



SECP
Insurance Division
Karachi

[Karachi]

Before Tariq Hussain , Director (Insurance)

In the matter of

East West Life Assurance Company Limited

Show Cause Notice Issue Date: December 30, 2013

Date of Hearings: February 13, 2014

Attended By: Mr. Maheen Yunus Chief Executive Officer
Mr. Imran Ali Dodani Chief Operating Officer
Mr. Sohail Nazeer Company Secretary

Date of Order: April 25, 2014

ORDER

(Under Section 35 read with Section 11(1), Section 63(1) and Section 156 of the Insurance Ordinance, 2000)

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This Order shall dispose of the proceedings initiated against M/s East West Life Assurance Company Limited and others ("the Respondent") for not complying with Section 35 read with Section 11(1) of the Insurance Ordinance, 2000 ("the Ordinance").

Background Facts

2. The relevant provision of Section 11(1) of the Ordinance states that:

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

...

(c) the provisions of this Ordinance relating to minimum solvency requirements are complied with;

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SECURITIES & EXCHANGE
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3. The relevant provisions Section 35 of the Ordinance lays down the provisions relating to the minimum solvency requirement. Section 35 of the Ordinance states that:

"Net admissible assets of life insurers.- (1) A life insurer shall at all times maintain in its shareholders" fund a surplus of admissible assets in Pakistan over liabilities in Pakistan of not less than the required minimum amount.

(2) For the purposes of the preceding sub-section, the required minimum amount is seventy-five million rupees or such higher amount as may be prescribed:

Provided that for the period from the commencement date and until 31st December 2004, in respect of an insurer which is authorised to carry on insurance business on the commencement date, this sub-section shall apply as if the amount of seventy-five million rupees specified therein shall be substituted by the amount of thirty million rupees.

(3) A life insurer shall, in each statutory fund maintained by it for the conduct of business other than investment-linked business, maintain at all times a surplus of admissible assets in Pakistan over liabilities in Pakistan, other than policyholder liabilities, equal to or greater than the amount of policyholder liabilities calculated in accordance with such principles as may be prescribed by the Commission.

(4) A life insurer shall, in each statutory fund maintained by it for the conduct of investment-linked business, maintain at all times a surplus of admissible assets in Pakistan over liabilities in Pakistan, other than policyholder liabilities, equal to or greater than a sum calculated in accordance with such principles as may be prescribed by the Commission.

(5) A life insurer shall, in each statutory fund maintained by it, maintain at all times, in each currency in which the policy liabilities of that statutory fund are denominated, a surplus of admissible assets denominated in such currency over liabilities including policyholder liabilities denominated in such currency, in an amount to be determined in accordance with such provisions in this respect as the Commission shall prescribe.

(6) Where a life insurer has issued policies the benefits under which are payable in a currency other than Pakistan Rupees, securities denominated in that currency and issued and guaranteed as to principal and profit or return (however called or designated) by the Government of the country in whose currency such benefits are expressed, shall be deemed for the purposes of this section to be admissible assets of a statutory fund to which such policies are referable.

(7) The Federal Government may prescribe a percentage or percentages of the assets of the shareholders" fund of a life insurer, or of a statutory fund of a life insurer, other than a statutory fund which contains only investment-linked policies, which shall be invested in Government securities, or in a combination of Government securities and other approved securities.

(8) The aggregate of percentages prescribed under sub-section (7) shall not exceed forty per cent."

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4. Rule 12 of the Securities and Exchange Commission (Insurance) Rules, 2002 (the "Rules"), as applicable on December 31, 2012, states that:

"12. Net admissible assets of life insurers.- (1) For the purposes of sub-section (2) of section 35 of the Ordinance, the required minimum amount to be maintained in the Shareholders' Fund shall be the sum of the following:

- (a) *A fixed amount which shall be as follows:*
- until 30 December 2012 – seventy five million rupees; and*
 - thereafter as per the following table;*

<i>On or After</i>	<i>Rupees</i>
<i>'31 December 2012</i>	<i>One hundred and five million</i>
<i>'31 December 2013</i>	<i>One hundred and thirty five million</i>
<i>'31 December 2014</i>	<i>One hundred and sixty five million</i>

- (b) *If the company has been given written permission by the Commission under Rule 12(2) below, a solvency margin calculated in accordance with the principles set out in Annexure III.*

