



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Adjudication Department-I

Adjudication Division

Through Courier & Email

No.ID/Enf/Shahen/2019/190/322

June 28 2024

Shahen Insurance Company Limited,
Through its Chief Executive Officer,
10th Floor, Shahen Complex,
M.R. Kayani Road,
Karachi

SUBJECT: ORDER IN RESPECT OF SHOW CAUSE NOTICE DATED MARCH 28, 2024 UNDER RULES 2(1)(B)(I), 4(2) AND 5(1) OF THE CREDIT AND SURETYSHIP (CONDUCT OF BUSINESS) RULES, 2018 READ WITH RULE 8 AND SECTION 156 OF THE INSURANCE ORDINANCE, 2000

Please find enclosed herewith a copy of Order dated June 28, 2024 for your record and necessary compliance.

Shafiq ur Rehman
Additional Joint Director



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

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Adjudication Division

Before

Shahzad Afzal Khan, Director / Head of Department (Adjudication-I)

In the matter of

Shaheen Insurance Company Limited

Show Cause Notice No. &
Issue Date:

ID/Enf/Shahen/2019/190
March 28, 2024

Date of Hearing:

May 27, 2024

Present at the Hearing:

Mr. Rizwan Akhtar (Chief Executive Officer)
Mr. Nisar Ahmed Almani (Chief Financial Officer)
Ms. Sumbal Faraz (Head of Underwriting)
Mr. Jamal Ahmed (Head of Compliance)
(Authorized Representatives)

ORDER

Show Cause Notice under Rules 2(1)(b)(i), 4(2) and 5(1) of the Credit and Suretyship (Conduct of Business) Rules, 2018 read with Rule 8 and Section 156 of the Insurance Ordinance, 2000

This Order shall dispose of the proceedings initiated against **Shaheen Insurance Company Limited (the Company and/or the Respondent)** under Rules 2(1)(b)(i), 4(2) and 5(1) of the Credit and Suretyship (Conduct of Business) Rules, 2018 read with Rule 8 and Section 156 of the Insurance Ordinance, 2000 (**the Ordinance**) vide Show-Cause Notice No. ID/Enf/Shahen/2019/190 dated March 28, 2024 (**the SCN**).

2. The Company is registered under the Ordinance to undertake the non-life insurance business in Pakistan. While examining the Statement of Credit & Suretyship Business of the Company for the year ended December 31, 2022 (**FY 2022**), it has been noted that the Company, *prima facie*, has contravened the requirements of Rule 4(2) of the Credit and Suretyship (Conduct of Business) Rules, 2018 (**the Suretyship Rules**), by not procuring adequate collateral in case of 85 guarantees/ performance bond/suretyship policies issued during the year 2022.

3. Moreover, review of the cases where the Company obtained collateral against guarantees/bonds shows that the Company has accepted 'undated cheques/ counter guarantees/ promissory note' as collaterals, which are not admissible in terms of Rule 2(1)(b)(i) of the Suretyship Rules. Therefore, the Company, *prima facie*, has contravened the requirements of Rule 2(1)(b)(i) of the Suretyship Rules.

4. The relevant department of the Commission advised the Company vide email dated November 30, 2023 to furnish its explanation on the aforesaid observations. The Company vide email dated December 22, 2023 submitted its reply as under:



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"...the Company is fully committed to SECP Rules, Regulations and directives issued by them and will make sure that from next year it will try to take into consideration all the guidelines issued by SECP on the Credit & Suretyship Business."

5. In view of the above, the Company, prima facie, has contravened the requirements of Rules 2(1)(b)(i) and 4(2) of the Suretyship Rules.

6. Furthermore, the review of the bank account statement for the relevant period, has revealed that separate bank account is not being maintained for keeping the amounts of collateral obtained against guarantees/bonds. The Statement of Credit and Suretyship Business of the Company for FY 2022 indicates that the Company has procured collateral in 18 cases; however, deposit of such collateral in the said bank account was traced in only 4 cases. Therefore, said bank account is not exclusively used for depositing and maintaining the collaterals obtained under the Suretyship Business, in line with the requirements of Section 217(2) of the Act.

