BEFORE APPELLATE BENCH NO. II

In the matter of

Appeal Nos. 22, 23,24,25,29,30 31 & 33 of 2007

(i) Shahid Anwar
(ii) Tariq Aleem
(iii) Dr. Wasim Azhar
(iv) Manzurl-Haq
(v) Shahid Latif Dar
(vi) Irfan Qamar & others
(vii) Mahmood Ahmed
(viii) Shezi Nackvi ....Appellants

(Appellants (i),(ii),(iii),(iv),(v), (vii) & (viii) all directors and Appellant (vi), former auditors of Crescent Investment Bank Limited)

Versus

Chairman,
Securities and Exchange Commission of Pakistan .....Respondent

Date of Hearing 30/07/15

Present:

For the Appellants No.(i) and (viii)

(i) Mr. Naveed ul Haq Chaudhry, Advocate Supreme Court

Appellant No.(viii)

(ii) Mr. Shezi Nackvi, Chief Executive at Dallah Al Baraka (Europe) Ltd

For the Appellant No (ii) & (iii)

(iii) Mr. Asad Ghani, Hassan & Hassan Advocates

For the Appellant No. (iv)

(iv) Mr. Haroon Dugal, Partner RIAA Barker Gillette

For the Respondent:

(i) Mr. Asif Jalal Bhatti, Executive Director (Specialized Companies Division)

(ii) Mr. M. Rashid Safdar Piracha, Director (Specialized Companies Division)

(iii) Ms. Saima Ahrar, Deputy Director (Specialized Companies Division)

(iv) Mr.Ibrar Saeed, Deputy Director (Prosecution and Legal Affairs Division)

ORDER

1. This order is in appeal Nos. 22, 23, 24, 25, 29, 30, 31 and 33 of 2007 filed under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the order dated 04/09/2007 (the "Impugned Order") passed by the Respondent.

2. The brief facts of the case are that Crescent Standard Investment Bank Limited (CSIBL) was a public company limited by shares incorporated as a Non-Banking Finance Company (NBFC) under the Companies Ordinance, 1984 (the Ordinance). It was a listed company and its shares were quoted on all the Stock Exchanges of Pakistan. CSIBL obtained licenses from the Commission to engage in the business of Investment Finance Services and Leasing Services within the meaning of Non-Banking Finance Companies (Establishment & Regulation) Rules, 2003 (NBFC Rules).

3. The Commission ordered an on-site inspection of CSIBL in exercise of its powers under section 282-I of the Ordinance vide Inspection Order dated

28/09/05. The on-site inspection commenced on 3/10/05 and a team of seven (7) officers were appointed who conducted an on-site inspection of CSIBL at its registered office.

4. The inspectors appointed by the Commission discovered various irregularities and mismanagement in the affairs of CSIBL in violation of prevalent laws, rules and regulations which were compiled in their inspection report dated 10/03/06 ("Inspection Report"). The list of violations by the Appellants as per inspection report is as follows listed below:

   a) Violation of Sections 230 and 234 of the Ordinance and Rule 7(1)(a) of the NBFC Rules:

      i) Two parallel books of account maintained at CSIBL were discovered, with undisclosed balance of assets and liabilities amounting to Rs.5.252 billion. Maintenance of parallel books of accounts by CSIBL was being done under the pretext of Managed Portfolio. While the published accounts for the half year ended 30/06/05 showed an asset base of Rs.9.559 billion, the parallel balance sheet showed an asset footing of Rs.5.252 billion. The balance sheet worth Rs.5.252 billion was hidden and was never made part of the published financial statements of CSIBL. The details of off-balance sheet assets and liabilities are as under:

(Rs.in million)

Item	Amount
Placements	1,914
Investment in Shares	1,323
Investment in PIBs	549
Musharaka Ventures with MDPL	885
Musharaka Venture with Waqas Khan	409

Musharaka Venture with DHA & Golf Club	50
Markup accrued	122
Total Assets	5,252
Borrowings from Financial Institutions- REPO Clean Borrowings from Financial Institutions	2,317 849
Long Term Borrowings from Orix. Invest. Bank	336
Musharaka with General Public & Financial Institutions	571
Deposits from Financial Institutions	830
Markup Accrued on above liabilities	77
Total Liabilities	5,252

ii) It was discovered that out of Rs.1.914 billion recorded in the parallel books as 'placements', an amount of Rs.1.817 billion was in fact an investment made by CSIBL in 20.896 million shares of Pakistan Industrial Credit and Investment Corporation Limited - Development Financial Institution (PICIC-DFI). This investment was not reported in the published financial statements of CSIBL as on 30/06/05 along with certain other investments. Therefore, total assets of Rs.5.252 billion were hidden in parallel books of account.

iii) The aforesaid investments had been made by money raised through borrowing from various financial institutions as well as the general public. Despite the fact that it represented a liability of CSIBL, the fact and quantum of the borrowing was excluded from the books of account of CSIBL as on 30/06/05.

iv) General ledger of the Lahore branch of CSIBL exhibited that it was maintaining six accounts in the name of Jhang Electric Supply Corporation (JESCO) depicting an aggregate activity of Rs.5.918 billion. These accounts were not reported in the printed General

Ledger of the said branch as of 30/06/05 and various payments were routed through these accounts to various parties.

