





# Securities and Exchange Commission of Pakistan

## For the Respondent:

- (i) Mr. Syed Nayyar Hussain, Director (Insurance)
- (ii) Mr. Farrukh M. Qureshi, Deputy Director (Insurance)

## ORDER

1. This order is in appeal No. of 32 of 2015 filed under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the order dated 31/03/15 (Impugned Order) dated passed by the Respondent.
2. The brief facts of the case are that an onsite inspection of the Pakistan Mutual Insurance Company (Guarantee) Limited (Company) was conducted on the order dated 23/04/13 under section 59A of the Insurance Ordinance, 2000 (Insurance Ordinance) during which revealed the following:
  - a. Provision for unexpired risk: The Company did not follow 1/24<sup>th</sup> method to calculate the provision for unexpired risk for policies issues for the period of one year, as prescribed under Regulation 8(4) of Part B of Annexure II of the Securities and Exchange Commission (Insurance) Rules, 2002 (Regulations). However, instead it calculated at 40% of the total premium written during the year and considered it as the provision for unexpected risk. Thus, prima facie the Company did not comply with Regulation 8(4) of the Regulations.
  - b. Provision for Incurred but Not Reported Claims: A review of the annual audited accounts of the Company for the year ended 31/12/12 revealed that the Company did not have any practice to calculate the IBNR as required under Regulation 9(3) of the Regulations. Policy of the Company relating to recognition of claim liability was stated as the annual audited accounts as under:

“3.12 Estimated liabilities in respect of outstanding claims - Liability in respect of outstanding claims is based on certified returns of the branches and represents



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estimates of claims intimated or assessed before the end of the accounting year less anticipated recoveries.”

- c. **Employee Benefits:** The Company was offering terminal benefits to its employees in the form of gratuity. According to the information provided by the Company to the inspection team, total gratuity earned by the employees of the Company as of 31/12/12 was Rs.4,839,900. However, the Company did not recognize the cost in the period during which the gratuity benefits were earned, in contravention of Regulation 13(1) of the Regulations and the International Accounting Standard - 19 (IAS 19). IAS 19 requires that the cost of providing employee benefits should be recognized in the period in which the benefit is earned by an employee, rather than when it is paid out or becomes payable. Whereas, the Company has not create any provision in this regard. Resultantly, the accounts do not provide true and fair picture of the status of the Company, as by this, the Company overstated its profit by not recognizing its liability and understating its expenses.
- d. **Netting off Assets and Liabilities:** The Company received cash as security deposit and got the agreements signed by its branch managers. This security deposit remained with the Company till that branch manager worked with the Company. It was then observed that when a certain branch manager resigned or left the Company for any reason, the Company returned the amount of security deposit to that particular branch manager. However, the Company’s ledger for the year 2012 was perused, and it was found that the Company netted off the security deposits from the amounts paid by the Company for various purposes such as; security deposit for telephone, for building acquired for rent etc. The Company paid Rs.200,000 as cash security on account of office rent during the year 2012.

The Company understated its liabilities by netting off from assets of the Company and, therefore, did not present true and fair picture in its financial statements. Alongside, the Company appeared to be in violation of para 32 of IAS 1 by offsetting its assets and liabilities, which states that “An entity shall not offset



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assets and liabilities or income and expenses, unless required or permitted by an IFRS.”

3. Show Cause Notice dated 21/02/13 (SCN) was issued to the Appellants calling upon them to show cause as to why the fine, as provided under section 156 and 158 of the Insurance Ordinance should not be imposed for non-compliance with Regulation 8(4), Regulation 9(3) and Regulation 13(1) of the Regulations. The Appellants submitted their response to the SCN vide letter dated 06/03/14 and 27/01/15 and hearing in the matter was conducted on 13/01/15 and 11/03/15 via video conferencing connecting the Head Office with the Lahore Office of the Commission. The hearing was attended by Ch. Abdul Karim, Chief Executive of the Company, Mr. Hafiz M. Farooq Afzal- Manager Finance of the Company, Mr. Owais and Mr. Irfan Ilyas, Partner, M/s Ilyas Saeed & Co., Chartered Accountants, for and on behalf of the Appellants.
4. The Respondent No. 2 dissatisfied with the response of the Appellants held that the default of Regulation 8(4), Regulation 9(3) and Regulation 13(1) of the Regulations is established and the default was committed knowingly and willfully. Therefore, in exercise of the power conferred under section 156 and 158 of the Insurance Ordinance, instead of imposing the maximum fine as provided under these sections, a fine of Rs.10,000 was imposed on each of the Appellants. The Appellants were further directed to ensure full compliance with the Ordinance, rules, regulations and directives of the Commission in future. In case of failure to comply with the Order, the Respondent shall be bound to initiate proceedings under section 63(2)(d) and section 65 of the Ordinance. However, in case any willful misstatement is subsequently found in the submissions made by the Appellants, the Commission shall initiate proceedings under section 158 of the Insurance Ordinance.