(2) *The Commission may grant written permission to a life insurer to maintain the solvency margin calculated in accordance with the principles set out in Annexure III in its shareholders' fund and statutory funds in aggregate (this being in addition to the fixed amount prescribed in Rule 12(1)(a)) instead of in each statutory fund on the following conditions:*

(a) *The life insurer makes an application in writing, not less than three months before the date on which such permission is to come into effect, seeking permission to maintain the solvency margin calculated in accordance with the principles in Annexure III in its shareholders' fund and statutory funds in aggregate instead of in each statutory fund, such margin being in addition to the fixed amount specified in Rule 12(1)(a); and*

(c) *The application in Rule (12)(2)(a) is supported by a non-revocable resolution of the Board of Directors of the life insurer to maintain the solvency margin calculated in accordance with the principles in Annexure III in its shareholders' fund and statutory funds in aggregate for a period of not less than ten years from the date of the application, and, during this period, not to declare any dividend without the express written consent of the Appointed Actuary of the life insurer.*

(3) *For the purpose of sub-section (3) of section 35 of the Ordinance, the surplus of admissible assets in Pakistan over liabilities in Pakistan, other than policyholder*

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liabilities, which a life insurer shall maintain at all times in each statutory fund maintained by it for the conduct of business other than investment-linked business shall be the amount of policyholder liabilities plus, unless written permission has been granted to the life insurer under Rule 12(2) to maintain the solvency margin in its shareholders' fund and statutory funds in aggregate, a solvency margin calculated in accordance with the principles set out in Annexure III.

(4) For the purpose of sub-section (4) of section 35 of the Ordinance, the surplus of admissible assets in Pakistan over liabilities in Pakistan, other than policyholder liabilities, which a life insurer shall maintain at all times in each statutory fund maintained by it for the conduct of investment-linked business shall be the amount of policyholder liabilities plus, unless written permission has been granted to the life insurer under Rule 12(2) to maintain the solvency margin in its shareholders' fund and statutory funds in aggregate, a solvency margin calculated in accordance with the principles set out in Annexure III.

(5) For the purpose of sub-Section (5) of Section 35 of the Ordinance, the surplus of admissible assets denominated in each currency over liabilities including policyholder's liabilities denominated in such currency shall be a solvency margin calculated in accordance with the principles set out in Annexure III with respect to policies denominated in such currency.

(6) Where sub-section (6) of section 50 applies in respect of a statutory fund, policyholder liabilities for the purposes of the said sub-sections shall not be less than the amount determined by the appointed actuary under that sub-section.”;

5. During examination of the returns and annual accounts for the year ended December 31, 2012 it was noted that the shareholder fund and all other statutory funds of the company are insolvent. The auditors in their report, given in the annual report, and the appointed actuary in his Financial Condition Report, also highlighted this fact.

6. Solvency position of the funds of the Company as at December 31, 2012 was;

Description	Shareholder Fund (Rs.)	Ordinary Fund (Rs.)	Universal Fund (Rs.)	A & H Fund (Rs.)	Aggregate (Rs.)
Total Admissible Assets	85,274,391	43,462,707	226,418,481	20,023,105	375,178,684
Less: Liabilities as BS	6,089,603	16,244,238	36,597,021	3,991,631	62,922,493
Net Admissible Assets	79,184,788	27,218,469	189,821,460	16,031,474	312,256,191
Less Fixed margin in SHF/PH Liabilities in BSFs	75,000,000	27,043,676	189,628,267	15,885,036	307,556,979



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Continuation Sheet 4

Less Fixed margin in SHF/ linked margin in BSFs	30,000,000	1,458,289	1,473,053	26,872,145	59,803,487
Net available solvency margin	(25,815,212)	(1,283,496)	(1,279,860)	(26,725,707)	(55,104,275)
Solvent (Yes/No)	NO	NO	NO	NO	NO

7. In view of the foregoing paras, it appeared that the Company had violated the provisions of Section 35 of the Ordinance, which implicated that the provisions of Section 11(1)(c) of the Ordinance have also been contravened.

Show Cause Notice

8. Accordingly, the Show Cause Notice was issued on December 30, 2013 under Section 35 read with Section 11(1), Section 63(1) and Section 156 of the Ordinance to the Chief Executive and Directors of the Company, calling upon them to show cause as to why the penalty, as provided under Section 63(1) and Section 156 of the Ordinance, should not be imposed upon the Company and/or its Directors for not complying with provisions of Section 35 read with Section 11(1) of the Ordinance.

