Securities and Exchange Commission of Pakistan

BEFORE THE APPELLATE BENCH

In the matter of

Appeal No. 21 of 2024

Crescent Star Insurance Limited.

.... Appellant

Versus

Director/HOD, Adjudication-I, SECP.

.... Respondent

Date of Hearing: August 28, 2025

Present:

For the Appellant:

1. Mr. Saadat Ali Saeed, Legal Counsel
2. Mr. Tanveer Ahmed, Resident Director

For the Respondent:

1. Mr. Sohail Qadri, Director/HOD, Adjudication-I, SECP
2. Mr. Shafiq-ur-Rehman, Additional Joint Director, Adjudication-I, SECP

ORDER

1. This Order shall dispose of Appeal No. 21 of 2024 filed by Crescent Star Insurance Limited (the "Appellant") against the Order dated February 28, 2024 (the "Impugned Order") passed by the Director/HOD, Adjudication-I, SECP (the "Respondent") under Section 156 of the Insurance Ordinance, 2000 (the "Ordinance").

2. Brief facts of the case are that an onsite inspection of the Appellant, a registered non-life insurer, was conducted by the Securities and Exchange Commission of Pakistan ("the Commission") under Section 59A of the Ordinance, read with Section 6A(2)(f) of the Anti-

Money Laundering Act, 2010 (the "AML Act"). The inspection, conducted pursuant to Inspection Order dated January 11, 2023, covered the period from January 01, 2022, to September 30, 2022, and aimed to assess the Appellant's compliance with applicable insurance laws and the AML/CFT framework. During the inspection, the following non-compliances were observed:

(i) failure to obtain collateral against the entire guarantee business in violation of Rule 4(2) of the Credit and Suretyship (Conduct of Business) Rules, 2018 (the "CSR");

(ii) misreporting of reinsurance amounts as collateral in Form GCS, constituting violation of Rule 6 of the CSR;

(iii) absence of a mechanism for evaluating the technical and financial strength of prospective bondholders, in breach of Rule 3A of the CSR;

(iv) variance in premium rates charged and disclosed in policy documents in contravention of Section 45(6) read with Section 45(4) of the Ordinance;

(v) recognition of accrued interest income of Rs. 310 million on advances to Dost Steels Limited ("DSL") without contractual or documentary support, in violation of para 9 of International Financial Reporting Standards 15 ("IFRS"), Section 46(1)(b) of the Ordinance and Rule 19 read with Note 2 of Annexure II of the Insurance Rules, 2017 (the "Insurance Rules"); and

(vi) failure to provide essential documents during the inspection, constituting violation of Section 59A(3) of the Ordinance.

3. Subsequently, a 'Letter of Findings' was sent to the Appellant on May 12, 2023, whereas the Inspection Report was shared with the Appellant on September 6, 2023. Show-Cause Notice (the "SCN") was issued to the Appellant on August 11, 2023. In response, the Appellant submitted its written reply vide letter which was received on October 10, 2023, whereby the Appellant denied the allegations and raising certain objections.

4. A personal hearing was granted to the Appellant on October 12, 2023, wherein its authorised representative appeared and reiterated the written submissions but failed to furnish any supporting documentation as directed. Upon conclusion of proceedings, and after considering all written and oral arguments, the Respondent imposed an aggregate penalty of Rs. 800,000/- on the Appellant.

5. The Appellant preferred the instant appeal on the following grounds *inter alia*, that the Impugned Order is in breach of Articles 4 and 10-A of the Constitution of Pakistan, 1973, which guaranteed due process and the right to a fair trial. The Appellant stated that a valid SCN must afford adequate time to respond, provide access to the evidence relied upon, and be decided by an unbiased authority on the basis of relevant facts and law. The Appellant argued that these minimum guarantees which ensures fair trial were denied in the present matter, thereby undermining the integrity of the proceedings and the protection owed to the Appellant. The Appellant further contended that such denial of process vitiated the Impugned Order.

6. The Appellant further submitted that the SCN emanated from the Commission's inspection, as is evident from the opening paragraph of the SCN. The Appellant argued that, procedurally, the SCN ought to have been issued after completion of all inspection formalities, including sharing of the final Inspection Report with the Appellant. The Appellant contended that serving the SCN before sharing the final Inspection Report deprived it of the opportunity to understand and address regulatory gaps, thereby infringing constitutionally protected rights. The Appellant further submitted that its preliminary objections on this point were neither appreciated nor discussed in the Impugned Order, amounting to a violation of Section 24-A of the General Clauses Act, 1867, which required lawful, reasonable, and speaking orders. The Appellant also argued that the Respondent prejudiced the sanctity of the adjudication by initiating parallel proceedings through a notice under Section 60 of the Ordinance, on the very same alleged breach of Rule 4(2) of the CSR, which demonstrated bias and constituted double jeopardy.

