



SECP

Insurance Division
Karachi

[Karachi]

Before Tariq Hussain, Director (Insurance)

In the matter of

Pak Kuwait Takaful Company Limited

Show Cause Notice Issue Date: January 08, 2013

Date of Hearing: March 12, 2013

Attended By: Mr. Syed Wajahatullah Quadri
Chief Financial Officer
M/s Pak Kuwait Takaful Company Limited

Date of Order: April 08, 2013

ORDER

(Under Regulation 3(1) and Regulation 16(1)(a) of Part B of Annexure II of the Securities and Exchange Commission (Insurance) Rules, 2002 and Section 46(1)(b) Read with Section 34 and Section 156 of Insurance Ordinance, 2000)

.....

This Order shall dispose of the proceedings initiated against M/s Pak Kuwait Takaful Company Limited ("the Company") for not complying with the provisions of Regulation 16(1)(a) of Part B of Annexure II of the Securities and Exchange Commission (Insurance) Rules, 2002 (the "Rules") and Section 34 of the Insurance Ordinance, 2000 (the "Ordinance").

Background Facts

2. The relevant provision of Sub-section (1) of Section 46 of Ordinance requires every non-life insurer to file annual audited financial statements. For the purpose of ready reference, Section 46(1) of the Ordinance is reproduced as follows:

"Accounting and reporting.- (1) Every insurer shall at the expiration of each year prepare and deliver to the Commission with reference to that year annual statutory accounts comprising the following statements duly audited by an approved auditor:

...

SECURITIES & EXCHANGE
COMMISSION OF PAKISTAN

Insurance Division, State Life Building-2
4th Floor, Wallace Road, Karachi, Pakistan

Tel: +92-21-32461053, +92-21-32465469 **Pak Law Publication** www.secp.gov.pk

**Office # 05, Ground Floor, Arshad Mansion, Near Chowk A.G Office,
Nabha Road Lahore. Ph. 042-37350473 Cell # 0300-8848226**

Ms.



(b) in the case of a non-life insurer,

- (i) a statement of assets and liabilities;
- (ii) a statement of profits and losses;
- (iii) a statement of cash flows;
- (iv) a statement of premiums;
- (v) a statement of claims;
- (vi) a statement of expenses;
- (vii) a statement of investment income;
- (viii) a statement of claims analysis;
- (ix) a statement of exposures; and
- (x) such other statements as may be prescribed by the Federal Government;

each in such form as may be prescribed by the Commission and prepared in accordance with such regulations as are issued by the Commission from time to time in this behalf."

3. Further that Regulation No. 3(1) of Part – B of Annexure II of the Rules prescribes the additional financial statements, which amongst others, includes the Statement of Assets for Solvency Purpose (Form GJ). The said Regulation states that:

"The form of Regulatory Returns shall consist of the following which shall be submitted according to the published Forms annexed to these Regulations:

- ...
- *Statement of Assets for Solvency Purposes (Form GJ) which is hereby prescribed under S46(1)(b)(x) of the Ordinance.*
- ..."

4. The Company had filed its Statement of Assets for Solvency Purposes (Form GJ) for the year ended December 31, 2011 in pursuance of Section 51(1) of the Ordinance, which showed that the Company had taken all its Available for Sale investments at market value.

5. Section 34 of the Ordinance lays down the condition for the valuation of assets and liabilities for the purpose of solvency. This Section requires that:

"Valuation of assets and liabilities.- (1) For the purposes of this Part, assets and liabilities shall, subject to sub-section (2), be valued in accordance with such accounting rules as may be prescribed by the Commission.

(2) For the purposes of this Part, as at any date (the "balance date") to which a statement of assets and liabilities (however called or described) is made up:

(a) no asset of an insurer shall be valued at more than the amount, net of transaction costs incurred by the transferor, at which it could be transferred in an orderly market in a transaction between two willing but not anxious parties;

..."

6. Regulation 16(1)(a) of Part B of Annexure II of the Rules lays down the requirement for valuation of Available for Sale investments as:

"Investment and Investment Properties.- For the purpose of all statements prepared under these regulations, and for the purpose of S34(1) of the Insurance Ordinance 2000.

