



Through Courier

Before The Director / HOD (Market Surveillance and Special Initiative Department)

In the matter of Show Cause Notice no. issued to Mr. Muhammad Shoaib, Chief Executive

Officer of AI – Meezan Investment Management Limited

under Section 15 E(3) of the Securities and Exchange Ordinance, 1969

Date of Hearing:

July 18, 2014

Present at the Hearing:

Representing Mr. Muhammad Shoaib

- | | |
|--------------------------------|---|
| (i) Mr. Muhammad Asad | Chief Investment Officer,
AI – Meezan Investment Management Limited |
| (ii) Mr. Muhammad Rashid Zafar | Head of Internal Audit and Compliance,
AI – Meezan Investment Management Limited |

Assisting the Director (SMD)

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|-----------------------|--------------------|
| (i) Ms. Tayyaba Nisar | Assistant Director |
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Date of Hearing:

September 23, 2014

Present at the Hearing:

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| (i) Mr. Muhammad Shoaib | Chief Executive Officer,
AI – Meezan Investment Management Limited |
| (ii) Mr. Muhammad Asad | Chief Investment Officer,
AI – Meezan Investment Management Limited |

Assisting the Director (SMD)

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|------------------------|--------------------|
| (i) Mr. Amir Saleem | Deputy Director |
| (ii) Ms. Tayyaba Nisar | Assistant Director |

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SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Surveillance and Special Initiative Department)

ORDER

- 1 This order shall dispose of the proceedings initiated through Show Cause Notice bearing No. SMD/MSW/Al-Meezan/66/2014-551 dated June 18, 2014 (“**the SCN**”) issued by the Securities and Exchange Commission of Pakistan (“**the Commission**”) under Section 15E(3) of the Securities and Exchange Ordinance, 1969 (“**the Ordinance**”) to Mr. Muhammad Shoab, Chief Executive Officer of Al Meezan Investment Management Limited (“**the Respondent**”).
- 2 The brief facts of the case are that the Respondent is the Chief Executive Officer (“**CEO**”) of Al Meezan Investment Management Limited (“**AMIML**”). AMIML is registered as a Non - Banking Finance Company under the Non - Banking Finance Companies (Establishment and Regulation) Rules, 2003 and NBFC Entities Regulations 2007 with the Commission to do the business of asset management and investment advisory. AMIML is also licensed as a Pension Fund Manager under Voluntary Pension System Rules, 2005.
- 3 Karachi Stock Exchange Limited (“**KSE**”) published its notice announcing re-composition of KSE – Meezan 30 Index (“**KMI - 30**”) on May 27, 2014 at 05:40 pm, vide which the list of Incoming and Outgoing Companies of KMI – 30 were announced as follows:

Sr. #	Incoming Companies	Outgoing Companies
1	ICI Pakistan	Lafarge Pakistan Limited
2	Kot Addu Power Company	Lotte Chemical Limited
3	Pioneer Company Limited	Pakgen Power Limited

- 4 The perusal of data of Karachi Automated Trading System (“**KATS**”) for May 27, 2014 showed that two funds of AMIML namely Meezan Islamic Fund (“**MIF**”) and Meezan Tahaffuz Pension Fund (“**MTPF**”), herein after referred as **the Funds**, traded in the scrip of ICI Pakistan Limited (“**ICI**”) and Pioneer Cement Limited (“**PIOC**”) in both Ready and Off – Market. Summary of the trading is given below:

MEEZAN ISLAMIC FUND					
DATE	MARKET SEGMENT	SYMBOL	MEMBER NAME	BOT_QTY	SOLD_QTY
2014-05-27	Ready	ICI	Taurus Securities Limited	0	440,000
2014-05-27	Ready	PIOC	Shajar Capital Pakistan (Pvt.) Ltd	150,000	0
2014-05-27	Off - Market	PIOC	Shajar Capital Pakistan (Pvt.) Ltd	1,046,000	
				1,196,000	440,000
MEEZAN TAHAFFUZ PENSION FUND					
ORD_DATE	MARKET SEGMENT	SYMBOL	MEMBER NAME	BOT_QTY	SOLD_QTY
2014-05-27	Ready	ICI	Arif Habib Ltd.	80,000	0
2014-05-27	Off - Market	PIOC	Shajar Capital Pakistan (Pvt.) Ltd	142,000	
				222,000	0

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SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Surveillance and Special Initiative Department)

- 5 Further, details of trading data of ICI for May 27, 2014 and May 28, 2014 revealed that MIF sold – off its position to Al Meezan Mutual Fund and MTFP and subsequently purchased majority of the shares from both Funds on May 28, 2014. It is pertinent to mention that the said transactions by MIF, MTPF and Al Meezan Mutual Fund contributed to majority volume in the scrip. The details of the transaction is summarized as below:

