



Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH NO. II

In the matter of

Appeal No. 34 of 2016

MCB-Arif Habib Savings and Investments Limited ...Appellant

versus

- 1) The Commissioner (SCD)
Securities and Exchange Commission of Pakistan ...Respondent No.1
- 2) Sheikh Zain-ul-Abedin ...Respondent No.2

Date of Hearing 14/11/16

Present:-

For the Appellant:-

- 1) Mr. Syed Sohail Ahmed (Head of Compliance, MCB-Arif Habib Savings and Investments Limited)
- 2) Mr. Iqbal L.L Bawaney, Counsel

For the Respondent No.1:-

- 1) Mr. Imran Inayat Butt, Executive Director (SCD)
- 2) Mr. Javed Akhtar Malik, Joint Director (SCD)

ORDER

1. This Order is passed in the matter of appeal No. 34 of 2016 filed under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the Order dated 05/05/16 (Impugned Order) passed by the Respondent No. 1.
2. Brief facts of the case are that MCB-Arif Habib Savings and Investments Limited (Appellant) is a non-banking finance company licensed to undertake the business of asset management and investment advisory services under the Non-Banking Finance Companies (Establishment and Regulation) Rules, 2003. The Appellant appointed



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Standard Chartered Bank (Pakistan) Limited (Distributor) for certain of its Open End Schemes including MCB Pakistan Asset Allocation Fund (MCB-PAAF). Shaikh Zain-ul-Abedin (Respondent No.2), who invested Rs.7.5 million in MCB-PAAF on 04/12/15 through the Distributor, Shahra-e-Quaideen Branch lodged a written complaint with the Commission and alleged that:

- i. MCB-PAAF was 'missold' to him by the Distributor.
 - ii. An amount of Rs 297,540/- was deducted as Front End Load (FEL) from the Respondent No.2's investments of Rs.7.5 million in MCB-PAAF without any prior intimation to him.
 - iii. Offering document of MCB-PAAF was not given by the Distributor and the same was only given by Ms. Aliya Irfan, Customer Service Head, of the Appellant on 29/12/15 after the Respondent No.2 approached the Appellant.
 - iv. The first statement regarding his investment and deduction of FEL was received by him on 28/12/15 i.e. after a lapse of twenty-four days.
 - v. Customer Service Head of the Appellant informed him that he has been guided wrongly as MCB-PAAF is meant for long term period and not suitable for monthly income purposes.
 - vi. The Branch Manager of the Distributor informed the Respondent No.2 that investment in MCB-PAAF is suitable for regular monthly income.
3. The Supervision and Enforcement Department of the Specialized Companies Division (Respondent No.1) called information and documents from the Appellant and also had a separate meeting with the representatives of the Appellant and the Distributor. The following facts were gathered by the Department from the information and documents provided by the Appellant and the Respondent No.2:
- i. The Respondent No.2 opted for monthly payment frequency which is mentioned on the duly filled investment form.
 - ii. The Appellant in an e-mail dated 14/01/16 has informed that MCB-PAAF does not offer any type of income units.

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- iii. The Customer Investment Profile (CIP) Form forwarded by the Distributor to the Appellant appears to have been filled electronically by the officers of the Distributor.
- iv. CIP mentions that the Respondent No.2 is not above the retirement age, whereas, the date of birth of the Respondent No.2 is 20/04/1955 which indicates that the Respondent No.2 was of 60 years and 7 months age at the date of signing of the form i.e. 24/11/15.
- v. CIP indicates that the Respondent No.2 has high net worth (i.e. Rs 57 million) and the sources of income are "Business Income". The Investment Form also indicates that the source of funds of Respondent No.2 is business income. However, the supporting document provided by the Appellant, a copy of the employment certificate of the Respondent No.2, indicates that the Respondent No.2 is a salaried person.
- vi. CIP highlights selection of options pertaining to high risk product features. However, the Investment Form mentions investment in a monthly payment frequency which is low risk. Furthermore, the fund i.e. MCB-PAAF sold by the Distributor to the Respondent No.2 does not offer monthly payment frequency.
- vii. No action was taken by the Distributor or Appellant to remove the inconsistencies in duly filled CIP and Investment Form.
- viii. High risk product has been sold to a person who is more than 60 years old and was in need of monthly payment.
- ix. Distributor is the sole beneficiary of the FEL on mutual funds sold through it.
- x. Units of MCB-PAAF were issued by the Appellant on 04/12/15 and account statement to this was emailed to the Respondent No.2 on 08/12/15. However, intimation of the deduction of FEL which was required to be sent to the Respondent No.2 within 48 hours of realization of funds in terms of Circular 26 of 2015 dated 15/07/15 has not been conveyed by the Appellant.
- xi. It was construed from the facts gathered that the Appellant, prima facie, has not made compliance to sub-sections (b), (c), and (d) of section 66A of the



