



Securities and Exchange Commission of Pakistan
Specialized Companies Division

No.SCD-SD(Enf)/NAFA/2014/320

BEFORE THE EXECUTIVE DIRECTOR

IN THE MATTER OF NBP FULLERTON ASSET MANAGEMENT LIMITED (NAFA)

In Respect of Show Cause Notice under Section 282J (1) read with Section, 282D and Section 282M of the Companies Ordinance, 1984 for Violations of Regulation 59 (1) and Regulation 59 (3) of the Non-Banking Finance Companies & Notified Entities Regulations 2008

No. and date of Show Cause Notice (SCN)	No.SCD-SD(Enf)/NAFA/2014/149; dated June 12 , 2014
Date of Hearing:	August 20, 2014
In Attendance:	1. Dr. Amjad Waheed – Chief Executive Officer - CEO (in personal capacity and on behalf of the Company) 2. Mr. Sajjad Anwar – Chief Investment Officer/ Fund Manager Mr. Asim Ahmed Khan – Senior Trader Equities

ORDER

1. This order shall dispose of the proceedings initiated against M/s. NBP Fullerton Asset Management Limited (hereinafter referred as the **"Company" or "NAFA"** and its officers through a Show Cause Notice (**"SCN"**) dated June 12, 2014 issued under Section 282J (1) read with Section 282D and Section 282M of the Companies Ordinance, 1984 (the **"Ordinance"**) for violation of Regulations 59(1) and 59(3) of the Non-Banking Finance Companies & Notified Entities Regulations 2008 (the **"NBFC Regulations"**).
2. The SCN was issued to the Company and its officers hereinafter collectively referred as the **"Respondents"** for executing fund to fund equity transactions without obtaining approval of the Board of Directors (BoD) and consent of the Trustees of the funds. Therefore, this act of the Respondents was in violation of Regulation 59(1) of the NBFC Regulations. Resultantly, these fund to fund equity transactions were also not disclosed in the annual reports of funds in violation of Regulation 59 (3) of the NBFC Regulations.



3. The facts narrated in the SCN are presented here under;

- i. On November 01, 2012 at 15:06:21, the senior trader of NAFA placed an offer through Taurus Securities in NAFA Stock Fund (NSF) for sale of 111,500 shares of Attock Cement Pakistan Ltd. (ACPL) at the rate of Rs. 104.60 per share (there was no other offer placed for ACPL at the same time). At that point of time, on the bid side, the highest placed bid was Rs. 104.50 for 4,500 shares. Further, in total, a bid of 61,000 shares was available at price ranging from Rs.94.95 to Rs. 104.5 (at an average rate of Rs. 101.46 price per share). In such scenario, the NSF could have sold only 61,000 shares at price of Rs. 101.46 per share for an amount of Rs. 6,188,805. However, while placing an offer on behalf of NSF, a bid for purchase of 111,500 shares were also placed at price of Rs.104.6 per share in NAFA Multi Asset Fund (NMF) through Optimus Capital Management, in order to match with already placed offer price of NSF. Consequently, total of 111,500 shares of ACPL were sold by NSF to NMF at price of Rs. 104.6 per share totaling Rs. 11,662,900.
- ii. Similar instance was also noted in the case of sale of Cherat Cement Company Ltd. (CHCC) by NSF. On January 22, 2013 at 11:28:48 senior trader of NAFA placed an offer for sale of 100,000 shares of CHCC at Rs. 48.9 per share through Foundation Securities. At that time, a bid of total 50,500 shares was available for purchase (at average rate of Rs. 47.42) with highest bid of 48.7 for 2500 shares. At the same time, through the same broker "Foundation Securities" in NMF CHCC were purchased from NSF by placing a bid exactly matching with already placed offer in terms of quantity and price.
- iii. Relevant information of KATs data showing execution of above said transactions is given below:

Date	Time	Seller	Qty	Price	Broker	Script	Buyer	Broker
1-Nov-12	15:06:21	NSF	111500	104.6	Taurus	ACPL	NMF	Optimus
22-Jan-13	11:28:48	NSF	100000	48.9	Foundation	CHCC	NMF	Foundation

- iv. The above mentioned sale/purchase transactions in the portfolio of NSF and NMF were approved by investment committee in its meetings dated Oct 31, 2012 and dated Jan 21, 2013.
4. In response to the SCN initiated, the management of NAFA vide letter dated June 27, 2014 contended that;



- i. *"The sale of ACPL and CHCC shares in NSF and simultaneous purchase in NMF at the same price (at market level), the Investment Committee (IC) decisions in both the cases were made independent of each other and were made in the best interest of the unit holders of both funds.*
- ii. *Regarding sale of shares of ACPL by NAFA Stock Fund and simultaneous purchase by NMF, please note that on October 31, 2012 ACPL holding in NSF was 4.43% of the Fund size whereas it was 0.02% of the Fund size of NMF. Selling in NSF was on account of reduction in exposure in ACPL due to increase in overall exposure in the Construction and Material sector, which had increased to 28% of the Fund size (NSF), even though the IC was bullish in this scrip. NMF purchased ACPL share as it didn't have exposure in this particular scrip. Subsequent to the purchase of ACPL shares by the NMF, the stock price increased by around 12% in just 3 trading sessions from the purchase price. NSF sold 127,000 shares and NMF purchased 112,000 shares, while total trading volume was 300,000 shares on that particular day.*
- iii. *With regard to trading of CHCC shares on January 21, 2013; NSF & NMF exposure in CHCC was 9.83% & 4.91% of their fund sizes respectively. Sale of CHCC shares in NSF was to regularize the exposure in the cement sector, which had breached the 30% regulatory limit due to price appreciation on January 21, 2013. On the other hand, NMF was only 15.4% invested in the construction & Material sector. Even after this sale, NSF holding in the CHCC was 9.38% of the Fund size, and NMF weightage in this share increased to 6.06%. It may be mentioned here that total trading volume of the share on that particular day was 1.6 million shares while NSF sale was a mere 100,000 shares. Another important point is that NSF sold 100,000 shares while NMF bought 138,000 shares on that particular day.*
- iv. *We reiterate that it was the Trader's own and independent decision to execute these transactions in this manner to naively ensure that he got the desired quantities in the buyer fund (NMF for both the shares) in view of relatively low liquidity in the aforementioned shares. Please note the following points:*
 - a. *The transactions were carried out at the prevailing market price. As a result, NSF unit holders did not suffer any abnormal loss/gain due to sale transaction.*
 - b. *NMF unit holders got shares at the prevailing market price and therefore did not experience any abnormal gain/loss. However, the shares price did rise*



- substantially in the days following the transactions.*
- c. NAFA employees or the AMC did not benefit from these transactions.*
 - d. Both the funds performed very well versus their benchmarks and the peer groups.*
 - e. There was no materiality in the transaction versus the overall size of the funds.*
 - f. These transactions were approved by the IC as independent decisions as can be witnessed from the minutes of the IC meetings.*
- v. *These were only two transactions among thousands of transactions carried out by NAFA, where the Trader made a judgment error. He should have not carried out these transactions in this manner. Trader has been issued with a strong disciplinary note in this regard and the Trader admitted his mistake.*
- vi. *They request SECP that no penalty be imposed on NAFA. A warning is sufficient. They have already taken steps to ensure that this does not happen in the future”.*

5. During the course of hearing, the Respondents argued that;

- i. The subject transactions were carried out with the prior approval of the Investment Committee. Both of these transactions were independent of each other and were executed in the best interest of unit holders of the funds.
- ii. They had no intention to execute any fund to fund transaction without obtaining approval from their BoD and consent of the Trustees of the funds.
- iii. It was the Trader's own judgment and independent decision to execute these transactions in this manner because of low liquidity in the aforementioned shares.
- iv. NAFA and its management regretted on this unintentional violation and ensure that such incident shall not happen in future. Further, executions of these transactions were solely responsibility of the Trader and the Fund Manager/CIO or the CEO had no role during the execution.
- v. No such instruction was given to the Trader to execute buy/sale transaction between funds. It was the Trader who executed these transactions at his own will and judgment.