Trade Date	Name	Counter Party Name	Bought Qty	Sold Qty
2014-05-27	Meezan Islamic Fund	Al Meezan Mutual Fund		360,000
		Meezan Tahaffuz Pension Fund		80,000
	TOTAL			440,000
2014-05-28	Meezan Islamic Fund	Al Meezan Mutual Fund	345,400	
		Meezan Tahaffuz Pension Fund	77,800	
	TOTAL		423,200	

- 6 The information pertaining to minutes of meeting of Islamic Index Policy Committee (“Committee”) dated May 26, 2014 were obtained from KSE, which provided the copy of circular for approval of KMI – 30 re-composition by the Committee. The circular was signed by the Respondent and Mr. Ali Hassan Khan, Head of product Development of AMIML on behalf of AMIML.
- 7 The review of Fund Monthly Report of AMIML for the month of May 2014 depicts that the Respondent is a member of Investment Committee (“IC”) of AMIML and is responsible for investment decision making of the Funds of AMIML.
- 8 Keeping in view of the above, prima facie, it appeared that the Respondent passed on inside information regarding the Incoming and Outgoing Companies in KMI – 30, which he possessed by virtue of his position as a member of the Committee and based on which the Funds traded in the shares of PIOC and ICI just before the public dissemination of the notice. Therefore, explanation was sought from AMIML to provide the rationale of the transaction in question vide letter dated June 18, 2014. AMIML, vide letter dated June 24, 2014 submitted its response. Relevant segment of the response is reproduced hereunder:
- Out of the three incoming companies in the KMI – Index 30, MIF only increased exposure in the scrip of PIOC through Ready and Off Market due to availability of large block of shares. MIF had started increasing the exposure in the scrip of PIOC on May 22, 2014 which was far prior to the meeting of KMI Re-composition Committee.

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Securities Market Division
(Market Surveillance and Special Initiative Department)

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- On the other hand MIF has reduced its exposure in ICI by selling 440,000 shares. Further, in case of ICI, if it had to take benefit of information of Index re-composition, it had not sold ICI, rather purchased it.
 - Investment of MTPF is different from the rest of the Funds and exposure in ICI and PIOC was increased only due to realization of major inflows which was deployed accordingly.
 - AMIML also holds exposure in the scrip of Pakgen Power Limited, which was an outgoing company on the KMI – Index as per announcement of May 27, 2014. Had AMIML intended to trade on the basis of preferential information it would have sold off its position in Pakgen Power Limited.
 - The rebalancing of Index was previously done on December 16, 2013 and none of the funds of AMIML had been involved in the trading of any incoming or outgoing companies in the KMI – 30 Index in the history.
- 9 However, the explanation submitted by AMIML was not found satisfactory, therefore a SCN dated July 03, 2014 was issued to the Respondent as to why action should not be taken against him under section 15E (3) of the Ordinance for passing on material non-public information to the Funds. The Respondent was required to submit his written reply to the SCN within ten days of the SCN and appear before the undersigned on July 18, 2014 for hearing in the matter.
- 10 The written response by the Respondent was submitted vide letter dated July 10, 2014.
- 11 On the date of hearing Mr. Muhammad Asad, Chief Investment Officer and Mr. Muhammad Rashid Zafar, Head of Internal Audit and Compliance appeared to represent the Respondent. The assertions made by the Respondent in its written reply and by the Representatives of the Respondent during the course of hearing are summarized below:
- a) *AMIML started increasing its exposure in PIOC on May 22, 2014 which was well before the actual notice of re-balancing of the KMI – 30 or even before the date of meeting of the Committee for re-composition of KMI – 30. Further, decision for investment in the scrip of PIOC was done on May 19, 2014.*



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Surveillance and Special Initiative Department)

