



# Securities and Exchange Commission of Pakistan

## BEFORE APPELLATE BENCH NO. II

In the matter of

Appeal No. 64 of 2011

NBP Fullerton Asset Management Limited

...Appellant

Versus

Executive Director (SCD)

Securities and Exchange Commission of Pakistan

...Respondent

Dates of hearing:

05/09/11 and 11/11/15

Present:

For Appellant:

- i. Dr. Amjad Waheed, CEO NAFA
- ii. Muhammad Murtaza Ali, COO NAFA
- iii. Mr. Ali Almani, Advocate

For Respondent:

- i. Mr. Shahid Naseem, Executive Director (SCD)
- ii. Mr. Asif Paryani, Joint Director (SCD)
- iii. Mr. Javed Akhter Malik, Joint Director (SCD)

## ORDER

1. This order shall dispose of appeal No. 64 of 2011 filed under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the order dated 12/08/11 (the Impugned Order) passed by the Respondent.

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2. The NBP Fullerton Asset Management Limited (the Appellant) is a Non-Banking Finance Company licensed by the Securities and Exchange Commission of Pakistan to carry out the business of asset management services. The Appellant is managing different open-end schemes including NAFA Income Opportunity Fund (the NIOF). The brief facts leading to the case are that:
- a. The Central Depository Company (the CDC) in its capacity as trustee of NIOF opened a saving account with KASB Bank Limited (the Bank) on 10/04/06. On 23/06/08 the Bank wrote a letter to the CDC and introduced product namely Mahana Khazana and offered 13% p.a. on Rs.625 million and above, on daily day end credit balance. The Bank invested Rs.500 million through a cheque in the NIOF with cash dividend as option on 24/06/08. The NIOF maintained daily average balance of more than Rs.625 million with the Bank during the period from June 2008 to October 2008, however, the Bank paid markup in the range between 10.86% to 11.88% p.a and for the month of November 2008, the Bank paid return @ 3.18% p.a only. Furthermore, from 01/12/08 to 30/04/09, i.e. for five (05) months, the Bank did not pay any return to the NIOF.
  - b. On 30/04/09, the Appellant, wrote a letter to the Bank and requested them to pay the overdue profit amounting to Rs.43.058 million. In reply the Bank wrote a letter on 25/05/09 wherein it was stated that the Bank is one of the investors in the NIOF and have not received any dividend on its investment since October 2008, therefore in view of current market situation, the Bank has decided to give return of 5% per annum. In response dated 26/05/09 the Appellant stated that NIOF is a Mutual Fund and there could be no fixed and guaranteed returns on investment, whereas, the NIOF has a saving account with the Bank where the markup rate was agreed at 13% per annum. The Bank denied the claim vide reply dated 30/05/09 and stated that by virtue of relevant clause of the account opening form, it has the right to amend, add or change the terms and conditions of account. It was further argued that Mahana

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Khazana was a PLS saving account, therefore, its rate of profit fluctuated from time to time and the Bank had the right to revise it.

- c. The Appellant insisted on 13% return and a number of letters were exchanged, however, the Bank remained adamant on 5% per annum return on the deposits. The Bank paid markup @ 5% to the NIOF for the period 01/07/09 to 31/01/11 i.e. for 19 months, on balance of Rs.649 million, whereas, during the said period the average return offered on Corporate PLS accounts by A- rated banks was in the vicinity of 10% to 13%.
  - d. The Appellant agitated the matter of low markup rate with the Bank however, the Bank refused to credit the deposit along with the accumulated markup as per the directions of the Appellant. In such letters the Appellant has categorically communicated to the Bank that the deposit transactions by the Appellant and investment of the Bank in NIOF are separate transaction and have no nexuses, therefore the Bank cannot evade its obligation on account of low profits on investment made by the Bank.
3. In view of the foregoing, a Show Cause Notice (the SCN) dated 04/02/11 was issued to the Appellant, its directors, managers, the audit committee, the internal auditor, the investment committee under Section 282J (1) and Section 282J (2) of the Companies Ordinance 1984 (the Ordinance) for violation of Regulation 38(a) read with 38(b) of the Non-Banking Finance Companies and Notified Entities Regulations 2008 (the NBFC Regulations of 2008).
  4. After issuance of the SCN the Appellant has raised the issue of reduction of markup rate, refusal of withdrawal of deposit and dishonoring of cheque by the Bank with the State Bank of Pakistan vide letter dated 15/02/11 which was subsequently forwarded to the Banking Mohtasib Pakistan vide letter dated 24/02/11 by the State Bank of Pakistan. The Banking Mohtasib Pakistan vide letter dated 25/06/11 to the Appellant stated that the Bank has communicated that the transaction stands