Company's Response to the Show Cause Notice

9. The Company vides its letter no. EWL/HO/CEO/SECP/2014-197 dated January 10, 2014, submitted reply to the Show Cause Notice on behalf of the Company, and the Chief Executive and Directors of the Company, whereby they had had stated that:

"...In this regard, we wish to apprise that it is surprising for us to receive the subject Show Cause Notice on December 31st, 2013 wherein, according to the Commission, during examination of the returns and annual accounts for the year ended December 31st, 2012, it has been noted that the Shareholders' Fund and all other Statutory Funds of the company are insolvent. Whereas, the Commission was fully aware of all the proceedings behind this situation at each step of the way. Sir, we have always complied with the rules and provisions of the Insurance Ordinance, 2000 while we have also valued the guidelines provided by the Commission from time-to-time. It is evident from our actions when, due to abnormal conditions of the country's economy and unique factors being faced by the company, we foresaw that we will not be in a position to meet the solvency margins in accordance with the Securities and Exchange Commission (Insurance) Rules, 2002 after their amendment in January of 2012. Accordingly, we submitted an application vide our letter number EWI/HO/MD/SECP/2012-8415 dated October 10th, 2012 to grant permission to

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Continuation Sheet 5

maintain solvency margins as at December 31st, 2012 under Securities and Exchange Commission (Insurance) Rules, 2002 prior to January of 2012 amendments. This application was completely merit based as the change in rules were affecting our company the most by far and increased solvency margins were not necessary for our company in view of the size of our business portfolio.

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Nevertheless, it was quite obvious that, since the 2012 accounts had been closed and December 31st, 2012 has passed, it was not possible to inject the necessary funds/capital into the company to meet the latest solvency regulations notified by the Commission in the Securities and Exchange Commission (Insurance) Rules, 2002 amended in January of 2012. The same was communicated by the company via our letter number EWL/HO/MD/SECP/2013-1089 dated February 18th, 2013.

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...on submission of the annual accounts by the External Auditors, which pointed-out that the amended solvency margins are not being met by the company, the Board of Directors in their meeting held on May 10th, 2013 approved a rights issue to address the matter. The injection of funds was reflected in our half yearly accounts ended June 30th, 2013. The approved right shares issue of Rs. 93.8355 million, raising the company's capital to Rs. 594.2915 million, was completed successfully and the amount was duly allotted on July 31st, 2013. Since June of 2013, the Company has adequate solvency margins in the Shareholders' Fund and each Statutory Fund, thereby, complying fully with all requirements as well as provisions of Insurance Ordinance, 2000 alongwith Securities and Exchange Commission (Insurance) Rules, 2002 after January of 2012 amendments.

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At present, the company is easily meeting all requirements of the Insurance Ordinance, 2000 and SEC (Insurance) Rules, 2002. The debt ratio (liabilities against assets) of the company is also favorable and shows that the company has sufficient assets to meet its total liabilities. In this connection, we would like to present below the solvency positions of the company as of the half-year ended June 30th, 2013 and quarter ended September 30th, 2013:

Solvency Position of the Funds of the Company as at June 30th, 2013

Description	Shareholders'	Ordinary Life	Universal Life	Accident & Health	Aggregate
	Fund (Rs.)	Fund (Rs.)	Fund (Rs.)	Fund (Rs.)	(Rs.)
Total Admissible Assets	147,849,900	61,969,172	224,276,429	26,570,441	460,665,942
Less: Liabilities as per BS	6,953,588	36,526,579	38,686,787	3,182,804	85,349,758



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Continuation Sheet 6

Net Admissible Assets	140,896,312	25,442,593	185,589,642	23,387,637	375,316,184
Less: Fixed Margin in SHF/PH Liabilities in BSFs	105,000,000	25,390,227	185,238,261	8,899,448	324,527,936
Less: Linked Margin in BSFs*	29,894,649	-	-	-	29,894,649
Net Available Solvency Margin	6,001,663	52,366	351,381	14,488,189	20,893,599
Solvent (Yes/No)	Yes	Yes	Yes	Yes	Yes

* Linked margins in the amount of Rs. 963,925/- in the Ordinary Life Fund, Rs. 1,471,349/- in the Universal Life Fund and Rs. 27,459,375/- in the Accident and Health Fund (Total of Rs. 29,894,649/-) are being maintained in Shareholders' Fund as per application to SECP via letter number EW/HO/MD/SECP/2013-3366 dated May 29th, 2013.

