respondent No. 3 stated that although the risk profiling of Respondents No. 1 and 2 was based on the information provided, however, it was the Appellant's responsibility to ensure that Respondents No. 1 and 2 were well aware that the selected product was not suitable for them. Respondent No. 3 contended that the 'risk appetite' column in the need assessment form had not been allocated a correct score and keeping in view the other considerations/criteria given in the form and scoring given against them, prudence demanded that the risk appetite column be scored as 'low' rather than 'moderate'. Respondent No. 3 further stated that merely incorporating associated risks and

disclaimer as per Circular No. 16 of 2014 does not absolve the Appellant from the responsibility unless such facts are effectively communicated to the investor. Furthermore, Respondent No. 3 stated that the Appellant performs a licensed and regulated activity and the relationship of the Appellant and its clients is based on trust and clients entrust their funds to the Appellant and with the expectation, that the advice given to them and investments made on their behalf are in their best interest. Respondent No. 3 stated that Circular 2 of 2020 merely codifies the implied role of an AMC.

10. Respondent No. 3 stated that the claims of the Appellant that sufficient steps were taken to inform Respondents No. 1 and 2 of the risks associated with the investment, is not acceptable because as per Appellant's assessment Respondents No. 1 and 2 had no prior experience in equity investments and their investment knowledge was basic. Respondent No. 3 stated that although a 'moderate' risk tolerance level was assigned to Respondents No. 1 and 2, whereby capital protection was guaranteed, however, due to aggressive investment in equity, the capital investment was eroded.

11. The Appellate Bench (the Bench) has heard the parties and perused the record including the grounds of appeal and written comments of Respondent No. 3. The Bench is of the view that sales agents should appropriately advise the investors for the investment decision and adequately highlight the associated risks and potential downside of equity investment through mutual funds. After reviewing the record, it has come into the knowledge of the Bench that Respondents No. 1 and 2 had made the investments without later responding to a 'welcome call' that was intended to inform them of the risks and exposure involved. The Bench believes that, if Respondents No. 1 and 2 had been deceived by the Appellant's relationship manager/sales staff, they should have made the investment decision after analysing all the information about the risks associated with investing in equity and also should have been more vigilant with regard to the 'welcome call' by the Appellant, as required by the "Caveat Emptor" (buyer beware) doctrine, which holds Respondents No. 1 and 2 responsible for their investment decision. In view thereof, the Bench believes that Respondents No. 1 and 2 also failed to proceed vigilantly, however, this fact does not completely absolve the Appellant.

12. The Bench is of the view that the purpose of the need assessment section of the AOF is to determine the suitability of a person for investments, however, the Appellant has failed to proceed in the required manner and in result, thereof, a major portion of the investments of Respondents No. 1 and 2 were allocated to the 'high-risk' equity fund (average investment in equity funds during the Plan duration remained 66.11%). The Bench has noted that the 'risk appetite' column in the need assessment form of the Appellant had not been allocated a correct score, and given other considerations/criteria given in the form and scoring against them, prudence demanded that 'risk appetite column' to be scored as 'low', rather than 'moderate'. It is important to note here that in the AOF, the equity investment solution has been provided for a high tolerance level client. The Bench is of the view that regardless of the incorrect risk tolerance scoring, instead of offering a capital protection fund, they had been guided to an equity fund.

13. The Bench endorses the Appellant's stance that at the time when Respondents No.1 and 2 made the investment there was no specific law requiring it to consider specific risk categorization and the same were introduced vide Circular No. 2 of 2020. However, the Bench is of the view that this matter is not whether the Appellant failed to follow any specific risk categorization, the allegation against the Appellant is that it failed to accurately categorize the risk tolerance level of Respondents No.1 and 2 as per the given data and information. The Bench does not doubt that the Appellant had failed to understand the object of AOF and admitted a major portion of the investment of Respondents No. 1 and 2 investment in an equity fund. The Bench is of the view that AOF was not a mere formality rather it was a key document to determine the investment tolerance level of Respondents No. 1 and 2. The Appellant's Relationship Manager/sales staff committed serious irregularities in this regard. The sanctity of the AOF cannot be undermined and it appears to the Bench that the Appellant also has no mechanism to check and verify the accuracy and suitability of data provided by the Relationship Manager/sales staff to avoid incidents of incorrect risk categorizations.

14. The Bench rejects the Appellant's plea that any adverse decision in this appeal may undermine the growth of the mutual funds industry in Pakistan. The Bench is of the view

that while protecting the growth of mutual funds or other regulated activities, the Securities and Exchange Commission of Pakistan (the Commission) cannot overlook the violations committed by the regulatees and especially where cases of investor exploitation by the regulatees are evident. The Bench is of the view that as per the requirements of the Securities and Exchange Commission of Pakistan Act, 1997, the Commission has the responsibility to protect both, whether it is a regulated entity or an investor.

15. In view of the arguments put forth by the parties, the Bench is of the view that the doctrine of "Caveat Emptor" (buyer beware) applies to the case at hand as it has been established that the Respondents No. 1 and 2 did not respond to the 'welcome calls' made by the Appellant and in case these calls had been received, Respondents No. 1 and 2 would have been better aware of the risks associated with their investments. The Appellant cannot avoid its fiduciary duty towards its customers by merely relying upon the 'welcome calls' to inform customers of the risks associated with their investments as at the time of the submission of the AOF, the Relationship Manager of the Appellant should have clearly explained the risks involved with the investments to their customers.

16. In view of the foregoing, the Bench considers it justified to convert the penalty into a warning with a direction to the Appellant to ensure comprehensive training of its distributor/sales staff and take disciplinary action against any officer involved in mis-selling of any product of the Appellant. The instant Appeal is disposed of on above terms without any order as to costs.

(Akif Saeed)
Chairman/Commissioner

(Abdul Rehman Warraich)
Commissioner

Announced on: 09 OCT 2024