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Non-Banking Finance Companies and Notified Entities Regulations, 2008 (NBFC Regulations), clauses (1), (2) and (3) of Circular 23 of 2013 and sub clause (c) of Circular 26 of 2015.

4. Show Cause Notice dated 24/03/16 under section 282J(1) read with section 282M(1) and section 282D of the Companies Ordinance, 1984 (Ordinance) was issued to the Appellant whereby it was called upon to show cause in writing as to why penal action may not be taken against it for the aforesaid contraventions and hearing was fixed for 07/04/16. In response to the SCN, the chief executive of the Appellant through letter dated 31/03/16 requested for extension of seven days in time for submission of reply and hearing. The extension was granted till 11/04/16 for submission of reply and hearing was rescheduled to 14/04/16. In response to the SCN, Mr. Rabel Z. Akhund of Akhund Forbes, submitted reply dated 11/04/16 on behalf of the Appellant.
5. In exercise of powers conferred by section 282J read with 282M of the Ordinance, an aggregate fine of Rs.500,000 was imposed on the Appellant. Moreover, in exercise of powers conferred by section 282D of the Ordinance, the Appellant was directed to:
 - (i) Refund Rs.297,540/- to the Respondent No.2 within seven days from the receipt of this Order, if the same has not yet been refunded by the Distributor pursuant to Banking Mohtasib Order dated 14/04/16;
 - (ii) Amend the distribution agreements with all its Distributors within one month from the date of this Order by incorporating clear terms and conditions for avoidance of fraud or misselling, use of same risk profiling criteria by the Distributor and the Company and procedure to be adopted for ensuring suitability of product to the investors; and
 - (iii) Ensure placement and implementation of centralized control function entrusted with the responsibility to verify the information given/application forwarded by the sales staff and Distributor so that reoccurrence of such violations are eliminated in future and that the funds are sold by the

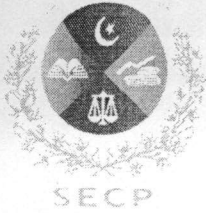


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Appellant and its Distributors strictly in accordance with the NBFC Regulatory Framework and in compliance to distribution agreement.

6. The Appellant preferred the appeal on the following grounds:

- (i) The Impugned Order is unsustainable in law and the complaint was lodged with a malafide intent. Furthermore, undue sympathy has been shown towards the Respondent No.2 who is highly educated and admittedly drawing US\$ 7,920 per month, which is equivalent of more than Rs. 800,000/- per month. The allegations contained in the complaint were false and an afterthought and the Respondent No.2's grievance was only in relation to (i) charging of FEL and (ii) investment made in a product, which did not provide monthly income. However, Respondent No.1 has imposed fine for various alleged violations which were not the subject matter of the complaint.
- (ii) The specific terms and conditions of the Distribution Agreement were never subject matters of the complaint. If Clause 5.1(e) of the Distribution Agreement was not in consonance with the Commission's Regulations or Circulars, that would have been a separate subject matter for which the Commission could have initiated proceedings. However, simply because the Distribution Agreement did not obtain specific terms and conditions for avoidance of fraud and misselling of Collective Investment Schemes, it does not entail that the Distributor committed fraud or missold Units of MCB-PAAF. There is no evidence to that effect, whereas, on the contrary there is cogent evidence of the Respondent No.2 himself opting for investment in MCB-PAAF after having fully read and understood the terms and conditions for investments in mutual funds as contained in the Form and Investment Form (IF), Offering Document of MCB-PAAF, Wealth Management Guide and Most Important Document (MID). After written application by the Respondent No.2 was submitted for purchase/subscription on Units and acceptance of the Application by MCB-AHSIL, there is legal estoppel against the Respondent No.2 from denying the contents of the Form under Qanun-e- Shahadat Order, 1984 (Qanun-e-Shahadat). Reliance is placed in the matter of *S. Sadiq Hasan and others versus Mumtaz Bank Ltd, Lahore* cited at *A.I.R. 1929 Lahore page 656*, wherein, it