As per the Inspection Report, the above mentioned were violations of sections 230 and 234 of the Ordinance and rule 7(1)(a) of the NBFC Rules. These provisions required CSIBL to keep proper books of account, balance sheet and profit and loss accounts depicting a true and fair view of the state of affairs of CSIBL.

(b) Violation of Section 208

i) CSIBL had taken exposure in its associated companies and undertakings by way of investment in their shares amounting to an aggregate of Rs.562.027 million as of 30/06/05 without obtaining shareholders' approval by way of a special resolution which constitutes a violation of section 208 of the Ordinance.

ii) CSIBL was also found to have entered into musharaka ventures involving real estate with its associated company, namely, Maghreb Development Corporation (Private) Limited ("MDPL") for an aggregate amount of Rs.1.540 billion (Rs.655 million as shown on the parallel books of account being maintained by CSIBL under the head of managed portfolio. As per the borrower's basic fact sheet and corporate application form provided to the inspection team, Appellant No. 7 namely Mr. Mahmood Ahmed was also the CEO of MDPL and Mr. Tariq Aleem was also a director of MDPL. As such, MDPL was an associated company of CSIBL and no authority for these financial arrangements was obtained from the shareholders or the Board of Directors of CSIBL.

c) Violation of 282C (license to be issued for specific purpose)

Real estate transactions involving MDPL, CSIBL was also found to have entered into similar financial arrangements involving real estate with property dealers. CSIBL has undertaken these transactions without possessing a license for Housing Finance Services which constitutes a violation of section 282C(2) of the Ordinance.

d) Violation of Prudential Regulations:

i. CSIBL had undertaken exposure on group companies by way of investment in their shares amounting to an aggregate of Rs.2.163 billion as on 30/06/05. Moreover, as stated above, CSIBL was providing financing facilities amounting to Rs.1.540 billion to its associated company, MDPL. On an aggregate basis, CSIBL's exposure to its group companies was Rs.3.703 billion which was far in excess of the statutory limit as provided in regulation 1(2) of Part 2 of the Prudential Regulations. Details of investment in shares of its group companies is as under:

Name of Company	No. of shares	Market Value as on 30/06/05 Rupees
Shakarganj Mills Ltd	850,500	41,674,500
Crescent Leasing Corporation Ltd	6,412,316	95,543,508
Crescent Standard Modaraba	728,500	4,371,1000
Safeway Mutual Funds Ltd	7,159,102	171,460,492

Asian Stock Funds Ltd	20,753,500	222,062,450
International Housing Finance Ltd	1,218,500	10.966,500
Crescent Commercial Bank Ltd	1,222,901	12,657,025
PICIC Commercial Bank Ltd	99,000	3.291.750
PICIC DFI	22,880,360	1,601,625,200
Total		2,163,652,426

ii. The annual audited accounts of MDPL revealed that the equity of the company was Rs.20.744 as per audited accounts for the year ended 30/06/03 and the same was negative Rs.235.487 as per un-audited accounts for the year ended 30/06/04. Therefore, provision of financing facilities amounting to Rs.1.540 to MDPL, was in violation of regulation 3(1) of Part 2 of the Prudential Regulations.

All the aforementioned were violation of sections 230 and 234 of the Ordinance and rule 7(1)(a) of the NBFC Rules. The provisions required CSIBL was required to keep proper books of accounts, balance sheet and profit and loss accounts depicting a true and fair view of the state of affairs of CSIBL.

(e) Violation of Board Authority

In addition to the aforesaid violations, the CEO of CSIBL acted in excess of powers delegated to him by the Board. The Board in its meeting held on 19/07/03 approved exposure limits that may be incurred by the CEO. In terms of these exposure limits, the CEO was authorized to approve Long Term and Short Term financing through modaraba, musharaka,

discount/purchase of promissory notes against Bank Guarantee and Cash Collateral (Deposit Certificates) of an amount not exceeding 25% of the liquid net worth of CSIBL. CSIBL's liquid net worth as on 30/06/05 was Rs.415 million and, therefore, only facilities amounting to less than Rs.103 million could have been approved and granted by him as per his authority. The CEO, however, approved and granted the following finance facilities as the CEO of CSIBL.

