SECP

Securities and Exchange Commission of Pakistan

BEFORE THE APPELLATE BENCH

In the matter of

Appeal No. 50 of 2020

UBL Fund Management Limited

...... Appellant

versus

1. Sodagar Hussain
2. Munir Ahmad Nadeem
3. Muhammad Imran
4. Saqlain Ghazanfar
5. Lubna Tersa
6. Naghmana Shahzad
7. 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. 50 of 2020 filed by UBL Fund Management Limited (the Appellant) against the Order dated March 09, 2020 (the Impugned Order) passed by the Executive Director, Adjudication Department-I, Adjudication Division, SECP (the Respondent No. 7) 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 to 6 lodged complaints against the Appellant through the complaint management system (SDMS) of the Securities and Exchange Commission of Pakistan (SECP). The complaints were referred to the Supervision and Enforcement Department, Specialized Companies Division of SECP for detailed scrutiny and after initial examination of the complaints, the Appellant was found to be involved in several violations of the Regulations.

3. In light of the aforementioned violations of the requirements of the Ordinance and Regulations, a Show Cause notice (the 'SCN') dated November 08, 2019 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 November 18, 2019. Hearing on the matter was held on January 17, 2020 which was attended by the authorized representatives of the Appellant, and after hearing the Appellant, the Respondent in exercise of powers delegated, held that the Appellant has violated Regulation 66A(c)(i), 66A(c)(iv), 66A(d) and 66A(f) of the Regulations and therefore imposed a penalty of Rs. 800,000/- under section 282J(1) read with section 282(M)(1) of the Ordinance, through the order dated March 09, 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 through signed undertakings and recorded 'Welcome' phone calls, risks associated with the Plan were fully communicated to Respondents No. 1 to 6. The Appellant stated that the Respondents No. 1 to 6 properly/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 risk profiling was entirely based on the information provided by the Respondents No. 1 to 6 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 to 6 also signed an undertaking acknowledging the risks of investment, therefore, in the presence of documentary evidence, recorded call log and signed investment forms, it cannot be assumed that

Respondents No. 1 to 6 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 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 to 6 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 and the alleged written guarantee produced as 'evidence' by the Respondent No. 3, is certain information written down on a piece of paper that is incorrect in almost every aspect and mere stapling of the business card of an employee does not make a document official correspondence or endorsement by the employer, as the Appellant has a very strict policy against giving such assurances. 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 Respondents No. 1 to 6, 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. 7 erred in law by not acknowledging and applying the doctrine of "Caveat Emptor" (buyer beware) which requires that Respondents No.1 to 6 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 mandatory particular 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 AOF and initial investment form contained the requirements laid down by the SECP Circular 16 of 2014. Furthermore, the Appellant stated that for the first time, Respondent No. 7 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 also contended that even after receipt of

the 'Welcome' phone call which explained all associated risks, Respondents No. 1 to 6, had not withdrawn their investment during the 'cooling-off' period as per SECP Direction No. 31 of 2016. 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.7 rebutted the grounds of appeal and stated that the Appellant's Relationship Manager failed to offer a suitable investment plan to Respondents No.1 to 6, therefore, it should not take refuge in the call log. Respondent No. 7 stated that investors only listen 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. 7 admitted that although no evidence was provided by Respondents No. 1 to 6 regarding mis-selling and guaranteed returns on investment, however, the allegation that sales representative had guaranteed profit and preservation of capital, cannot be completely overlooked. Respondent No.7 contended that as a common phenomenon in the mutual fund industry, some sales agents highlight the returns more without explaining the associated risks and potential downside of investing in mutual funds. Respondent No. 7 stated that the sales representative persuaded the Respondents No. 1 to 6 to sign the relevant forms by concealing the associated risks of investment. Respondent No. 7 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. 7 further stated that the claims of the Appellant, that sufficient steps were taken to inform Respondents No. 1 to 6 of the risks associated with the investment, is not acceptable because as per the Appellant's assessment, Respondents No. 1 to 6 had no prior experience in equity investments and their investment knowledge was rather basic. Respondent No. 7 stated that this fact had been recognized in the Impugned Order that Respondents No. 1 to 6 were made aware of the risks associated with the investment, and their decision to remain invested in the respective plan may be considered a weak judgment call. Respondent No. 7 stated that although a moderate

risk tolerance level was assigned to Respondents No. 1 to 6, whereby capital protection was guaranteed, however, due to the aggressive investment in equity, the capital investment was eroded.

