

**Securities and Exchange Commission of Pakistan
Enforcement and Monitoring Division
7th Floor, NIC Building, Jinnah Avenue,
Blue Area, Islamabad.**

June 17, 2002

Before Rashid Sadiq, Executive Director

In the matter of

Prudential Discount & Guarantee House Limited

Number and date of show cause notice No.
Law/E&M/2002/2972

Misc-1/DD

dated
May 08, 2002

Date of hearings
May 15, 2002

Present:

Mr. Mazhar-ul-Haque Siddiqui Chief Executive

ORDER UNDER SECTION 309 OF THE COMPANIES ORDINANCE, 1984

This order will dispose of the show cause proceedings initiated against M/s. Prudential Discount & Guarantee House Limited (the "Company") under Clause (c) of Section 309 of the Companies Ordinance, 1984 (the "Ordinance").

2. The Company was incorporated on May 05, 1991 as a public company limited by shares. It commenced its business on May 06, 1991. The Company is listed on all the three Stock Exchanges. It is maintaining its Registered Office at Mehersons Street, 1st Floor, Block-1, Talpur Road, I. I. Chundrigar Road, Karachi. The authorized capital of the Company is Rs.200 million divided into 20 million ordinary shares of Rs.10/- each whereas its paid up capital is Rs.100 million divided into 10 million ordinary shares of Rs.10/- each. The primary object of the Company *inter alia* is discounting & purchasing of negotiable instruments etc. The Company is categorized as a non-banking financial institution (the "NBFI") by State Bank of Pakistan (the "SBP").

3. The relevant facts leading to this case, briefly stated, are that SBP, being a primary regulatory authority of all Banks, Financial Institutions and NBFIs informed this Commission vide its letters dated April 16, 2002 about the precarious financial health of the Company as revealed by investigation conducted by SBP's inspection team. The inspection report as of June 30, 2001 indicated un-satisfactory financial position resulted from gross negligence shown by the Board of Directors, non-existence of proper management and heavy losses due to imprudent lending activities.

4. The following facts were also reported to highlight the deteriorating financial health of the Company:

- i. Assets to the tune of Rs. 148.916 million (89.78% of total assets) are classified as loss.
- ii. All advances/loans are non-performing and securities held against the facilities are either illiquid or non-recoverable.
- iii. No earning assets except FIBs amounting to Rs. 3.0 million.
- iv. Shortfall of provisioning to the tune of Rs. 103.949 million
- v. Adjusted losses, as on June 30, 2001 were Rs.96.794 Million after taking the effect of shortfall in provisioning of Rs.103.949 Million

5. It was also reported that the company had been mis-representing/camouflaging its real financial position since a number of years. Unrealized mark up of Rs 19.847 million was taken to income in quarterly statement of affairs as of June 30, 2001 instead of suspense account. Moreover, management/sponsors are totally non-interested in running the affairs of the Company as no proper management team has been put in place. Neither full time Chief Executive has been appointed nor any responsible person was empowered to provide authenticated information to SBP. In order to address the shortcomings pointed out in the inspection report of June 30, 1999, a memorandum of understanding was signed by the management on January 01, 2001. It was, however, noticed that the management had totally mis-represented in its compliance report to SBP. Besides, the management also failed to respond to SBP recommendations mentioned in the inspection report as on June 30, 2000. The management of the company also failed to respond to the draft inspection report as of June 30, 2001 in spite of the fact that time for the same was extended for three times. The financial position of the Company was worsening and its continuity as a going concern was very much doubtful, the report concluded.

6. Keeping in view the aforesaid state of affairs i.e. total financial disruption, non-existence of proper management, non-seriousness of the Board of Directors/management to run the affairs of the Company, non-compliance of the SBP directives/findings in inspection reports, mis-representation/camouflaging of financial data and non-finalization of even draft financials as of June 30, 2001, SBP has recommended winding up of Prudential Discount & Guarantee House Limited under the Companies Ordinance, 1984 ("the Ordinance").

7. In view of the above, a notice dated May 08, 2002 was served upon the Chief Executive of the Company under Clause (c) of Section 309 read with Section 305 of the

Ordinance calling upon him to show cause as to why a petition may not be presented before the honorable High Court for winding up of the Company in terms of the aforesaid provisions of the Ordinance. In order to provide an opportunity of making representation and of being heard the case was fixed for hearing on May 15, 2002, Mr. Mazhar ul Haq Siddiqui, Chief Executive represented the Company in the hearing. He also submitted a written reply to the show cause notice.

