



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

BEFORE MS. JAWERIA ATHER, DIRECTOR (NBFC D)

ORDER

IN THE MATTER OF ASIAN STOCKS FUND LIMITED (ASFL)

No. and date of Show-cause notice	NBFC/MF-D (NBFC D)/243/2006 dated April 24, 2006
Dates of hearings	June 30, 2006, July 26, 2006 and August 07, 2006
Present	Mr. Faisal Islam Legal Counsel representing directors and CEO of Asian Stocks Fund Limited

This order shall dispose of the proceedings initiated against directors including Chief Executive Officer of Asian Stocks Fund Limited (“ASFL”) for alleged violation of provisions of Rule 49(3) and Rule 49(4) of the Non-Banking Finance Companies (Establishment & Regulation) Rules, 2003 (the “NBFC Rules”).

2. The underlying facts of this case, briefly stated below, are that ASFL is an investment company duly registered under the NBFC Rules as a closed-end fund and as per provisions of the NBFC Rules applicable to closed end funds, ASFL was obliged to adhere to the investment limits specified therein including those provided in Rule 49 of the NBFC Rules.

3. It was observed from audited accounts for the year ended 30 June 2005 and second quarter accounts for the period ended 31 December 2005 that ASFL had made investments in securities of Pakistan Industrial Credit and Investment Corporation (“PICIC”), Crescent Standard Investment Bank Limited, Crescent Leasing Corporation Limited, Crescent Steel and Allied Limited, Shakarganj Mills Limited, Crescent Standard Modaraba and International Housing Finance Limited, in apparent contravention of sub rule (3) of Rule 49 *ibid*. Details of the aforesaid investments made by ASFL, in relation to

its net assets and in relation to paid-up capital of investee companies, are given in Table–A and Table–B, respectively:-

TABLE – A

Investment by ASFL in relation to its net assets of Rs. 833.112 million (as on 30 June 2005) and net assets of Rs. 870.093 million (as on 31 December 2005) in violation of Rule 49(3) of the NBFC Rules

Name of Investee Company	AS ON JUNE 30, 2005			AS AT DECEMBER 31, 2005		
	No. of shares held by ASFL	Market Value of shares held by ASFL (Rs)	% age of investment (at market price) with respect to NAV	No. of shares held by ASFL	Market Value of shares held by ASFL (Rs)	% age of investment (at market price) with respect to NAV
PICIC	1,796,357	124,397,772	14.93	1,960,450	127,037,160	14.60
Crescent Standard Investment Bank Ltd.	9,000,000	140,400,000	16.85	9,000,000	108,450,000	12.46
Crescent Leasing Corp. Ltd.	6,918,750	102,397,500	12.29	7,077,594	89,885,444	10.33
Crescent Steel & Allied Ltd.	1,335,000	101,593,500	12.19	1,492,300	117,145,550	13.46
Shakarganj Mills Ltd.	1,800,000	88,200,000	10.59	2,070,000	98,325,000	11.30

TABLE – B

Investment by ASFL with respect to paid-up capital of investee companies in violation of Rule 49(3) of the NBFC Rules

Name of Investee Company	AS ON JUNE 30, 2005			AS AT DECEMBER 31, 2005		
	Paid-up Capital of Investee Company (No of Shares)	Investment by ASFL (No of Shares)	Investment by ASFL as %age of Paid-up capital of Investee company	Paid-up Capital of Investee Company (No of shares)	Investment by ASFL (No of shares)	Investment by ASFL as %age of Paid-up capital of Investee Company
Crescent Standard Modaraba	10,000,000	1,793,500	17.94%	-	-	-
International Housing Finance Limited	40,000,000	5,000,000	12.50%	45,000,000	4,500,000	10.00
Crescent Leasing Corporation Ltd.	40,346,700	6,918,750	17.15%	45,390,000	7,077,594	15.59

4. Furthermore, audited annual financial statements for the year ended 30 June 2005 and second quarter accounts for the period ended 31 December 2005 indicated that ASFL had invested in the Investment Companies & Banks sector significantly more than twenty five percent of its net assets in apparent contravention of sub rule (4) of Rule 49 of the NBFC Rules. Position of investment in different companies belonging to the Investment Companies & Banks sector is given in Table–C.

