BEFORE APPELLATE BENCH III

In the matter of

Appeal No. 45 of 2012

1. Mr. MD Sadequl Islam, Ex-CEO
2. Mrs. Rokia Afzal Rahman, Ex-Director
3. Mr. Faruq Ahmed Chaudhry, Ex-Director
4. Mr. Fazl-e-Hasan Abed, Director
5. Mr. Muhammad Faridur Rehman, CEO ....Appellants
   (Of Brac Pakistan (Guarantee) Limited)

Versus

Director (Enforcement)/Additional Registrar of Companies, Securities and Exchange Commission of Pakistan ....Respondent

Date of Hearing 22/07/13

ORDER

Present:

For the Appellants:

Mr.Javed Panni (Chief Executive, M J Panni Associates)

For the Respondent:

Ms. Bilal Rasul, Director (Enforcement)

Mr.Moeed Hassan, Assistant Director (Enforcement)

1. This Order is in appeal No. 45 of 2012 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 against the order dated 18/09/12 (the "Impugned Order") passed by the Respondent.

2. M/s Brac Pakistan (Guarantee) Limited (the "Company") was incorporated under the Companies Ordinance, 1984 (the "Ordinance") on 04/2/08 as public company with a liability limited by guarantee, under section 42 of the Ordinance. The principal activity of the Company is to undertake programs associated with socio-economic development in Pakistan, particularly in the fields of micro-financing, health, education, and poverty alleviation.

3. The Enforcement Department (the "department") of the Commission, while examining the annual audited accounts of the Company for financial year ended on 31/12/09 (the "Accounts"), observed that an amount of Rs. 62.238 million (2008: Rs. 36.281 million) was shown against microcredit receivables on account of *security deposits*. Furthermore, it was stated that in accordance with the microcredit policy of the Company, 10% (in case of 1st Cycle) and 5% (in case of 2nd cycle) of the amount of microcredit disbursed, is retained as security deposit, which is repayable after recovery of the full amount of the principal and interest thereon from the borrowers. The Commission vide letter dated 12/12/11 advised the Company to furnish evidence of compliance with the provisions of section 226 of the Ordinance.

4. Show Cause Notice dated 15/05/12 ("SCN") was issued to the Chief Executive Officer ("CEO") and directors of the Company to submit written explanation within fourteen (14) days from the date of the SCN as to why penal action may not be taken against them under section 226 read with section 229 and section 473 of the Ordinance. The Chief Executive Officer

("CEO") vide authority letter dated 23/05/12 authorized M/s. MJ Panni & Associates (the "Authorised representative") to represent the Company and Directors before the Respondent. The Authorised representative submitted its reply to the SCN vide letter dated 18/06/12 and hearing in the matter was held on 11/09/12. The Respondent after hearing the Authorised representative and reviewing the written submissions held that the Company had failed to provide any information/documents evidencing compliance with any of the aforesaid requirements of section 226 of the Ordinance. In exercise of the powers under section 229 of the Ordinance, the Respondent, imposed a penalty of Rs. 2000/- each on four out of the five Appellants with total amount aggregating to Rs. 8000/-. Further, the CEO was directed to deposit the security deposit in a special account with scheduled bank within 30 days of the Impugned Order, to submit audit certificate and submit compliance of the above direction within 45 days of the date of the Impugned Order.

5. The Appellants have preferred the instant appeal against the Impugned Order. The Appellants' representative argued that no amount has been received by the Company from the borrower which could be treated as a *security* or *deposit* in terms of section 226 of the Ordinance. Further, the amount retained from the borrower is in fact a *margin* and is neither a *security* nor *deposit* as explicitly mentioned in section 226 of the Ordinance. The Respondent has relied on a non-legal interpretation of the term *security deposit*. It has been explained in Note 16.1 to the Accounts that it is the policy of the Company to retain 10% (in case of first cycle) and 5% (in case of second cycle) from the borrower of the amount of microcredit disbursement. The amount is in fact retained as *margin* and is adjusted against last installment. The terms *security* and *deposit* used in section 226 of the Ordinance have very specific and restrictive application and should not be interpreted to give it a wider interpretation beyond the section itself.

