SECP
Insurance Division
Karachi

[Karachi]

Before Tariq Hussain, Director (Insurance)

In the matter of

Pak Qatar Family Takaful Limited

Show Cause Notice Issue Date:	March 31, 2014
Date of Hearing:	April 29, 2014
Attended By:	1. Mr. Muhammad Kamran Saleem, Chief Financial Officer / Company Secretary, Pak Qatar Family Takaful Limited; 2. Mr. Jehanzaib Ahmed, Head – Legal & Compliance, Pak Qatar Family Takaful Limited; 3. Mufti Zahid Sangharwi, Head of Shariah Compliance, Pak Qatar Family Takaful Limited; and 4. Mr. M. Ahsan Qureshi, Senior Manager – Finance & Accounts, Pak Qatar Family Takaful Limited.
Date of Order:	May 21, 2014

ORDER

(Under Section 18(1) read with Section 21(5) and Section 156 of the Insurance Ordinance, 2000)

....

This Order shall dispose of the proceedings initiated against M/s Pak Qatar Family Takaful Limited ("the Company") for not complying with Section 18(1) read with Section 21(5) of the Insurance Ordinance, 2000 ("the Ordinance").

Background Facts

2. The relevant provision of Section 18(1) of the Ordinance states that:

> *"**18. Disposition of assets of statutory funds.- (1)** The assets of a statutory fund are only available for expenditure related to the conduct of the business of the statutory fund."*

3. The Revenue Account statement (Form LD) of the Participant Takaful Funds of the Company for the year ended December 31, 2012 depicted a transaction / contribution of Rs. 10,000,000/- from the Group Family Participants' Takaful Fund (PTF) to the Group Health PTF of the Company.

4. It was further observed that the total amount of capital contributed by the Shareholders' Fund to the Group Family PTF, amounting to Rs. 8,493,282/-, was repaid back to the Shareholders' Fund of the Company during the year 2012.

5. Hence, in the light of the para above, there was no further capital contribution available in the Group Family statutory fund to be distributed to another statutory fund of the Company.

6. The provisions of Section 21(5) of the Ordinance lay down the modes in which capital contribution may be distributed, if it is available. The said provisions of the law state that:

> *"(5) Capital contributed to a statutory fund may only be distributed in the following ways:*
>
> *(a) by transfer to the shareholders" fund;*
> *(b) by transfer to another statutory fund of the company; or*
> *(c) by distribution as bonuses to holders of participating policies."*

7. Hence, in the light of the provisions of Section 18(1) and Section 21(5) of the Ordinance, it appeared to the Commission that the contribution of Rs. 10,000,000/- from the Group Family PTF to the Group Health PTF of the Company was not allowable, as there was no outstanding balance of the capital contribution available in the Group Family PTF, which could have been distributed to another statutory fund.

8. The Commission, vide its letter no. ID/SD/PQFTL/2013/18038 dated October 29, 2013, had advised the Company to furnish its comments / clarification on the aforesaid observation, on which the Company in its reply dated November 20, 2013 stated that:

"As you are aware that the Company is operating under "Waqf Wakala Model" and has created a Participant Takaful Fund (PTF) or waqf fund. As permitted under the Waqf deed, the Waqf is further sub divided into sub-funds for different segments i.e. Individual Family(IF), Group Family (GF) and Group Health (GH). Since the PTF is a common risk pool, we believe that any surplus after providing for technical reserves of one segment can be utilized to overcome deficit of another segment or to make another segment solvent; thus the surplus/deficit of PTF as a whole should be considered and in case of deficit, capital from shareholders sub-fund should be contributed accordingly."

9. The above-quoted reply of the Company could not have been termed as satisfactory, and that the PTF being a common risk pool cannot relieve the Company from complying with the provisions of the Ordinance, and hence, the capital contribution (if any) that was to be made to the Group Health Statutory Fund / PTF should have made through the Shareholders' Fund of the Company and not through the Group Family PTF.

10. Accordingly, in view of the foregoing paras hereof, it appeared that the Company has contravened the provisions of Section 18(1) read with Section 21(5) of the Ordinance, which attract the penal provision as provided under Section 156 of the Ordinance.

Show Cause Notice

11. Hence, the Show Cause Notice was issued on March 31, 2014 under Section 18(1) read with Section 21(5) and Section 156 of the Ordinance to the Company, its Chief Executive and the Directors of the Company, calling upon them to show cause as to why the penalty, as provided under Section 156 of the Ordinance, should not be imposed upon the Company, its Chief Executive Officer and/or the Directors of the Company for not complying with provisions of Section 18(1) read with Section 21(5) of the Ordinance.