TABLE - C

Investment by ASFL in violation of Rule 49(4) of the NBFC Rules

Name of Companies belonging to Investment Companies & Banks Sector	AS ON JUNE 30, 2005		AS AT DECEMBER 31, 2005	
	Market value of shares held by ASFL (in Rs.)	Percentage to Fund's NAV	Market value of shares held by ASFL (in Rs.)	Percentage to Fund's NAV
PICIC	124,397,772	14.93	127,037,160	14.60
Crescent Standard Investment Bank Limited	140,400,000	16.85	108,450,000	12.40
International Housing Finance Ltd.	43,000,000	5.16	37,125,000	4.26
Javed Omer Vohra & Company Ltd.	-	-	50,115,000	5.76
Total investment in the sector	307,797,772	36.94	322,727,160	37.08

5. Accordingly, a show cause notice No. NBFC/MF-D (NBFC/D)/243/2006 dated April 24, 2006 ("SCN") was served on the directors including Chief Executive Officer of ASFL (collectively referred to as "Directors"), calling upon them to show cause as to why a fine may not be imposed upon them as provided in Rule 63 of the NBFC Rules for the aforesaid contravention.

6. Written replies to the said SCN were submitted by all the Directors through their legal counsel, Sami Zafar & Islam, Advocates & Legal Consultants ("Counsel"), vide letters dated 25 May 2006, 06 June 2006, 28 June 2006 and 03 August 2006. Opportunities of hearing were also provided to Directors who made representations before me through their Counsel on 30 June 2006, 26 July 2006 and 07 August 2006. After due consideration of written replies and verbal arguments given by the Counsel in the matter, my observations on various points raised by the worthy Counsel are as follows.

7. **Applicability of NBFC Rules to Investment Companies:** The validity of the NBFC Rules relating to investment companies has been challenged by the Directors through the Counsel. Their contention is primarily that the Federal Government is not empowered to make rules relating to an investment company under Section 282B of the Companies Ordinance 1984 ("CO 1984"); hence provisions of the NBFC Rules would not be applicable to ASFL, being an investment company. Furthermore, it has been argued by the Counsel that despite the registration of ASFL under Rule 38 of the NBFC Rules, such provision of the NBFC Rules is ultra vires. The Counsel argues that registration of ASFL continues under the Investment Companies and Investment Advisers Rules, 1971. However, these rules - having been repealed - no longer provide the legal framework for investment companies.

8. It is important to consider that the NBFC Rules have been framed by the Federal Government in pursuance of Section 282B of the CO 1984 and are administered by the Securities and Exchange Commission of Pakistan (“SECP”). Any issue challenging the validity of the NBFC Rules cannot be taken up by the SECP since it is not the forum to decide the validity of these Rules. Nevertheless, I have logically considered the arguments presented by the Directors and have found them unreasonable. The governing section, i.e. Section 282B of the CO 1984 allows the Federal Government to frame rules for the “effective regulation of NBFCs and companies established under the rules framed hereunder.” Since investment companies are registered under the NBFC Rules, they fall within the scope of the NBFC Rules as allowed by Section 282B. Furthermore, ASFL has been registered with the SECP under Rule 38 of the NBFC Rules and conditions of the said registration certificate explicitly require ASFL to comply with the NBFC Rules. Hence, the arguments raised by Directors through the Counsel do not appear to be tenable in this regard.

9. **Response to Table A of the SCN:** The Counsel has argued that for the purpose of Rule 49(3) of the NBFC Rules, the paid-up capital, instead of the net asset value, of ASFL will be the basis to consider its investment in other companies. If I accept the contention of the Counsel for the sake of argument to measure the value of investments at cost to paid-up capital, even then ASFL has defaulted in complying with Rule 49(3) as is evident from the details submitted by the Counsel and summarized in the following table:

Name of Investee Company	%age of Investment (at cost) to paid-up capital of ASFL		
	30 June 2005	31 December 2005	31 March 2006
PICIC	12.79%	10.11%	-
Crescent Leasing Corporation Limited	12.21%	11.11%	-
Crescent Steel & Allied Ltd.	10.73%	-	-
Shakarganj Mills Ltd.	-	-	10.53%

10. It is apparent that the Directors have admitted to making excessive investments in PICIC, Crescent Leasing Corporation Limited and Crescent Steel and Allied Limited as on 30 June and 31 December 2005, even if calculations are made according to the basis that they have insisted upon, i.e. investments (at cost) to the paid-up capital of ASFL. In case the mechanism to calculate investments is switched to investments (at market value) to net assets of ASFL – which in my opinion, and as discussed in para 17 of this Order, is required by Rule 49(3) – then ASFL is in contravention of the said Rule as on 30 June and

31 December 2005 in case of investments in PICIC, Crescent Standard Investment Bank Limited, Crescent Leasing Corporation Limited, Crescent Steel and Allied Limited and Shakarganj Mills Limited.

11. Response to Table B of the SCN: It has been contended that SECP had earlier raised the issue of violation of Rule 49(3) with regard to investments mentioned in Table B of the SCN in August 2005, followed by a SCN in November 2005. Thereafter, the issue has been satisfactorily resolved as indicated by correspondence between SECP and ASFL in March 2006. The Counsel has contended that SECP is estopped from raising the issue of violation of Rule 49(3) with regard to investments mentioned in Table B.