Name of Entity	Amount in Rupees
MDPL	Rs.1.540 billion
Mr. Rashid Bashir	Rs.250 million
Mr. Yousuf Shafee	Rs.250 million
Dossalani Securities (Private) Limited	Rs.300 million
Engr. Sajid Masood	Rs.200 million

6. Show Cause Notices dated 17/03/06, 03/05/06 and 04/05/06 were served on Mr. Mahmood Ahmed, Chief Executive Officer (CEO or Appellant No. 7), Mr. Shahid Latif Dar, Chief Financial Officer (CFO or Appellant No.5) and on the Board of Directors of CSIBL namely Mr. Shahid Anwar (Appellant No.1), Mr. Tariq Aleem (Appellant No.2), Dr. Wasim Azhar (Appellant No.3), Mr. Manzurl-Haq (Appellant No.4) and Mr. Shezi Nackvi (Appellant No.8) for violation of Section 208, 282K, 282J of the Ordinance. Show Cause Notice dated 11/05/06 was served on the Auditors, M/s Syed Hussain & Co. Chartered Accountants (Auditor's Firm or Appellant No. 6) for violation of section 260 and 492 of the Ordinance. Several hearings were held in the matter and the last hearings were joint hearings held on 15/08/06 and 19/12/06 in all SCNs since they were being heard together as connected matters. The Respondent dissatisfied with the response of the Appellants held that the Appellants 1, 2, 3, 4, 5, 7 and 8 were

guilty of committing violation of regulatory framework as directors of CSIBL and a penalty of Rs.1,000,000 was imposed for contravention of section 208 of the ordinance and a further penalty of Rs.5,000,000 was imposed for violation of 282(J)(I) of the Ordinance. The Appellant No. 6 as auditors were found to in violation of section 260 of the Ordinance and a penalty of Rs.100,000 was imposed on every partner of the Auditor's Firm. Further, Appellant No. 6 was also found in violation of section 492 of the Ordinance and a further penalty of Rs.100,000 was imposed on every partner of the Auditor's Firm.

7. The Appellants have preferred the instant appeal against the Impugned Order. The Appellants and counsel for Appellants 1, 3, 4 and 8 argued that:

a) Section 208(1) of the Ordinance does not apply since CSIBL falls under the ambit of section 208(4) of the Ordinance which was in force prior to 2007. In 2007 the law changed when section 208(4) was omitted and section 2A was inserted by the Finance Act, 2007 which provides that the Commission may by notification in the official Gazette, specifies the class of companies or undertakings to which the restriction provided in sub-section (1) shall not apply. Subsequently, vide S.R.O 819(1)/2007 dated 13/08/07 the Commission notified which companies shall be exempt from the requirement of obtaining the authority of a special resolution for making investment in associated companies or undertaking. For the purposes of the instant case, section 208(4) of the Ordinance was still in force at the time passing of the Impugned Order and shall apply to the facts of the case. CSIBL is a NBFC approved by the Commission. In terms of Paragraph 72 of the Impugned Order, the Respondent itself has accepted the position that CSIBL was a NBFC and would, therefore, fall within the definition of "financial institution" in section 215(1) of the Ordinance. The Respondent, however, assumed that for a financial institution to be excluded from the purview of section 208 of the Ordinance specific approval is required from the Commission. The certificate issued by the Commission for all intents and purposes implies that CSIBL is "a financial

institution approved by the Commission". Section 208(4) of the Ordinance does not provide for any specific approvals that may be required from the Commission. The term "approval" is to be read with in conjunction with section 282C(1) and (2). The section provides that notwithstanding anything contained in the Ordinance, a NBFC shall not carry on business unless it holds a license issued in that behalf by the Commission. CSIBL was carrying on the business as a NBFC and was duly approved by the Commission in this regard. The Respondent has failed to appreciate the term "approval" used in section 208(4) of the Ordinance which does not provide for any specific approval. Once the approval is granted, there is no further approval required for any "said purposes" from the Commission;

b) The Board of Directors of CSIBL approved the accounts on the basis that such accounts were true and correct to the best of their knowledge. There was no question of any malafide on part of the directors particularly the non-executive directors while approving the accounts. Such accounts have not been approved by the directors willfully knowing them to be false. The Respondent has interpreted and applied section 282J and section 282K of the Ordinance without appreciating in the context in which words "knowingly" and "willfully" are used. The word "knowingly" means "with knowledge" and "willfully" means "with intent". At no stage the Respondent has established that the Appellants "knowingly" and "willfully" committed any irregularity. The Impugned Order has failed to establish that the directors had knowledge and there was a willful default. Reliance is placed on the Lahore High Court judgment of *Pakistan Indus Promoters Limited* vs. *Monopoly Control Authority*, cited at *CLC 1008 1990*, wherein, a "willful act" is generally defined as an act committed deliberately, intentionally and knowingly. The Impugned Order has interpreted "willfully" and "knowingly" against the provisions of the Ordinance. Moreover, penalty was imposed twice for the same offence which is a case of double jeopardy. The purpose of introducing sections 282J and 282K of the Ordinance is to safeguard

and secure the interest of the shareholders from any malafide intentions. The investments in the associated companies have been profitable to CSIBL on the whole and thus the shareholders did not sustain any loss;