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5. The Appellants have preferred the instant appeal against the Impugned Order. The Appellant's counsel in his written submissions and the Appellant No (ii) at the hearing made the following arguments:

- (a) The Respondent No.2 has erred in law by inferring without any lawful justification that the default committed by Appellants No.2 to 8 is willful and deliberate which it is neither. The directors of the Company are not its shareholders and derive no monetary benefits, perks, salaries, bonus, profit, dividends etc. from the funds of the Company, therefore, the penalty imposed on them is against the principles of justice. Moreover, the Appellants cannot afford to pay the respective penalties, as the Company is unable to meet even its most basic administrative costs. The Impugned Order is, therefore, liable to be set aside.
- (b) The Impugned Order passed by Respondent No.2 does not have the sanction of the law as section 156 and 158 of Insurance Ordinance confers no jurisdictional powers upon him, nor can he derive the same by way of delegation the powers to adjudicate and decide the matter in dispute. The order being "Coram non jure", is liable to be set aside.
- (c) The Respondent No.2 has failed to appreciate the fact that the Appellant company is "Mutual" in nature and formation as stipulated in section 28 of the Insurance Ordinance, 2000, it has no share capital or shareholding, in the circumstances the penalty imposed in individual capacity upon Appellants 2 to 8, who have no financial involvement or stakes in the Company is unjust and harsh.

6. The Respondent rebutted the arguments as follows:

- (a) The provisions of Section 156 of the Insurance Ordinance specifically hold the directors of an insurer responsible in case if the insurer is a company. Further, in terms of the provisions of Section 46 and Section 51 of the Insurance Ordinance and Section 196(2)(h) of the Companies Ordinance, 1984, the directors of an



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insurance company are required to approve and sign the financial statements/accounts of the insurance company, which have to be prepared so as to reflect true and fair picture of the affairs of that insurance company in terms of Section 234 of the Companies Ordinance, 1984. Therefore, the directors of an insurance company are fully responsible for any material misstatement made by them in the financial statement/accounts of an insurance company, for which they are liable to be penalized in terms of the provisions of Section 158 of the Insurance Ordinance. The default of Regulation 8(4), Regulation 9(3) and Regulation 13(1) of the Regulations was willful on part of the Appellants, as the directors of the Company had approved the financial statements on the basis of which penalty was imposed on the Appellants. Furthermore, winding up proceedings are to be initiated against the Company as the Company is unable to comply with the requirements of the law.

- (b) The Impugned Order was passed fully within the bounds of the law and the Respondent No. 2 was fully empowered by the Commission to take cognizance under Section 156 and Section 158 of the Insurance Ordinance by virtue of S.R.O. No. 1354(I)/2012 dated 31/10/12 and S.R.O. No. 221(I)/2015 dated 11/03/15. The Impugned Order, therefore, is not liable to be set aside and must be upheld.
- (c) Section 2(xxxix) of the Insurance Ordinance provides that, “Mutual Insurance Company’ means an Insurer, being a company incorporated under Law of Pakistan or any country or state other than Pakistan, which has no share capital and of which, by its constitution, only and all policy holders are members”. The reason for taking action against the Appellants was protection of the interests of the policyholders of the Company, who are its only members.

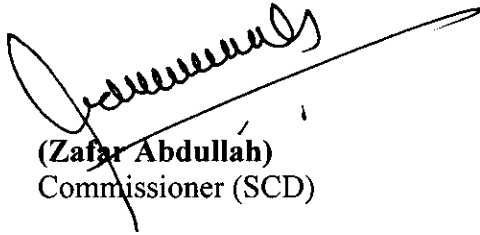
7. We have heard the parties and perused the record provided to us by the parties i.e. Appellant and the Respondent.



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8. The Appellants are unable to comply with the requirements of the law in terms of section 156 and 158 of the Insurance Ordinance. The Respondents have rightly penalized the Appellants, however, given the state of affairs of the Company which is unable to even meet its basic expenses and administrative costs and the fact that winding up proceedings have now also been initiated by the Respondent, taking a lenient view, we set aside the Impugned Order to the extent of penalty. The Appellants are warned that they must ensure compliance of the laws and regulations and directions of the Commission in future.

9. Parties to bear their own cost.

  
(Zafar Abdullah)  
Commissioner (SCD)

  
(Tahir Mahmood)  
Commissioner (CLD)

Announced on: 14 SEP 2015