6. During the hearing, audio recordings obtained from NAFA during the onsite inspection, were played wherein Mr. Asim Ahmed Khan (Senior Trader) was suggesting the brokers (Foundation Securities and Optimus) to execute these fund to fund transactions. The Senior Trader was asked to explain his position, in this connection he responded that, the fund to fund transactions were executed on his own will and judgment and that he was unaware about the required approval of the Board and the Trustee, prior to the executing the transactions between the connected parties. He admitted that he was solely responsible for trading between funds and requested for leniency. The CEO of NAFA stated that the recording played during the hearing was a part of the control mechanism placed at NAFA by the management and that if they had committed the violation of Regulation 59 intentionally, they would have deleted or not provided the said recording to the inspection team, resultantly the SCN would have not issued to the Respondents. The CEO of NAFA also requested this forum to acknowledge this fact before reaching conclusion on the subject SCN. The CEO further added that they would ensure that all the traders are educated on the prevalent Regulatory Framework.
7. The management of NAFA vide letter dated September 29, 2014 also updated this forum about their actions through which they plan to eliminate the chances of reoccurrence of the subject violation in future:
 - i. *"The CIO has been assigned with the responsibility to regularly arrange training session to educate Traders on the applicable regulatory framework pertaining to execution of trades.*
 - ii. *In case of execution in illiquid stocks, Risk Management Department (RMD) have been assigned the responsibility to randomly check the execution trail through KATS sheets of relevant Funds.*
 - iii. *In case of simultaneously buying and selling in single scrip on behalf of different funds, RMD particularly examine the execution cycle through KATS sheets of both funds with trade timings to establish related party transactions.*
 - iv. *All the call recordings of trading room would be listened and scrutinized selected on randomly basis."*
8. I have considered the explanations given by the Respondents through their written submissions and during the hearing, in light of the relevant provisions of the



Ordinance, the NBFC Regulations and Constitutive Documents of the Fund. I have also reviewed the record placed before me and have come to the conclusion that the Senior Trader executed these fund to fund transactions on his own will and judgment. During the course of hearing he regretted the subject violation and apologized for his act which as per his statement, was primarily due to lack of knowledge on NBFC Regulatory Framework. The said violation neither resulted in any benefit to the Respondents nor loss to the unit holders of the funds. It was further observed that trading controls were in place at NAFA, however the same was not utilized to ensure appropriate vigilance over the trading activities.

9. The management of NAFA in their subsequent response submitted that they have assigned their CIO with the responsibility to regularly educate their Traders on the applicable laws and they further pledged to listen and scrutinize call recordings of the trading room on random basis to ensure appropriate vigilance over the trading activities.
10. After careful consideration of the facts, admitted default by the Senior Trader, request of the Respondents to condone this violation and their firm commitment to avoid such instances in future and that no benefit has been availed by the respondents, I am inclined to take a lenient view resultantly no penalty is imposed on the Respondents in pursuance of the subject show cause notice. However, the Respondents are strictly warned to be cautious in future and to ensure that all the requirements given under the prevailing NBFCs regulatory framework are followed with dedication in letter and spirit. In case of reoccurrence of such type of violation strict action will be taken which may be noted.
11. The management of NAFA is directed to educate and keep its entire staff updated regarding prevailing NBFC regulatory framework and ensure appropriate vigilance on the trading room activities as committed during the course of hearing and confirmation given through their letter dated September 29, 2014.
12. This order is issued without prejudice to any action, which may be taken or warranted for the above said defaults under any other provision of the law.


(Shahid Nasim)
Executive Director

Announced: 07th November, 2014 at Karachi