7. The relevant department of the Commission advised the Company vide email dated November 30, 2023 to provide its explanation on the aforesaid observation. The Company vide email dated December 22, 2023 submitted its reply as under:

".....It is respectfully submitted that few of the policies issued during FY 2022 were renewals; the collateral of which was deposited in prior periods. It is further submitted that Company earmarked this account for such deposits and maintained adequate balance there against".

8. In view of the above, the Company is not maintaining a separate bank account specifically for the purpose of collaterals. Therefore, the Company, prima facie, has contravened the requirements of Rule 5(1) of the Suretyship Rules.

9. The aforesaid non-compliances attract penal provisions contained under Rule 8 of the Suretyship Rules read with Section 156 of the Ordinance. Accordingly, the Respondent/Company was called upon to show cause in writing within fourteen (14) days of the date of the SCN as to why penalty may not be imposed on it for contravening the aforesaid provisions of the law.

10. The relevant provisions of the law are reproduced as under:

Rule 2(1)(b) of the Suretyship Rules:

(1) collateral" means —

- i) cash, ready money which can be used as money without being converted into another form and which circulates as money including bank bills but does not include promissory notes or post-dated cheques;*
- ii) bearer bonds which are fixed-income security that is owned by the holder (bearer), rather than a registered owner and are negotiable instruments with a stated maturity date and coupon interest rate;*
- iii) back-to-back / counter-guarantees of banks/DFIs/NBFIs rated at least 'A' or equivalent by a credit rating agency, in favor of the insurer;*
- iv) an approved security as defined in section 2(iii) of the Ordinance;*
- v) other liquid assets duly pledged with the insurer; and*
- vi) any other security approved by the Commission.*

Rule 4(2) of the Suretyship Rules:

(2) Subject to limit prescribed under sub-rule (1), an insurer shall procure collateral in case of guarantees / bonds of an amount equivalent to at least 80% of sum insured / amount of bond/ guarantee less reinsurance in respect of a particular guarantee /bond;

Rule 5(1) of the Suretyship Rules:

5. Treatment for Collateral Procured by an Insurer and Settlement of Claim— (1) The amount of collateral procured by an insurer shall be kept by the insurer in compliance with section 217 of the Companies Act, 2017 (in case the collateral, partially or wholly, is procured in cash).

Rule 8 of the Suretyship Rules:

8. Penalty: Any contravention with the requirement of these rules shall be punishable in accordance with the provisions of the Ordinance.

Section 156 of Ordinance:

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.

11. In response to the SCN, the Company vide letter dated May 24, 2024 submitted its reply, the relevant extracts of which are reproduced as under:

(Quoted):

It is respectfully submitted that the issues raised in the above mentioned SCN were also discussed during onsite inspection of year 2022 as well as during the hearings of the SCNs issued with regard to onsite inspection. The same issues have again been raised now for which we have already been penalized.

We would further like to respectfully make following submissions for the error / weaknesses intimated through abovementioned SCN:

Rule 4(2) of the Suretyship Rules

Shaheen Insurance is doing bond business with utmost care and under its prudent underwriting policy. We evaluate the risk/ requirement of insurance guarantee under the perspective of financial / technical strength of contractors. Most of the contractors are our clients since many years.

It is respectfully submitted that our market / competitors is operating in this class of business either on very low cash margins or zero margins at all. Further, for small time period (less than six months) contracts, clients are unwilling to place any cash margins or other recognizable collaterals. In the wake of above constraints, company has to underwrite the bond / surety business either with low cash margins or without cash margins. We try our utmost to get the maximum recognizable collaterals including cash margins; however, some time we succeed and sometime not.

It is further submitted that the Company also obtained undated cheques / promissory notes / counter guarantees as an additional security, over and above the main collateral i.e. cash margins; to secure payments in default situation. We may also respectfully submit that this is in line with the industry practice, and in the backdrop of hardships faced by small companies like Shaheen Insurance for procuring business.





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Rule 5(1) of the Suretyship Rules

It is respectfully submitted that we had earmarked a special bank account only for the purpose of amounts related to collaterals cash margin.

All collaterals amount specially and specifically deposited in this special account ore as per the requirements of the regulation and never any deposit or withdrawals of collateral been placed in any other account.

