

Securities and Exchange Commission of Pakistan

BEFORE THE APPELLATE BENCH

In the matter of

Appeal No. 25 of 2019

Army Welfare Trust Investments Ltd.

...Appellant

versus

- i. Commissioner (Specialised Companies Division)
- ii. Mr. Zahid Oosman

...Respondents

Date of Hearing: 19/11/20

Present:

For the Appellant (via Zoom Video Conferencing):

- i. Mr. Haroun Sharif, Counsel
- ii. Mr. Salman Haider Sheikh, CEO AWT Investments Ltd
- iii. Mr. Rizwan Faiz, Counsel

For the Respondent No.1 (via Zoom Video Conferencing):

- i. Ms. Tanzila Mirza, Additional Director (Adjudication-1)
- ii. Mr. Khawaja Abdul Moeed Ahmad, Deputy Director (Adjudication-1)

For the Respondent No.2 (via Zoom Video Conferencing):

- i. Ms. Natalya Kamal, Counsel
- ii. Mr. Hasan Adnan, Counsel

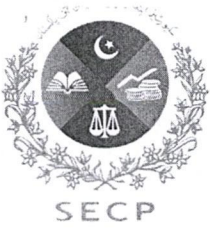
ORDER

1. This Order is passed in the matter of Appeal No. 25 of 2019 filed under section 33 of the Securities and Exchange Commission of Pakistan Commission Act, 1997 (the SECP Act) against the order dated 18/04/19 (the Impugned Order) passed by Commissioner (Specialized Companies Division) (the Respondent No.1).

Appellate Bench

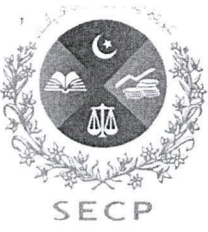
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2. The brief facts of the case are that upon receipt of a complaint on 31/08/18 from Mr. Zahid Oosman (the Respondent No.2), an enquiry was ordered under section 282I of the Companies Ordinance, 1984 (the Companies Ordinance) vide Order dated 19/11/18.
3. The Show Cause Notice dated 08/01/19 (the SCN) was issued to Army Welfare Trust Investments Limited (the Appellant) to show cause in writing by 18/01/19 as to why penal action may not be taken for alleged violations of Regulation 38(1)(a), 38(2)(b) and 38(2)(l) of the Non-Banking Finance Companies and Notified Entities Regulations, 2008 (the NBFC Regulations) and Circular 26 of 2015. The Appellant submitted its reply vide letter dated 17/01/19 and an opportunity of hearing in the matter was provided on 23/01/19.
4. The Respondent No.1 dissatisfied with the response of the Appellant held that the arguments provided by the Appellant are not tenable. The Respondent No.1 further held that leniency on non-compliance towards requirement of NBFC Regulations 38(1)(a), 38(2)(b), 38(2)(l) and Circular 26 of 2015 is not possible as safeguarding the investors' interest is the paramount and supreme objective of the Securities and Exchange Commission of Pakistan (the Commission). Therefore, under section 282J(l) read with section 282M(l) of the Companies Ordinance an aggregate fine of Rs 1,000,000 was imposed on the Appellant. Moreover, in exercise of powers conferred under section 282D of the Companies Ordinance, the Appellant was directed by the Respondent No.1 to make good the investors' losses since the losses had been caused due to the fraudulent as well as irresponsible conduct of its employees' and in terms of Regulation 38(2)(b) of the NBFC Regulations, the Appellant was held responsible for the acts and omissions of all persons whom it may delegate any of its functions.
5. The Appellant preferred the instant appeal *inter alia* on the following grounds:
 - a) The Impugned Order's basis is solely based on Respondent No.2's allegations whose veracity has been taken as prime facie true, without an examination of the facts. The Impugned Order lacks even a cursory reference to any facts discovered by the Respondent No.1's investigation, if any, which support the Impugned Order's punitive action against the Appellant.