c) The Appellants who were non-executive directors carried out their functions with diligence and care and had not violated any law, rule or regulation. The Appellants as directors had met the standard of care as provided in the Code of Corporate Governance. Moreover, a non-executive director lacking any knowledge of irregularities and illegalities on the part of the management, if any, does not tantamount to a lapse in the discharge of duty of care as directors. Reliance is placed on the judgment of Re City Equitable Fire Insurance Co Ltd [1925] Ch 407 which provides that, "...*In discharging the duties of his position thus ascertained, a director must, ofcourse, act honestly; but he must also exercise some degree of both skill and diligence required of him, the authorities do not, I think, give any very clear answer. It has been laid down that so long as the director acts honestly he cannot be made responsible in damages unless guilty of gross or culpable negligence in a business sense. But as pointed out by Neville J in Re Brazilian Rubber Plantations and Estates Ltd, one cannot say whether a man has been guilty of negligence, gross or otherwise, unless one can determine what is the extent of duty which he is alleged to have neglected. ...the care that he is bound to take has been described by Neville J in the case referred to above as 'reasonable care' to be measured by the care an ordinary man might be expected to take in the circumstances on his own behalf*..." The Appellants who were non-executive directors had no reason to question the actions of the management. Some investments in associated companies were not new or fresh investments and were carried over to the accounts for the periods ending 31/12/04 and 30/06/05 from the year 2002. As far as the vigilance of the Board is concerned, it was assured that the applicable law was being fully observed. Appellant No. 8 submitted that the non-executive directors were informed by the CEO, CFO and

the internal auditors that the accounts were in order in all respects. Material information was willfully suppressed from the Appellant No. 8 and other directors. Appellant No. 8 has stated that he immediately resigned once the mismanagement of the affairs of CSIBL came to his knowledge. In view of the above, the imposition of penalties on Appellants who were non-executive directors under these circumstances is unwarranted and legally unjustified.

8. The Appellants No. 2, 5, 6 and 7 made the following written submissions:

a) Appellant No 7 as CEO has submitted that section 234 of the Ordinance deals with the provision of a true and fair view of a company's affairs at the end of a financial year and does not, as such, deal with the half yearly financial statements. The allegations made in the SCN with respect to the half yearly accounts ended 30/06/05 cannot be covered under section 234 of the Ordinance. The SCN as well as the Order is not valid as per law. Further, the investments in real estate were undertaken by MDPL and not CSIBL. CSIBL, therefore, could not be termed to have made investments in real estate without possessing a housing finance license in violation of section 282C of the Ordinance. CSIBL provided financing to a client to undertake a real estate venture and did not undertake the real estate venture itself. Additionally, the said finance facilities were duly secured through adequate security in the shape of equitable mortgages and promissory notes payable on demand and thus cannot be said to be in the nature of investments. The Appellants did not make a statement in any document, prospectus, report, return, accounts, information or explanation required to be furnished in pursuance of the Ordinance or the NBFC Rules, which was false in any material particular knowing it to be false, or omitted to make a material statement. The Appellants could not be held liable under section 282K of the Ordinance. The Appellants did not depart from established NBFC business practices and procedures or tried to circumvent the regulations/restrictions laid down by the Commission from time to

time. Furthermore, it is specifically reiterated that the maintenance of the separate books of accounts in respect of managed portfolio discretionary accounts was based on bona fide understanding that CSIBL was required to treat such accounts as "separate" from its other activities. As soon as CSIBL was made aware that its understanding was not in accordance with that of the Commission, CSIBL immediately, as per decision taken at the Board of Directors of CSIBL on 28/11/05, took steps to merge the assets and liabilities as advised by the Commission in its correspondence dated 21/11/05;

b) All decisions taken by Appellant No 5 as CFO of CSIBL were taken bona fide and in the best interests of the company. The Appellant No. 5's case cannot be equated with case of the Appellant No. 7 who was the CEO of CSIBL. Further it is denied that the Appellant No.5 failed to maintain proper books of accounts of CSIBL and has willfully made statements which were false knowing them to be false. The financial statements were checked by the Chief Internal Auditor and externally audited by the Chartered Accountants Firm, thereafter, were brought to the Appellant No. 5 for signing/recommending to the Board of Directors. The Appellant No 5 had resigned on 13/06/05 from the post prior to the preparation and approval of the accounts for the period ending 30/06/05;

c) Appellant No. 2 argued that he was non-executive director and had no role in the operations of CSIBL. The conclusion in paragraph 150 of the Impugned order that the Appellant No.2 served as an interim CFO of CSIBL at the time of drawing up the half yearly accounts and balance sheet as of 30/06/05 is against the facts and evidence before the Respondent. The Respondent has not taken into account the fact that after the resignation of Appellant No. 5 as the CFO, an email was generated on 04/06/05 without the consent and notice of the Appellant No 2 which stated that the Appellant "will assume" responsibilities as the CFO of CSIBL. After receiving the offer, the Appellant No 2 informed the Appellant

No.7 that he was not ready to take the offer and the Appellant No 7 appointed Mr. Faqir Hussain as the CFO of CSIBL in place of Appellant No. 5; and

d) Appellant No. 6 submitted that the Impugned Order is full of contradictions and the Respondent has no basis or justification for awarding punishment to the Appellant No 6 as external auditors by invoking the provisions of sections 255, 260 and 492 of the Ordinance. As Appellant No. 6 had no malafide or gained any benefit from the alleged contraventions of defaults, penal provisions of section 260 and 492 of the Ordinance are not attracted and penalty imposed on them should be set aside.