12. The argument is incorrect since the earlier correspondence and the SCN dated 2 November 2005 related to ASFL's violation of Rule 49(3) as on 31 March 2005. The current SCN, on the other hand, relates to alleged violations as on 30 June 2005 and 31 December 2005. As SECP has not raised this issue earlier, it is not estopped from doing so at this stage. Given that no reasonable argument has been provided to clarify the excessive investments of ASFL as contained in Table-B of the SCN, I conclude that ASFL has contravened the provisions of Rule 49(3) by making investments in Crescent Leasing Corporation Limited, Crescent Standard Modaraba and International Housing Finance Limited as on 30 June 2005 and in Crescent Leasing Corporation Limited and International Housing Finance Limited as on 31 December 2005 in excess of 10% of the respective issued capital of these companies.

13. Mechanism to Calculate Investments in Companies for the Purpose of Rule 49(3): With regard to the mechanism for calculation of investments for the purpose of Rule 49(3), a copy of SECP's Circular 27 of 2003, dated 16 October 2003 was provided to the Counsel. The Counsel alleged that the said Circular is illegal and void as it seeks to make an amendment in the NBFC Rules. He has requested that the Circular may not be read while reading Rule 49(3) of the NBFC Rules for the purpose of the SCN.

14. I have acceded to the request of the Counsel that Circular 27 of 2003 may not be referred to for the purpose of these proceedings. The said Circular had not been referred to in the SCN issued to the Directors; hence, it may be unfair to read it alongside Rule 49(3) for the purpose of disposing of the SCN.

15. It has been argued by the Counsel that the mechanism for calculation of value of investments by an investment company on the basis of market value of shares held by it and its net asset value ("NAV") are alien to Rule 49(3) of the NBFC Rules. Accordingly,

the threshold of 10%, as specified in Rule 49(3), has to be taken into consideration at the time of investment, i.e. based on the cost of investment and not on the basis of present value of the investment, i.e. market value of such investment. According to him, this is the spirit of the said Rule.

16. If Rule 49(3) is considered in two parts, it would emerge that one part requires investment of a closed-end fund in any company not to exceed, at any time, an amount equal to 10% of the paid-up capital of the closed-end fund. The second part requires investment of a closed-end fund in any company not to exceed, at any time, an amount sufficient to acquire 10% of issued capital of that company. An investment company is required to remain within the lower of the two thresholds.

17. A plain reading of Rule 49(3) reveals that the intention of first part of Rule 49(3) is to measure investments of a closed-end fund at market value and not at cost, as contended by Directors. The requirements of Rule 49(3) are not stagnant at a single point of time; rather they require investment in a company not to exceed the given threshold at any time. Measurement at cost is a historical basis and is linked to the value of investment at a single point in time. Instead, measurement at market value follows the spirit of Rule 49(3) and allows the investment to be measured at any time based on the prevailing price. Furthermore, Rule 49(3) is applicable to both investment companies and closed-end scheme (constituted by way of trust). It is important to consider that the concept of paid-up capital does not exist in case of a closed-end scheme, constituted as a trust. In such a case, net assets form the basis of investment decisions and strategy of the closed-end scheme. Given the above, it appears to be the intention of Rule 49(3) to link investment decisions to the net assets of closed-end funds.

18. On a similar premise, the second part of Rule 49(3) seems to require investments to be measured at market value at any time. Hence the argument of the Counsel that the requirements of Rule 49(3) are to be determined at historical cost of investment is not acceptable.

19. In terms of the above, ASFL is clearly in violation of Rule 49(3) in case of investments made in securities of PICIC, Crescent Standard Investment Bank Limited, Crescent Leasing Corporation Limited, Crescent Steel and Allied Limited, Shakarganj Mills Limited, Crescent Standard Modaraba and International Housing Finance Limited as on 30 June and 31 December 2005.

20. **Reliance on Classification of Stock Exchange for the Purpose of Rule 49(4):**

The Counsel has argued that reliance of Rule 49(4) of the NBFC Rules on a classification of listed companies by the stock exchange may lead to absurd results. The stock exchanges do not have any basis for and guideline to classify a particular set of companies as a sector. The said classification, therefore, cannot be strictly followed for the purpose of Rule 49(4). With particular reference to PICIC, it has been held that classification of PICIC as an investment company is not appropriate given that it is regulated by State Bank of Pakistan ("SBP") and is in the process of merging with a scheduled bank, subject to SBP's approval.

