



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
SPECIALIZED COMPANIES DIVISION

BEFORE COMMISSIONER (SPECIALIZED COMPANIES DIVISION)

IN THE MATTER OF SHOW CAUSE NOTICE ISSUED TO FIRST DAWOOD
INVESTMENT BANK LIMITED, THROUGH ITS CHIEF EXECUTIVE OFFICER
UNDER SECTION 282 J (1), J (2) & J (3) OF THE COMPANIES ORDINANCE, 1984

Date of hearing

March 5, 2018

Present on behalf of

- First Dawood Investment Limited*
- (i) *Mr. Rizwan-ul-Haq-Senior Executive Vice President*
 - (ii) *Syed Musharraf Ali- Chief Financial Office*
- Assisting the Commissioner (SCD)*
- (i) *Mr. Imran Inayat Butt-Executive Director*
 - (ii) *Mr. Nasir Askar- Director*
 - (iii) *Ms. Saima Ahrar-Joint Director*
 - (iv) *Mr. Rizwan-ul-Haq-Additional Joint Director*

ORDER

This order shall dispose of the proceedings initiated against First Dawood Investment Bank Limited (“**FDIBL**”) through its Chief Executive Officer (“**CEO**”) vide Show Cause Notice (hereinafter referred to as the “**SCN**”) dated December 28, 2017 issued under section 282J (1), J (2) & J(3) of the Companies Ordinance, 1984 (the “**Ordinance**”) for violation of rule 7(3) of the Non-Banking Finance Companies (Establishment & Regulation) Rules, 2003 (the “**NBFC Rules**”) and regulation 4 of the Non-Banking Finance Companies and Notified Entities Regulations, 2008 (the “**NBFC Regulations**”).

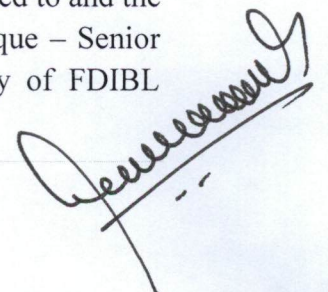
2. The brief facts of the case are as follows:

- (i) FDIBL was licensed by the Securities & Exchange Commission of Pakistan (the “**Commission**”) to provide investment finance services. The license expired in 2009 and was not renewed owing to non-compliance with minimum equity requirement (“**MER**”).
- (ii) As per the audited annual accounts of FDIBL for the year ended on June 30, 2016, the reported equity was Rs. 676 million and FDIBL also booked deferred tax assets (“**DTA**”) amounting to Rs. 680 million.
- (iii) The statutory auditors of FDIBL gave qualified opinion on the accounts of June 30, 2016 due to recording of above-mentioned DTA.

- (iv) After deducting the DTA, the adjusted equity of FDIBL worked out to negative Rs. 3.64 million as on June 30, 2016.
- (v) The Commission took up the matter with the management of FDIBL vide letter dated July 24, 2017 and it was informed that necessary provisions are required to be made in the books of FDIBL for providing for DTA.
- (vi) FDIBL responded vide its letter dated August 22, 2017 stating that *“DTA raised in the balance sheet is not against any accounting principles or rules and it has merely been qualified, since it does not have a valid license. Therefore, it is concluded that the only impediment in progress of ‘FDIBL’ is renewal of its license and restoration of the same will offer certainty for the existing and prospective shareholders of ‘FDIBL’.* FDIBL thereafter provided a copy of a letter issued by its auditors wherein the auditors have stated that *“we have qualified ‘DTA’, because presently ‘FDIBL’ does not have a valid license to ensure future taxable income for FDIBL... we hereby confirm that upon ‘renewal of license’ by the Commission, FDIBL will have a clear roadmap to attract interest of a possible right issue / new equity partner(s) to ensure liquidity. Hence, FDIBL will be in a position to invest in profitable ventures to generate a revenue stream and to utilize taxable profits. We further confirm that the aforesaid development will result in removal of the qualification”.*
- (vii) The Commission informed FDIBL vide letter dated October 12, 2017 that DTA cannot be considered for regulatory minimum equity requirement purposes. The adjusted equity of FDIBL (after deducting DTA) as on June 30, 2016 amounted to negative Rs. 4 million.
- (viii) The reported equity of FDIBL as per the annual audited accounts for the year ended June 30, 2017 decreased to Rs. 409.45 million. As on June 30, 2017, FDIBL reported DTA amounting to Rs. 381.21 million in its books of accounts as compared to Rs. 679.70 million as of June 30, 2016. The statutory auditors of FDIBL again gave a qualified opinion on its accounts for the year ended June 30, 2017. The adjusted equity of FDIBL (after deducting DTA) as on June 30, 2017 amounted to Rs. 28 million.