7. The Appellant further submitted that the core controversy regarding the interpretation and application of Rule 4(2) of the CSR remained unadjudicated. The Appellant stated that, following the issuance of S.R.O. 1010(I)/2022 dated July 05, 2022 (the "SRO"), the collateral requirement was reduced from 80% to 10% and the words "less reinsurance in respect of particular guarantee/bond" were omitted. The Appellant argued that, for the period from January 01, 2022 to July 05, 2022, a conjunctive reading of Rule 4(1) and Rule 4(2) meant the insurer was to maintain a net retained exposure not exceeding 2.5% of shareholders' equity, and the collateral requirement was 80% of the sum insured less reinsurance in respect of a particular guarantee/bond. The Appellant submitted that its guarantee/bond portfolio had been placed on 100% facultative reinsurance so that the net retained exposure was zero and no collateral was required.

8. The Appellant further contended that facultative reinsurance operated as a back-to-back arrangement equivalent in substance to collateral within the meaning of Rule 2(b)(ii), which recognized back-to-back/counter-guarantees issued by Banks/Development Finance Institutions ("DFIs")/Non-Banking Finance Companies ("NBFIs") rated at least "A" by a credit rating agency. The Appellant submitted that the Impugned Order rejected this position in a cursory manner by merely stating that facultative reinsurance did not satisfy the definition of collateral, without reasons or analysis, contrary to the duty to render a reasoned determination.

9. The Appellant further submitted that the findings concerning the advance against issue of shares to DSL were misconceived because the relationship was one of investment and not a service contract, rendering paragraph 9 of IFRS 15 inapplicable. The Appellant stated that DSL received the advance in lieu of shares, but failed to issue the shares, and the Appellant charged interest and pursued legal proceedings, so the suggestion that prior approval of DSL was required for charging interest was unfounded. The Appellant argued that this very controversy was already *sub judice* in Appeal No. 27 of 2018 and was ignored by the Respondent. The Appellant further contended that reliance on Rule 19 read with Note 2 of Annexure II of the Insurance Rules was misplaced because these provisions prescribed formats for statements, which the Appellant had duly filed, and that any asserted impact on profit or solvency could not convert a procedural filing requirement into a substantive violation.

10. The Appellant also submitted that the alleged breach of Section 45(6) of the Ordinance regarding Afghan transit trade business overlooked discounts granted through endorsements to high-volume customers, which explained the lower premium rates actually charged, and that the inspection team and the Respondent failed to consider those endorsements. Lastly, the Appellant prayed for setting aside the Impugned Order.

11. In response to the submissions of the Appellant, the Respondent *inter alia* submitted that the Appellant's allegations of violation of due process is incorrect, asserting that the Appellant was afforded ample opportunity to defend itself. It was submitted that following the issuance of the 'Letter of Findings' dated May 12, 2023, the Appellant filed a written reply on June 15, 2023. Subsequently, after issuance of the SCN, the Appellant was allowed to present its defence through written submissions and supporting documents and was also given a personal hearing. The Respondent submitted that fair treatment, due process, and the constitutional rights under Articles 4 and 10A of the Constitution were fully observed.

12. The Respondent further submitted that the Company's submissions in response to the SCN were duly considered before passing the Impugned Order, which was made after evaluating the merits of the case in a fair and reasonable manner. The Respondent highlighted that para 16 of the Impugned Order, including sub-paras (a) to (h), provided a detailed account of how the defaults were established under applicable provisions of law. It was emphasized that the Impugned Order is a self-explanatory, well-reasoned, and speaking Order, and the Appellant's contention is misconceived.

13. The Respondent refuted the allegation of double jeopardy. The Respondent stated that the instant proceedings under Section 156 of the Ordinance are punitive in nature, arising out of alleged violations of the CSR and provisions of the Ordinance, whereas the direction proceedings initiated under Section 60 of the Ordinance through Notice dated January 31, 2024 are independent and distinct in scope and objective. Therefore, both sets of proceedings were lawfully initiated, and no infringement of rights has occurred.