(a) available for sale investments shall be stated at the lower of cost or market value (market value being taken as lower if the fall is other than temporary). In the case of fixed income investments redeemable at a given date and where the cost is different from the redemption value, such difference shall be amortized uniformly between the date of acquisition and the date of maturity in determining "cost". The market value of investments at the balance sheet date shall be disclosed, as shall the effect of non-compliance with IAS 39;

..."

7. In this view, it appeared that the Company has contravened the provisions of Section 34 of the Ordinance read with Regulation 16(1)(a) of Part B of Annexure II of the Rules.

8. Furthermore, it was also observed that the Company had committed similar contravention in the Statement of Assets for Solvency Purpose for the year ended December 31, 2010, for which the Company had undertaken to comply with the provisions of Regulation 16(1)(a) of Part B of Annexure II of the Rules, vide Company's letter dated January 5, 2012.

9. In view of the foregoing paras, it appeared that the Company has failed to comply with Regulation 16(1)(a) of Part B of Annexure II of the Rules and Section 34 of the Ordinance, which attracts penal provision as provided under Section 156 of the Ordinance.

Show Cause Notice

10. Accordingly, the Show Cause Notice was issued on January 8, 2013 under Regulation 3(1) and Regulation 16(1)(a) of Part B of Annexure II of the Rules and Section 46(1)(b) Read with Section 34 and Section 156 of Ordinance to the Chief Executive and Directors of the Company, calling upon them to show cause as to why the penalty, as provided under Section 156 of the Ordinance, should not be imposed

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upon the Company and/or its Directors for not complying with provisions of Regulation 16(1)(a) of Part B of Annexure II of the Rules and Section 34 of the Ordinance.

Company's Response to the Show Cause Notice

11. In response to the said Show Cause Notice, the Company, vide their letter of January 22, 2013, stated that:

"...Clause 2 "Applicability" of Part B states that:

(1) These Accounting Regulations shall be applied to the Regulatory Returns and the Published Financial Statements, except insofar as:

(a) any of its provisions includes an express statement that it is not to apply to the regulatory returns or to the published financial statements, as the case may be; and

(b) a provision contained in the Companies Ordinance or in Rules thereto or in an instrument issued there under overrides a provision in these Accounting Regulations so far as concerns the published financial statements.

Part V of the Insurance Ordinance, 2000, specifically deals with "Solvency Requirements" and specifies admissible and inadmissible assets and liabilities which should be considered in determination of Solvency of the Company at a particular date.

Further, section 34 under this part requires that:

Valuation of assets and liabilities.- (1) For the purposes of this Part, assets and liabilities shall, subject to sub-section (2), be valued in accordance with such accounting rules as may be prescribed by the Commission.

(2) For the purposes of this Part, as at any date (the "balance date") to which a statement of assets and liabilities (however called or described) is made up:

(a) no asset of an insurer shall be valued at more than the amount, net of transaction costs incurred by the transferor, at which it could be transferred in an orderly market in a transaction between two willing but not anxious parties;

In view of above we understand that the returns should be prepared under the requirements of Accounting Regulations are considered for the purpose of preparation of regulatory returns and published financial statements. However, Subsection (1) of Section 34 of the Ordinance, 2000 requires that assets and liabilities shall, subject to *Ms:*



sub-section (2), be valued in accordance with such accounting rules as may be prescribed by the Commission. Subsection 2 of section 34 requires that an asset shall be valued not more than amount at which that asset could be transferred in an orderly market in a transaction between two willing but not anxious parties. Further, as stated above in (b) of clause 2, a provision of the Companies Ordinance or in Rules there overrides the provision of the Accounting Regulations, therefore, as part V specifically states the requirements of valuation of assets and liabilities for solvency purposes shall overrides the clause or requirements of accounting regulations.

The company's investments classified as available for sale are in mutual funds refer note 3.2 to the statement of assets and solvency purpose, which are stated at redemption price based on their net asset value (NAV) per unit as at 31 December 2011. This is the price at which units could have been redeemed at the counter of respective mutual funds. Therefore, these have been revalued and included in the statement of assets for solvency purpose which is also consistent with the industry practice..."