3. Keeping in view the weak operational position, deteriorating financial performance, non-compliance with MER, no injection of fresh funds by the sponsors/directors, absence of concrete, viable, time bound plan for its revival and adverse remarks by its statutory auditors, the Commission took cognizance of the matter and SCN was issued to FDIBL through its CEO on December 28, 2017.

4. The dates for submission of written reply to the SCN was January 04, 2018 and the hearing was scheduled for January 15, 2018. FDIBL submitted its written response on January 03, 2018 and requested for an extension in time of hearing i.e., after finalization of its half yearly accounts for the period ended December 31, 2017. The request was acceded to and the hearing was fixed for March 05, 2018. On the given date, Mr. Rizwan-ul-Haque – Senior Executive Vice President and Mr. Syed Musharaf Ali - Company Secretary of FDIBL



(Authorized Representatives) appeared before me through videocon from Company Registration Office of the Commission in Karachi.

5. During the hearing, the Authorized Representatives stated that FDIBL was compliant with the licencing requirements and its investment finance services license may be renewed. The Authorised Representatives were advised to submit documentary evidence in support of their verbal assertions. FDIBL vide its letter dated March 05, 2018 submitted its written response along with various additional documents which interalia included the following:

- (i) Half-yearly accounts for the six months ended December 31, 2017; and
- (ii) Legal opinion from its legal counsel on the liabilities written back by FDIBL.

6. The response of FDIBL along with the additional documents provided were examined in detail. The examination revealed the following:

- (i) As per half-yearly accounts of FDIBL for the period ended December 31, 2017, FDIBL earned an after tax profit of Rs. 128 million. The profit was attributed to the following:

- a) "Liabilities written back" amounting to Rs. 62 million; and
- b) "Reversal of provision for potential lease and other loan losses – net" amounting to Rs. 45 million.

- (ii) With regard to "Liabilities written back", the amount pertained to mark-up payable to House Building Finance Corporation ("HBFC"). FDIBL obtained a loan from HBFC and the repayment of the loan was under litigation. The Honourable Supreme Court vide its order dated March 31, 2016 ordered FDIBL to make payment of the loan to HBFC along with cost of funds. As per FDIBL, a dispute emerged between FDIBL and HBFC with regard to "cost of funds" allowed by the Honourable Supreme Court and HBFC reportedly approached the Honourable Sindh High Court for resolution of the matter instead of approaching the Honourable Supreme Court. FDIBL made payments on the basis of cost of funds appearing in the credit rating report of HBFC issued by JCR-VIS. Based on the facts that HBFC did not challenge FDIBL understanding and accepted the payments made by FDIBL and the legal opinion obtained by FDIBL from a law firm, FDIBL reversed the mark-up payable to HBFC.

The statutory auditors added an emphasis para on the reversal of mark-up in the half-yearly accounts for the period ended December 31, 2017. Further, the matter is still not resolved as HBFC approached the Honourable Sindh High Court in March 2017 for recovery of its loan. Keeping in view these facts, the reversal of mark-up by FDIBL is not appropriate.

