



Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH NO. III

In the matter of

Appeal No. 25 of 2009

Cooperative Insurance Society of Pakistan Limited Appellant

Versus

Executive Director (Insurance) Respondent
Securities and Exchange Commission of Pakistan

Date of Hearing 26/10/15

Present:

For the Appellant:

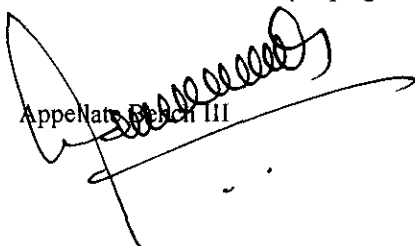
- (i) Mr. M. Haneef Niazi, Advocate
- (ii) Mr. Shoaib Ahmad, FCA, Financial Advisor, Cooperative Insurance Society of Pakistan
- (iii) Mr. Muzaffar Hussain Shah, Branch Manager, Cooperative Insurance Society of Pakistan

For the Respondent:

- (i) Mr. Ali Azeem Ikram, Executive Director (Insurance)
- (ii) Mr. Tariq Bakhtawar, Director (Insurance)

ORDER

1. This order is in appeal No. 25 of 2009 filed under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the directive dated 08/05/09 (Impugned Directive) passed by the Respondent.


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2. Cooperative Insurance Society of Pakistan Limited (Appellant) is a co-operative Society and was registered under the Co-operative Societies Act, 1925 (Act). The Appellant purchased a building situated at Shahrah-e-Quaid-e-Azam, Lahore by investing an amount of Rs.2,968,125. The building was re-valued at Rs.232,030,497 in the year 2000. The annual audited accounts of the Appellant for the year ended 31/12/01 revealed that in order to meet the minimum paid up capital requirement the Appellant raised its paid up capital from Rs.2,641,350 to Rs.82,641,350 by transferring a sum of Rs.80,000,000 from surplus on revaluation of land and building to the paid up capital. The annual audited accounts of the Appellant for the year ended 31/12/02 revealed that the paid up capital of the Appellant was further enhanced from Rs.82,641,350 to Rs.84,146,750 by way of issuance of right shares to the members of the Appellant. The Appellant re-valued the building at Rs.883,167,239 in the year 2006. The annual audited accounts of the Appellant for the year ended 31/12/07 revealed that the Appellant again transferred Rs.75,852,050 from surplus on revaluation of land and building to the paid up capital thereby enhancing its paid up capital to Rs.160,000,000. The Respondent passed the Impugned Directive against the Appellant stating that the transfer of surplus on revaluation of land and building to the paid up capital is neither allowed under the Act nor provided in the Insurance Ordinance, 2000 (Ordinance), as such, the Appellant failed to comply with section 11(1)(a) and (b) read with section 28 of the Ordinance. The Appellant also failed to maintain statutory deposit in terms of section 29 of the Ordinance. The Respondent directed the Appellant to comply with the aforesaid requirements and cease from entering into new contracts of insurance. The direction to cease entering into new contracts of insurance under section 63(1) of the Ordinance would be effective one month from the date of the direction. Further, the direction to cease entering into new



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contracts of insurance would only be revoked if the reasons for the direction shall cease to exist.

3. The Appellant preferred the instant appeal and Appellate Bench hearing in the matter was held on 21/01/15. However, no one appeared on behalf of the Appellant and the appeal was dismissed for non-prosecution on 22/01/15. Subsequently, the request of the Appellant to restore the appeal was refused by the Appellate Bench. The Appellant filed commercial appeal No. 2 in the Lahore High Court and the Lahore High Court vide Order dated 28/09/15 remanded the appeal to the Appellate Bench to be decided within a period of 45 days from the date of the Order.

4. The Appellant preferred the appeal on the following grounds:

- a) The Appellant being a Cooperative Society can maintain a reserve fund out of its profits arising from the transactions carried by it and can invest the same in the business of the Appellant or in the shares. The Appellant had purchased building by investing an amount of Rs.2,968,125 which is known as Cooperative Insurance Building, 23-Shahrah-e-Quaid-e-Azam, Lahore. The value of the building had increased and in the year 2000 it was revalued at Rs.232,030,497. After obtaining permission from the Registrar, the authorized capital of the Appellant had increased from 10 million to 100 million vide letter dated 08/12/01. Further, the surplus on the revaluation of building was shown as Rs.229,718,227. In fact it was a reserve fund which was created by the Appellant on profit earned on the building transaction. Out of this reserve fund, an amount of Rs.80 million was transferred to paid up share capital with the sanction of the general body and bonus shares were allotted to the members and the share certificates were issued to the shareholder societies as there is no individual member of the Appellant. The Appellant was competent to



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create a reserve fund under section 39 of the 1925 Act and could invest the same in the business of the Appellant or in the shares under section 37 of the said Act.