6. The department's representatives argued that the provisions of section 226 of the Ordinance are applicable as the deposit in the instant case, is in substance a *security deposit*. The legal interpretation of section 226 of the Ordinance is that any amount retained by the Company which collateralizes an advance or loan should be categorized as *security* or *deposit*. The contention of the Appellant does not hold because of the widely accepted concept of *"Substance over form"*. The concept entails the use of judgment and *economic substance* of transactions to be considered rather than merely their legal form in order to present a true and fair view of any of the transactions. Further, the Company has used a nomenclature *security deposit* in the accounts audited by M/s Ernst and Young, as such, the Company is denying its own financial statements.

7. We have heard the parties. Section 226 of the Ordinance is reproduced for ease of reference:

> ***226. Securities and deposits, etc.-*** *No company, and no officer or agent of a company, shall receive or utilise any money received as security or deposit, except in accordance with a contract in writing; and all moneys so received shall be kept or deposited by the company or the officer or agent concerned, as the case may be, in a special account with a scheduled bank:*
>
> *Provided that this section shall not apply where the money received is in the nature of an advance payment for goods to be delivered or sold to an agent, dealer or sub-agent in accordance with a contract in writing.*
>
> Emphasis Added

Section 226 of the Ordinance provides that no money received as *security* or *deposit* shall be utilized by the Company except in accordance with a contract in writing and must be kept in a special account with a scheduled bank. The term *security* has not been defined in the Ordinance, however, *security* is defined by the '*Black Law Dictionary*' as a term which "*...is usually applied to an obligation, pledge, mortgage, deposit, lien, etc., given by a debtor* (Emphasis Added) *in order to make sure the payment or performance of his debt, by furnishing the creditor with a resource to be used in case of failure in the principal obligation. Deposit* is defined by the '*Black Law Dictionary*' as, "*Funds placed by an individual or institution with a Bank or authorized Depository which are then used to finance operations. Acceptance of the deposit creates a liability for the accepting bank and requires payment of periodic Coupon interest and return of funds at maturity or on presentation...*" In terms of the definition of *security*, a *security* is an amount given by the debtor to the creditor to ensure the performance of his debt.

We have also perused Note 16.1 to the Accounts and agree with the Appellant that the Company did not receive any money as security or deposit from the borrowers as envisaged in section 226 of the Ordinance. In fact, the 10% of the microcredit loan disbursed to each borrower is withheld and used for settlements against last installment. Moreover, there was no obligation or pledge given by the borrower, "*...by furnishing the creditor* (lender) *with a resource to be used in case of failure in the principal obligation.*" which at best can be treated as a 'margin' and in no way can be deemed to be a *security* or *deposit*. The title of account as *security deposit* used in the Company's account had created the misimpression that it is a *security deposit* in terms of section 226 of the Ordinance and need to be placed in a separate account. We have perused Note 5 to the Accounts ended 30/06/11 and observed that the Company has removed the ambiguity in the annual accounts for the year 30/06/11 and corrected the head of account to "Amount withheld for settlement against last installments". In so far as the contention of the Respondent

of "*substance over form*" is concerned, it has been incorrectly applied and section 226 of the Ordinance has been interpreted on threshold of the aforesaid principle which is not applicable in the instant case. Further, it is observed that the true intention of the legislature should only be gathered from the wording of the section. The principle of applying the *plain meaning* also known as the *literal rule* ought to be applied to the section and cannot be 'disregarded' as has been the case in the Impugned Order. Reliance is placed on *General Rules of Interpretation, Chapter II, page 12, Understanding Statutes Canons of Construction, Second Edition* by *S.M.Zafar*.

In view of the foregoing, we set aside the Impugned Order, with no order as to cost.

(**Zafar Abdullah**)
Commissioner (SMD)

(**Imtiaz Haider**)
Commissioner (SCD)

Announced on: 11/09/13