- (iii) With regard to "Reversal of provision for potential lease and other loan losses – net", as per details provided by FDIBL, it had reversed against various loans and major reversal (Rs. 42 million) pertained to a term loan granted to M/s. Al-Tamiraat. The loan granted to Al-Tamiraat was categorized as "loss" and the outstanding principal

of Rs. 74 million was fully provided. During the period, neither the loan was rescheduled/ restructured nor any repayment was made by the borrower. However, FDIBL reversed the provision on the basis of fresh valuation report obtained on December 31, 2017. As per the NBFC Regulations, the external auditors are required to verify on an annual basis that the NBFC has complied with all the requirements for classification, provisioning and provision reversals as contained in the NBFCs regulatory framework. The provision reversal would be in order, if the case is reviewed and provision reversal is verified to be in accordance with regulations by external auditors as part of the annual audit of FDIBL. Alternatively, FDIBL may obtain a certificate from its external auditor certifying that the case has been reviewed in detail and provision reversal is in order.

(iv) In view of the foregoing, the equity of FDIBL as on December 31, 2017 was, *prima facie*, still non-compliant with the MER.

7. In order to provide an opportunity to FDIBL, the above observations were shared with FDIBL vide letter dated April 12, 2018. FDIBL vide its letter dated April 17, 2018 submitted its response wherein it reiterated the stance taken by it in its letter dated March 5, 2018.

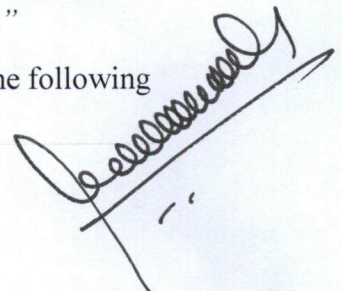
8. I have heard the arguments presented by the Authorized Representatives at length during the hearing. Additionally, I have perused the available record, financial statements of FDIBL and written response filed by FDIBL.

9. As per the half yearly accounts of December 31, 2017, the adjusted equity of FDIBL (after adjusting the DTA) worked out to Rs. 99.5 million which is slightly less than the MER. However, after accounting for the observations contained in para 6, the equity of FDIBL works out to negative Rs. 7 million which is significantly less than the MER. My observations on the two issues are as under:

(i) **Liability Written Back – HBFC:** I have examined the order passed by the Honourable Supreme Court dated March 31, 2016. The Honourable Supreme Court was pleased to order as under:

“For reasons to be recorded later, this petition is dismissed. However, on account of the concession granted by the respondent’s counsel upon instructions, the decretal amount shall be paid by the petitioner in 12 monthly installments, which shall be paid every month commencing from April, 2016. It is directed that 10% of the decretal amount shall be deposited by the petitioner by 05th April, 2016 towards the first installment. The remaining 11 monthly installments shall be equally divided and deposited the 10th of each month. In case of default of any two consecutive installments, the concession of making payment in installments shall stand withdrawn and the Executing Court shall proceed to recover the entire outstanding decretal amount. Taking into consideration the deposits made through installments, the security tendered by the petitioner shall be proportionately released.”

As per the order, FDIBL was ordered to make payments to HBFC as per the following schedule:



| Date | Amount to be paid |
|-------------------------------|---|
| April 5, 2016 | Rs. 7.5 million plus cost of funds. |
| May 10, 2016 | Rs. 6.1 million plus cost of funds |
| June 10, 2016 to Mar 10, 2017 | Monthly payments of Rs 6.1 million plus cost of funds |

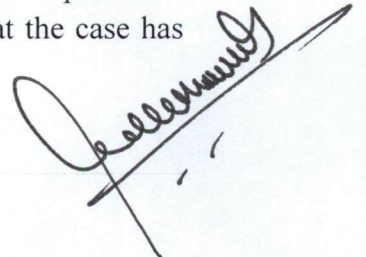
The Honourable Supreme Court further ordered that the concession of making payments in monthly installments would stand withdrawn in case of default in making two consecutive payments. The Honourable Supreme Court further ordered that the security deposited by FDIBL with Nazir, Honourable Sindh High Court shall be proportionately released.

