



# SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

**Before The Director / HOD (Market Supervision & Capital Issue Department)**

**In the matter of Show Cause Notice no. 1(14)FFC/MSW/SMD/2011/02 dated November 23, 2011**

**issued to Fauji Fertilizer Company Limited Provident Fund**

**under Section 15 E of the Securities and Exchange Ordinance, 1969**

**Date of Hearing:**

*January 06, 2012*

**Present at Hearing:**

*Representing Fauji Fertilizer Company Limited Provident Fund:*

- |                               |   |
|-------------------------------|---|
| <i>(i) Mr. Zahir Riaz</i>     | <i>Partner, Orr Dignam &amp; Co</i>     |
| <i>(ii) Mr. Anjum Tanveer</i> | <i>Senior Advocate</i>                  |
| <i>(iii) Muhammad Jamil</i>   | <i>Assistant Executive Finance, FFC</i> |

*Assisting the Director / HOD (MSCID)*

- |                                       |                           |
|---------------------------------------|---------------------------|
| <i>(i) Mr. Muhammad Atif Hameed</i>   | <i>Deputy Director</i>    |
| <i>(ii) Ms. Natasha Jehangir Khan</i> | <i>Deputy Director</i>    |
| <i>(iii) Mr. Umair Zahid</i>          | <i>Assistant Director</i> |

1. This order shall dispose of the proceedings initiated through Show Cause Notice no. 1(14)FFC/MSW/SMD/2011/02 dated November 23, 2011 (“SCN”) issued by the Securities and Exchange Commission of Pakistan (“**the Commission**”) under Section 15E of the Securities and Exchange Ordinance, 1969 (“**Ordinance**”) to Fauji Fertilizer Company Ltd Provident Fund (“**the Respondent**”) through its Board of Trustees comprising of the following at the time of issuance of SCN:

- i) Lt. Gen (Rtd.) Malik Arif Hayat - Chairman
- ii) Brig. (Rtd.) Akhtar Abbas Janjua - Trustee
- iii) Mr. Saulat Hussain – Trustee
- iv) Mr. Nasir Mahmood Khan – Trustee
- v) Mr. Naik Muhammad Hanif – Trustee



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2. The Respondent is governed by its Trust Deed and the Rules made thereunder and the members or beneficiaries of the Respondent are permanent employees of Fauji Fertilizer Company Limited (“FFC”).
3. Through its notice dated January 3, 2011, addressed to the three stock exchanges, Fauji Fertilizer Bin Qasim Limited (“FFBL”) announced that the meeting of Board of Directors (“BOD”) of the Company will be held on January 25, 2011 to consider the Annual Accounts for the year ended December 31, 2010. Subsequently on January 25, 2011 FFBL announced its financial results for the year ended December 31, 2010 wherein it announced Earning Per Share (“EPS”) of Rs. 6.97 over last year EPS of Rs. 4.50. The Company also announced final Cash Dividend of 35%.
4. Moreover, FFC in its notice dated January 19, 2011, addressed to the three stock exchanges and the Commission disclosed that the meeting of Board of Directors of FFC will be held on January 27, 2011 to consider the Annual Accounts for the year ended December 31, 2010. Subsequently, on January 27, 2011 FFC announced its financial results for the year ended December 31, 2010 wherein it announced EPS of Rs. 16.25 over last year EPS of Rs. 13.00. The Company also announced final Cash Dividend of 35% and Bonus Shares of 25%.
5. The perusal of Off Market trading data of KSE for January 24, 2011 showed that the Respondent bought 5,000,000 shares of FFBL. Moreover, the review of trading data of Karachi Automated Trading System (“KATS”) of the KSE revealed that the Respondent bought 65,217 and 1,966,460 shares of FFC on January 25, 2011 and January 26, 2011 respectively.
6. Keeping in view the above, the matter was taken up with FFC vide letter dated February 18, 2011. Subsequently, various correspondences were exchanged with the FFC on the matter which submitted its replies and supporting documents. The review of documents provided by FFC showed that the Chairman of the Board of Trustees of the Respondent is Lt. Gen (Rtd.) Malik Arif Hayat (“MAH”) who was also Chief Executive/Managing Director of FFC and Director of FFBL at the time of purchase of aforementioned shares by the Respondent. Furthermore, it was also observed