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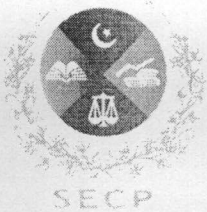
was held that, “the contract is complete when acceptance is communicated...” Furthermore, if there is a written document for a transaction, any oral evidence to challenge the same is not permissible under Article 102 and 104 of the Qanun-e-Shahadat Order. The Offering Document and Fund Manager’s Report are prolixious documents. The Distributor’s representative read out and explained the salient features and information contained in these documents, including applicability of FEL and the Respondent No.2 seemed to be fully satisfied with the same. The Respondent No.2 was not interested in obtaining the hard copies thereof. Call Back Confirmation (CBC) was also followed and the Respondent No.2 confirmed that the details of the product had been properly disclosed to him.

- (iii) The law does not make it compulsory for an asset management company (AMC) to use its own risk profiling to assessing the suitability of a product by a potential investor. At any rate, the CIP and the MID and Debit Authority Form used by the Distributor clearly specify the risk factors. The Respondent No.2 after having signed the CIP and the Form is estopped from taking the plea that he was not aware of the risk. The Respondent No.1 has failed to take into account necessary factors i.e. a handsome monthly income earned by the Respondent No.2, substantial investments and reasonable net worth of the Respondent No.2. Furthermore, the Respondent No.2 was a healthy and highly educated working Marine Engineer. Therefore, neither the Distributor nor the Appellant could have refused to accede to the request of the Respondent No.2 for investing in MCB- PAAF.
- (iv) The Respondent No.1 has erred in observing that by not using AOF, risk profiling was not correctly done by the Distributor and MCB-PAAF would not have been sold to the Respondent No.2. There were no non-compliances of Regulation 66A of the NBFC Regulations and Clauses (1) (2) and (3) of Circular 23 of 2013 and there has been no misselling of MCB-PAAF. The same has been sold on the basis of the net worth and credentials of the Respondent No. 2 in accordance with his own choice. There was no false or misleading statement on the part of Distributor or concealment of material facts or the risk factors. The Appellant and the Distributor did not violate provisions of NBFC Regulations and Commission’s

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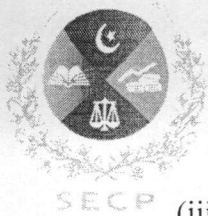
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Circulars and, therefore, sections 282J and 282M of the Ordinance are not attracted to the case.

- (v) The Distributor was not made a party to the proceedings and no SCN was issued to the Distributor. The Distributor was a proper and necessary party to the proceedings without which the Impugned Order could not have been passed. The Respondent No.1 also did not issue any notice to the Respondent No.2 and the Appellant did not get a chance to cross examine the Respondent No.2.

7. The Respondent No.1 rebutted the arguments of the Appellant as follows:

- (i) The Order is lawful and issued after analyzing all the facts of the case, relevant provisions of the Ordinance, NBFC Regulations, Circular referred and the arguments put forth by the Respondent No.1 in writing as well as during the course of hearing. The officers of the Commission were not fully satisfied with the explanation provided by the Appellant and Distributor. Furthermore, no undue sympathy has been shown towards the Respondent No.2 as only a fine of Rupees five hundred thousand is imposed on the Appellant against the maximum provision of Rs 50 million allowed under the law.
- (ii) Risk profiling of the fund and frequency of profit payouts was explained to the Respondent No 2 and he opted for capital growth preference. The risks associated with the fund are mentioned in the Offering Document of the Fund which was not provided by the Distributor to the Respondent No.2 and this fact has also been admitted by the Appellant. If the profit payouts in the fund had been explained to the Respondent No.2, he would not have opted for a monthly payout while filing the IF. Moreover, as per CIP carried out by the Distributor, sole objective of the Respondent No.2 was capital protection of his investment. However, instead of selling a Capital Protected Fund or Fixed Income Fund, an Asset Allocation Fund was sold which is high risk fund where a chance of erosion of capital exists. Furthermore, statement of the Respondent No.2 with respect to not drawing his investment referred in the CIP pertains to his investment with Distributor and not with respect to investment in mutual funds.



