



**Securities and Exchange Commission of Pakistan
Specialized Companies Division**

No.SCD-SD(Enf)/MCB-AHSIL/2014/321

BEFORE THE EXECUTIVE DIRECTOR

IN THE MATTER OF MCB-ARIF HABIB SAVINGS & INVESTMENTS LIMITED

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 37(3)(g) & Regulation 38(n) read with Regulation 6(3) of the Non-Banking Finance Companies & Notified Entities Regulations 2008

No. and date of Show Cause Notice (SCN)	No.SCD-SD(Enf)/MCB-AHSIL/2014/161 dated June 27 , 2014
Date of 1 st Hearing:	August 08, 2014
In Attendance:	1. Mr. Yasir Qadri – Chief Executive Officer - CEO (in personal capacity and on behalf of the Company & other Respondents) 2. Mr. Saqib Salim – Company Secretary (on behalf of Respondents) 3. Mr. Muhammad Asif Mehdi Rizvi – Head of Internal Audit & Compliance
Date of 2 nd Hearing:	September 08, 2014
In Attendance:	1. Mr. Yasir Qadri – Chief Executive Officer - CEO (in personal capacity and on behalf of the Company & other Respondents) 2. Mr. Saqib Salim – Company Secretary (on behalf of Respondents) 3. Mr. Muhammad Asif Mehdi Rizvi – Head of Internal Audit & Compliance 4. Mr. Rabel Ahmed – Advocate (representing Mr. M. Asif Mehdi)

ORDER

1. This order shall dispose of the proceedings initiated against MCB-Arif Habib Savings and Investments Limited (Formerly: Arif Habib Investments Limited) (hereinafter referred as **"Company"** or **"AMC"**) and its officers through a Show Cause Notice (**"SCN"**) dated June 27, 2014 issued under Section 282J (1) read with Section 282D and Section 282M of the Companies Ordinance, 1984 (the **"Ordinance"**) for violation of Regulation 37(3)(g) & Regulation 38(n) read with Regulation 6(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 failing to manage investments of MCB Dynamic Allocation Fund (MCB-DAF) for 225 days as per the requirements of the constitutive documents (*the trust deed, offering document and other principal documents, including all related material agreements*) of the fund which is a violation of Regulations (37)(3) (g) and 38 (n) of the NBFC Regulations. "
3. The SCN was issued to the Respondents encompassing the following facts;
 - i. On May 31, 2014, investment of MCBDAF in government securities was observed to be 65.8% of its net assets. Similar investment pattern was observed in MCBDAF during the different periods starting from September 19, 2013 till May 31, 2014 against the limit of 50% of net assets restricted vide clause 14.6 of the offering document of MCBDAF. Details of investments in government securities by MCBDAF is as under;

Period	Range - Exposure to Govt. Securities as % of net assets	No. of days
19 Sep 2013 – 25 Dec 2013	51.63% - 75.28%	98
23 Jan 2014 – 24 Mar 2014	57.35% - 82.58%	61
27 Mar 2014 – 31 May 2014	59.54% - 70.80%	66
Total Number of Days		225

- ii. As per Clause 14.6 of the offering document of MCBDAF, the fund is only permitted to take exposure up to 50% of its net assets in government securities at any point in time. Moreover, Clause 14.6 of the offering document also provides exposures to different investment avenues/assets classes for MCBDAF including exposure in listed equity/debt securities up to 100%; exposure in unlisted equity securities up to 25%; exposure in unlisted debt securities (minimum A- rated) up to 100%; exposure in Modaraba/Musharaka Certificates / Sukuks / Debentures up to 50%; Deposits with commercial bank (minimum BBB rated) up to 50% etc.
- iii. Regulation 37 (3) (g) of NBFC Regulations 2008 requires Investment Committee to ensure investments of CIS(s) shall not deviate from the Constitutive documents or the Regulations or directions given by the Commission. However, prima facie Investment Committee of MCBDAF failed to manage the investments of MCBDAF according to its constitutive documents. During the periods starting from September 19, 2013 – May 31, 2014, for 225 days investment of MCBDAF in government securities were observed to be maintained more than 50% of its net assets.



- iv. Further, Regulation 38 (n) of NBFC Regulations 2008 requires AMCs to manage CIS(s) according to their constitutive documents, NBFC Rules & Regulations, Circulars and directives issued by the Commission. However, AMC also failed to manage MCBDAF according to its constitutive documents.
 - v. Regulation 6 (3) of NBFC Regulations 2008 requires the Internal Audit & Compliance function of AMC to monitor compliance with the Ordinance, Rules and Regulations. However the internal audit and compliance function at MCB-AHSIL also failed to capture the said non-compliance and inform the respective investment function at AMC.
 - vi. Consequently, the unit holders of the fund who invested in MCBDAF in view of the authorized investments, disclosed under the constitutive documents were totally misled as the investments of MCBDAF were not made in accordance with the mandate given by the unit holders of the fund.
4. In response to the subject SCN , the CEO of AMC vide letter dated July 04, 2014 contended that;
- i. *"The Offering Document of MCB-DAF was issued on March 12, 2008, in order to incorporate the changes required by NBFC Regulations dated November 21, 2008 and SECP's Circular No. 7 of 2009 dated March 06, 2009, the AMC submitted First Supplemental Offering Document the Commission on September 12, 2012 along with Trustee Consent for SECP's approval. These changes also include the change of exposure limit of Government Securities from 50% to 100%.*
 - ii. *AMC received final comments from SECP vide email dated May 23, 2013 wherein change of exposure limit of Government Securities was not mentioned in the comments. Meanwhile SECP also approved the Second Supplemental Offering Document of MCBDAF on May 17, 2013. On receipt of approval of Second Supplemental Offering Document, the AMC inadvertently concluded that the changes of First Supplemental Offering Document had also been approved and aligned the exposure of MCBDAF according to the First Supplement Offering Document.*
 - iii. *It is to be stated that SECP vide Circular No. 7 of 2009 allows Asset Allocation Funds to invest its assets in any type of securities at any time with a provision to diversify its net assets across multiple types of securities and investment styles as specified in their Offering Document and the Management Company had sent the amendment to Offering Document to allow the Fund to take benefit of investing in*