- b) *PIOC is relatively illiquid scrip and due to availability of large block of shares from an interested seller, the purchase was made in the scrip on May 27, 2014 through Negotiated Deal Market ("NDM").*
- c) *Purchase of 150,000 shares of PIOC by MIF in the Ready Market was done on Rs. 46.13 and the purchase of 1.046 Million shares of PIOC in NDM was executed at Rs. 47.00, wherein both the transactions were executed near or above the closing rate of May 27, 2014 which was Rs. 46.56.*
- d) *Investment in the scrip of PIOC is not for trading purposes but it is due to the fact that it is fundamentally attractive as per AMIML's analysis.*
- e) *Further, trading in the scrip of ICI indicates that MIF actually sold off 440,000 shares of ICI despite the fact that it was included in the KMI – 30. Had AMIML intended to trade on the basis of information pertaining to re-composition of KMI – 30, it should have increased the exposure instead of selling the stock.*
- f) *Moreover, the investments policies and limits of MTPF are different than rest of the funds of AMIML. The exposure of PIOC and ICI was increased in MTPF – Equity which was due to realization of major inflows that were deployed accordingly.*
- g) *No funds of AMIML other than the Funds took positions in the scrips highlighted in KMI – 30 re-composition. Activity in the scrips of PIOC and ICI was done on the basis of the fundamental decisions, rather than by the Respondent's intention to benefit from the insider trading.*
- h) *The Representatives of the Respondent during the course of hearing submitted minutes of meeting of IC dated May 19, 2014; which contained the recommendation for purchase of shares of ICI and PIOC by AMIML.*
- i) *It was also contented that there is no such history of AMIML for information based trading. And the instances in questions were purely coincidental and without any malafide intention.*



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Surveillance and Special Initiative Department)

- j) *During the course of hearing, the Representatives of the Respondent highlighted the procedure of KMI – 30 re-composition. There are two segments of KMI – 30 re-composition, and AMIML is only concerned with the Shariah compliance of the companies, which are short listed by KSE. The decision for inclusion or exclusion of a company in KMI - 30 lies with KSE, whereby AMIML performs Shariah Screening of the said companies.*
- k) *The final list of Incoming and outgoing companies is finalized through circular, not through a meeting. The KSE on May 26, 2014 emailed the KMI – 30 Memo to AMIML to obtain the signatures of the participants of AMIML in order to confirm the list of incoming and outgoing companies. The notice for the same was circulated on May 27, 2014.*
- l) *Further, IC of AMIML decides for investment in the shares and pricing is done by the Fund Managers. Investment in PIOC was done on the basis of positive news and was long term investment not for purpose of benefitting due to information available to the Respondent.*
- m) *They further contended during the hearing that the selling of ICI by MIF to Al Meezan Mutual Fund and MTPF on May 27, 2014 and subsequent purchase on May 28, 2014 from the same entities is for the purpose of gain realization. The transaction was not executed in NDM due to objection raised by its auditors in the past. The Fund Managers of MIF, MTFP and Al Meezan Mutual Fund are different.*
- n) *However, currently there is no mechanism in place to avoid such conflict of interest. The Representatives of the Respondent assured the such scenario will be taken care of in future to avoid the situation.*
- 12 After the hearing Mr. Ali Hassan Khan submitted a copy of the email dated May 26, 2014 which was forwarded by KSE to AMIML.



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Surveillance and Special Initiative Department)

13 Subsequently, the Commission received a letter from AMIML dated August 08, 2014 seeking another opportunity of hearing. The Commission vide letter dated September 15, 2014 acceded to the request and hearing was fixed on September 23, 2014.

14 On the date of hearing the Respondent and Mr. Muhammad Asad appeared to represent their view. The assertions made by the Respondent in its written reply and during the course of hearing are summarized below:

a) *The circumstantial chronology of events as alleged in the SCN suggests that the Funds of AMIML indulged in insider trading on the basis of inside information. Further, on the face of it, any changes in the composition of a widely followed and tracked index can be construed as "insider information". Internationally there are multibillion dollars funds which track the index in their investment strategies. Whereas, KMI – 30 index is a very smaller index with approximate worth of less than Rs. 1 billion and currently is tracked by only one fund namely KMI Index Fund.*

b) *A comparative of weightage of the incoming companies in the KMI – 30 Index is presented as follows:*

• KAPCO	– 4.08%
• ICI	– 0.76%
• PIOC	– 0.48%

Based on Index tracking fund size worth Rs. 1 billion, an investment of Rs. 40.80 million will flow into KAPCO, Rs. 7.60 million in ICI and Rs. 4.80 million in PIOC during the period when index tracker funds will do the relocation of their funds to align it with the index. Based on the price of the scrip on May 27, 2014 a natural demand of 680,680 shares, 19,498 shares and 103,093 shares of KAPCO, ICI and PIOC, respectively would be generated.

c) *This background information and statistics lead to the conclusion that small changes in the index which is not widely tracked, are not likely to have significant market impact on the price of the security.*

d) *Further, keeping in view the Commission's contention that the re-composition of the index was an inside information, AMIML should have opted for investment in the scrip of KAPCO out of the three incoming companies, however, it invested in PIOC which possessed the least weightage.*

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SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Surveillance and Special Initiative Department)