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- (iii) CIP had been filed electronically by the officers of the Distributor. Apart from CIP, IF and AOF have been filed by the Respondent No.2 on the same date i.e. 24/11/15. The three forms have many inconsistencies and the Distributor has made no effort to remove the inconsistencies in the duly filled CIP and IF. Furthermore, it is important to mention here that customer representative was not fully aware of the product features and knowledge of the mutual funds which is evident from the recording.
- (iv) AOF used by the Distributor was old despite the fact that the new AOF was implemented and uploaded by the Appellant in May 2015 which also contains criteria for risk profiling. In the event the Distributor had used the new AOF, the risk profiling would have been correctly done by the Distributor in accordance with the risk profiling criteria given in the new form and the fund would not have been sold to the Respondent No.2. As per Circular # 23 of 213 dated 06/12/13 and Regulation 66A(d), an AMC and its Distributors are bound to take reasonable care to ensure suitability of the scheme to the investor while selling the same. Based on the requirement, AMCs have devised risk profiling criteria for analyzing risk appetite of the potential investors and same has to be used by their agents i.e. distributors while selling its products. In the instant case, the risk profiling criteria has also been made by the Appellant which considers investor's age, source of income, investment horizon, existing investment of potential investor in equity market, objective of investment and risk tolerance. The Distributor, however, had not used the risk profiling questionnaire given by the Appellant and used its own risk profiling for assessing the suitability of product to the Respondent No.2. The risk profiling carried out by the Distributor ignored three main factors which a company considers i.e. age, source of income and existing investment of Appellant in equity market. Additionally, information regarding age, source of income and investment objective was inconsistent in the AOF and CIP. Due to these inconsistencies in the CIP and AOF and use of its own risk profiling criteria, the Distributor was not able to properly ensure the suitability of product for the Respondent No.2. Moreover, due to inconsistency in risk profiling criteria used by the Distributor and Appellant, the Distributor was not able to consider all relevant


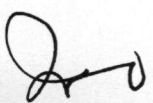
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factors which normally a company considers for evaluating the suitability of product when an investor approaches the company directly. Furthermore, neither the Distributor nor the Appellant have made any efforts to remove the discrepancies in the information provided by the Respondent No.2. The case is a misselling on part of Distributor to a retail investor for their maximum personal gain as the Distributor gets maximum benefit in shape of sales load and sharing in management fee if a high mutual fund is sold. If such misselling is allowed, it would be detrimental to the confidence of retail investors and would also hamper the efforts to shift the reliance of mutual fund industry from corporates to individuals. The Appellant and Distributor have both violated provisions of NBFC Regulations and Commission's circulars and Section 282J and 282M of the Ordinance.

- (v) No notice to the Respondent No.2 for appearance at the time of hearing was issued as the Respondent No.2 had already submitted his complaint and produced all relevant record with the Commission. Prior to issuing SCN to the Appellant, several meetings were held by the Commission with the Appellant who was accompanied by the representatives of the Distributor and Respondent No.2. Moreover, this objection was never raised by the Appellant while submitting its written submissions or at the time of hearing.

8. The Respondent No.2 stated that the appeal be decided on basis of the following written submissions:

- (i) While being briefed about the said product, he was not informed about the Front End Charges (FEL) from the Distributor. He purchased the product and signed the documents but the Distributor did not ask him to read the forms. The product book was only given to him by Miss Aliya Irfan, Head of Customer Service of the Appellant on 29/12/15 when he went and complained for the first time.
- (ii) He invested PKR 7.5 million in the hope that he will get a monthly return above 8% but it was a surprise for him when Rs 2,97,450 was deducted after receiving his first statement. Thereafter, he rushed to the Distributor but they failed to resolve his problem.



