BEFORE APPELLATE BENCH

In the matter of

Appeal No. 27 of 2018

Crescent Star Insurance Limited

...Appellant

Versus

The Commissioner (Insurance) SECP, Islamabad.

...Respondent

Date of hearing: September 19, 2019

Present:

For Appellant:

1. Mr. M. Zeeshan Abdullah, Advocate
2. Mr. Tanveer Ahmed

For Respondent:

1. Mr. Hasnat Ahmad, Director Insurance, SECP.
2. Mr. Muhammad Mateen Abbasi, Assistant Director, SECP.

ORDER

1. This order shall dispose of Appeal No. 27 of 2018 filed under Section 33 of the Securities and Exchange Commission of Pakistan Act, 1997, by Crescent Star Insurance Company Limited (the Appellant) against the Order dated May 16, 2018 (the Impugned Order) passed by the Commissioner Insurance, SECP (the Respondent) for contravening Rule 13 of the Securities and Exchange Commission (Insurance) Rules, 2002 (the Rules) read with Section 11(1)(c), Section 32(2)(g), Section 36 and Section 156 of the Insurance Ordinance, 2000 (the Ordinance).

2. As per the facts of the case, there were two phases of adjudication for the alleged violations of aforestated legal provisions. In the first phase of adjudication the Respondent issued a Show Cause Notice dated January 4, 2017 (the First SCN) to the Appellant and its directors under Rule 13 of

the Rules read with Section 11(1) (c), Section 32(2) (g), Section 36 and Section 156 of the Ordinance. It was alleged in the First SCN that examination of the financial statements for the period ending September 30, 2016 revealed that the Appellant was insolvent by an amount of Rs.74.303 million and citing investment of Rs. 421 million in the shares of a related party i.e. Dost Steel Limited (DSL) as the main reason of insolvency. The Appellant, in its reply and during the hearing of the First SCN, stated that Rs. 421 million were paid to DSL as Advance, against its shares, however, due to frustration of the agreement dated July 1, 2016 (the Agreement) only 4.7% shares of DSL, instead of 30%, were acquired by the Appellant. The Securities and Exchange Commission of Pakistan (the Commission) vide letter dated May 29, 2017, advised the Appellant to provide status of the aforesaid amount in terms of its classification as an investment in the shares of DSL or as a loan and the relevant provision under which it should be considered as an admissible asset for the purpose of solvency calculation. The Appellant replied vide a letter dated June 29, 2017 that it received only 15 million shares of Rs. 67.5 million due to gross violation of the Agreement, therefore, the balance amount of Advance (Rs. 354 million) has been converted into loan/debt at 3% plus KIBOR till such time the shares are issued. The proceedings of the First SCN were concluded vide an Order dated August 1, 2017 (First Order) whereby, the off-site wing of the Insurance Division was directed to evaluate the impact of converting the investment in the shares of DSL into a loan/debt, on solvency position of the Appellant.

3. As per facts mentioned in the Impugned Order, in compliance of the First Order, the Respondent had reviewed the Financial Statements of the year ended December 31, 2016 (the Accounts), which revealed that the Appellant reported an advance of Rs. 386.379 million to the DSL *(balance amount of Advance 354 Million + 32 Million markup)*, which carried markup @ 1 year KIBOR plus 3% p.a. This Advance was not a fully admissible asset under Rule 10 of the Rules read with Section 32(2) of the Ordinance, therefore, Appellant's solvency margin was deficient by Rs. 227.431 million on December 31, 2016. In view of aforementioned facts, a Show Cause Notice Dated October 26, 2017 (the SCN) was issued to the Appellant and its directors for the contravention of Rule 13 of the Rules read with Section 11(1) (c), Section 32(2) (g) and Section 36 and Section 156 of the Ordinance. Hearing of the SCN was held on March 28, 2018, wherein, Appellant's representative denied the allegation contained in the SCN however, the Respondent being dissatisfied with the response, passed the Impugned Order and imposed a fine of Rs. 1,000,000/- (Rupees One Million Only) on the Appellant for its failure to meet the mandatory requirement relating to the minimum solvency for the year ended December 31, 2016.