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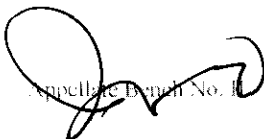
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closed/settled and Appellant funds has been transferred to the nominated NIB Bank. Thereafter the Banking Mohtasib Pakistan vide letter dated 19/07/11 refused to proceed with the matter as the State Bank of Pakistan has already disposed of the complaint of the Appellant.

5. The Appellant filed a reply to the SCN and hearing was conducted. The Respondent being dissatisfied with the response of the Appellant passed the Impugned Order and imposed a penalty of Rs.1,000,000 (One Million Rupees) on the Appellant for the contravention of Regulation 38(a) of the NBFC Regulations 2008. The Respondent further directed the Appellant to make good the loss of Rs.19 million to unit holders of NIOF through its trustee; the CDC under Regulation 38(b) of the NBFC Regulations 2008 and issued warning to Board of Directors, the Chief Executive Officer (CEO), members of the Investment Committee, Fund Managers, head of Internal Audit and the CDC as trustee of NIOF.
6. The Appellant has preferred the instant appeal against the Impugned Order on the following grounds:
  - a. That the Impugned Order is void, without jurisdiction and has been passed ignoring relevant consideration and is based on irrelevant considerations.
  - b. The Respondent has failed to establish any single condition contained in Regulation 38 (a) of NBFC Regulations 2008. The Respondent also failed to appreciate that the decision not to withdraw the deposit earlier was a business judgment made in view of the general economic climate and the available alternatives and Respondent was not authorized to interfere with the decisions of the business.
  - c. The Regulation 38 (b) of NBFC Regulations 2008 clearly provides that Appellant is required to compensate trustee for any loss caused to the fund only

  
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when certain conditions are met, therefore the Respondent was not authorized to take cognizance under said Regulation.

- d. Under Section 282J of the Ordinance, the Respondent is only authorized to impose a fine for the contravention of the NBFC Regulations 2008, therefore the Respondent is not empowered to direct the Appellant to compensate the trustee for any perceived loss caused to unit holders. In this case, the CDC and the Appellant have filed a joint recovery suit against the Bank. It is, therefore, clear that Regulation 38(b) of NBFC Regulations 2008 is not applicable to the circumstances of this case.
- e. The deposit placed with the Bank, and the investment made by the Bank in the NIOF, were not reciprocal investments. The Respondent has wrongly calculated the opportunity loss caused to the NIOF at Rs.19 Million.
- f. The Impugned Order is mala fide and has been issued at a time when the Appellant was pursuing the issue before the SBP and Banking Mohtasib and had planned to initiate litigation if no positive result was achieved.

7. The Respondent denied the grounds of the appeal in the following manner:

- a. This ground is vehemently denied. The Order dated 12/08/2011 has been passed by the Respondent having proper jurisdiction while considering all the facts.
- b. The three conditions as laid down in Section 38 (a) of NBFC Regulations 2008 have been discussed in the Impugned Order and as per evidence and cited circumstances the Appellant had failed to manage the assets of the NIOF in good faith, to the best of their ability while gaining the undue advantage for itself. Moreover business decisions are part of everyday management of the affairs of a company, therefore the Respondent was duty bound to monitor the decisions of the companies such as the Appellant in which public money is involved. In the present case there is abundant evidence on record that shows that the Appellant had not taken decisions in the interest of the NIOF and its unit holders. Moreover

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the replies in respect of approximately Rs.18 million management fee earned by the Appellant on the investment of the Bank in NIOF available on record.