Though by performing all the co/laterrals transactions in the above special account we complied with the requirements of the regulation, but to be more specific we later on during the year 2023 transferred all the funds of collateral to a dedicated bank account being maintained with JS Bank.

In view of the above submissions, it is requested that a lenient view may please be taken and these inadvertent violations be condoned, being unintentional.

In the meantime, we assure you that every possible step will be taken to avoid such occurrence in future.

(Unquote)

12. In order to provide the Respondent Company an opportunity of personal representation, hearing in the matter was fixed for May 27, 2023. The said hearing was attended by Mr. Rizwan Akhtar (CEO), Mr. Nisar Ahmed Almani (CFO), Ms. Sumbal Faraz (Head of Underwriting), Mr. Jamal Ahmed (Head of Compliance) as the Authorized Representatives of the Respondent (**the Authorised Representatives**). During the hearing, the Authorised Representatives were advised to submit the reasons for alleged non-compliances, as narrated in the SCN. The Authorized Representatives reiterated the submissions made in the written reply. During the hearing proceedings, the Authorised Representatives apprised that most of the insurance guarantees have expired and the Company has discontinued the practice of obtaining inadequate collateral against the guarantees. It was also apprised that the Company has now established a dedicate bank account for the purpose of maintaining the collaterals. The Authorised Representatives were advised to furnish an evidence of current status of the guarantees as well as evidence of maintaining the special bank account within one week of the date of hearing; however, the same were not furnished.

13. I have examined the facts of the case in light of the applicable provisions of the law and considered the written as well as verbal submissions and arguments of the Respondent and its Authorised Representatives and have observed as under:

(a) **Wrong Impression of Again Taking Cognizance of the Instant Matter:**

The Respondent is of the view that the Commission has already taken cognizance of the instant matter, which is incorrect. It is a matter of record that the Commission vide Order dated January 29, 2024 has previously adjudicated default of the Suretyship Rules in respect of only Afghan transit trade policies issued during FY 2022. As a matter of fact, the said policies were not reported in Credit & Suretyship Statements for FY 2022. However, the instant proceedings have been initiated on account of alleged contraventions of 85 insurance guarantees/bonds issued during FY 2022, which were reported in Credit & Suretyship Statements of the Respondent for FY 2022.

(b) **Insurance Guarantees Issued Without Obtaining Admissible and Adequate Collateral:**

As per the Statement of Credit and Suretyship Business for FY 2022 filed by the Company, the Respondent issued 91 insurance guarantees/bonds during the year. Analysis of the insurance guarantees issued during the year shows that prior to July 5, 2022, aggregate shortfall in required collateral amounts to Rs. 107.410 million in 47 guarantees. The aggregate deficiency in

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required collateral amounts to Rs. 55.287 million in 38 guarantees, which were issued on or after July 5, 2022. Thus, total shortfall in 85 guarantees issued during the year amounts to Rs. 162.698 million.

The Respondent, while explaining its position in the matter, has stated that their clients are not willing to place any cash margin or other recognizable collaterals in respect of contracts with a tenure of less than six (6) months. It has been further stated in the reply that their competitors are operating the suretyship class of business with low cash margins or even zero margin at all. Accordingly, the Respondent has to underwrite the suretyship business with low cash margins or without cash margin. The Respondent has assured that it undertakes the suretyship business under a prudent underwriting policy.

Contrary to the aforesaid stance of the Respondent, it needs to be realized that obligation for obtaining admissible and adequate collaterals against insurance guarantees issued by an insurer cannot be compromised under any circumstances as the Suretyship Rules imposes this obligation for the protection of interest of both the insurer as well as guarantee-holder. Therefore, the suretyship business of the Respondent would not be considered as being conducted under prudent underwriting policy in the absence of admissible and adequate collaterals against insurance guarantees.

The aforesaid obligation has been explicitly provided under Rule 4(2) of the Suretyship Rules, which requires that an insurer shall procure collateral in respect of particular guarantee / bond of an amount at least equivalent to:

- Prior to amendment made vide SRO 1010(I)/2022 dated 5.7.2022=> 80% of sum insured/ amount of bond/ guarantee less reinsurance; and
- Post amendment => 10% of sum insured/ amount of bond/guarantee.