4. The Appellant has challenged the Impugned Order *inter alia* on the grounds that to determine the solvency status for the period ended December 31, 2016, the Respondent had wrongly relied upon the Insurance Rules, 2017. The Appellant stated that conversion of Advance into loan was because of DSL's failure to perform the Agreement, however, the Respondent had excluded Rs.386.379 million *(Balance Advance 354 Million + 32 Million markup)* from the admissible assets. The Appellant has alleged that the Respondent had ignored the fact that shares of full amount of Rs.421 million could not be acquired, therefore, the Appellant unilaterally converted the remaining amount of Advance into loan. The Appellant contended that irrespective of unilateral change of Advance into loan by the Appellant, DSL's accounts always showed it as Advance, however, the Respondent had failed to consider this fact. The Appellant has taken the plea that DSL's management vide a letter dated December 9, 2017 had assured to issue shares against the balance amount of Advance, therefore, the Appellant had reverted the amount of Rs.354 million as Advance (Note 22.1 of Annual Account of 2017, page 69). The Appellant indicated that the Impugned Order is not a speaking order because in para 22 of the Impugned Order the Respondent had stated that whether the amount of Advance is investment or a loan, it is not inadmissible by such percentage as prescribed under Rule 10 of Rules. However, no reason or justification or calculation had been given for the alleged inadmissibility of said amount by such percentage as prescribed by Rules. The Appellant has taken the stance that the Respondent had also failed to refer to the specific clause of Section 32(2) of the 2000 Ordinance, under which the balance amount of Advance (Rs. 354 million) had been treated and to what percentage it was excluded from admissible assets of the Appellant.

5. The Appellant had taken further plea that the Respondent had failed to differentiate between investment and loan, as there is a considerable difference in admissible percentages of investment and loan. In support of the aforestated plea, the Appellant stated that it is an undisputed fact that the Appellant made payment to DSL for a specific purpose of investment and in consideration DSL had issued some shares and remaining shares are to be issued against the balance amount of Advance. Appellant further stated that, if the said amount is neither treated as investment nor as a loan, even then it is an admissible asset under clause (c) of Section 32(1) of the Ordinance because Advance is not an inadmissible asset under clauses (a) to (w) of Section 32(2) of the Ordinance.

6. The Appellant stated that amount of Rs. 354 Million was an investment in shares of DSL (Listed Company), however, the Respondent had not only excluded this amount form the admissible

assets under clause (q) of Section 32(2) of the Ordinance but also failed to include Appellant's other investments in listed companies as admissible assets under clause (q) of Section 32(2) of the Ordinance, which, allows admissibility of 50% of the total investments. Appellant's total investments as on December 31, 2017 were Rs. 798,237,906 and as per clause (q) of Section 32(2) of the Ordinance, 50 % of the investments in listed companies was Rs. 399,118,953 and this amount was sufficient to meet the minimum solvency requirement.

7. The Appellant further contended that the Respondent had failed to appreciate that it had increased paid up capital by Rs. 250 million through a rights issue and at the time Impugned Order was passed, the process of right issue was completed. Therefore, the required solvency requirement was achieved. The Appellant further stated that the Appellant and DSL are not related companies because there is no common control, or ownership interest of more than 49% or, being natural persons, they are members of the same family. In Appellant's case all three conditions were missing therefore, clause "P" of Section 32 of the Ordinance was not applicable. Lastly, Appellant has taken the plea that an amount of Rs. 354 Million was advanced to DSL, therefore, it cannot be treated as a loan in terms of Section 32(2) of the Ordinance.

8. The Respondent had rebutted the grounds of Appeal through covering letter/written comments dated October 18, 2018. In para six of the written comments and para 22 of the Impugned Order the Respondent had stated that whether the Advance to DSL is treated as loan or investment, it is inadmissible by such percentages as prescribed under Rule 10 of the Rules. Furthermore, in para ten of the written comments, the Respondent stated that during the year ended December 31, 2016, the status of Advance was loan therefore, solvency calculation was based on clause "t" of Section 32 (2) of the Ordinance and Rule 10 of the Rules. Therefore, in cases where Advance was treated as loan, only 1% loan is admissible for the calculation of solvency. The Respondent stated that in view of above facts, Appellant had failed to maintain minimum solvency requirement.