- c. The contents of this ground are accepted to the extent that every Asset Management Company (AMC) (as Appellant in this case) is required to compensate trustee for any loss caused to fund when it establishes that the loss has been caused by the negligence, reckless or willful act or omission of the AMC. In the instant case the trustee has not acted inspite of negligence, reckless or omission of the Appellant that caused the loss in the value of the assets of the NIOF was apparent.
- d. The direction issued by the Respondent to the Appellant for compensation of loss to the unit holders of the NIOF through trustee was in accordance with the section 282 J of the Ordinance because the trustee itself could not issue directions to the AMC for compensation of loss caused by the negligence of AMC to the unit holders of the Fund; rather it is the Respondent which can pass any order and issue directions which may be deemed appropriate and the same was done in the Order dated 12/08/2011.
- e. During the hearing the CEO of the Appellant confirmed that the placement of deposit with the Bank and investment of the Bank in NIOF was reciprocal deal. The Respondent has calculated the amount of loss caused to the unit holders, by considering the rate of deposit of all banks (published by SBP) and applied to the amount of deposit, over and above the Bank's investment in NIOF, from 01/08/2008 till 31/01/2011 and the loss amount works out to Rs.19.039 million.
- f. It is vehemently denied that the Impugned Order is mala fide. It is to be noted that the Impugned Order was issued while providing the Appellant with an opportunity to be heard in order to fulfill the requirement of natural justice.

8. In addition to the facts and grounds of the appeal, Dr. Amjad Waheed, the CEO of the Appellant apprised the Appellate Bench that the Appellant time and again tried to amicably settle the dispute, however, the Bank informed that the request for

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withdrawal of deposit shall either not be honored or deposit shall be returned after deduction of the loss that the Bank had incurred on its investment in NIOF. Therefore, the Appellant was left with no other choice but to maintain the deposit with the Bank until the performance of NIOF improved, so as to compel the Bank to pay the agreed rate of return. The management of the NIOF had considered the option which was in the interest of the unit holders.

9. The Respondent in response to averments made by the CEO of the Appellant argued that the Appellant acted in a manner which caused loss to the unit holders of NIOF. The issue of non-payment of the agreed interest @ 13% on the Savings Account started in the first month of deposit i.e. June 2008. From 01/12/08 to 30/04/09, i.e. for five (05) months, the Bank did not pay any return on daily (day end) balance, however, no objection was raised by the till the end of April 2009. Further, the Appellant paid no heed to the observations of the onsite inspection carried by the Respondent for the period 01/07/08 till 30/06/09, the observation of CDC as trustees of NIOF and the audit observations made by the auditors namely A.F Ferguson & Co in their audit report for the year ended 30/06/10. The inaction on part of the Appellant shows that it was not operating to best of its ability in order to safeguard the interest of the unit holders of NIOF.

10. The Counsel of the Appellant argued that the Appellant could not have been penalized for violation of Regulation 38(a) of the NBFC Regulations 2008. The Respondent in the Impugned Order has failed to show: that the assets were not managed in good faith and to best of company's ability and the Appellant has gained an undue advantage for itself. The allegation on the Appellant that it was negligent in taking timely action to protect the interest of the unit holders does not fall in the preview of Regulation 38(a) of the NBFC Regulations 2008. The Counsel placed reliance on definition of "good faith" as cited in the General Clauses Act, 1897 and argued that the acts of the Appellant were done honestly. Moreover, the Appellant could not have been charged

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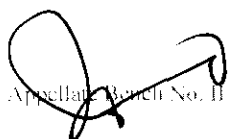
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for acting negligently in terms of Regulation 38(b) of the NBFC Regulations 2008 as the decision to delay the withdrawal of deposit from the Bank was taken after carefully considering and weighing all available options. Regulation 38(b) of the NBFC Regulations 2008 establishes the right of the trustee to seek such compensation if the trustee is of the view that the management company has acted negligently, recklessly or willfully and such action or inaction has caused loss to the fund. In the instant case the Respondent has acted beyond its jurisdiction by taking action under the said provision.