9. The Respondent rebutted the arguments of Appellants 1, 3, 4, 6 and 8 as follows:

a) The merger of CSIBL with Paramount Leasing, First Leasing and Pacific Leasing was approved by the Commission on 26/05/04 under section 282L of the Ordinance and the bank was NBFC duly approved and licensed by the Commission to undertake the business of leasing and investment finance services. Therefore, for a financial institution to be excluded from the application of section 208 of the Ordinance as per clause (b) of sub-section (4), specific approval from the Commission would be required for this purpose, which was lacking in the case of CSBIL. In order for a NBFC to be incorporated under section 282C of the Ordinance, it has to first obtain an NOC or approval for incorporation as a NBFC from the Commission. This NOC or approval is limited only to the extent of allowing its incorporation as a NBFC and cannot be equated with the Commission's approval envisaged by clause (b) of sub-section (4) of section 208 of the Ordinance. Even once incorporated, a NBFC cannot carry on any business as such let alone invest in associated companies without first obtaining a separate license from the Commission, which is yet another form of approval for a different purpose. Moreover, it would defeat the purpose of the statute of general

prohibition against investment in associated companies contained in section 208(1) of the Ordinance if every NBFC by the sheer fact of getting incorporated and obtaining a license for a certain form of business could then freely invest in associated companies. The requirement of the Commission's approval stipulated in clause (b) of section 208(4) of the Ordinance is thus specific to section 208 and in order to avail the exemption under the said provision, a financial institution is required to be specifically approved by the Commission for the said purpose under section 208 of the Ordinance. Since no specific approval of the Commission was obtained by CSIBL from the Commission for the purpose of availing the said exemption, the argument of the appellant is not maintainable. As far as the second form of exemption claimed by CSIBL under clause section 208(4)(d) of the Ordinance is concerned, it is correct that CSIBL held licenses for Investment Finance Services and Leasing Services. Exemption under section 208(4)(d) of the Ordinance is only available to those companies whose "principal" business is acquisition of shares, stock, debenture or other securities. The legal issue thus involved is whether a NBFC holding an Investment Finance Services license could be termed to be a company whose principal business is the acquisition of shares, stock, debenture or other securities. Rule 14 of the NBFC Rules is relevant in the context which sets out the entire spectrum of business activities that a NBFC holding license for Investment Finance Services can undertake. There are twenty six different entries categorized under five major heads of activities that are listed in rule 14. These heads are: (i) money market activities; (ii) capital market activities; (iii) project financing activities; (iv) corporate finance services; and (v) general activities. The scope of a company's business holding license for Investment Finance Services is not only much wider but varied than what is mentioned in rule 14(b)(i) of the NBFC Rules. As such, it cannot be deemed in respect of a NBFC licensed to undertake Investment Finance Services that its principal business is acquisition of shares, stock, debenture or other securities and as such it is not NBFC approved by the Commission which is

exempted from requirements of Section 208 of the Ordinance;

b) Section 208 of the Ordinance holds the directors of a company liable for any default of the provisions of section 208 which is willful. Ignorance of law is no excuse. The least that was expected from the experienced Directors of CSIBL was to inquire if compliance with section 208 had been properly made by the management. The Appellants, instead, chose to remain silent and approved the accounts for the period ended 31/12/04 and 30/06/05. It is important to inform the Bench that the Commission while granting approval for appointment of Appellants as Directors on board of CSIBL specifically informed that:

"We expect that the new director is fully aware of his obligations as director of the company and would discharge his duties as elaborated in the corporate laws. In this regard, he is advised to re-visit relevant provisions of the Companies Ordinance, 1984, the Securities and Exchange Ordinance, 1969, the Non-Banking Finance Companies (Establishment & Regulation) Rules, 2003, Prudential Regulations for Non-Banking Finance Companies and the Code of Corporate Governance."