all Asset categories irrespective' of duration and rating as allowed in aforementioned Circular.

- iv. *Notwithstanding anything stated above, it is further submitted that the management have been disclosing the actual holding of Government Securities to the Unit Holders and Trustee through the Fund Manager's Reports and Financial Statements and to the SECP through monthly SECP Reporting.*
 - v. *It is therefore humbly requested to please take lenient view on this matter as the interest of Unit Holders of MCBDAF has not been compromised."*
5. Further, the CEO of AMC vide letter dated July 12, 2014 also contended that;
- i. *On identification of the non-compliance by the SECP through the SCN the internal audit and compliance department as well as fund manager have updated their Daily Compliance Monitoring Sheets and assure that similar non-compliance would not occur in future. Moreover, we are in the process of developing automated controls to mitigate these types of non-compliance.*
 - ii. *We humbly regret and apologize on the occurrences of the subject non-compliance and assure that the management has developed controls which will significantly reduce the possibility of reoccurrence of similar non-compliances."*
6. During the course of Hearings, the Respondents argued that;
- i. The exposure breach of government securities in MCBDAF was not willful. It all happened due to the misunderstanding on their part. Initially, they applied for the amendments of first supplemental offering document to increase exposure in government securities from 50% to 100% along with change of benchmark of MCBDAF. The initial application was pending and in the meantime they further applied for second supplemental offering document. There was no difference of opinion on the increase of exposure limits between the AMC and the SECP. However, they were informed to change the benchmark of the fund. In the meantime, SECP approved the second supplemental offering document and they inadvertently assumed that the exposure limit has also been approved with the second supplemental offering document.
 - ii. Due to the said misunderstanding, the investment committee of MCBDAF decided to increase exposure in government securities and as soon as the non-compliance was raised by SECP through the SCN, the exposure of MCBDAF in government securities was brought under the authorized limits given in the

offering document. Similarly, due to the said reason the internal audit and compliance function of the AMC also did not observe and report the said non-compliance to the respective investment function at AMC. However, the investment was made in government securities which are relatively secure investments as compared to investments in debt securities or equity securities and interest of the unit holders were protected to the best of their efforts.

- iii. Respondents regretted the misunderstanding on their part. The CEO of AMC further added that they would improve their systems and controls so that such violations could not occur in future.
7. The CEO of MCBHSIL vide letter dated October 20, 2014 also apprised the SECP about their endeavor to minimize the chances of reoccurrence of subject violations and stated;
- i. *"The Board of Directors of AMC in their meeting held on September 09, 2014 has decided to segregate the Compliance Department from Internal Audit Department. Since then the Compliance Department is working under the supervision of the CEO and Internal Audit Department is continuing reporting to Audit Committee.*
 - ii. *The Management of the AMC intends to build a comprehensive Module which would encompass not only the Regulatory Compliances but also internal compliances that has been placed by the management through Constitutive Documents and decision of Investment Committee Meetings. Further, scope of work for the Module has been finalized with the Management and I.T. Department; and development work has also started which would generate reports on various exposure limits given under the regulatory framework and internal guidelines. Further, for all Funds having Listed Equity exposures both Sector limits and Company Limits are being monitored through the System."*
8. I have considered the explanations given by the Respondents through their written submissions and during the course of hearings in the matter, 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 MCBHSIL should not have made additional investments in government securities before the amendment was approved by the SECP in the offering document of the fund. The Respondents admitted their mistake, apologized and regretted on this violation and pledged to install better systems and controls so that such violations shall not occur in future. The Board of Directors of MCBHSIL has segregated the compliance function from the internal audit function and also installed



the compliance module in their Plex Asset System to enforce effective controls over the activities of the funds under their management.

9. The Respondents were expected to adhere with the requirements of prevailing regulatory framework and constitutive documents for making investments as per the prescribed limits only. At this point I would also like to make it clear that, there is no space for any misunderstanding and self-assumptions in the business involving the management of public funds and in case of any ambiguity pertaining to the approval of amendments in the offering documents, the Respondents should have sought clarifications from the SECP rather than exercising their own assumptions. The asset manager must act according to the commitment made in the offering documents issued at the time of raising funds from the general public and the amendments made/approved thereafter.
10. After careful consideration of the facts, admitted default by the Respondents, request of the Respondents to take a lenient view in the matter due to unintentional mistake and their firm commitment to avoid such instances in future, I am inclined to take a lenient view, resultantly I impose no penalty 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 and constitutive documents are followed in letter and spirit.
11. The management of MCBAHISL is directed to ensure placement of appropriate controls, so that reoccurrence of such violations are eliminated and that the funds are managed strictly in accordance with the NBFC Regulatory Framework.
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