As per the aforesaid requirement of the Suretyship Rules, the amount of collateral required in respect of each guarantee/bond issued by the Respondent prior to July 5, 2022 was an amount equivalent to at least 80% of sum insured/amount of bond/guarantee less reinsurance. The required collateral was an amount equivalent to at least 10% of sum insured/amount of bond/guarantee in respect of every insurance guarantee issued on or after July 5, 2022. However, the Company admittedly failed to obtain the required amount of collateral against insurance guarantees/bonds, which constitutes violation of Rule 4(2) of the Suretyship Rules.

(c) Acceptance of Inadmissible Collateral in Contravention of Rule 2(1)(b)(i) of the Suretyship Rules:

The Company has accepted undated cheques, counter guarantees, promissory notes as collaterals against 18 insurance guarantees issued during FY 2022. The Respondent has stated that in line with industry practice, the Respondent obtained undated cheques, promissory notes, counter guarantees as additional security over and above the main collateral i.e. cash margin in order to secure payments in situation of defaults.

In this context, it needs to be noted that a plain reading of Rule 2(1)(b)(i) of the Suretyship Rules shows that it lays down the criteria for valid and admissible forms of collateral for the suretyship business. Rule 2(1)(b)(i) of the Suretyship Rules states that:

“Collateral means cash, ready money which can be used as money without being converted into another form and which circulates as money including bank bills but does not include promissory notes or post-dated cheques”.

Thus, promissory notes are not admissible collaterals and cannot be accepted as collaterals. Since undated cheques could neither be regarded as cash nor they could be recognized as ‘ready



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money'. In fact, 'ready money' becomes immediately available without any delay or difficulty. However, in case of undated cheques, there could be circumstances where such cheques may delay the procurement of cash. Moreover, undated cheques cannot be used as ready money unless they are converted into cash upon being presented and honoured at bank. Furthermore, for a cheque to be a valid instrument, there are certain basic ingredients and "date" is one of them. Hence, undated cheques cannot be considered as valid collaterals. As far as counter guarantees are concerned, only counter guarantees issued by banks/DFIs/NBFIs can be considered as collateral, which is not the case in the matter at hand; therefore, counter guarantees issued by other parties cannot be considered admissible collateral for the purpose of suretyship business. Therefore, the Respondent, prima facie, has contravened the requirements of Rule 2(1)(b)(i) of the Suretyship Rules.

(d) **Lapses in Deposit of Amounts of Collateral in Special Bank Account in Contravention of Rule 5(1) of the Suretyship Rules:**

Review of the bank statement for the relevant period furnished by the Company indicates that deposit of amount of collateral was made in the said bank account in only 4 cases out of 18 cases where collaterals was obtained. Review of the said bank statement shows that numerous other transactions were done through the same bank account which confirms the fact that the said bank account was not being exclusively used for deposit of and maintaining the collaterals obtained under the Suretyship Business. The Respondent has contended that though all the transactions of collaterals were performed through the special bank account but to be more specific, during the subsequent year i.e. 2023, all the funds of collaterals were transferred to another dedicated bank account. The foregoing stance of the Respondent confirms that previously bank account was not being exclusively used for depositing and maintaining the amounts of collaterals. Therefore, the Respondent has contravened the requirements of Rule 5(1) of the Suretyship Rules.

14. Keeping in view the aforesaid contraventions/ non-compliances, I, in exercise of the powers conferred under Section 156 of the Ordinance read with Rule 8 of the Suretyship Rules and other enabling provisions of the law, hereby impose an aggregate penalty of **Rs. 100,000/- (Rupees One Hundred Thousand Only)** on the Respondent.

15. The Respondent is hereby directed to deposit the aforesaid penalty in the designated Bank Account maintained in the name of the Securities and Exchange Commission of Pakistan with MCB Bank Limited or United Bank Limited within thirty (30) days of the date of this Order and furnish receipted voucher evidencing payment of the same.

16. This Order is being issued without prejudice to any other action that the Commission may initiate against the Respondent and / or its management (including CEO of the Respondent) in accordance with the law on matters subsequently investigated or otherwise brought to the knowledge of the Commission.

Shahzad Afzal Khan
Director/Head of Department
(Adjudication Department-I)

Announced:
June 28, 2024
Islamabad