The directors, therefore, cannot plead ignorance of their responsibilities and statutory duties. It is further submitted that responsibility of the directors whether executive or non-executive is towards all the stakeholders. In the event of any violations of law, the director being the representative of the shareholders must bring the same before other board members in their board meeting. The Board of Directors while approving the accounts of 31/12/04 and 30/06/05 should have noticed the heavy investments made by the bank in its associated companies. The Appellants have not practiced prudence in managing the affairs of CSIBL, therefore, have failed to discharge their fiduciary duties under the deeming clause of the proviso to sub-section (1) of section 282J of the Ordinance. The conduct of the board of directors was against the provisions of section 282J of the Ordinances by choosing to keep silent on the CSIBL's investments in associated

concerns despite their knowledge of the same. The directors, therefore, knowingly and willfully authorized/permitted the contravention of section 208 of the Ordinance and were, therefore, penalized not only under section 282(J) of the Ordinance but prosecution proceedings are also warranted against them under section 282(K) of the Ordinance. There was no question of double jeopardy as one penalty was imposed for violation of section 208 of the Ordinance and the other penalty was imposed for mismanagement of the affairs of the Company under section 282(J) of the Ordinance; and

c) In accordance with the provisions of corporate governance at the time, the role of Executive and Non-Executive Directors is as follows:

"There is no legal distinction between executive and non-executive directors and likewise the Code does not distinguish between their responsibilities. The Code does not clearly define the role of the non-executive director and such definition requires construction from various frameworks of corporate governance; however, one finds that the role has been universally defined and there is an inescapable global sense in which the non-executive director's role is seen as balancing that of the executive director so as to ensure that the Board as a whole functions effectively. Effectively, the non-executive director provides an independent view of the company that is removed from its day to day running. Non-executive directors are fundamentally appointed for purposes of bringing independence, impartiality, wide experience, special knowledge and personal qualities to the Board. Although all directors should be capable of seeing company and business issues in a broad perspective, non-executive directors are usually chosen for their experience, caliber and personal qualities and may have some expertise that would provide the Board with valuable insight. This, annexed with their independence, brings a degree of objectivity to the Board's deliberations and also allows for the monitoring of executive management. The introduction of independent judgment to the Board's activities provides interested parties with greater assurance that the correct strategies are likely to be adopted."

From the above para, it is clear that there is no distinction between an executive and a non-executive director as far as the legal responsibilities are concerned. Therefore, Appellants who were non-executive directors are equally responsible for their actions. The management may have concealed information from the Board of Directors but with respect to investments in associated companies, the published annual accounts for the year ending 31/12/04 and the half yearly accounts for 30/06/05 clearly list investments by CSIBL in its associated undertakings/companies and the same were presented to the Board of Directors for approval. In view of this, the plea of the non-executive directors that they did not have any knowledge of the irregularities and illegalities in the affairs of the bank is not tenable. Therefore, the conduct of the board of directors was against the provisions of section 282(J) of the Ordinance as by choosing to keep silent on the Bank's investments in associated concerns despite their knowledge of the same, the Appellants as non-executive directors knowingly and willfully authorized the contravention of section 208 of the Ordinance and were, therefore, not only penalized under section 282(J) of the Ordinance but also prosecution proceedings are warranted against them under section 282(K) of the Ordinance.

10. The Respondent rebutted arguments of Appellant No. 2,5, 6 and 7 as follows:

a) CSIBL had an undisclosed investment of Rs.1.3 billion in musharaka/real estate properties. CSIBL in doing so used its fully owned subsidiary i.e. MDPL whose CEO was again Appellant No 7 himself. The methodology was used as a tool to get around the prevalent laws and regulations which barred investment banks from entering into real estate transactions. CSIBL did not possess a license for Housing Finance Services necessarily required under section 282C of the Ordinance read with the NBFC Rules and, hence, could not have invested into real estate for the purposes of its business. Even if CSIBL had a valid House Finance Services license, it could not have involved itself in real estate business due to provisions of NBFC Rules. CSIBL in fact obtained finances from other

financial institutions and the general public and invested the same in real estate through its wholly-owned subsidiary. Out of a total financing advanced to MDPL, Rs.655 million were recorded in the books of CSIBL and Rs.855 million related to managed portfolio accounts were kept outside CSIBL's books. The Appellant No. 7 has not explained as to why some of the amount was shown on the books of CSIBL while the rest kept off. The corresponding liability of Rs.855 million cannot be traced in the liability section of the parallel books and balance sheet which shows that in fact CSIBL had borrowed from financial institutions in its own name using its own financial statements and then advanced these funds to its fully-owned subsidiary. The Appellant No.7's argument that these finances were secured is not based on reality as there was no collateral against them. In case CSIBL was actually maintaining separate accounts under the head of 'managed portfolios', it should have been acting only as an agent for its clients without exposing itself to any risk. CSIBL was, however, found to have raised an undisclosed borrowing of around Rs.5.2 billion in its own name from various financial institutions at exorbitant fixed mark-up rates and also from the general public. The fact and amount of these liabilities was totally excluded from the books of account of CSIBL both as on 31/12/04 and 30/06/05 despite the fact that it represented a liability of CSIBL and it was liable to pay it back. Further, the funds obtained by CSIBL from different financial institutions were at exorbitantly high rates of 40% to 50% whereas the market rates in the same time span had been around 12% to 16%. While some individuals could utilize the services provided by CSIBL for maintaining cash management accounts, this possibility is remote in cases of lending obtained from financial institutions in the shape of REPO, deposits and long term borrowings. All these financial institutions along with the general public have thus been defrauded by the acts of the Appellant No.7 heading the CSIBL's management, particularly in not recording these borrowed amounts in the books of accounts and financial statements of CSIBL. The Appellant No. 7's contention that parallel books of account did not represent