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that the Board of Trustees in its meeting held on September 8, 2010 appointed Investment Committee (“IC”) comprising of employees of FFC for management of investment portfolio of the Respondent. The detail of said members of IC is given in Table – I below:

**Table - I**

Sr. No.	Name	Position in FFC
1.	Mr. Taqi Ahmed Khan	Senior Manager Finance (Portfolio)
2.	Mr. Riaz Ahmed	Manager Finance (Payroll & Employee Funds)
3.	Mr. Muhammad Jamil	Asst Exec Finance (Employee Funds)

7. From the aforesaid, *prima facie*, it appeared that MAH passed on inside information to IC of the Respondent regarding improved financial positions of FFC and FFBL, which he possessed by virtue of occupying his positions in the Companies and based on which the IC purchased the aforesaid shares on behalf of the Respondent just before the public dissemination of financial results. Therefore, SCN was issued to the Respondent through its Board of Trustees as to why action should not be taken against it under section 15E of the Ordinance for engaging in Insider Trading by trading in the shares of FFC and FFBL on the basis of inside information. The Respondent was required to submit its written reply to the SCN within ten days of the SCN and appear before the undersigned on December 7, 2011 for hearing in the matter.
8. In response to the SCN, M/s Orr Dignam & Co Advocates (“**the Legal Counsel**”) vide letter no. R/6214 dated December 2, 2011 informed that they have been engaged by the Respondent to file reply and appear on its behalf in the matter of the SCN. Moreover, the Legal Counsel also requested for extension in the date of submission of written reply till December 20, 2011 and date of hearing afterwards.
9. The aforementioned request of the Legal Counsel was acceded to vide letter No. 1(14)FFC/MSW/SMD/2011/06 dated December 8, 2011 in the interest of justice and they were required to submit written reply to the SCN by December 20, 2011. The Legal Counsel submitted its written reply to the SCN vide letter no. R/AT/6248 dated December 20, 2011.



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10. Subsequently, vide letter no. 1(14)FFC/MSW/SMD/2011/07 dated December 29, 2011 the date of hearing was fixed for January 06, 2012. On the date of hearing Mr. Zahir Riaz, Partner Orr Dignam & Co and Mr. Anjum Tanveer Senior Advocate appeared on behalf of the Respondent. Moreover, Legal Counsel was also accompanied by Mr. Muhammad Jamil, Assistant Executive- Finance FFC who is also member of IC of the Respondent. The assertions made by the Legal Counsel in its written reply and during the course of hearing are summarized below:

- a. *The basis of para 1 to 4 of the SCN is the fact that MAH happens to be Chief Executive/Managing Director of FFC, a Director of FFBL and the Chairman of Board of Trustees of the Respondent. Accordingly it has been assumed that, by virtue of MAH occupying these positions, he must have been responsible for having released information which led to the investment decision by the Respondent. This view is circumstantial and is not based on any evidence. It has been incorrectly assumed that MAH had access to inside information on the relevant dates. MAH was not involved in any manner in passing on/disclosing or dealing with inside information regarding the actual or projected financial results or profits of FFBL and FFC to the Respondent or any of members of IC.*
- b. *MAH had knowledge only to the extent of the financial results of FFC for the year ended December 31, 2010 in his capacity as Chief Executive FFC. Of this period, the financial results of first nine months had been published and were in public knowledge. However, MAH was not aware of the expected announcement for any pay-out (i.e. expected dividends and bonus to be announced) by the Companies. The decision regarding dividends and bonus shares was taken and approved by the BOD of the Companies during the BOD meetings which were held after the shares were purchased by the Funds. The transactions in question had already taken place when the inside information was divulged to the BOD of FFC. MAH had no means of knowing the final decision of the BOD of the Companies in this regard and could not, therefore, have passed on such inside information to the Respondent as such the inside information only came into existence after the transactions had concluded and the shares in question had already been purchased by the Respondent. With regard to FFBL the position of MAH is that of one of the several directors on the BOD of FFBL. MAH*