14. Lastly, the Respondent rebutted the Appellant's stance on substantive violations. It was submitted that the Appellant misinterpreted Rules 4(1) and 4(2) of the CSR by treating facultative reinsurance as a substitute for collateral, which is contrary to Rule 2(1)(b) of the CSR. For guarantees prior to July 05, 2022, collateral equivalent to 80% of each guarantee less reinsurance was required, and after the amendment of July 05, 2022, a minimum of 10% collateral was mandated regardless of reinsurance. The Respondent also highlighted improper recognition of Rs. 310 million accrued interest without contractual basis, in violation of IFRS 15, which misstated financial statements and impacted solvency margins. Furthermore, misstatement of premium income in Afghan transit trade guarantees was observed, as premiums were recorded below policy schedule rates without evidence of endorsements, constituting contravention of Section 45 of the Ordinance.

15. The Appellate Bench (the "Bench") has heard both the parties at length and perused the record. The main controversy relates to the interpretation of the expression "collateral" in Rule 2(1)(b) of the CSR, and whether facultative reinsurance can be treated as a back-to-back guarantee. The other issue which requires determination is whether the placement of 100% reinsurance excluded the requirement of collateral in terms of Rule 4(2) of the CSR, both prior to and subsequent to its amendment. The Bench observes that Rule 2(1)(b) of the CSR defines the term *"collateral"* as;

> *"back-to-back / counter-guarantees of banks/DFIs/NBFIs rated at least 'A' or equivalent by a credit rating agency, in favor of the insurer."*

This definition makes it abundantly clear that only back-to-back or counter-guarantees from institutions within the category of Banks, DFIs, or NBFIs, and holding the prescribed minimum credit rating, could qualify as valid collateral. The provision does not extend the ambit of collateral to facultative reinsurance arrangements, which in their very nature are risk-transfer mechanisms between insurers and reinsurers rather than back-to-back or counter-guarantees issued by financial institutions.

16. Further, Rule 4(2) of the CSR, as amended vide the SRO, prescribes that;

> *"Subject to limit prescribed under sub-rule (1), an insurer shall procure collateral in case of guarantees / bonds of an amount equivalent to at least 10 percent of the sum insured / amount of bond/guarantee."*

Prior to this amendment, Rule 4(2) provided that;

> *"Subject to limit prescribed under sub-rule (1), an insurer shall procure collateral in case of guarantees / bonds of an amount equivalent to at least 80 percent of the sum insured / amount of bond/guarantee less reinsurance in respect of a particular guarantee / bond."*

It is therefore evident that both before and after amendment, the CSR Rules required insurers to obtain collateral in prescribed proportions.

17. With respect to collateral requirements prior to the amendment of July 05, 2022 vide the SRO, the Appellant has contended that by placing its entire guarantee portfolio on 100% facultative reinsurance, its net retained exposure was reduced to nil and therefore no collateral was required. However, the Appellant has failed to prove that there was any reinsurance of its guarantee business, as the reinsurance company stated by the Appellant has categorically denied any reinsurance arrangement with the Appellant.

18. The Appellant has also contented that facultative reinsurance itself should be treated as "back-to-back" collateral. In our opinion, the Appellant's viewpoint is incorrect. Facultative reinsurance is a contractual risk-sharing arrangement, but it cannot be equated with a "back-to-back / counter-guarantee" of a Bank, DFI, or NBFI as defined in Rule 2(1)(b) of the CSR. The legislative language is precise and restrictive, deliberately limiting what qualifies as collateral, thereby excluding reinsurance contracts from its scope.

19. This interpretation also stands reinforced by international regulatory frameworks. For instance, under the *EU Solvency II Directive* as well as the standards issued by the International Association of Insurance Supervisors ("IAIS"), reinsurance companies are treated strictly as part of the insurance sector, and not as NBFIs or Banks.

20. It is concluded that the Appellant failed to obtain reinsurance and/or the collateral in case of guarantee business during the period under consideration i.e. January 01, 2022 to September 30, 2022.

21. Turning to the issue of premiums, the Appellant's stance that discounts were allowed through endorsements to high-volume customers deserves consideration. Insurance law and practice recognize flexibility in underwriting and pricing, and discounted premiums *per se* are not prohibited. In the absence of any material irregularity, the variance in premium rates should not be treated as a violation *per se*. However, insurers must ensure that proper documentation is maintained to demonstrate discounts allowed, to avoid misreporting in the future.

22. In light of the above circumstances, it is justified to reduce the penalty from Rs. 800,000/- to Rs. 500,000/-.

23. The appeal is disposed of in the above terms with no orders as to costs.

(Abdul Rehman Warraich)
Commissioner

(Zeeshan Rehman Khattak)
Commissioner

Announced on: 19 SEP 2025