the assets and liabilities of CSIBL and were in fact mere discretionary accounts being managed by CSIBL for its clients is neither true nor convincing. It is not only contrary to the findings contained in the Inspection Report but the Appellant No.7 also failed to support his contention with any reliable evidence. Even if these parallel books of account pertained to discretionary client accounts, a true and fair view of the affairs of CSIBL was still not presented. While managing discretionary client accounts could be said to be allowed under rule 19 of the NBFC Rules, there is no provision in the prevailing regulatory framework, including the Ordinance, the NBFC Rules and the Prudential Regulations that allows a NBFC to carry out any undisclosed and unreported activity. Rule 19 of the NBFC Rules only stipulates that discretionary client accounts are to be managed separately from other activities of the NBFC. The said rule does not sanction that discretionary client accounts are to be considered as an off-balance sheet item. Moreover, if one also subscribes to the Appellant No. 7's position that the maintenance of the separate books of account in respect of discretionary client accounts was based on a *bona fide* understanding that CSIBL was required to treat such accounts as separate from its other activities, the books of account and financial statements of CSIBL yet again fail to present a true and fair view of the affairs of CSIBL;

b) Appellant No. 5 being the CFO of CSIBL was aware of every financial transaction occurring within the company. Lack of knowledge is not an excuse. The Appellant had not raised his voice on any of the violations committed by CSIBL as mentioned in the Show Cause Notice issued, and, therefore, is considered party to the wrongdoings of the management. The Appellant No.5 was the CFO of CSIBL from 25/04/02 to 13/06/05 and the accounts of 31/12/04 were finalized during his tenure as CFO and the transactions accruing until June 2005 were also in his knowledge;

c) Appellant No.2 had been appointed as CFO on 04/06/05 but no e-mail was received from Appellant clarifying his position that he has not accepted the position of CFO and half-yearly accounts were also drawn during that time period, therefore, Appellant No.2 is considered responsible for all the financial activities as CFO during that period. It is pertinent to point out that the e-mail informing employees of CSIBL about Mr. Faqir Hussain as the CFO was dated 30/07/05. There was a difference of almost two months between the two e-mails. This casts doubts upon Appellant No.2's statement that he was never the CFO of CSIBL; and

d) The duties of external auditors is towards the shareholders of the entity they are auditing. The Appellant No. 6 as auditors did not highlight the violations and dubious transactions in their audit report to the members/shareholders which constitutes violation of section 492 of the Ordinance under which the auditors are penalized. In case the management was not providing them with any information/documents, it was their duty to qualify their opinion on accounts and bring it to the knowledge of the members of CSIBL which was never done by Appellant No.6. Therefore, the Appellant No.6's failure to properly discharge their responsibilities constituted violation of section 492 of the Ordinance under which the Appellant No.6 was penalized.

11. We have heard the arguments.

12. Section 208(4) of the Ordinance was in force at the time of passing of the Impugned Order and section 208(4)(b) applied to financial institutions approved by the Commission. However, we need to read this section in its context, as approval generally does not mean the approval of license but specific approval by the Commission for the purposes of section 208 of the Ordinance. The interpretation of approval by the Appellant would broaden the scope of the definition of approval to

an extent that it would be absurd and against the spirit of the statute which generally prohibits investment in associated companies contained in section 208(1) of the Ordinance without approval through special resolution or exemption on the basis of approval obtained from the Commission. The Appellants have pleaded that they were exempt being financial institution. For a financial institution to be excluded from the application of section 208 of the Ordinance as per clause (b) of sub-section (4), specific approval from the Commission was required for this purpose, which was lacking in the case of CSIBL.

13. We have reviewed the accounts 31/12/04 and 30/06/05 which clearly show investments in associated undertakings by CSIBL. The accounts are signed by all the executive and non-executive directors. It is beyond our comprehension that directors of such solid financial experience and background could overlook and plead ignorance of the situation. Further, if it is assumed that they were negligent in their duties, the culpable negligence they have shown tantamount to willful misconduct. As far as the case of double jeopardy is concerned, reliance is placed on the Supreme Court of Pakistan judgment of Muhammad Nadeem Anwar versus Securities and Exchange Commission of Pakistan, cited at 2014 SCMR 1376, wherein, it was held that. "...the petitioner committed offences under two different enactments though by commission of act and omission on one go and do not at all fall within the ambit of the same offence. In such circumstances, provisions of Article 13(A) of the Constitution of Islamic Republic of Pakistan, 1973, section 403 of the Code of Criminal Procedure, 1898 and section 26 of the General Clauses Act, 1897 are not relevant in the instant case because the petitioner committed offences which are neither similar to each other nor under the same enactments..." In the instant case, penalties were imposed for two different offences committed by Appellants i.e. violation of the provisions of section 208 of the Ordinance and violation of section 282J of the Ordinance for mismanaging the affairs of CSIBL as directors and, therefore, this not a case of double jeopardy.