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*does not have access to information that is not available to other directors. MAH was not aware of the expected distribution by the Companies before the holding of BOD meeting of the Companies.*

- c. The Trustees of the Respondent have appointed three employees of FFC as the members of the IC through their resolution dated September 8, 2010 to manage expeditious transactions and management of investment portfolio, of the Respondent, including purchase and sale of shares. The IC is independent entity distinct from FFC and MAH is not member of the IC. The decisions regarding investment in shares are independently taken by the IC and MAH is not involved in day to day matters and affairs regarding the routine operations of the Respondent. The IC comprises of middle level officers who have no direct or indirect access to the BOD of the Company and are not privy to notices or decisions of the BOD of FFC. Naturally they have no connection at all with the decisions taken by the BOD of FFBL. The IC has, as matter of policy, been kept distinct from the Chairman and other Trustees of each Fund, in order to ensure the highest degree of transparency. The decisions of the each IC are independent with out any requirement of approval or endorsement by FFC or its BOD or management of FFC. The members of IC have no knowledge of the actual or projected financial results of the Companies. These officers are mandated to invest in the shares as and when funds are available with the Respondent. Their function is independent and they are not required to report or justify their decisions to the Chairman of the Board of Trustees of the Respondent. In order to ensure the independence of the IC of the Respondent, FFC has deliberately ensured that the IC is comprised of relatively junior management.*
- d. The investment in the Companies shares is treated as fixed income by the Respondent. MAH neither has any interest in the choice of the investment made by the IC nor was he present at the meetings of the IC. There is no basis in fact for the allegation that he provided inside information to any member(s) of the IC.*
- e. The quarterly accounts of the listed companies are published within one month of the close of the accounting period. Accordingly, all material information of the Companies for the last nine*



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month period was in knowledge of the general public and the shareholders. Moreover, stock brokers, investment advisors, financial analyst and the Pakistan press and media project annual performance and anticipate financial results of the Companies which are normally very close to the actual results when announced. The annual results of FFC including the EPS happened to be in line with the market expectations due to this reason. All the information that could affect the market price of the shares of the Companies was already in the public knowledge and accessible to any interested person intending to review the same.

- f. It is common knowledge that both the Companies are highly successful listed companies with proven track record of success with significant profit and dividend declaration on an annual basis. Review of past results of the Companies shows that no particular expertise is involved in predicting the financial success of the Companies based on the past records alone. It is for this reason that the shares of the Companies are regarded as safe investment by several pension and employees funds. It does not require inside information to ensure a successful transaction in shares of the Companies given the consistently high profitability of the Companies proven over a period of time. The Respondent has only invested in shares of the Companies regularly as these are sound investments with a virtual guarantee of profit/return based on historical record. The decision by the IC to invest in shares of the Companies was neither sudden nor unusual or based on any inside information.
- g. The production and sale of Urea and DAP are compiled and announced by the Government of Pakistan at the end of each month (through Ministry of Industries and Production), analyst from different brokerage houses carry out assessment/ evaluations on the basis of this information and therefore publish the data for general consumption. It is, therefore, a simple exercise to project the EPS of any fertilizer company. The financial results of the Companies could have been calculated on the basis of public information for which no recourse to inside information was necessary. Moreover, FFBL is in monopolistic situation as it is the only DAP producer in the country.