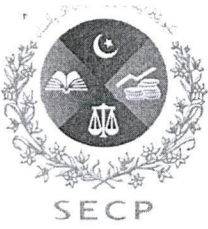
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b) The Appellant was known as Primus Investment Management Limited (the PIML) before shareholding in the Appellant was acquired from Pak Brunei Investment Company (the PBIC) by the Army Welfare Trust (the AWT) in 2017. This transaction was completed through a Share Purchase Agreement (the SPA) and Shareholders Agreement both dated 14/12/16 where AWT bought 70% of PIML's shares. The SPA through an amendment dated 23/07/18 included an indemnity in favour of the Appellant against any acts of fraud committed by the Appellant while it was managed by PBIC. Subsequently, through a second SPA dated 06/01/18, the Appellant bought the remaining 30% shares in PIML from PBIC. The Respondent No.2, his brother Mr. Shahid Oosman and Oosman Brothers Hard Board (Pvt.) Ltd., (Oosman Brothers (Pvt.) Ltd.) through their letter dated 20/02/18 have alleged that Mr. Shahzad Kaimkhani, their former account manager (Mr. Kaimkhani) made unauthorized withdrawals from their accounts and without authorization converted their investments from low risk (income funds) to high risk funds (equity funds) and that Mr. Kaimkhani embezzled Rs 5.8m through two separate redemptions to a 3rd party by forging the Respondent's No.2 signatures on fake authority letters. It must be emphasized that in the period in which Mr. Kaimkhani's purported acts took place, the operation of the Appellant's Administration, Human Resource, Information Technology, and Internal Audit departments were outsourced to PBIC under a Shared Services Agreement (the SSA) dated 01/10/14. The said SSA included an indemnity against liabilities arising out of PBIC's failure to properly carry out their work. The Appellant further launched an investigation into the Respondent No.2's allegations and the Board of Directors in its 32nd meeting on 27/04/18 engaged Deloitte Yusuf Adil Chartered Accountants (the Deloitte) to conduct a preliminary audit into the allegations. Subsequently, the Appellant sent Mr. Kaimkhani a legal notice and lodged a FIR against Mr. Kaimkhani for embezzling Rs 5.8m of the Respondent No.2's funds and criminal proceedings were initiated against Mr. Kaimkhani for cheating and misappropriation in the Karachi District Courts. However, the Respondent No.1 in the Impugned Order failed to address the fact that the major ostensible motive of Mr. Kaimkhani in committing the purported acts of fraud was to avail sales commission every time a conversion from low risk to high risk fund was made and the Appellant's front-end load (the FEL) commission policy came to an end on 08/06/17 and a number of the alleged unauthorized conversions happened after the policy ended. The Respondent failed to

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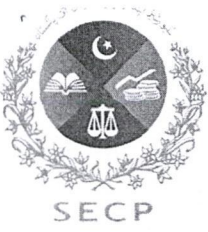
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appreciate the evidence, or even consider, the pattern of behavior, substantiated by written communication, in which the Respondent No.2 abdicated a large amount of their authority over their investment decisions to Mr. Kaimkhani specifically, through an email dated 30/01/17.

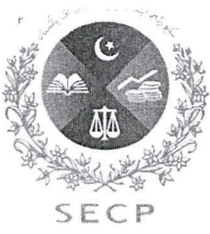
- c) The Respondent No.1 further failed to appreciate evidence that the Respondent No.2 had placed in Mr. Kaimkhani's possession signed but unfilled redemption and investment forms. In addition, the Respondent No.2 had left a number of signed, but unfilled cheques in the possession of Mr. Kaimkhani. Such proof, which is on record, clearly undermines the Respondent No.2's allegation that Mr. Kaimkhani acted without authority and is evidence that the Respondent No.2 and Mr. Kaimkhani colluded to violate the Commission's mandated rules put in place to prevent exactly the type of purported fraud the Respondent No.2 alleges against the Appellant. The mere presence of unsigned investment forms is enough to vitiate the requirement of consent, which the Respondent No.2 has based his allegations on.
- d) The Respondent No.1 failed to appreciate the evidence that the Respondent No.2 himself made a number of investments into the very high-risk funds which he claims were never authorized by Mr. Kaimkhani to invest in. More importantly, the withdrawals from the high-risk funds were in excess of the Respondent No 2's investments into those funds; therefore, the only way for them to have access to those excess funds would have been through conversions from low risk funds. The Respondent No.2 for example in 2017 made withdrawals of over Rs 18 million from PIML Value Equity Fund without ever having made any investments into it. Therefore, by withdrawing funds from the high-risk funds, which were proceeds of conversions from low-risk funds, the Respondent No.2 acquiesced to the conversions he now disputes.
- e) The Respondent No. 1 has in the Impugned Order waded into a matter of factual controversy under the auspices of section 282D of the Company Ordinance by deciding on the substantive issue of whether or not the Appellant is in fact liable for the purported fraud alleged by Respondent No. 2, that otherwise is a civil claim Respondent No. 2 may pursue before the appropriate forum. A mere finding of alleged violations of the Commission's various



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regulations does not automatically result in a conclusive finding of guilt on the Appellant in regard to Respondent No. 2's claim.