11. The Respondent in response to the Appellant Counsel assertions stated that the requirements of Regulation 38(a) of the NBFC Regulations 2008 were fully met. The findings of the Impugned Order establishes that the Appellant was not managing the NIOF in the interest of the unit holders; the conduct of the Appellant lacked bona fides and did not acted to the best of its abilities in saving the interest of the unit holders. Moreover, Regulation 38(b) of the NBFC Regulations 2008 entrust the power to the Respondent to issue direction for compensation of the loss incurred to the Fund.
12. We have heard the parties and perused the record with the able assistance of parties i.e. Appellant and Respondent.
13. The CEO of the Appellant has tried to make out a passionate case through presentation and has gone at length to explain the market situation prevalent at the time of deposit and during the entire deposit period. The CEO of the Appellant has also deliberated at length on the options available and has tried to establish that the Appellant had made the best choice available to it. The CEO of the Appellant has shown his dissent to the direction of the Respondent to withdraw the deposit from the Bank and has argued that the best course was to maintain the deposit with the Bank until the performance of NIOF improved, so as to compel the Bank to pay the agreed rate of return.

  
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14. It is a matter of record that the investment of Rs.625 million in the product of the Bank namely Mahana Khazana @13% p.a. was followed by the Bank investment of Rs.500 million in NIOF with cash dividend as option, however this reciprocal arrangement of the Appellant and the Bank has no impact on the merits of the case. The Bank failed to pay the committed return of 13% p.a from the month of June 2008 till November 2008. Moreover, no return was deposited from the month of December 2008 till April 2009. It was only in end of the April that the Appellant brought the matter to the notice of the Bank. The delay of more than 10 months in raising such a critical issue shows that the Appellant was not managing the assets to the best of its ability. The Appellant should have been vigilant and either should have raised the issue with the Bank in the year 2008 or should have proceeded to withdraw the deposit and reinvest the deposit with another bank at the earliest in order to safeguard the interest of the unit holders of NIOF.
15. The assertion that the Appellant was left with no other choice but to maintain the deposit with the Bank until the performance of NIOF improved, so as to compel the Bank to pay the agreed rate of return is not a rationale judgment. The option to initiate legal proceedings against the Bank was available at the time when the Bank committed default but the Appellant has exercised this right at relevant time and adopted legal course after lapse of considerable time. Had the Company initiated the legal proceedings in the year 2008, the probability of settlement of the issue would have been much higher today. The reasons asserted by the Appellant for not initiating the legal proceedings does not absolve it, as it has finally reverted to the option of legal proceedings after considerable time. The intervention of SBP was also sought at a belated stage, which speaks volume about the apathy of the Appellant towards the interest of the unit holder.
16. The obligations stated in the Regulation 38 (a) and (b) of NBFC Regulations 2008 are regulated by the Respondent, who may issue directions and take necessary action

  
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where such obligations are not met by an AMC. In terms of section 282J of the Ordinance, the Respondent has been empowered to take penal action or pass any other order which it may be deem appropriate against the AMC, directors, managers or officers of an AMC who fails, refuses, makes a default or contravenes the requirement of NBFC Regulations 2008, therefore no illegality could be attributed towards the Impugned Order.

17. In view of the above, the argument of the Appellant Counsel that the Respondent could not proceeded to pass an order directing the Appellant to make good the loss of Rs.19 million incurred to the unit holder through the CDC as trustee, is not tenable. The Respondent was empowered and he has rightly issued such in the Impugned Order. The Appellant failure to initiate the legal proceedings against the Bank for recovery of principal deposit along with the outstanding markup at the time when the Bank refused to honor its commitment to pay 13% markup is an evidence that the Appellant has not acted in the best interest of unit holders of the NIOF, therefore, the delay in initiation of legal proceedings against the Bank cannot be condoned or ignored.

18. In the view of the aforesaid facts, we find no reason to interfere with the Impugned Order, therefore the Appeal is hereby dismissed, however, the Respondent is directed to determine the timelines given in the Impugned Order for compliance, if any, from the date of this order.

19. Parties to bear their own cost.

  
(Fida Hussain Samoo)  
Commissioner (Insurance)

  
(Tahir Mahmood)  
Commissioner (CLD)

Announced on:

30 NOV 2011