12. The reply of the Company reveals that the Company has misinterpreted the provisions of Section 34 of the Ordinance and the applicability of the Accounting Regulations (i.e. Part B of Annexure II of the Rules). The Company appears to be under the impression that the provisions of Section 34 of the Ordinance override the provisions of the Accounting Regulations, whereas on the other hand, the sub-Section (1) of Section 34 of the Ordinance fully endorses the applicability of the Accounting Regulations subject to the provisions of sub-Section (2) of that Section of the Ordinance. And, the provisions of sub-Section (2) of Section 34 of the Ordinance are not in conflict / in contradiction with the provisions of Regulation 16(1)(a) of the Accounting Regulations. The sub-Section (2) of Section 34 of the Ordinance determines the maximum reachable value of an asset or liability, but it does not bind the Commission to prescribe a value that is lower than the maximum reachable value, and in the instant case, the insurers shall be bound to comply with the provisions of the Accounting Regulations in terms of sub-Section (1) of Section 34 of the Ordinance.

13. Moreover, the Company appears to be under the impression that the provisions of the Companies Ordinance, 1984 shall prevail so far as the applicability of the Accounting Regulations is concerned. However, the provisions of Regulation No. 2 of the Accounting Regulations states that wherever the Accounting Regulations explicitly require any provision to be applicable only to the Regulatory Returns or to the Published Financial Statements, the Accounting Regulations shall not apply to that extent. Furthermore, Regulation No. 2 of the Accounting Regulations also states that wherever the provisions of the Companies Ordinance, 1984 override any provisions of the Accounting Regulations as far as for the Published Financial Statements are concerned, the provisions of the Accounting Regulations shall not apply to that extent.



Hearings of the Case & Subsequent Developments

14. Although, the Company had not requested for hearing in the matter, the Commission, on its own motion, had scheduled the hearing in the matter for February 7, 2013 at 10:30 a.m., which was communicated to the Company via the Commission's hearing notices no. ID/Enf/PKTCL/2013/15351 dated January 28, 2013.
15. The Company, vide its letter dated February 4, 2013, had requested the Commission not to initiate any proceedings under Section 156 of the Ordinance.
16. It would be pertinent to mention that no one appeared for the hearing in the matter, which was scheduled for February 7, 2013.
17. Thereafter, in order to provide another hearing opportunity to the Company, the Commission had scheduled the hearing in the matter for March 12, 2013 at 11:00 a.m., which was communicated to the Company via the Commission's hearing notice no. ID/ENF/PKTCL/2013/15766 dated February 28, 2013.
18. Accordingly, the said hearing was attended by Mr. Syed Wajahatullah Quadri, Chief Financial Officer of the Company (who will be referred to as the "Company's representative" hereinafter).
19. Brief proceedings of the hearing of March 12, 2013 are as follows:
- a. Prior to the start of the hearing proceedings, the Company's representative handed over the blanket Power of Attorney to the Commission;
 - b. The said Power of Attorney was signed by Mr. Imtiaz Bhatti, Managing Director / Chief Executive Officer of the Company, wherein the reference was made to the resolution of the Board of Directors of the Company dated March 7, 2013, hence accordingly, the extracts of the said resolution of the Board was also provided to the Commission in which Mr. Imtiaz Bhatti, Managing Director / Chief Executive Officer was authorized by the Board to represent the Company and its Directors in any proceedings that may be brought against the Company by any department of the Commission in relation to the manner in which the affairs of the Company have been managed in the past. The said resolution of the Board also empowered / authorized Mr. Imtiaz Bhatti, Managing Director / Chief Executive Officer of the Company to delegate this power to any of the employees of the Company, which has been delegated to the Company's representative;
 - c. The Company's representative was asked to present the stance of the Company, to which the Company's representative stated that all the Available for Sale (AFS) investments are unquoted investments, and that



the Commission had directed the Company to state its AFS investments at cost, way back in 2010;