8. While resisting the show cause notice, Mr. Mazhar ul Haq Siddiqui has raised the contentions that the inspection report cannot form the basis for filing of a winding up petition against the Company under Section 309 of the Ordinance. He also vehemently contested the findings of SBP inspection report. It was also argued that the Company has been paying dividend from time to time in the past and it is making serious efforts for turnaround. An assurance was also given to finalize the accounts for the year ended June 30, 2001 within minimum possible time. No assurance was, however, provided for injection of additional equity to meet shortfall reported by SBP.

9. While elaborating his first contention, Mr. Mazhar ul Haq Siddiqui argued that the show cause notice has been issued by the Commission on the basis of on site inspection report of the SBP, pursuant to a routine inspection conducted under Section 40 of the Banking Companies Ordinance, 1962. It was also contended that Section 309 of the Ordinance empowers the Commission to present a petition for winding up after an investigation into the affairs of a Company has been conducted by the Commission or some inspector appointed by the Commission u/s 265 of the said Ordinance. At this point it is necessary to advert to the aforesaid legal provisions. Section 40 of the Banking Companies Ordinance, 1962 empowers SBP to conduct inspections of banking companies including non-banking financial institutions. In the case of banking companies, SBP is empowered to move for winding up in case circumstances of a banking company if warrants so. In the case of non- banking companies, there is a limited application of Banking Companies Ordinance, 1962. SBP monitor these institutions in relation to their activities, which have implications for the monetary or credit policies of SBP. As the non-banking financial institutions are incorporated under the Companies Ordinance, therefore, SBP refers such investigations report to the Commission where an action is required under the Ordinance. Even otherwise, the provisions of Clause (c) of Section 309 of the Ordinance do not require that the investigation for the purpose of this provision is to be conducted by the Commission. In this particular case SBP being the primary regulatory body has conducted the investigation and I find no reasons as to why the same could not form the basis for winding up of the Company under Section 309 of the Companies Ordinance. I am of the view that the inspection conducted by SBP in respect of non-banking financial institution can legitimately form the basis for action by the Commission and there is no need for any further investigation by the Commission. The objection of the Company that the Commission cannot initiate winding up proceedings on the basis of inspection pursuant to Section 40 of the Banking Companies Ordinance, 1962 is not sustainable. If in the opinion of the SBP, the continuance of a non-banking financial institution as a going concern is very much doubtful, all the loans/advances are classified and the securities there against are illiquid or non-recoverable, the earning assets are not even close to break even, there is no proper

management and the management had resorted to imprudent lending activities resulting in concentration of facilities into few clients, there is failure to prepare and present annual accounts, the directions of SBP are not being complied, additional capital is not being put in to save the institution, correct information is not being provided to SBP, then if recommended by the SBP, it become obligatory for the Commission to consider that recommendation after taking appropriate procedure under the provisions of the Ordinance. In this respect, it is also noted that SBP is having powers, responsibility and duty of regulating and monitoring the performance of banks, financial institutions and non-banking financial institutions. It is the body, which has all the information and knowledge with respect to the financial institutions. It is an independent and impartial body with objects of public interest. SBP has its own mechanism for watching these institutions and once SBP recommends an action based on its inspection, the Commission has to proceeds in accordance with the law. However, the Commission exercises its own application of mind on the basis of facts and circumstances of each case before forming an opinion.

10. The Company has also contested the findings of the inspection report of SBP. It was argued that findings of SBP inspection report are not based on true facts. It was denied that financial position of the Company has become unsatisfactory due to gross negligence on the part of Board of Directors, non-existence of proper management and imprudent lending activities. The Chief Executive, however, could not substantiate his contentions. The financial position continue to deteriorate, there is no full time Chief Executive, no second line management and no commitments for further injection of capital by the directors. The irregularities observed by SBP could not be rectified even after taking substantial time.