9. The Appellate Bench (the Bench) has heard the parties and perused the record with the able assistances of Appellant's and Respondent's representatives. Appellant's representative reiterated the grounds of Appeal, whereas Respondent's representative argued that the Impugned Order had been passed in accordance with the requirements of applicable law. Appellant's plea that the Respondent had relied upon the Insurance Rules 2017, while determining the solvency status for the period ended December 31, 2016, is factually incorrect therefore, we do not find merit in it.

The Bench has observed that the Impugned Order had been passed without determining the status of "Advance" under Section 32 of the Ordinance and Rule 10 of the Rules. The Bench has no doubt to hold that Respondent was required to affirm "Advance " either as loan or investment and accordingly was required to apply relevant calculation of admissible percentage for the purpose of minimum solvency, however, no such exercise was performed. The Bench is not inclined to maintain the Impugned Order because adjudication without application of relevant provision and calculation of admissible part of Advance cannot be appreciated as a reasonable order. The Bench has also observed that in the written comments, the Respondent had not only reiterated its previous stance *(i.e. whether the amount of Advance is investment or loan, it is not inadmissible by such percentage as prescribed under Rule 10 of Rules)* but also taken a contradictory stance and claimed that the amount of "Advance" was treated as loan, in the Impugned Order. The Bench is of the view that Respondent's subsequent plea is nothing but an attempt to support incurable flaws of Impugned Order. Furthermore, Respondent had failed to substantiate subsequent stances through the contents of the Impugned Order, therefore, it cannot be allowed.

10. The Bench is of the view that the amount of Advance is neither loan nor investment, therefore, clause "p" and "t" of Section 32 (2) of the Ordinance are not applicable in Appellant's case. Clause "p" deals with "shares in any one company or in group of related companies" whereas clause "t" is about "loans to any person or group of related persons in aggregate". Admittedly, the Appellant had paid Rs. 421 million to DSL for shares purchase, however, instead of 30%, only 4.7% shares of the DSL (i.e. 15 million shares amounting to Rs. 67.5 million) were acquired by the Appellant and thereafter, the Appellant unilaterally converted the balance amount of Advance (Rs. 354 million) into loan, till such time the shares are issued. Clause "p" is applicable only to the extent of value of shares purchased by Appellant. The Bench, endorse Appellant's stance that the DSL is not its related company in terms of Section 32(7) of the Ordinance. Although, Section 32(2) has no provision with regard to treatment of "Advance", however, this fact does not bring Appellant's case within the scope of Section 32(1) (c) of the Ordinance. Therefore, Appellant's assertion that the Advance with DSL (Rs.354 Million) should have been treated as fully admissible asset under clause (c) of Section 32(1) of Ordinance, is not tenable because when shares in companies are not fully admissible under clause "p" and "q" of Section 32 (2) of the Ordinance, then how, Advance for purchase of shares can be treated as a fully admissible asset.

11. The Bench is astonished that the Respondent had also not analyzed the impact of right issue for the calculation of minimum solvency. The Bench has reviewed Appellant's contention that the amount of Rs. 354 Million and other investments in listed companies should have been treated under clause "q" of Section 32(2) of the Ordinance and Rule 10(q) of the Rules. However, this assertion is not acceptable because the amount of Rs. 354 million was merely an Advance to DSL for purchase of shares, therefore, it cannot be treated as investment under the scope of Rule 10(q) of the Rules. However, investment in other listed companies should have been treated under Rule 10(q) of the Rules for the purpose of calculation of minimum solvency requirement.

12. In view of discussion and analysis contained in para eight, nine and ten of this order, and due to Respondent's failure to apply correct admissible percentage of assets to calculate minimum solvency requirement we, hereby set-aside the SCN, Impugned Order and remand the matter to decide it afresh. Parties to bear their own cost.

(Shauzab Ali)
Commissioner (SMD)

(Aamir Ali Khan)
Chairman/Commissioner(CLD-CSD)

Announced on: 18 DEC 2019