- e) *Rationale of investment in PIOC was purely based on fundamental analysis and was recommended by the research team in the meeting of Investment Committee of AMIML held on May 19, 2014. The minutes of the said meeting and presentation by the research team recommending the "BUY" stance for PIOC were also presented.*
- f) *There were three incoming and three outgoing companies in KMI – 30 Index and wherein, the funds of AMIML only invested in scrip of PIOC and sold ICI. Further, total trading executed by the Funds of AMIML in PIOC on May 27, 2014 constitutes less than 6% of the total volume of the the scrip that day.*
- g) *The Representatives accepted the circumstantial events indicate that the Respondent was an insider being a member of the Committee and member of the IC of the Funds at the same time and the information pertaining to the re-composition of the KMI – 30 is an inside information. But also contended that there was no malafide intention of the Respondent in the execution of the said transactions by AMIML. Further, the Respondent has also committed to develop a Chinese wall at AMIML to avoid such conflict of interest in future.*
- h) *The Respondent submitted that AMIML is already working in collaboration with KSE to avoid any such situation occurring in the future and also sought advice of the Commission to adopt a careful approach in future.*

15 I have thoroughly analyzed and examined the facts, evidence and documents on record, in addition to the written replies to SCN and assertions made by the Representatives of the Respondent during the hearings and my findings on the issues are as follows:

- a) The approval of re-composition of KMI – 30 was done on May 26, 2014 through circular by the members of Islamic Index Policy Committee. The members of the Committee included Mr. Nadeem Naqvi, Mr. Haroon Askari and Mr. Mohammad Hussain from KSE, Mr. Imran Usmani and Mr. Farhan Usmani from Meezan Bank Limited and Mr. Muhammad Shoaib and Mr. Muhammad Aasid from AMIML.
- b) KMI – 30 is co-branded index developed and managed by KSE and AMIML. As per the roles assigned to AMIML and KSE in the KMI Agreement, AMIML performs Shariah Screening and KSE performs the Technical Ranking based on 50% Free Float and 50%

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SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Surveillance and Special Initiative Department)

Impact Cost. It is pertinent to mention that the inclusion/ exclusion of scrip sat KMI – 30 is a price sensitive information and may affect the liquidity and price of the scrip.

c) AMIML is a renowned institution and holds a reliable reputation in the market, therefore it attracts a significant responsibility to refrain from the actions which raise conflict of interest.

16 On review of the arguments, made both in written and verbal form, it is noted that the Respondent admitted a number of points which were raised in the SCN according to which by definition, the Respondent was insider being a member of the Committee and member of the IC of the Funds at the same time. In this connection as stated in the SCN the Respondent falls under the definition of Insider as defined under Section 15C (1a) of the Ordinance at the time of trading of aforementioned shares by the Funds.

17 From the facts of the case mentioned above, it is established that the Respondent being the member of the Committee, at the time of trading of shares by the Funds, was an insider and had prior information regarding incoming and outgoing companies of KMI – 30. Further the pattern and timing of trading also leads to the suspicion that trading by the Funds might be based on inside information provided by Respondent but in the absence of any clear and convincing evidence and any benefit made thereafter, the preponderance of evidence is in favor of the Respondent. The Commission is convinced of the fact that although by definition and on the basis of the chronology of the events, AMIML has indulged in the insider trading on the basis of the inside information disclosed to it by the Respondent, but the supporting documents and clarifications made, have established that there was no malafide intent behind the execution of such transaction. However, it signifies an act of negligence committed by the Respondent while being at a responsible position which demanded more confidentiality and transparency.

18 It is noted with deep concern that the Respondent holding a responsible post at a reputable institution is entrusted with a duty to carry out the activities with responsibility and strictly abided by the law. It was his duty to keep a close eye on the operations of the Funds and ensure that its operations are conducted in such a manner that no violation of regulatory framework is exercised or conflict of interest arises. By virtue his position being on member of both



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division
(Market Surveillance and Special Initiative Department)

committees, the duty to exercise reasonable care, skill and diligence in case of Respondent was heightened.

- 19 In view of the forgoing, the Respondent is hereby warned with directions to ensure that appropriate controls should be developed and implemented to check that inside information is not disclosed in violation of section 15 E (3) of the Ordinance. Further, it is also directed that the investment policies of the Funds should be reviewed especially with regards to investments in the shares of such companies which are under review for inclusion in / exclusion from in KMI – 30.
- 20 This Order is issued without prejudice to any other action that the Commission may initiate against the Respondent in accordance with law on matters subsequently investigated or otherwise brought to the knowledge of the Commission or on the same facts for violation of any other provision of the Ordinance.

(Abid Hussain)
Director/HOD (MSSID)

Announced on 3.10.2014
Islamabad.