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- h. *The trading in the shares of the Companies by the IC did not benefit any person including members of the IC and BOD of Trustees and beneficiary of the Funds.*
- i. *For the sake of argument if the IC of the Respondent wanted to use inside information then they could have:*
- (i) *purchased the shares on January 3, 2011 when the notice was issued to the BOD of FFBL and the price of the shares of FFBL was Rs. 35.08 rather Rs. 41.86 on the date of actual purchase.*
- (ii) *purchased the shares of FFC on January 20, 2011 when the notice was issued to the BOD of FFC and the price of the shares of FFC was Rs. 148.57 rather at Rs. 153.66 and Rs. 156.16 on the date of actual purchase.*
- j. *The time the IC actually decided to purchase the shares in question; their prices had risen substantially as investors pressed demand given the Companies historical dividend records. If there was intent of misusing the inside information then shares would have been acquired at an earlier date when price was low. The IC of the Respondent assumed that dividend would be high based on (i) historic record and (ii) published information accessible to all potential investors.*
11. During the hearing the Legal Counsel requested for a period of ten days to submit further documents in support of the said arguments, which was granted. Subsequently, the following documents were submitted through letter dated January 16, 2012:
- i) Notice dated January 19, 2011 addressed to MAH and all Directors regarding 145<sup>th</sup> BOD meeting to be held on January 27, 2011.
- ii) Notice dated January 17, 2011 addressed to MAH and all Directors regarding 86<sup>th</sup> BOD meeting to be held on January 27, 2011.
12. 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 Legal Counsel during the hearing and my findings on the issues are as follows:



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- i. On review of the arguments made both in written and verbal form, it is noted that the Legal Counsel of the Respondent has admitted to a number of points, which were raised in the SCN. The Legal Counsel accepted that MAH was insider of both the Companies. In this connection as stated in the SCN, MAH falls under the definition of Insider as defined under section 15C(1a) of the Ordinance as he was Chief Executive/Managing Director of FFC and is also Director of FFBL at the time of purchase of aforementioned shares by the Respondent. However, on review of documents provided by the Legal Counsel it was also observed that the members of the IC of the Respondent are also insiders, with regard to FFC, being part of Finance Department of the FFC. The above scenario also gives rise to the possibility that the members of the IC being part of the Finance Department of FFC had directly obtained inside information regarding financial results of the FFC without the involvement of MAH.
- ii. The Legal Counsel in its written reply and during the course of hearing contended that the financial results of the Companies are predictable with quite accuracy on the basis of the production figures of DAP and Urea which are announced by the Government of Pakistan at the end of each month through the Ministry of Industries and Production. In support of his arguments, the Legal Counsel provided data of fertilizer production from the fiscal year 1989-90 to 2009-10 along with copies of Research Reports from different brokerage houses which were issued days before the announcement of financial results of the Companies for the year ended December 31, 2010. The review of Research Reports provided by the Legal Counsel showed that the analysts' expectation regarding final results of the Companies were in line with the actual results. From perusal of the supporting documents there appears a possibility that the IC might have traded in the scrip of the Companies on the basis of expected results of the Companies. Having said that, this argument is mitigated by the fact that members of IC were insiders.
- iii. Further, the Legal Counsel during the hearing and in the written reply stated that the majority shares of both the Companies are owned by Fauji Foundation which historically requires maximum dividends from its subsidiaries in order to fund its welfare activities. Therefore, by end of 4<sup>th</sup> quarter, investors/brokers are aware that entire profit of the Companies will be distributed.





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In this regard it is pertinent to note that during the first three quarters of the year 2010 both companies had already distributed almost all the profit earned by them. Moreover, similar payment pattern was observed in the preceding years, which shows that the Companies as a practice distribute majority of its earnings.

