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SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN INSURANCE DIVISION

[Karachi]

Before Nosreen Rashid, Executive Director (Insurance)

In the matter of

Reliance Insurance Company Limited

Show Cause Notice Date	May 3, 2010
Date of Company Reply Letter	May 11, 2010
Date of Order	June 1, 2010

ORDER

(Under Section 11 & 12 read with Section 156 of the Insurance Ordinance, 2000)

This Order shall dispose of the proceedings initiated against Reliance Insurance Company Limited ("the Company") for the business of the Company not being carried out with integrity, due care and professional skills, appropriate to the nature and scale of its activities, at all times, as required by the relevant provisions of Section 11 and Section 12 of the Insurance Ordinance, 2000 ("the Ordinance").

Background Facts

- An Onsite Inspection of the Company was conducted under the Order of the Executive Director of the Insurance Division, in exercise of powers conferred under Section 59A(1) of the Ordinance, on February 1, 2010, which commenced on February 15, 2010 and completed on March 30, 2010. The Onsite Inspection Report ("the Report") was issued on April 15, 2010. According to the Onsite Inspection Report, during the course of the Onsite Inspection, it was found that no reinsurance register was being maintained by the Company in which the Company would record premiums ceded to its re-insurers as per the prescribed formula in the respective reinsurance treaties. It was also found that the amount of reinsurance premium ceded was being calculated on an "estimated" basis rather than according to the terms and conditions of the reinsurance treaties.
- For the FY 2009, it was also found that using the estimated method of calculating the premium to be ceded, the Company had actually ceded premium Rs. 11.108 million less than what it should have according to the terms and conditions of their reinsurance treaties. Given that an "Inspection of Records" clause is present within its reinsurance treaties, the Company carries the risk of cancellation of its reinsurance treaties due to the abovementioned maladministration.
- The relevant provisions of Section 12 of the Ordinance state that:

"Criteria for sound and prudent management.- (1) For the purposes of this Ordinance, the following shall, without limitation, be recognised as criteria for sound and prudent management of an insurer or applicant for registration as a person authorised to carry on insurance business:



(a) the business of the insurer or applicant is carried on with integrity, due care and the professional skills appropriate to the nature and scale of its activities;

(d) the insurer or applicant maintains adequate accounting and other records of its business;

(2) Accounting and other records shall not be regarded as adequate for the purposes of clause (d) of sub-section (1) unless they are such as:

(a) to enable the business of the insurer or applicant to be prudently managed; "

5. Section 11(1)(f) of the Ordinance states that:

"Conditions imposed on registered insurers.-(1) An insurer registered under this Ordinance shall at all times ensure that:

(f) the insurer meets, and is likely to continue to meet, criteria for sound and prudent management including without limitation those set out in section 12;"

6. The Report, which refers to the Company as RICL, states:

"It was observed that no re-insurance register is maintained by RICL in order to record premium cessions to Re-insurers. Further, it is practice of company to cede premium to reinsurance on estimated basis. In this regard, the terms and conditions of the treaty are not being followed. The management was requested to calculate the amount of reinsurance premium to be ceded in accordance with the treaty for the FY 2009. The working obtained from the management in this regard revealed that an amount of Rs. 189.783 million was actually ceded to reinsurers against Rs. 200.891 million worked out on the basis of treaty. Therefore, an amount of Rs. 11.108 million was paid less than the amount that should have been ceded if reinsurance premium had been calculated according to treaty. It is pertinent to mention that re-insurance treaties carry "Inspection of Records clause", which allows the Re-insurer to check the records of RICL. Hence RICL carrying a risk of cancellation of treaty due to its mal practice in cessions of reinsurance premium to re-insuresr. In other words, the business of the insurer is not being carried on with integrity, due care and professional skills as required by Section 12 of the Insurance Ordinance"

7. The findings of the Onsite Inspection regarding the reinsurance premium ceding calculation being in violation of the terms and conditions of the Company's reinsurance treaty arrangements, thus, risking the cancellation of its treaties and non-maintenance of proper records of reinsurance premium ceded reflect that the business of the Company is not being carried out with integrity, due care and professional skills at all times, as required by the abovementioned relevant provisions of Section 11 and Section 12.