10. The Appellate Bench (the Bench) has heard the parties and perused the record including the grounds of Appeal and Respondent No. 7's written comments. The Bench is of the view that to influence the investment decision of investors, it is a practice of the sales agents to highlight the returns without adequately explaining the associated risks and potential downside of equity investment through mutual funds. After reviewing the record, the Bench found that Respondents No. 1 to 6 had made their investments in the year 2017 and had received 'Welcome' calls informing them of the risks and exposure involved. Despite this, they had proceeded with their investment. The Bench is of the view that, if Respondents No. 1 to 6 had been deceived by the Appellant's relationship manager/sales staff, they should have made a wise choice after receiving the 'Welcome' call and information about the risks associated with investing in equity, as required by the "Caveat Emptor" (buyer beware) doctrine, which holds Respondents No. 1 to 6 responsible for their investment decisions. In view thereof, the Bench believes that Respondents No. 1 to 6 also failed to proceed vigilantly, however, this fact does not completely absolve the Appellant.

11. The Bench is of the view that the purpose of the need assessment section of the AOF was to determine the suitability of a person for certain investments, however, the Appellant has failed to proceed in a required manner and in result thereof, a major part of Respondents No. 1 to 6 investment was allocated to the high-risk equity fund (average investment in equity funds during the Plan duration remained 66.11%). Notwithstanding hereinbefore, as per the risk assessment section of the AOF, Respondents No.1 to 6, who had been assigned a moderate risk tolerance level, should have been admitted to a capital protection fund and other balanced funds, however, their major investment was made in an equity fund. 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 level, instead of offering a capital protection fund, they had been admitted to an equity fund.

12. The Bench endorses the Appellant's stance that at the time when Respondents No.1 to 6 made their 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 it is not a matter that the Appellant failed to follow any specific risk categorization, but rather that the Appellant failed to accurately categorize the risk tolerance level of Respondents No. 1 to 6 as per the given data and information, although Respondent No. 2, himself opted to invest in a medium risk plan. The Bench does not doubt that the Appellant had failed to understand the object of AOF and admitted the major part of Respondents No. 1 to 6 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 the Respondents No. 1 to 6, however, the Appellant's Relationship Manager/sales staff had 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.

13. 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 when cases of investor exploitation by the regulatees is 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.

14. During the hearing before the Bench, the Appellant's representatives apprised the Bench that without admitting guilt, and on compassionate grounds, the Appellant is ready to compensate the loss suffered by Respondents No. 5 and 6, due to the fact of them being housewives and having no knowledge about the equity fund market. Thereafter, to the

extent of Respondent No. 6, the Appellant's representative vide email dated August 2, 2024, shared a settlement agreement dated July 25, 2024 executed between the Appellant and Respondent No. 6, whereby, the Appellant paid the amount of loss suffered by Respondent No. 6, through UBL Cheque No. 60381504 (Rs. 204,560) dated July 29, 2024, and to the extent of Respondent No.5, the Appellant's representative vide email dated August 19, 2024, shared a settlement agreement dated August 12, 2024, executed between the Appellant and Respondent No. 5, whereby, the Appellant paid the amount of loss suffered by the Respondent No. 5, through UBL Cheque No. 60381545 (Rs. 153,420) dated August 12, 2024 *(the documents have been made part of the Appeal file).*

15. The Bench appreciates the compassionate act of the Appellant and its senior management whereby the loss suffered by Respondents No. 5 and 6 has been compensated, therefore, we find it appropriate to waive off the penalty to their extent. However, as far as Respondents No. 1 to 4 are concerned, the Bench is of the view that the Relationship Manager of the Appellant should have clearly explained and highlighted the risks involved/associated with the investments to their customers and 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, however, complete liability of the loss cannot be imposed upon the Appellant as the Respondents No. 1 to 4 should have exercised due care and caution while tendering investment before the Appellant as required by the "Caveat Emptor" (buyer beware) doctrine and the general understanding that the entire liability of losses cannot be imposed/implied upon the Appellant.

16. The Bench has observed that the penalty imposed upon the Appellant through the Impugned order is Rs. 800,000/-. It is to be noted that the settlement of the claim amount to the extent of the Respondents No 5 and 6, accumulates to a round off figure of Rs. 350,000/-. However, the Bench also considers that the Appellant cannot be held solely liable for the losses incurred to Respondents No. 1 to 4 as the investor always has to consider the downsides and risks associated with investment into a mutual fund.

17. In view of the foregoing, the Bench considers it justified to convert the penalty into a warning with the 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.

18. We hereby dispose of this Appeal, without any order as to cost.

(Akif Saeed)
Chairman/Commissioner

(Abdul Rehman Warraich)
Commissioner

Announced on: 25 SEP 2024