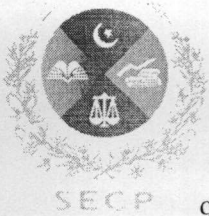


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- (iii) He was not explained about the risk profiling in detail including the applicability of FEL and the frequency of profit payouts. He was not given any booklet containing the information about different kinds of mutual funds. All the risks associated with the product were only mentioned in written form in the booklet which was not provided by the Distributor.
- (iv) In AOF, he has correctly been shown as Salaried Person whereas in MCB-AHSL AOF (Form B-1), Business Income was ticked even though he has no business income as he is a Marine Engineer by profession. Similarly, in MCB-AHSL AOF (Form B-1) payment frequency has been shown as "Monthly", whereas, it is a long term investment policy. He had already explained to the branch manager that he was in need of a monthly income for his kitchen expenses as he works on a contract basis and has no regular income.
- (v) MID and Know Your Customer (KYC) forms were filled by the Distributor's staff and not by him in which his personal details i.e. age, source of income and details of assets were wrongly filled. He signed the forms in the Distributor's office but could not read them at home, however, the Distributor's management assured him that all things were correct. It was not possible for him to read the plethora of documents and he relied on the branch manager thinking the Distributor is the reliable custodian of his money. The Distributor did not inform him about 3% fee deduction as FEL charges. Furthermore, if he had come to know about this deduction, he would not have invested in the product. In the electronically filled CIP Form by the Distributor's staff, the column "I am above the retirement age" was ticked as "NO" whereas his date of birth as per CNIC is 20/04/1955 and his age at that point was 60 years and 7 months which meant that he had crossed the retirement age of 60 years. Furthermore, CIP form indicates that he possesses high net worth i.e. Rs.57 million which was also exaggerated probably to make him eligible for the product of high risk and this also constitutes as misselling. The appeal is not maintainable as the Distributor sold their investment product on misrepresentation that they will give him a return of 8% per month on his investment which was not the case.

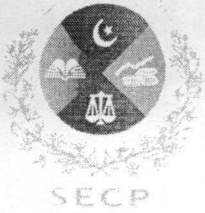

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9. We have heard the parties i.e. the Appellant and the Respondents. We have also been provided a copy of the Order dated 17/11/16 of the President of Pakistan by the Appellant, wherein, the Order of the Banking Mohtasib has been set aside and it was held that in view of factual controversies between the stance of the Respondent No.2 and the Distributor, it was a fit case to be resolved by a court of competent jurisdiction after recording of evidence of both parties. The Appellant has argued that there was no misselling and no non-compliances of any of the provisions of the law and the Impugned Order is unsustainable. The Respondent No.1 has argued that there were inconsistencies in the forms and if the Distributor had used the new AOF, risk profiling would have been done correctly in accordance with the risk profiling criteria given in the new form and the product would not have been sold to the Respondent No.2. The Respondent No.2 has argued that he was not informed by the Distributor about the FEL charges and all the risks associated with the product were in the booklet which was not provided to him.
10. We are of the view that the matter before the President of Pakistan, and prior to that the Banking Mohtasib, is distinguishable from the matter in appeal. The Banking Mohtasib's proceedings were pursuant to section 82D of the Banking Companies Ordinance 1961 read with section 9 of the Federal Ombudsman Institutional Reforms Act No. XIV of 2013, while the Respondent No.1 passed the Impugned Order for the various non-compliances of NBFC Regulations. We have observed that the Distribution Agreement does not contain any clause with particular reference to avoidance of fraud and mis-selling by the Distributor and the Offering Document was also not provided to the Respondent No.2 to highlight the risk factors. Furthermore, the Distributor has not used the risk profiling questionnaire given by the Appellant and used its own risk profiling and as a result also ignored the main factors of age, source of income and existing investment. The Distributor, therefore, had not taken reasonable care to ensure suitability of the scheme to the Appellant. It was the responsibility of the Appellant to ensure that updated account opening form is used by the Distributor and, moreover, the Distributor has also not provided latest annual/semi-annual accounts to the Respondent No 2. Furthermore,



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no action has been taken by the Distributor to remove the discrepancies in various documents prior to the Respondent No.2 accepting investment. Moreover, in the Call Back Confirmation (CBC) made to the Respondent No.2, there was no mention to the Respondent No.2 regarding removal of these discrepancies. The Appellant also failed to send account statement to the Respondent No.2 within the stipulated time.

11. In view of the above, the Impugned Order is upheld with no order as to costs.

(Fida Hussain)

Commissioner (Insurance)

(Tahir Mahmood)

Commissioner (CLD)

Announced on: 03 FEB 2017