As per the annual audited accounts for the year ended June 30, 2016 and June 30, 2017, FDIBL made a total principal payments of Rs. 18.7 million during the period from April 2016 to March 2017 as against required principal payments of Rs. 75 million. FDIBL is in default of the order of the Honourable Supreme Court as it did not make the requisite payments. In March 2017, HBFC filed a suit in the Honourable Sindh High Court for recovery of an amount of Rs.133.93 million along with cost of funds from March 10, 2017 till the date of realization of the whole amount. In its submissions, FDIBL took the plea that the securities were not proportionately released and therefore it made payments after deducting the amount of securities to be released. Reading of the order of the Honourable Supreme Court reveals that it did not allow such privilege to FDIBL. If there was any non-compliance with the orders of the Honourable Supreme Court, FDIBL should have approached the Honourable Supreme Court for initiating the appropriate proceedings.

In view of the foregoing, the entry passed by FDIBL for reversal of mark-up of Rs. 62 million is incorrect. No reversal should be made until and unless the dispute with HBFC is fully resolved and its claim is settled.

- (ii) **Reversal of provisions:** As per NBFC Regulations, a NBFC can reverse provisions held against classified loan portfolio in case of any cash recovery. Further, a NBFC can take benefit of mortgaged assets duly supported by a valid valuation report. As per regulation 25(10) of the NBFC Regulations, the external auditors as a part of the annual audit of the NBFC are required to verify that all requirements under these Regulations or any other circular issued by the Commission for classification of assets and determination of provisions required against them have been complied with.

FDIBL has reversed provisions amounting to Rs. 45 million. In view of the provisions contained in the NBFC Regulations, FDIBL can be allowed the reversal of provision if it can provide a certificate from its statutory auditors certifying that the case has been reviewed in detail and provision reversal is in order.



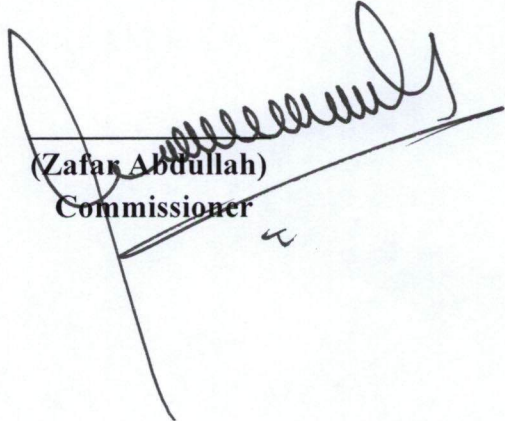
10. In view of the foregoing, the equity of FDIBL is still non-compliant with the MER as per details given below:

| Particulars | Rs. in million |
|--|-----------------------|
| Equity as per financial statements | 528.5 |
| Less: Deferred Tax Assets | (429.0) |
| | 99.5 |
| Less: HBFC Reversal of markup | (62.5) |
| | 37.0 |
| Less: Provision reversal (Al-Tamiraat) | (43.9) |
| Net regulatory equity | (6.9) |

In case FDIBL is able to produce a certificate from its external auditors verifying that provision reversals have been made in accordance with the requirements of NBFC Regulatory framework, the regulatory equity of FDIBL would be Rs. 37 million which is still non-compliant with the MER.

11. It is established that FDIBL is non-compliant with the MER, therefore cancellation of license under section 282J (2) of the Ordinance and winding up of FDIBL under section 282 J (3) of the Ordinance can be immediately initiated. However, I am providing one final opportunity to FDIBL to comply with the MER by June 30, 2018. FDIBL is directed to submit the statement of its equity as of June 30, 2018 duly accompanied by a certificate from its statutory auditor on or before July 31, 2018. In case FDIBL fails to comply with this order by July 31, 2018, its license to undertake investment finance services shall stand cancelled under section 282J (2) of the Ordinance and the department shall initiate proceedings for its winding-up under section 282J (3) of the Ordinance.

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.


(Zafar Abdullah)
Commissioner

Announced: May 24, 2018
Islamabad