Company's Response to the Show Cause Notice

12. In response to the said Show Cause Notice, the Company, vide their letter no. PQFTL/HoL&C/2014 dated April 3, 2014, declared that Mr. Muhammad Kamran Saleem (Chief Financial Officer & Company Secretary of the Company), Mr. Ahsan Qureshi (Senior Manager - Finance & Accounts of the Company) and Mr. Jehanzaib Ahmed (Head - Legal & Compliance of the Company) intend to appear in person along with the written representation as clarification to the aforesaid Show Cause Notice, which was served upon the Company, its Chief Executive Officer and the Directors of the Company for the aforementioned contravention of the Ordinance.

Hearings of the Case & Subsequent Developments

13. As requested by the Company, vide their letter no. PQFTL/HoL&C/2014 dated April 3, 2014, the hearing in the matter was scheduled for April 29, 2014, which was communicated to the Company via Commission's hearing notice no. ID/Enf/PQFTL/2014/19411 dated April 7, 2014.

14. Accordingly, the said hearing was attended by Mr. Muhammad Kamran Saleem (Chief Financial Officer & Company Secretary of the Company), Mr. Ahsan Qureshi (Senior Manager - Finance & Accounts of the Company), Mr. Jehanzaib Ahmed (Head - Legal & Compliance of the Company) and Mr. Zahid Sangharwi (Head of Shariah Compliance of the Company), all of which were duly authorized by the Board of Directors to attend the said hearing in the matter of the aforesaid Show Cause Notice, through a Power of Attorney, duly attested by the Notary Public on April 5, 2014. Hence, in view of the said Power of Attorney, the above-named four persons shall be referred to as the "Company's representatives" hereinafter.

15. Brief proceedings of the hearing of April 29, 2014 are as follows:

a. The Company's representatives were asked to present the Company's contentions in the matter of the aforesaid Show Cause Notice.

b. The Company's representatives stated that the inter-fund contribution was allowed by virtue of the governing Waqf Deed, which is in-line with the principles of Islamic Shariah, and the contention was duly supported by the opinion of the Company's Shariah Advisor. The Company's representatives further argued that if a statutory fund of the Company is in surplus and if at the same time the other statutory fund is in deficit, then it is very much in-line with the Shariah to transfer / contribute the amount from the first statutory fund to the other in order to remove the deficit arising in the other fund;

c. It was then clarified to the Company's representatives that Waqf Deeds are made in pursuance of the Rules appertaining to the business of takaful, hence, if there is any contradiction between the provisions of the Rules and the Ordinance, the Ordinance shall prevail, and therefore, if the Ordinance has already forbidden a particular transaction / act, then the Company may not undertake any such transaction / act, and if such an act is so done, the same shall be construed as a clear violation of the provisions of the Ordinance;

d. It was also clarified that the Company's Group Family PTF and the Group Health PTF are two separate statutory funds in the light of the provisions of the Ordinance, and accordingly, if there is no capital contribution available in the Group Family PTF which could have been distributed in-line with the provisions of Section 21(5) of the Ordinance, then the Company could not have contributed / transferred / distributed an amount of Rs. 10,000,000/- from the Group Family PTF to the Group Health PTF, rather if the Group Health PTF was in deficit, the amount should have been obtained directly from the Shareholders' Fund in the very first place, which would have been in-line with the provisions of Section 18(1) and Section 21(5) of the Ordinance;

e. Thereafter, the Company's representatives relied upon the argument that the business of takaful is altogether different than the conventional mode of doing insurance business, and stated that the Company's Shariah Advisor has endorsed the transfer or distribution of funds from one statutory fund to another. Moreover, the nature of both the statutory funds is group business;

f. Lastly, the Company's representatives submitted a written response (letter no. PQFTL/HoL&C/2014 dated April 25, 2014) along with the clarification from the Company's Shariah Advisors and the copies of the Waqf Deed and the supplemental deeds during the course of hearing.