On 04/02/03 show cause notice under section 28 and 11 read with section 68 of the Ordinance was issued to the Appellant by the then Executive Director, Insurance. The position of the share capital as reflected in the balance sheet for the year ended December 2001 was accepted by the Commission according to which the Appellant had complied with the requirement of share capital as laid down under section 28 of the Ordinance. Thereafter, no objection was raised and during subsequent years, the Appellant had been paying supervision fee to the tune of Rs.100,000 each year and has also been depositing other dues like the Central Excise Duty and Federal Insurance Fee. The Appellant, therefore, had complied with the requirement of share capital as laid down under section 28 of the Ordinance. However, in the year 2007 it was communicated to the Appellant that the amount of paid up capital shall not be less than Rs.120 million as at 31/12/07 and in the year 2008 it was increased to Rs.160 million and in the year 2009 it was increased to Rs.200 million. To meet the above requirements, the Appellant increased its share capital to Rs.160 million with the approval of the General body and Registrar Cooperative Societies and amendment was accordingly made in its bye-laws and bonus shares out of reserve funds were allotted to its members. In the year 2006 the building was re-valued to Rs.883,167,239. The revaluation had been duly indicated in the balance sheet for the years 2006 and 2007. However, no objection was raised on the said revaluation and allotment of bonus shares to the shareholders during the aforesaid years. It is, therefore, obvious that as far as the objection regarding the paid up share capital as required by section 28 of the Ordinance is concerned, the same was held to have been complied

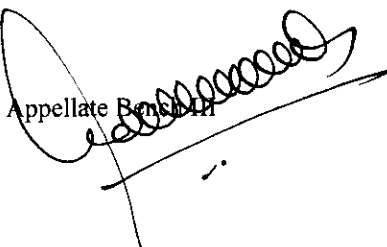


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with. Reliance is placed on the Supreme Court of Pakistan judgment of Pakistan vs Muhammad Himayatullah Farukhi cited at PLD 1969 Supreme Court 407, wherein, it was held that an Order cannot be withdrawn by a competent authority once it has taken legal effect and when certain rights are created in favour of the individual. In the instant case, the issue of paid up capital was resolved in 2003 when the show cause notice issued to the Appellant was withdrawn vide Appellant's letter dated 16/05/03. Therefore, in the instant case, a valuable right was created in favour of the Appellant and it became a past and close transaction.

The Appellant vide letter dated 21/08/08 was directed to raise the statutory deposit by 30/09/08 as it was below the required level. The solvency margin of the Appellant was 64.22% as per certificate issued by the Auditor as on 08/05/08 and it was thus requested by the Appellant that requirement of minimum deposit level be reduced to zero. The Appellant's request was turned down vide letter dated 09/09/08, however, the Appellant once again requested that the requirement of deposits be reduced to the minimum amount i.e. zero as the solvency level was 64.22%. However, the said request was turned down and on 08/05/09 the Impugned direction was passed and the Appellant was directed not to enter into new contracts of insurance w.e.f. one month from the date of direction. It is submitted that the Impugned direction is uncalled for and unsustainable in the eyes of the law.

- b) The discretion contemplated by the proviso of section 29(2) of the Ordinance may graciously be exercised in favour of the Appellant so that it may be able to run its business smoothly and compete with big companies. In the event if at all any security is needed the same can be submitted in the form of the building or in the form of approved Government Security already lying with the State Bank of Pakistan and

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also with Industrial Development Bank of Pakistan and shares of sound companies including government owned entities. It is further submitted that requirement of deposit may be reduced to zero and if cannot be reduced to zero, then should be reduced to some reasonable extent. As far as development of the insurance industry is concerned, the same cannot be achieved by making deposits to the tune of Rs.16,000,000 in State Bank of Pakistan. On the contrary, if the said deposit amount remains with the Appellant, it can carry on more business instead of blocking its money by depositing in the bank. Further, such directions contravene the provisions of Article 18 of the Constitution of the Islamic Republic of Pakistan which inter alia provides that every citizen has the right to enter upon any lawful profession or occupation and to conduct any lawful trade and business. Reliance is placed on the Supreme Court judgment of Arshad Mehmood & others vs. Government of Punjab cited at PLD 2005 SC.193, wherein, it was held that only reasonable restrictions can be imposed for running a business or occupation. The direction to deposit Rs.16,000,000 in the bank is by no means a reasonable restriction.