11. It now remains to be examined as to whether the Company is conducting its business in a manner oppressive to its members, it is being run and managed by persons who failed to maintain true and proper accounts and refused to act according to the requirements of its Memorandum and Articles of Association and the provisions of the Ordinance. The only argument of Mr. Mazharul Haq Siddiqui is that there is no complaint from any shareholder. It was also informed that the Company has been paying dividends from time to time in the past. He also claimed that the financial position of the Company would improve in future. I have gone through the latest financials of the Company as of June 30, 2000 and have noted the contentions of the Company. At this point, it is necessary for me to advert to the financials of the Company in detail. The Company was listed on Karachi Stock Exchange in 1992 with a paid up capital of Rs 100 million. For the last five years there has been no declaration of dividend. The market price of the share is also substantially discounted to its face value of Rs 10 each. During last three years the share was quoted on the Karachi Stock Exchange between Rs 1.25 – 0.50, 1.20 -2.50, 1.50 -2.25 for the years 2001, 2000 and 1999 respectively. SBP has capped the liabilities of the Company in the shape of COIs, prohibited it from participating in money market activities and stopped the Company from undertaking any lending activities. This action was taken due to failure of the Company to fulfill the requirement of minimum paid up capital. 89.78% of the total assets of the Company are classified, there is shortfall in the provisioning to the extent of Rs.103.949 million and

advances are 100% classified. The institution is finding it difficult to meet day-to-day expenses. The Company has no earning asset. There is no full time CEO. No second line management is in place. The Company has also failed to hold Annual General Meeting for the calendar year 2001 and present therein balance sheet and profit and loss account for the year ended June 30, 2001. The Auditors have also reportedly refused to audit the books of accounts of the Company. This state of affairs amply demonstrate that the Company is not having proper management, it is not presenting the real financial position to SBP, even it has failed to present accounts for the calendar year 2001 after a lapse of considerable time in violation of the provisions of the Ordinance and Memorandum and Articles of Association of the Company. The management has imprudently provided credit facilities to few borrowers, who are non-performing and as consequence thereof, the operations of the Company have been curtailed to such an extent that the Company could not undertake any business in future. The continuity of the Company as a going concern is very much doubtful. SBP has stopped the Company from undertaking lending activities. In consequence thereof, the object for which the Company was formed has substantially failed and it is now not possible for the Company to carry on its business except at a loss. Mr. Mazhar ul Haq Siddiqui did speak about holding of AGM but failed to give reasons for delay in holding of AGM for the calendar year 2001. He has also failed to produce any documentary evidence to support his contention that the Company would soon come out of the financial difficulties. On the other hand, there are sufficient evidence that the Company did not have a full time Chief Executive as required under the provisions of the Ordinance and this fact was not disputed by the Chief Executive who at the time of hearing admitted that he was a part time Chief Executive of the Company. In the backdrop of the above position, the Chief Executive was asked to explain the strategy of the directors to save this institution, particularly fresh injection of capital to meet the shortfall indicated by the SBP. He was not able to give any satisfactory explanation nor any commitment for fresh injection of capital was made. His stand was that the Company would be able to realize funds from the existing clients. He was however, unable to explain as to how the Company could be run profitably in the current situation. There appears to be no resources available to keep the Company afloat. There is no proper management who could come forward and is willing to take steps to save this Company. Substantial damage has already done to the shareholders and any delay would further jeopardize their interest.

12. From the above discussion and after careful consideration of all the facts and circumstances of the case and the submission made by the part time Chief Executive of the Company, the undersigned is of the opinion that continuity of the company as a going concern is doubtful. There is no reasonable prospect for the Company to run its affairs profitably. The Company has completely lost its substratum. It is conducting its business in a manner oppressive to its members, it is being run and managed by persons who fail to maintain proper and true accounts and is being managed by persons who refused to act according to the requirements of its Memorandum, Articles, the provisions of the Ordinance, and who also failed to carry out directions of SBP. Sufficient time was given to the management by SBP to rectify the situation, however, no funds were brought in after lapse of considerable time. Moreover, a part time Chief was appointed in utter disregard to the provisions of the Ordinance. In the circumstances, I do not think any

useful purpose would be served or the situation would improve in any way by prolonging these proceedings. It would be beneficial for the investors and creditors to immediately proceed for winding up of the Company as this will put an end to any further loss and consequently would restrict further reduction in distributable surplus to them.

13. The undersigned, therefore, in exercise of powers conferred on me under Section 309 of the Ordinance, hereby instruct my office to make immediate arrangements to file an application for winding up petition against the Company pursuant to the provisions of Sub-clauses (iii), (iv) & (v) of Clause (f) of Section 305 read with Proviso (c) of Section 309 of the Ordinance.

RASHID SADIQ
Executive Director (Enforcement & Monitoring)

Announced:
June 17, 2002
ISLAMABAD