16. The Company's letter no. PQFTL/HoL&C/2014 dated April 25, 2014 stated that:

"...Rule 9 of Takaful Rules 2005 educates us about the formation of a Participant Takaful Fund (PTF) with the purpose of pooling of risks amongst the participants. Rule 9 reads as under:

<u>Quote</u>
Participants Takaful Fund.-(1) A PTF shall be a separate fund the purpose of which shall be the pooling of risks amongst the participants. The role of the Takaful operator shall be the management of the PTF and related risks. At the initial stages of the set-up of the PTF the Takaful operator and any of its shareholders may at their discretion make an initial donation or qard-ehasna to the PTF. The objectives of the PTF shall be to provide relief to participants against defined losses as per the PTF rules and the PMD.
<u>Unquote</u>

As you are very well aware that all the Takaful companies operating in Pakistan are based on the Wakalah Waqf model operational methodology/system of the same can be explained through the following example; Some individuals form a Fund on the basis of Waqf and subsequently donate/contribute in the fund, hence giving it the name Participation Takaful Fund (PTF) with an understanding that if any calamity/risk befalls any of the participants of the fund, a decided amount would be donated (Tabbaru) to the effected. The fund would be monitored by a Takaful Operator on the *pattern of Waqf, to safeguard the deposits and to increase the profitability of the fund. Subsequently, the Takaful Operator would be paid its Wakalah agency fee. The example of a Waqf is similar to that of a Waqf asset Committee which receives its contributions from people for Maslahat-e-Waqf. Likewise, Takaful Company also acts as a Waqf operator. It will receive donations from the people and strengthen the fund. In case of a calamity to either of the members of the Fund, the company would pay the compensation just on the basis of Tabarru. Furthermore, it would do its level best to make the Waqf Fund/Takaful contribution more profitable and therefore, the company would receive its Wakalah fees for managing the Waqf Fund.*

The element of direct Riba (Interest) is removed from the whole system due to Tabrru contract as well as indirect Riba in such a manner that the Takaful company would invest in interest free institutions to make the fund more profitable while adhering to the rules and regulations of the Shariah. As far as Gharrar is concerned, it is not affective in Tabrru contracts.

Rule 19 read with Rule 20 of Takaful Rules 2005 educates the readers about the Investment Management of Funds within the PTF as well as in the PIF. Rule 19 states as under:

<u>Quote</u>
Investment management of funds.- Investment of participants contributions within the PTF as well as in the PIF shall be managed under a Wakala contract, a mudaraba contract or a combination contract as determined to be sound and workable by the Shariah Board of the Takaful operator. <u>The Takaful operator shall set the fee structure and the profit sharing ratio on the investment management based on the advice of the Shariah Board and the Appointed Actuary, if any.</u>
<u>Unquote</u>

Whereas Rule 20 read as under:

<u>Quote</u>
Product design.- A Takaful product shall be based on the principle of Wakala or mudaraba or both. The Appointed Actuary of the Family Takaful operator shall ensure that the products are sound and workable <u>whereas the Shariah Board of the Takaful operator shall ensure that these conform to the Islamic principles.</u>
<u>Unquote</u>

Section 32 of Takaful Rules 2005 applies the accounting regulations and statements to Takaful Business with appropriate modification based on the Guidelines of Shariah Board of the Takaful Operator. Section 32 reads as under:

<u>Quote</u>

Accounting regulations.- The regulations and statements under section 46 of the Ordinance shall apply to Takaful business with appropriate modifications based on the advice of the Shariah Board of the Takaful operator.
Unquote

Whereas, under Rule 9(2) of Takaful Rules 2005 the PTF rules were designed by the Shariah Advisory Board of Pak-Qatar Family Takaful (PQFTL).

(2) The Takaful operator shall define the PTF rules which shall be in accordance with the generally accepted principles and norms of insurance business suitably modified with guidance by the Shariah Board of the Takaful operator. Any subsequent changes to the PTF rules shall also be approved by the Shariah Board.

In compliance to Rule 9(2) of Takaful Rules 2005 Pak-Qatar Family Takaful (PQFTL) formed WAQF deed subsequently Waqf Rules on August 17, 2007 which were sent to SECP under Rule 13 (3) of the Takaful Rules 2005 for information and approval purposes.

Few of the salient features of the WAQF deed are mentioned below for ready reference:

1. *Under the WAQF deed PQFTL established an irrevocable Fund called Pak-Qatar Family Takaful Limited Waqf Fund [hereinafter referred to as the Participant Takaful Fund (PTF)] which was a separate and independent entity being capable of having title to ownership of, and possession of assets whether in the form of moneys, movable and immovable properties, and/or in any other tangible or intangible form legally possible and permissible along with the compliance with the Shariah Principles;*

2. *PQFTL has set apart Rupees Five hundred thousand only (Rs. 500,000) and hereby cede the same to the PTF being the Waqf money; and*

3. *PQFTL undertook to accept the responsibility of managing and operating the said PTF on the terms and conditions appearing in the Deed and in the Waqf Rules and in any other Supplementary Deed(s) made hereunder, on the basis of a predefined fee (the "Takaful Operator's fee").*

4. *Purposes, objectives and Assets of PTF are discussed in detail in Clause 2 and 3 respectively.*