5. The Respondent rebutted the arguments as follows:

- a) The annual audited accounts of the Appellant for the year ended 31/12/07 revealed that the Appellant transferred a sum of Rs.75,852,050 from surplus on revaluation of land and building capital thereby enhancing its paid up capital to Rs.160,000,000. The Appellant being registered under the Cooperative Societies Act 1925 (1925 Act) as per Clause 15(2) of its Bye Laws read with section 6 of the 1925 Act can only raise its capital through allotment of shares to members against the payment of full value of the shares.
- b) The Respondent had issued the directive to the Appellant on the non-compliance of section 11 of the Ordinance which states that an insurance



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company shall at all times ensure compliance with the provisions of the Ordinance relating to minimum paid up capital, statutory deposit & solvency requirements obtaining reinsurance arrangements and meeting criteria for sound and prudent management etc. The solvency margin of the Company was 89.14% of the total assets of the Company as at 31/12/07, however, the request to abolish the requirement for deposit made by the Appellant made under the proviso to section 29(2) of the Ordinance was refused. The Accounts did not reflect the true picture of the solvency of the Company as the Appellant had transferred the surplus on revaluation of land and building and enhanced its paid up capital to Rs.160,000,000.

6. We have heard the arguments and perused the record provided to us by the parties i.e. the Appellant and the Respondent.
7. We have reviewed the Supreme Court of Pakistan judgment of Pakistan vs Muhammad Himayatullah Farukhi cited at PLD 1969 Supreme Court 470 mentioned in paragraph 4(a) above, wherein, it was held that, "...Principle of locus poenitentiae (power of receding till a decisive step taken) is available to Government of relevant authorities...Authority competent to make order has power to undo it...Order, however, cannot be withdrawn or rescinded once it has taken legal effect and certain rights created in favour of any individual....General Clauses Act (X of 1897), S. 21..." We are of the view that it is on record that the stance of the Appellant on the issue of paid up capital had previously been accepted by the Respondent vide letter dated 16/05/03 and no objection had been raised thereafter. Therefore, once the Respondent had accepted the position of the Appellant on the issue of paid up capital, the Respondent cannot retract from the earlier stance. Moreover, it was argued by the Respondent that as per Clause 15(2) of the Bye Laws read with section 6 of the Act, the Appellant could only raise its capital through



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allotment of shares to members against the payment of full value of the shares. The surplus on revaluation was in fact profit earned on the transaction which was part of the reserve fund and there was full compliance of Clause 15(2) of the Bye Laws of the Appellant as the increase in the paid up share capital was approved with the general body and share certificates were issued to the shareholders. Therefore, we are of the view that the Appellant had fully complied with the requirements of section 11(1)(a) and (b) read with section 28 of the Ordinance.

8. Further, it was argued that since the solvency of the Appellant was 64.22%, therefore, the requirement for minimum deposit be reduced to zero under the proviso of section 29(2) of the Ordinance and the deposit could be used to expand the business of the Appellant. The Respondent has on the other hand stated that the solvency of the Appellant was 89.14%. However, the request to abolish the requirement of minimum statutory deposit was refused as it did not give the true picture of the solvency of the Appellant. Section 29(2) of the Ordinance states "For the purposes of this section the required amount is, either: (a) the higher of ten million rupees and ten percent (10%) of the insurer's paid-up capital; or (b) such amount as may be prescribed by the Commission: Provided that the Commission may, subject, to achievement of levels of solvency as required by this Ordinance, abolish the requirement for deposits specified in this section by reducing the required amount to zero." Further, the Commission vide Circular 15 of 2008 dated 07/07/08 had directed all insurance/takaful companies to ensure that they keep the deposit in compliance of section 29(2)(a) of the Ordinance and had withdrawn S.R.O dated 25/06/08 which had prescribed statutory deposit requirement of Rs.five million.

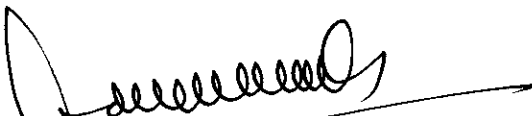
9. We have reviewed the judgment of the Supreme Court of Pakistan in the matter of Arshad Mehmood & others vs. Government of Punjab cited at PLD

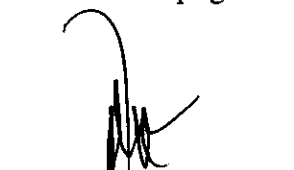


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2005 SC.193 mentioned in paragraph 4(b) above, wherein, it was held that, "...the limitation imposed upon a person on enjoyment of a right should not be arbitrary or of an excessive nature beyond what is required in the interest of the public...". The minimum solvency requirement was of Rs.50 million and in the instant case, the solvency margin according to the Appellant was 64.22%. The Respondent has also confirmed that the Appellant had a solvency margin of 89.14% of total assets of the Company. Moreover, we are of the view that the transfer of surplus of revaluation of land and building to paid up capital was also correct and, therefore, the Accounts reflected the true picture of the solvency of the Company. The solvency of the Appellant is more than sufficient and fully covers the interests of policy holders as prescribed in the Ordinance. The request of the Appellant to abolish the requirement for deposits specified in section 29(2) of the Ordinance is reasonable and, therefore, granted.

10. In view of the foregoing, the appeal is allowed and the Impugned Directive is set aside with no order as to costs.


(Zafar Abdullah)
Commissioner (SCD)


(Tahir Mahmood)
Commissioner (CLD)

Announced on 17 NOV 2015