14. We have reviewed the judgment of Re City Equitable Fire Insurance Co Ltd [1925] Ch 407 (Chancery Division) relied on by the Appellant No. 2 and , wherein, it is provided that, "...it is indeed impossible to describe the duty of directors in general terms, whether by way of analogy or otherwise. The position of a director of a company carrying on a small retail business is very different from that of a director of railway company. The duties of a bank director may differ widely from those of an insurance director, and the duties of one insurance company may differ from those of a director of another..." We are of the view that while it is true, that the standard of care to be exercised by a non-executive director will be different from that of an executive director involved in running the management affairs of a company, nevertheless, a director whether executive or non-executive must exercise prudence while approving the accounts of a company. The test for standard of care to be exercised by a director is what a director with reasonable prudence would have done in given circumstances. We are of the view that both the executive and non-executive directors by failing to raise their concerns regarding investments in associated undertakings and keeping silent did not exercise prudence reasonably expected of them as directors of CSIBL. These state of affairs resulted in failure to protect the interest of the small investors / depositors of CSIBL.

15. Appellant No.7 as CEO has argued he acted in a bona fide manner and did not mismanage the affairs of CSIBL. CSIBL sought to provide financing to a client to undertake a real estate venture and did not undertake the real estate venture itself. Moreover, the said finance facilities were duly secured through adequate security in the shape of equitable mortgages and promissory notes payable on demand and thus cannot be said to be in the nature of investments. Further, keeping separate books of accounts of CSIBL were kept on the bona fide understanding that CSIBL was required to keep such accounts as "separate" from its other activities. The Respondent on the other hand has argued that CSIBL had an undisclosed

investment of Rs.1.3 billion in musharaka/real estate properties and did not possess a license for housing finance services required under section 282C of the Ordinance read with the NBFC Rules and, therefore, could not have invested into real estate. Further, books of account and financial statements of CSIBL fail to present a true and fair view of the affairs of CSIBL. We concur with the Respondent that the Appellant No.7 has failed to satisfactorily show any evidence that the separate books of accounts were of discretionary clients contrary to the findings of the inspection report. The Appellant No. 7, therefore, has not followed the regulations of NBFC's in letter and spirit and has deviated from his responsibility as CEO of CSIBL to ensure full compliance of the NBFC rules and regulations.

16. Appellant No. 5 as CFO of CSIBL has been unable to satisfactorily show how the affairs of the company were not in his knowledge. The Appellant No. 5 was the CFO at the time of the finalization of accounts ending 30/12/04. Moreover, the Appellant No. 5 resigned as CFO on 13/06/05 shortly before the signing of the accounts ending 30/06/05, therefore, must have been aware of the transactions until that period and would have been responsible for maintenance of books and preparation of accounts. The Appellant No. 5 should have fulfilled his responsibilities by raising concerns on record on the mismanagement of the affairs of CSIBL which he omitted to do so;

17. We have reviewed the email dated 30/07/05 informing the management of CSIBL that Appellant No.2 was taking the office of CFO of CSIBL in addition to his existing responsibilities. There is no email on record to show that Appellant No.2 had turned down the offer to act as the CFO of CSIBL. The Appellant No.2, therefore, has been unable to provide any satisfactory evidence that he was not acting as the CFO at the time of finalization of the accounts ending 30/06/05;

18. Section 255 of the Ordinance requires auditor to express an opinion to the best of their information and according to the explanation given to them which gives a true and fair view relating to the affairs of the company. The auditors have an extremely important responsibility towards the shareholders and must ensure that the slightest of any mismanagement or misappropriation in the accounts is reflected in their opinion. The fact that the management of CSIBL concealed information and did not provide the actual position to them is no defence as the Appellant No. 6 had power under the law to obtain information from company. In case information was not provided, the auditor could have disclaimed opinion. The Appellant No. 6 as auditors of CSIBL by not qualifying their opinion failed in their responsibility; therefore, the penalty was rightly imposed on them under section 260 and 492 of the Ordinance.

19. When the mismanagement of the affairs of CSIBL came to the knowledge of the non-executive directors, they did not raise this issue at any forum be it in a board meeting or a court of law. Further even after more than 10 years, out of total deposits of over Rs.5 billion, over Rs.3 billion is still outstanding and has not been paid to the investors. No action for resolution of these outstanding dues has been taken by the non-executive directors. Therefore, by virtue of their conduct, the non-executive directors primarily failed to protect the interests of the shareholders as well as of investors.

20. In view of the foregoing, we see no reason to interfere with the Impugned Order. The appeals are dismissed with no order as to costs.

(Fida Hussain Samoo)
Commissioner (Insurance)

(Zafar Abdullah)
Commissioner (SCD)

Announced on: 13 OCT 2015