SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
INSURANCE DIVISION

SECP

[Karachi]

Before Nasreen Rashid, Executive Director (Insurance)

In the matter of

Saudi Pak Insurance Company Limited

Show Cause Notice Issue Date:	November 11, 2010
Written Reply Date:	November 23, 2010
Date of Hearing:	December 9, 2010
Hearing Attended by:	Capt. Azhar Ehtesham Ahmed (CEO) Mr. Mohammad Imtiaz A. Aziz (CFO & Company Secretary)
Date of Order:	January 4, 2011

ORDER

(Under Section 99(5) Read With Section 156 of the Insurance Ordinance, 2000)

....

This Order shall dispose of the proceedings initiated against Saudi Pak Insurance Limited ("the Company") for not complying with Section 99(5) Read With Section 156 of the Insurance Ordinance, 2000 ("the Ordinance").

Background Facts

2. 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 March 9, 2010, which commenced on March 24, 2010 and was completed on June 30, 2010. According to the Report, during the course of the Onsite Inspection, it was found that insurance agency commission amounting to about Rs. 2.27 million was paid to the Company's insurance agents by cash or cash cheque during FY 2006, FY 2007, FY 2008 and FY 2009 which was in direct contravention of Section 99(5) of the Ordinance and can be penalized under Section 156 of the Ordinance.

3. The Report, in its Executive Summery, states:

> *"It was noted that in the financial year 2006, 2007 and 2008, an amount of Rs. 83,248, Rs. 463,766 and Rs. 178,545 respectively was paid to agents on account of commission through cash cheques which is in contravention of Section 99(5) of the Insurance Ordinance, 2000. Further, an amount of Rs. 1.483 million in FY 2008 and Rs. 67,474 in FY 2009 was paid as commission to agents through petty cash in violation of the said Section."*

4. Section 99(5) of the Ordinance states:

"No payment of commission or other remuneration to an insurance agent shall be made otherwise than by a crossed cheque, pay order or electronic funds transfer or in such other manner as may be prescribed:

Provided that this sub-section shall not apply to payments to an agent which do not in the aggregate in one year exceed the sum of five thousand rupees."

5. The 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."*

Company's Response to the Draft Report

6. According to the Report, the Onsite Inspection team shared their observations on the issue with the management of the Company through the draft report. The response of the management was incorporated in the final version of the Report and has been reproduced below:

"The anomaly mentioned therein had already been identified by the Head of Internal Audit which was reported to the Audit Committee in its 6th Meeting held on October 20, 2007 and subsequently to the Board of Directors who were also apprised that the Management had taken corrective measures to ensure strict adherence to the prevailing laws.

Payment of commission was under pre-audit regime since inception of the Company which delayed its identification by the Head of Internal Audit until October 2007. Since then, the Company had adopted every desired corrective measure.

The said error last surfaced in November 2009 and, thereafter, the Company has maintained a strict adherence with the relevant law which was confirmed by the visiting inspection team as well. It is therefore requested that the Commission, considering the self identification and correction of the aforementioned error, acquit the Management for its past mistake"

Show Cause Notice

7. Accordingly, a Show Cause Notice dated November 11, 2010 under Section 99(5) read with Section 156 of the Ordinance was issued to the Company, the Chief Executive Officer (CEO) and its Directors, 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 99(5) of the Ordinance.

Company's Response to the Show Cause Notice

8. The CEO of the Company, via its letter dated November 23, 2010, in response to the abovementioned Show Cause Notice stated:

> *"Reference to your show cause notice dated 11th November 2010, kindly allow me to appear before you for a compassionate hearing on a date and time convenient to you, for which I will be greatly obliged."*

Hearing of the Case

9. In order to provide an opportunity to Company, the CEO and the Directors of the Company or their authorized representative for appearing in person to explain the reasons for not complying with the said provisions of the Ordinance, the hearing of the case was fixed for December 9, 2010 before Executive Director (Insurance).

10. On the date of the hearing Capt. Azhar Ehtesham Ahmed, the CEO of the Company appeared with a Power of Attorney to represent the Company, its Directors and himself. He was accompanied by Mr. Mohammad Imtiaz A. Aziz, the Chief Financial Officer (CFO) & the Company Secretary.

11. During the hearing of the case, the CEO of the Company stated that the Company was established in 2005 and its human resources came from different cultures and practices, hence mistakes were expected. The External Auditors at that time, BDO Ebrahim & Company, issued its Management Letter. The management of the Company was alarmed by the revelations of that Management Letter and accordingly an Internal Audit department was setup in 2006. The Head of Internal Audit was a non-industry person but was competent and was able to learn quickly. In October 2007 the Head of Internal Audit expressed reservations on the remuneration through cash and cash cheques. The management immediately agreed to stop such payments. However, the previous CFO of the Company was lax in his attitude towards this decision and although the management has decided to stop such payments, payments were still made in this manner.

12. The CEO further stated that contraventions occurred due to human error on part of the previous CFO. While accepting that the Company took two to three years to realize that the contraventions were occurring, the CEO stated that the Company had rectified the situation through various measures. The management of the Company had sacked the previous CFO and, to ensure that such contraventions did not occur again, raised the authorization level required for Journal Vouchers, eliminating human error through a method of self detection. Two different individuals are now required to make a Journal Voucher and it has to be authorized by the CEO, CFO or Chief Operating Officer of the Company along with the reasons for its authorization. Since the Head of Internal Audit had by now gained some experience, all payments are now routed through Internal Audit. Due to this measure, the frequency of Audit is now daily and is applicable on every payment. The CFO is a qualified Cost and Management Accountant and the Head of Internal Audit is a qualified Chartered Accountant.

13. The CEO stated that the Board of Directors was aware of the situation and that the Company's Audit Committee was very competent. The necessary controls have been established to ensure good corporate governance within the Company. The CEO had further stated that there was no *mala-fide* intent when the contraventions occurred and the Company had also rectified the situation by taking appropriate measures.

Conclusion

14. It has been established that the Company had acted in contravention of Section 99(5) of the Ordinance when it made commission payments other than by a crossed cheque, pay order or electronic funds transfer to its insurance agents. Furthermore, it took the Company two to three years to discover and rectify the situation. The Company can be held liable under Section 156 of the Ordinance as stated above.

15. However, the Company does appear to have acted decisively to tackle the issue. The Company removed its previous CFO and implemented new control mechanisms to ensure that the said contraventions did not occur again in the future.

16. These measures appear to have been implemented even before the Onsite Inspection was initiated. Since no further contraventions pertaining to FY 2010 were uncovered during the course of the Inspection and reported by the Onsite Inspection team in their Report, it appears that the measures were successful.

Order

17. In view of the foregoing material information, I, in exercise of powers conferred on me under Section 156 the Ordinance, will take a lenient view and instead of imposing a fine, hereby, **condone** the contravention by the Company. The Chief Executive, the Directors of the Company and the Company itself is, hereby, **warned** and advised to exercise due caution in complying with the requirements of the law in the future.

Nasreen Rashid
Executive Director (Insurance)