21. This argument is not acceptable as the explicit requirement of Rule 49(4) is to follow the classification of the stock exchange while making investments in any sector. In addition, PICIC is a development finance institution and is regulated by SBP as such. It is not a scheduled bank and remains a development finance institution to date.

22. **Use of NAV for the Purpose of Rule 49(4):** It has been further argued by the Counsel that investment in a sector by an investment company should be considered in relation to its net assets at the time of investment and not afterwards. According to the Counsel, this is the spirit of the said Rule. It is not possible to monitor and accordingly change the investments on a daily basis. Moreover, the use of NAV is alleged not to be practical in case of Rule 49(4) and a hypothetical example was provided in support of this contention.

23. The arguments of the Counsel given in this regard are not tenable. An investment company seeks to invest public funds into authorized investments according to a laid-out investment strategy. The purpose of Rule 49(4) is to enable an investment company to diversify its investments and, hence, the risks. The diversification is to be ensured at all times and not just at the time of investment to avoid concentration of funds into any one sector. Going by the argument of the Counsel, an investment company may subsequently end up concentrating its funds into a sector despite complying with Rule 49(4) at the time of investment into that sector. Hence, it would be exposing public funds to the risks inherent in any one sector. I, therefore, conclude that the Directors have violated the provisions of Rule 49(4) of the NBFC Rules in the case of investment in Investment Companies & Banks sector as on 30 June and 31 December 2005.

24. **Knowing and Willful Default:** The Directors have represented through the Counsel that in case ASFL is considered to be in violation of Rules 49(3) and 49(4) of the NBFC Rules, they were not knowingly and willfully party to the same. When the bulk of the

investments were made in October 2004, the composition of the Board of Directors of ASFL was different. Furthermore, Mr. Farooq Lakhani and Mr. S. M. Yousuf were not approved by the SECP as directors of ASFL and SCN to the said directors is inappropriate.

25. I have concluded, based on the preceding Paras, that ASFL was in contravention of Rules 49(3) and 49(4) of the NBFC Rules as on 30 June and 31 December 2005. Since the said Rules do not apply at the time of investment by a closed-end fund, Directors who were members of the Board at the time the violations existed are liable for any such default. Given that the SCN points out to default by ASFL as on 30 June and 31 December 2005, the Board as constituted on those dates is liable for the contravention and the consequent penalty. In addition, Mr. Farooq Lakhani and Mr. S. M. Yousuf were functioning as directors of ASFL as on 30 June, without the SECP's approval. They remain responsible for their acts during the period of their appointment as directors and the SCN issued to them is valid and appropriate.

26. I have reviewed circumstantial evidence to decide whether or not these defaults were committed knowingly and willfully by ASFL's Board of Directors. All of the companies in which ASFL has been holding excessive investments are Crescent Group companies. It appears that ASFL was holding strategic investments in these companies as a majority shareholder, in the interest of the Crescent Group and not in the interest of the general public whose funds have been pooled into ASFL. It is also important to note that all the Directors are employees of Crescent Group companies. Hence, I conclude that the Board of Directors of ASFL was in willful default of Rule 49(3) and Rule 49(4) of the NBFC Rules.

27. For the foregoing reasons, I, in exercise of powers vested in me under Rule 63 of the NBFC Rules, 2003, impose fine of Rs. 200,000/- on each of the following directors/ex-directors and Chief Executive Officer:

1. Mr. Ahmed Reza, Chief Executive Officer
2. Mr. Mahmood Ahmed, Ex-Director
3. Mr. Farooq Lakhani, Ex-Director
4. Mr. Shahid Latif Dar, Ex-Director
5. Mr. Faqir Hussain Khan, Ex-Director
6. Mr. Khursheed Yazdani, Director
7. Mr. Wasim Ahmad, Director
8. Mr. S. M. Yusuf, Ex-Director

28. I further impose fine of Rs. 300/- per day for continuous default aggregating to Rs. 136,200/- on each of the above mentioned directors/ex-directors and Chief Executive Officer.

29. The Chief Executive Officer and each of the above mentioned Directors of ASFL are hereby directed to deposit the aforesaid fines aggregating to Rs 2,689,600 (Rupees two million six hundred and eighty nine thousand and six hundred only) in the designated bank account maintained in the name of Securities and Exchange Commission of Pakistan with Habib Bank Limited within thirty (30) days from the receipt of this order and furnish receipted challan to SECP, failing which, among other actions, proceedings under the Land Revenue Act, 1976 will be initiated. It may also be noted that the said penalties are imposed on the Chief Executive and Directors in their personal capacity; therefore they are required to pay the said amount from their personal resources.

(JAWERIA ATHER)
Director (NBFCD)

Announced: 29 September 2006
ISLAMABAD