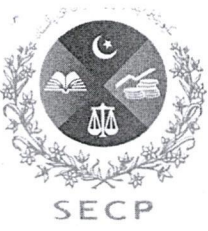
- f) The Respondent No.1 failed to appreciate that the Appellant that any liability for the purported fraud committed by Mr. Kaimkhani may only fall on the Appellant vicariously. Finally, the SPA indemnity serves to illustrate PBIC's role in the alleged fraud, and given the contractual nature of involvement, would also need to be impleaded in any proceedings. Clause 4.1 (ix) of the SPA does not absolve the Appellant of all responsibility, however, most of the allegations occupy a period in which PBIC had control of the company, and, therefore, culpability also needs to be accordingly distributed so that PBIC is also impleaded in the proceedings. The Appellant cannot act as a shield for PBIC's misconduct or negligence if any. Furthermore, any liability that the Appellant has under regulation 38(2)(b) of the NBFC Regulations can only accrue vicariously after a violation of the SSA has been ascertained which necessarily requires the guarantor of the SSA to bear their share of liability. Furthermore, ex-employees/officials who held key positions or had direct supervisory roles in the Appellant should also be impleaded as necessary and proper parties to the proceedings.
- g) The Respondent erred in making an adverse order against the Appellant on the basis of Mr. Kaimkhani's vicarious liability without first allowing the relevant court of law to determine Mr. Kaimkhani's guilt. The mere fact that a case has been filed against Mr. Kaimkhani is no indication of his guilt. The Respondent No. 2's allegations of loss are entirely based on pure economic loss which means that had he not invested in equity funds he would not have lost money. Even if it is established that funds were transferred to high risk equity funds without the Respondent No.2's authorization, the loss he suffered is too remote to claim under settled law because the alleged losses were entirely speculative, being based on the ebb and flow of the stock market. It is settled law that recovery for pure economic loss is not recognized in common law jurisdictions such as Pakistan.
6. The Respondent No.1 rebutted the arguments of the Appellant *inter alia* on the following grounds:
- a) The Respondent No.1 has examined the facts of the case, written responses submitted along with documentary evidences, the arguments put forth by the Appellant during the course of hearing and the relevant regulatory requirements. After thorough examination of the matter,



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the Respondent No.1 has documented the reason for his decision at para 8 and 9 of the Impugned Order, with clarity.

- b) The Appellant has not provided any evidence in support of its allegation that the Respondent No.2 had colluded with Mr. Kaimkhani to violate the applicable regulatory framework. Even if the argument is given some consideration, it only indicates the weaknesses of internal controls of the Appellant, whereby, one of its own employees collaborated with an outsider and acted against the interest of the Appellant. However, it may be noted that this matter is beyond the scope of the Impugned Order.
- c) The Respondent No.2's investment in any other high-risk funds or ventures has no direct relevance with the matter of the Impugned Order. Even if consideration is given to the unfounded speculation that the Respondent No.2 withdrew Rs 18 million from the high risk fund personally, or in collusion with the sales agent of the Appellant, the onus of processing and execution of the entire transaction falls on the respective Appellant, as stipulated in regulation 38(2)(b) of the NBFC Regulations. The Appellant was required to investigate such a huge withdrawal and in terms of regulation 38 (2)(b) of the NBFC Regulations, the ultimate responsibility of any acts or omissions of all persons to whom its functions are delegated lies with the Appellant and, therefore, liability for the purported fraud committed by Mr. Kaimkhani directly falls on the Appellant. Furthermore, lodging of the FIR by the Appellant is evidence that the Appellant was also of the opinion that he had been involved in fraudulent activities. It is pertinent to note that none of the parallel proceedings underway in this matter restrains the Commission from conducting its regulatory responsibilities. The Commission is not required to wait for the conclusive determination of liability by other forums since all are independent to make their own decisions without any binding effect on each other.
- d) There was no evidence available to implead PBIC in any proceedings. The relevance of the SPA and the SSA signed between PBIC and the Appellant in this matter is only to the extent of being mutually agreed arrangements between the two parties with respect to the terms and conditions and is independent of the complaint due to which the Impugned Order was passed. Moreover, the indemnity signed by PBIC and AWITL is an internal arrangement between the two for compensating the Appellant for any losses arising out of any fraudulent activities.



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It does not in any case absolve the Appellant being a licensed Asset Management Company (the AMC) of its fiduciary responsibilities.