5. *Clause 4 (i) of the WAQF Deed 2007 of PQFTL empowers PQFTL to establish sub-funds within the PTF. The relevant clause is reproduced below for ready reference:*

Quote:
The management of the PTF. The Operator may create further sub-funds within the Waqf Fund after approval from the Shariah Board and the Appointed Actuary. The risk

contributions and Takaful Operators' fee and the liabilities related to each sub-fund would be transferred to their respective sub-fund.
<u>Unquote</u>

Likewise, PQFTL is also operating under 'Waqf Wakala Model' and has created a Participants Takaful Fund (PTF). As permitted under the Waqf deed, the waqf is further sub divided into sub funds for different segments i.e. individual Family (IF), Group Family (GF) and Group Health (GH).

Pak Qatar Family Takaful Participant Fund (Supplemental Deed) was issued on August and Rules thereof were issued on December 10, 2007. Pak Qatar Group Health Takaful Participant Fund (Supplemental Deed) and Rules thereof were issued December 10, 2007 and Pak Qatar Individual Takaful Participant Fund (Supplemental Deed) (hereinafter jointly referred to as the "Supplemental Deeds") and rules thereof were issued on December 10, 2007. The same were sent to SECP for information and approval purposes

Furthermore, Clause 4.6 of the Waqf deed 2007 read with Clause 4.2 of the Supplemental Deeds allows PQFTL to share the surplus of one segment to overcome the deficit of the other segment. Clause 4.6 read as under:

<u>Quote</u>

Clause 4.6 of Waqf Deed, 2007

Atleast at the end of each accounting year the Operator shall evaluate the assets and liabilities of the PTF either on an overall basis or for each sub-fund created as per clause 4.1 and determine whether the operations for that particular period had produced a surplus for sharing amongst the Participants under advice of the Appointed Actuary and the Shariah Board. The mechanism of surplus determination as well as surplus distribution would be defined in the PTF Rules as well as in the PMD.

<u>Clause 4.2 of the Supplemental Deeds</u>

<u>The Operator shall have the right to set off the loss in any supplementary fund with the surplus of another supplementary fund</u>

<u>Unquote</u>

Since PQFTL received no objection from the SECP upon the submission of the Supplemental Deeds along with the rules thereof, PQFTL has been acting in accordance with the same under the impression that the said modus operandi is well-known to SECP and that SECP has no objection in this regard.

The above approach has also been approved by the PQFTL's Shariah Board & appointment actuary and concurred by the PQFTL's external auditors.

Had we transferred this surplus to SHF and routed through it, then this would have been translated as if surplus from Group Family Waqf fund has been withdrawn and taken to shareholders fund and then the Qarad-e-Hasan (capital contribution) was contributed by SHF. If this would have been accounting treatment, it would have been real non-compliance with accounting regulations as well as Takaful rules 2005 hence, with the prior consent and approval of Shariah board, Appointed Actuary, and External Auditors we made the direct inter-fund movement of Rs. 10,000,000/- which was in line with prerequisites laid down in the Waqf Deed already approved by all quarters including SECP.

<u>PRAYER</u>

Keeping in view the above submissions, you are requested to accept to our written representation and withdraw the Show Cause Notice in the interest of justice..."

17. The above-quoted reply of the Company reveals that the Company had created a right of its own to set off the loss of one supplementary fund with the surplus of another, and that too, in contradiction with the provisions of Section 18(1) read with Section 21(5) of the Ordinance.

18. The PTF Rules and the supplemental deeds of each statutory fund / PTF have been framed by the Company in pursuance of the provisions of the repealed Takaful Rules, 2005, and if any of the provisions of these PTF Rules and the supplemental deeds are in conflict with the provisions of the Ordinance, then the provisions of the Ordinance shall prevail.

19. The provisions of Section 18(1) require that the assets of a statutory fund should be used / consumed for expenditures of and within the bounds of that statutory fund. Any capital contribution by the Shareholders' Fund to any of the statutory fund has to be distributed, if so required, in the manner as stipulated under Section 21(5) of the Ordinance. However, if there is no capital contribution available in a particular statutory fund then the assets / funds of that statutory fund cannot be distributed to any other statutory fund even to offset the deficit in such other statutory fund.

20. The repealed Takaful Rules, 2005 focused majorly on the workability of the takaful products by the Appointed Actuary of the operators and Shariah compliance by the Shariah Board of that particular operator. Nowhere therein, the said repealed Rules ever forbid any operator to forgo compliance of the parent law i.e. the Ordinance, neither can this be possible ever. Accordingly, the operators were required to design commercially workable takaful products that should also observe the

compliance of the principles of Islamic Shariah, at the same time, however, it is quite imperative that the designed products and the functioning of the operator's funds can never be allowed to violate the provisions of the parent law i.e. the Ordinance.