- iv. During the hearing and in its written reply the Legal Counsel acknowledged that MAH was in possession of financial results of the FFC for the year ended December 31, 2010 in his capacity as Chief Executive/Managing Director of FFC. Whereas, with regard to the FFBL it was submitted that MAH had same level of information as other directors of FFBL. In this regard it may be noted that notice for meeting of BOD of FFBL was sent vide letter dated January 17, 2011 along with agenda items which implies that MAH was in possession of financial results of FFBL from January 17, 2011. From the aforementioned, it is clear that MAH was in possession of inside information regarding financial results of the Companies before the purchase of shares by the Respondent. Having said that there is no evidence on record to substantiate transmission of information from MAH to the IC. Further as stated above the members of the IC of the Funds being part of the Finance Department of FFC, were also privy to inside information. Therefore, it is highly likely that the trading by the Respondent in the shares of FFC was on the basis of inside information, regarding final results of the FFC, obtained directly by virtue of being member of Finance Department of FFC.
- v. This argument is further substantiated by the fact that the Legal Counsel in its written reply and during the course of hearing stated that the members of IC independently took the decision to purchase the shares of the Companies. The Trustees of the Respondent have constituted IC to manage investments expeditiously. In this regard, it may be noted that the review of the minutes of meeting of Board of Trustees of the Respondent wherein it was decided to constitute IC, transpires that IC was delegated the power to make investment decision on behalf of the Respondent, however, same did not show that MAH or any Trustee of the Respondent were barred from indulging in/monitoring the day to day affairs of the Respondent or from providing investment advice to the IC. The Legal Counsel also asserted that the members of IC are not answerable to the Board of Trustees of the Respondent regarding their investment decisions. This



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shows that the investment decision making process at the Respondent is completely entrusted to the members of IC who appear to be under no control of the Board of Trustees of the Respondent. It may be noted that the Trust Deed of the Respondent state that the funds are vested with the Board of Trustees of the Respondent, therefore, in spite of delegation of powers to IC the Board of Trustees of the Respondent are still responsible for the performance of the Respondent and delegation of powers does not in any way absolve them from their duties and responsibilities as Trustees of the Respondent.

- vi. In his written reply the Legal Counsel stated that the IC is mandated to invest in the shares as and when funds are available with the Respondent. Similar assertion was also made by FFC in its correspondence prior to the issuance of SCN. However, no evidence was provided in this regard which could prove that the shares in question were purchased due to availability of the excess funds.
13. From the facts of the case mentioned above, it is established that the members of the IC of Respondent by virtue of being members of the Finance Department of FFC were insider person and due to their position in FFC had information regarding financial performance of the FFC. Further the pattern of trading clearly establishes that the trading by the Respondent was based on inside information. Therefore, the case of insider trading against the Respondent is established on the basis preponderance of evidence and material on record against the Respondent.
14. Moreover, it is noted with deep concern that MAH being Chairman of the Board of Trustees of the Respondent and other Trustees have failed to monitor operations of the Respondent. It is their duty to keep a close eye on the operation of the Respondent and ensure that its operations are conducted in transparent manner. The Trustees are duty bound to exercise reasonable care skill and diligence in conducting the affairs of the Respondent. The manner in which the shares in question were purchased by the Respondent clearly defeats the main purpose i.e. transparency, for which the IC was constituted. The trading of the Funds in the scrip of the Companies clearly shows that the Respondent and Trustees of the Funds are not performing their duties towards the Respondent.



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15. In light of the above, in exercise of the powers under Section 15 E (1) of the Ordinance, I hereby impose a penalty of Rs. 500,000 (Rupees Five Hundred Thousand only) on the Respondent through its Trustees for contravention of the provision of sub-section (1) of the Section 15A by trading in the shares of FFC on the basis of inside information. I further direct the Respondent through its Board of Trustees to ensure that the operations of the Respondent are closely monitored by them and no trading is done on the basis of inside information in contravention of section 15 A of the Ordinance. Moreover, the Board of Trustees of the Respondent should also ensure that all the decisions of the IC are properly documented and brought to their notice. The investment policies of the Respondent should also be reviewed especially with regard to investment in the shares of group companies of Fauji Foundation.
16. The matter is disposed of in the above manner and the Respondent is directed to deposit the penalty as mentioned in paragraph above, in the account of the Commission being maintained in the designated branches of MCB Bank Limited not later than thirty (30) days from the date of this Order and furnish the copy of the deposit challan to the undersigned.
17. This Order is issued without prejudice to any other action that the Commission may initiate against the Respondent or any other person connected therewith in accordance with law on the 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.

**Imran Inayat Butt**  
Director / HOD (MSCID)

**Announced on April 13, 2012**

**Islamabad.**