- e) The Appellant was accorded approval for purchase of 70% shares of PIML by the Commission on 23/02/17 while approval for the remaining 30% was accorded on 05/03/18. Therefore, the Appellant was a major shareholder of PIML having management control as of 23/02/17 and the argument that the guarantor of the SSA is to bear their share of liability, has no locus standi.

7. The Respondent No.2 rebutted the arguments of the Appellant *inter alia* on the following grounds:

- a) The BOD of the Appellant had engaged Deloitte, being independent chartered accountants, to conduct a preliminary audit into the Respondent No.2's claims. Deloitte calculated a loss of Rs. 34.361 Million which the Appellant says is a loss of Rs. 15.9 Million. A brief summary of the findings of the audit report issued by Deloitte (the Deloitte Audit Report) is reproduced hereunder:

The then CEO Mr. Ahmed Atiq (the CEO) allowed three transactions on 04/01/17 by marking them as "OK" despite the caveat put by Mr. Asif Ali, Head of Compliance of the Appellant, to seek 'Client Verification'. However, the then CEO allowed execution of these transactions without carrying out any verification as suggested by its own Head of Compliance. The Appellant may have been able to avoid the loss and identify the fraud much earlier. The transaction details of the three conversions are reproduced hereunder:

- *Conversion of funds of PKR 20, 693, 728 from PIML IEF to PIML IF in the account of Shahid Oosman dated 04/01/17*
- *Conversion of funds of PKR 15,000,000 from PIML UEF to PIML IF in the account of Oosman Brothers Hardboard Private Limited dated 04/01/17.*
- *Conversion of funds of PKR 10,000,000 from PIML VEF to PIML IF in the account of Oosman Brothers Hardboard Private Limited dated 04/01/17.*

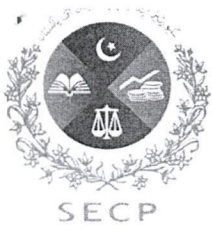
- b) Respondent no. 2 had given no mandate to Mr. Kaimkhani to make investment in equity/high risk funds. There is a fiduciary relationship which exists between an AMC and its client as Mr. Kaimkhani was only meant to do what was authorized by the Respondent No.2 and not



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exceed those acts. The Chief Investor Officer, Mr. Sami Malik issued an email dated 04/01/17 to the then CEO raising his concern that conversion transactions were being carried out in the accounts of the Oosman Brothers (Pvt.) Ltd, Respondent No.2 and Mr. Shahid Oosman which are highly volatile and that the distributor may be using these accounts for personal benefit by earning significant FEL.

- c) The Appellant violated its own Standard Operating Procedures (the SOPs) by allowing the staff to use scanned copies of the forms in the absence of 'Signature Verification Stamp'. Furthermore, 89 Conversions were carried out either on photocopies of forms or on forged signatures. The Oosman Brothers did not give any such mandate to Mr. Kaimkhani who had no authority to conduct any transactions on its behalf and signatures on the documents were forged. This shows lapse of internal controls on part of the Appellant.
- d) The Appellant's policy requires courier service usage for delivery of monthly statements. However, upon verification, it transpired that the copies of monthly statements had been signed by Mr. Kaimkhani who himself marked them as 'Received'. Therefore, there is no evidence, which suggests that the monthly statements had actually been delivered to the Oosman Brothers (Pvt.) Ltd, Respondent No.2 or Shahid Oosman. The Respondent No.2 can further provide video evidence, wherein, Mr. Kaimkhani states that no one in the company should deal with the clients and he alone should deal with the clients. In the presence of weaker internal controls, therefore, perpetration of fraud was inevitable.
- e) The two transfers of Rs 6,473,500 and Rs 478,634 dated 18/08/17 and 28/08/17, respectively were executed from the account of Respondent No.2 to Mr. Shahid Oosman's account. The Appellant failed to provide any supporting documentation in relation to these transfers, which had been carried through forged signatures and confirmed by forensic analysis carried out by police authorities and to process redemptions. In almost all the transactions, the distributor Mr. Kaimkhani, had not signed the form and only placed his name on them.
- f) The burden of proof rests upon the Appellant to prove that the 89 inter-fund transfers from all three accounts i.e. the accounts of Respondent No.2; Mr. Shahid Oosman; and Oosman Brothers Hardboard (Pvt.) Limited accounts were made on the basis of their authorization. Furthermore, Mr. Kaimkhani moved money without authorization from Respondent No.2's account by changing his email address. Even otherwise, needless to mention that if any



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purported authorization had been given, the Appellant cannot be absolved of its responsibility to act in accordance with the SOPs, internal controls and procedures and above all, in the best interests of the customer to maximize returns on his investment. Furthermore, Mr. Kaimkhani had no authority to operate the account of Oosman Brothers Hardboard (Pvt.) Limited. The Appellant has also misstated that unfilled cheques were provided to them which is entirely concocted.