21. With specific reference to Clause 4.2 of the Supplementary Deeds, the approval of the Waqf Deed and supplemental deeds by the Commission does not mean that the Commission has ever allowed the Company to indulge in such an act or perform such transactions that have not been allowed by the Ordinance, as any such approval, if so deemed / misinterpreted, to that extent shall be *ultra vires* and beyond lawful authority. Thus, the inclusion and exercise of all such clauses which, by virtue of any interpretation, permit the Company to enter into any illegal act, either in the Waqf Deed or the Supplemental Deeds, may be treated as *void* and *illegal*.

Consideration of Company's Submissions

22. I have carefully examined and given due consideration to the written and verbal submissions of the Company, its Chief Executive and the Directors (through their representatives, Mr. Muhammad Kamran Saleem, Chief Financial Officer / Company Secretary, Mr. Jehanzaib Ahmed, Head – Legal & Compliance, Mufti Zahid Sangharwi, Head of Shariah Compliance and Mr. M. Ahsan Qureshi, Senior Manager – Finance & Accounts), and have also referred to the provisions of the Ordinance. I am of the view that there has been an established default of Section 18(1) read with Section 21(5) of the Ordinance, as the Company's Group Family PTF had distributed an amount of Rs. 10,000,000/- to the Company's Group Health PTF over and above the capital contribution, which was already returned to the Shareholders' Fund during the year 2012, and that the Company's Group Family PTF's assets were utilized to fund or shoulder the loss-making statutory fund of the Company i.e. Group Health PTF. In this regard, the Company has justified the act by placing its adherence on the provisions of the Waqf Deed & Rules and the supplemental deeds of each statutory fund / PTF, which can never take precedence over the provisions of the primary legislature i.e. the Ordinance.

23. However, before proceeding further, I find it relevant to discuss the duties of the Directors. The Directors, in addition to the day-to-day running of the Company and the management of its business, also have some 'fiduciary' duties i.e. duties held in trust and some wider duties imposed by statute and breach of these statutory duties will usually be a criminal offence, punishable by fine or imprisonment. Hence, the Directors are gauged against a higher standard of accountability which requires them to be vigilant and perform their duties with due care. In the instant case, however, the Directors have failed to perform their duties with prudence. As the Directors are supposed to be well aware of their legal obligations in connection with the aforesaid statutory requirement of the Section 18(1) read with Section 21(5) of the

Mei

Ordinance, as already elaborated / explained hereinabove, therefore, it could be legitimately inferred that the default was committed.

Conclusion

24. After carefully examining the arguments and studying the facts and findings of the case as mentioned in the above paras of this Order, the default of Section 18(1) read with Section 21(5) of the Ordinance is established, as aforesaid. Therefore, the penalty as provided under Section 156 of the Ordinance can be imposed onto the Company, its Directors and/or the Chief Executive Officer.

25. Section 156 of the Ordinance states that:

> *"**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, 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."*

Order

26. In exercise of the power conferred on me under Section 156 of the Ordinance, I, instead of imposing the maximum penalty, take a lenient view, and thus, condone the Company due to the following reasons:

a. That the aforesaid contravention of the Ordinance surfaced out as a result of the misunderstanding due to provisions included in the Waqf Deed / Rules of the Fund and the supplemental deeds of the respective statutory funds / PTF's;

b. That to the best known fact, the principles of Shariah have not been violated / compromised to the extent of the aforesaid transaction;

c. That the participants / policyholders of either of the statutory funds / PTF's have not suffered any noticeable loss due the transaction under consideration, subject to its reversal.

27. However, the Company is hereby advised to immediately reverse the transaction of Rs. 10,000,000/- made during the year 2012 from the Company's Group Family PTF to Group Health PTF, and if any amount / contribution is so required in the Group Health PTF, it should ultimately be borne by the Shareholders' Fund or as

advised by the Shariah Advisors of the Company, in line with the principles of Islamic Shariah and the provisions of the Ordinance and the Rules made thereunder. Also, the Company is hereby issued a stern warning that in case of similar non-compliance in future a stronger action against the Company will be taken.

28. The Company is also advised to intimate the Commission within 14 days from the date hereof, the status of reversal of the aforesaid transaction of amount of Rs. 10,000,000/-.

29. This Order is issued without prejudice to any other action that the Commission may initiate against the Company in accordance with the law on matters subsequently investigated or otherwise brought to the knowledge of the Commission.

Tariq Hussain
Director