8. The applicable penal provision of the Ordinance, Section 156, states:

"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 or any direction made by the Commission, the Commission shall have the power to impose fine on the insurer, 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."



Show Cause Notice

9. Accordingly, a Show Cause Notice dated May 3, 2010 under Section 11 & 12 read with Section 156 of the Ordinance was issued to the Chief Executive and Directors of the Company, calling upon them to show cause as to why the penalty, as provided in Section 156 of the Ordinance, should not be imposed upon them for not complying with provisions of Section 11 & 12 of the Ordinance.

Company's Response to the Show Cause Notice

10. The Company, via its letter dated May 11, 2010, filed on May 12, 2010 in response to the abovementioned Show Cause Notice stated:

"It is submitted here that as our records were maintained manually including Underwriting and Reinsurance departments therefore we used to calculate premium cede-able to reinsurers on the basis of EPI and manually. However, upon the request of SECP inspectors we reworked the treaty premium cede-able in 'Excel' software and got the difference of Rs. 11 million against the total EPI of Rs. 186.50 million which works out to about 5.9%. If the impact of commission is taken into account, the difference reduces to Rs. 7.70 million and in terms of percentage 4.1%."

11. The Company added:

"We have initiated the implementation of specialized integrated software and henceforth all records of the company would be maintained at the new software to bring complete accuracy. We may add here that in order to draw the advantages of computer technology and to bring efficiency and promptness we have engaged the services of a software company i.e., M/s Sidat Hyder Morshad Associates and bought their renowned as "GLAS - General Insurance & Accounting Software"

12. The Company further stated that it maintains excellent business relations, confidence and trust of its reinsurers, that the Company, every year at the time of treaty renewals, submits the required information & records and that all possible efforts were made to maintain records with integrity, due care, prudence and professional skills.

Consideration of Company's Response

13. I have given due consideration to the written submissions of the respondents. The findings of the Onsite Inspection regarding the reinsurance premium ceding calculation reveal the violation of the terms and conditions of the Company's reinsurance treaty arrangements, thus, risking the cancellation of its treaties and non-maintenance of proper records of reinsurance premium ceded reflect that the business of the Company is not being carried out with integrity, due care and professional skills at all times, as required by the abovementioned relevant provisions of Section 11 and Section 12..

14. The Company, in its response to the Show Cause Notice, accepted the error in their calculations of reinsurance premium to be ceded stating that their records were being maintained manually and that the Company had started to move towards implementation of software and IT solutions. In addition, the Company further stated that it maintains excellent business relations, confidence and trust of its reinsurers, always submits the required information to their reinsurers and that all possible efforts were made to maintain records with integrity, due care, prudence and professional skills.



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Conclusion

15. Hence, it is established that the Company was acting in contravention of Section 11 & 12 of the Ordinance. Therefore, the Company can be held liable under Section 156 of the Ordinance. There may be a negative impact on the Company if Re-insurers come to know that they were under paid in terms of reinsurance premium ceded and they may cancel the Company's reinsurance agreements

16. The Company requested that their case be decided sympathetically on the basis of their written submissions. Accordingly, the case was finalized on the basis of their written reply.

Order

17. In view of the foregoing conclusion, I, in exercise of powers conferred on me under Section 156 of the Ordinance, hereby impose a fine of Rupees five hundred thousand (Rs. 500,000) on the Company.

18. *Reliance Insurance Company Limited* are hereby directed to deposit the aforesaid fine of Rupees five hundred thousand (Rs. 500,000) in the designated bank account maintained in the name of the Commission with MCB Bank Limited within thirty (30) days from the receipt of this Order and furnish receipted vouchers issued in the name of the Commission for information and record.

(Nasreen Rashid)
Executive Director (Insurance)