- d. The Company has further seen the current market practice being followed by almost all the insurers in the market, and that the Company has had a detailed discussion with its Auditors in relation to the treatment of the AFS investments. Further that Auditors of the Company (KPMG) have signed and authenticated the Company's financial statements including the Statement of Assets for Solvency Purposes, which implies that the Company's treatment of the AFS investments is very much in line with the understanding of their Auditors;
- e. The Company's representative further mentioned that the Company's accounting policy in respect of the AFS investments also says lower of cost or market value;
- f. The Company's representative mentioned that if the treatment of AFS investments be taken as per the Commission's interpretation of the relevant law, the difference would not be more than Rs. 800,000/-, approximately;
- g. Furthermore, it was also mentioned that the Company has disclosed the cost in their regulatory returns;
- h. It was clarified to the Company's representative that sub-Section (1) of Section 34 of the Ordinance requires an insurer to ensure compliance with the Accounting Rules, subject to the provisions of sub-Section (2) of that Section of the Ordinance. And that, the Accounting Regulations are not in contradiction with the provisions of sub-Section (2) of Section 34 of the Ordinance, as this sub-Section determines the ceiling value of an asset or liability, whereas the Accounting Regulations require an insurer to state its AFS investments at lower of cost or market value, which is very much in line with provisions of sub-Section (2) of Section 34 of the Ordinance, and that the provisions of sub-Section (1) of Section 34 of the Ordinance require compliance with the provisions of the Accounting Regulations;
- i. It was further clarified to the Company's representative that the Company should have sought a detailed clarification from the Commission instead of interpreting, assuming and applying any treatment of its own choice;
- j. The Company's representative stated that the Company did not have any negative intentions besides the treatment of their AFS investments at market value;

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- k. The Company's representative, while admitting the Commission's viewpoint on the treatment of AFS investments, stated that the Company was under a confusion regarding the interpretation of the law, and hence the contravention.

Consideration of Company's Submissions

20. I have carefully examined and given due consideration to the written and verbal submissions of the Company (through the Company's representative, Mr. Syed Wajahatullah Quadri, Chief Financial Officer of the Company, and have also referred to the provisions of the Ordinance and the Accounting Regulations. I am of the view that there has been an established default of Regulation 16(1)(a) of the Accounting Regulations and Section 34 of the Ordinance, as the Company was required to state their Available for Sales investments at lower of cost or market value in terms of the provisions of Regulation 16(1)(a) of the Accounting Regulations and Section 34 of the Ordinance, which have been violated as the Company has stated its Available for Sale investments at the prevailing market value on the date to which the Statement of Assets for Solvency Purpose was made up.

21. However, before proceeding further, I find it relevant to discuss the duties of the Directors. The Directors, in addition to the day-to-day running of the Company and the management of its business, also have some 'fiduciary' duties i.e. duties held in trust and some wider duties imposed by statute and breach of these statutory duties will usually be a criminal offence, punishable by fine or imprisonment. Hence, the Directors are gauged against a higher standard of accountability which requires them to be vigilant and perform their duties with due care. In the instant case, however, the Directors have failed to perform their duties with due care and prudence. As the Directors are supposed to be well aware of their legal obligations in connection with the aforesaid statutory requirement of the Section 34 of the Ordinance read with Regulation 16(1)(a) of the Accounting Regulations, as aforesaid, therefore, it could be legitimately inferred that the default was committed.

Conclusion

22. After carefully examining the arguments and studying the facts and findings of the case as mentioned in the above paras of this Order, the default of Section 34 of the Ordinance read with Regulation 16(1)(a) of the Accounting Regulations (i.e. Part B of Annexure II of Rules) is established. Therefore, the penalty as provided under Section 156 of the Ordinance can be imposed onto the Company and/or its Directors.

23. Section 156 of the Ordinance states that:

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"Penalty for default in complying with, or acting in contravention of this Ordinance.- Except as otherwise provided in this Ordinance, any insurer who makes default in complying with or acts in contravention of any requirement of this Ordinance, and, where the insurer is a company, any director, or other officer of the company, who is knowingly a party to the default, shall be punishable with fine which may extend to one million rupees and, in the case of a continuing default, with an additional fine which may extend to ten thousand rupees for every day during which the default continues."

Order

24. In exercise of the power conferred on me under Section 156 of the Ordinance, I, instead of imposing penalty, take a lenient view, and thus, condone the Company due to the following reasons:

- a. that the Company and its management had no intentions to violate the provisions of the law, and that it was truly a difference of interpretation; and
- b. that the effect of such contravention has not grossly plunged the Company into insolvency.

Also, the Company is hereby issued a stern warning that in case of similar non-compliance in future a stronger action against the Company will be taken.

25. This Order is issued without prejudice to any other action that the Commission may initiate against the Company and / or its management (including the Chief Executive Officer of the Company) in accordance with the law on matters subsequently investigated or otherwise brought to the knowledge of the Commission.



Tariq Hussain
Director