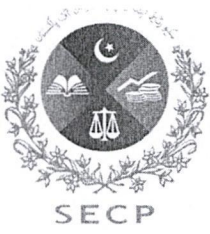
- g) The Appellant's assertion that the Appellate Bench should wait for the final outcome of the matters pending before law enforcement agencies is devoid of any merit. The matter pending before the law enforcement agency would only determine the criminal liability of Mr. Kaimkhani and the same in no way would compensate the Respondent No.2 for the losses incurred due to the fraudulent conduct of Mr. Kaimkhani. The Appellant is vicariously responsible for the actions of Mr. Kaimkhani and must compensate the Respondent No.2 who has directly been defrauded at the hands of its delinquent employee. Furthermore, if the Appellant wishes to pursue any case against Mr. Kaimkhani, it is purely a matter between the employer and employee and the same does not have any nexus with the Respondent No.2's claim. Furthermore, any purported indemnity is also a matter between the Appellant and its predecessor-in-interest. The present matter has no nexus with the ownership control of the Appellant and any indemnity provided in the SPA is for the Appellant to invoke against PBIC. Therefore, the PBIC cannot be impleaded into the present matter which would give rise to multiplicity of proceedings and the Appellant may claim for its losses from PBIC by way of separate proceedings. Furthermore, any liability also arising out of the SSA is for the Appellant to pursue by way of filing separate proceedings and the Appellant cannot evade its liability towards the Respondent No.2 under any circumstance.
- h) A Fine of Rs 1 million imposed on the Appellant should be enhanced and the Appellant may be directed to deposit a sum of Rs 40 million into the account of Oosman Brothers (Pvt.) Ltd, Mr. Shahid Oosman and Respondent No.2 which was the amount embezzled by Mr. Kaimkhani.

7. We have heard the parties i.e. the Appellant and the Respondents. The Appellant has not disputed that there were weaker internal controls which led to the circumstances at present and it has already been proven through forensic evidence that some of the unauthorized transfers took place through forged signatures of

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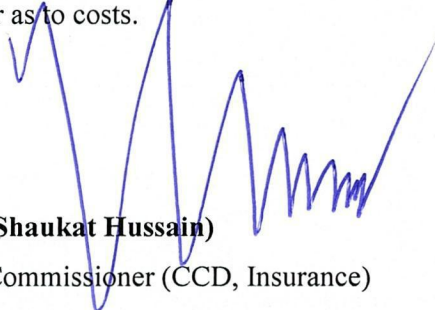


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the Respondent No.2. Therefore, there is no question that the Appellant's employee Mr. Kaimkhani has been involved in fraudulent and irresponsible conduct which has caused immense loss and suffering to the Respondent No.2. Moreover, regardless of whether the Appellant had been provided indemnity, it does not absolve the Appellant of its responsibility as an AMC towards Respondent No.2. Furthermore, it is the mandate of Respondent No.1 to regulate all AMCs and the Appellant was found to be in breach of NBFC Regulations for which they have been rightly penalized. Moreover, PBIC cannot be impleaded as a party in the instant case as any agreement on indemnity is a matter between the Appellant and PBIC. Furthermore, there is no justification for any of the ex-management staff to be impleaded in the matter as the Appellant itself has failed to justify why the internal controls were so weak and why SOPs were not followed by the Appellant at the time of the alleged fraud.

8. In view of the foregoing, the Impugned Order is upheld to the extent of penalty, however, we cannot rely solely on the Deloitte Audit Report to establish which losses were incurred by the Respondent No.2, Mr. Shahid Osman and Oosman Brothers (Pvt.) Ltd. Furthermore, we can also not accept the Appellant's contention that some of the losses are too remote to claim even if they are a direct result of unauthorized trading. Therefore, to the extent of losses the matter is remanded to Respondent No.1 to ascertain and look at all the evidence to establish which losses the Respondent No.2, Mr. Shahid Osman and Oosman Brothers (Pvt.) Ltd had actually suffered as a result of the unauthorized transactions so that the Appellant can reimburse them fully.
9. The appeal is disposed of accordingly with no order as to costs.


(Shauzab Ali)
Commissioner (SMD)


(Shaukat Hussain)
Commissioner (CCD, Insurance)

Announced on: **13 JAN 2021**