Solvency Position of the Funds of the Company as at September 30th, 2013

<u>Description</u>	<u>Shareholders' Fund (Rs.)</u>	<u>Ordinary Life Fund (Rs.)</u>	<u>Universal Life Fund (Rs.)</u>	<u>Accident & Health Fund (Rs.)</u>	<u>Aggregate (Rs.)</u>
Total Admissible Assets	157,536,076	76,041,741	224,886,725	27,973,360	486,437,902
Less: Liabilities us per BS	7,211,597	49,656,512	37,663,683	3,050,650	97,582,442
Net Admissible Assets	150,324,479	26,385,229	187,223,042	24,922,710	388,855,460
Less: Fixed Margin in SHF/PH Liabilities in BSFs	105,000,000	26,312,401	187,044,209	3,025,200	321,381,810
Less: Linked Margin in BSFs*	31,243,927	-	-	-	31,243,927
Net Available Solvency Margin	14,080,552	72,828	178,833	21,897,510	36,229,723
Solvent (Yes/No)	Yes	Yes	Yes	Yes	Yes

* Linked margins in the amount of Rs. 1,048,790/- in the Ordinary Life Fund, Rs. 1,479,964/- in the Universal Life Fund and Rs. 28,715,173/- in the Accident and Health Fund (Total of Rs. 31,243,927/-) are being maintained in Shareholders' Fund as per application to SECP via letter number EW/HO/MD/SECP/2013-3366 dated May 29th, 2013.

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The Management is quite certain that, as a result of the above submissions, the observation made in the Show Cause Notice does not attract any penal action under section 63(1) or section 156 of the Insurance Ordinance, 2000. The delay caused in compliance of the amended Securities and Exchange Commission (Insurance) Rules, 2002 from December 31st, 2012 to June 30th, 2013 may kindly be condoned...."

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Hearings of the Case & Subsequent Developments

10. The hearing in the matter was scheduled for February 13, 2014 at 11:30 A.M., which was communicated to the Company, its Directors and Chief Executive Officer via hearing notice dated February 4, 2014.
11. The said hearing was attended by Mr. Maheen Yunus, Chief Executive Officer, Mr. Imran Ali Dodani, Chief Operating Officer and Mr. Sohail Nazeer, Company Secretary of the Company on behalf of the respondent.
12. Brief proceedings of the hearing of February 13, 2014 are as follows:
 - a. The case was briefed by the Deputy Director with the instruction of the Director Insurance; the Respondent representative replied and restated their earlier reply that has already been submitted to this office in response of the notice;
 - b. The Respondent representative stated that we never wanted to be non-compliant, in this regard we applied on October 10, 2012 to SECP for relaxation in the amended Rules of Solvency, in this regards number of meeting were held with the officials of the SECP and in the meeting of December 26th, 2012, After detailed and positive discussion where it was admitted that at this stage, it is impossible for us to meet the solvency margins, we were asked to provide a three year business plan which was submitted by us. During all of these meetings, we were given favorable response towards our application whereas, via SECP letter on February 15th, 2013, our application was denied which was surprising for the Company. Then we approached the Commissioner and met him on March 12th, 2013 and discussed the issue once again and got verbal approval for the extension. Ultimately, no positive response were received on the issue and the commitment made with us, the denial on our request dated October 10, 2012 were too late and the financial year were closed, so the Company could not do for this non-compliance and mention in the Notice;
 - c. The Responded also stated that the Company have no choice and took alternative measures and process start for injection of fund and issue right shares and as of June 30th, 2013 the Company were become solvent in all statutory and shareholder funds and also report the same via our response to the notice;

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- d. Director Insurance asked that as per Annual Accounts 2012 the Company is insolvent and if you got the response on your application earlier then what would be the situation?
- e. The Respondent replied that, Yes the picture would be entirely different, and also stated that the Company again wrote an application for granting to present solvency on aggregate basis under the Solvency Rules, 2002, which was accepted and SECP gave us permission on February 10, 2014;
- f. The Respondent also mentioned that the Company never wanted to be non-compliant and always trying to abide the Laws, and also admitted that the non-compliance of the solvency as at December 31, 2012 and also mentioned that if SECP would have replied earlier this situation would have never gone so worst, therefore, it is requested to waive the penalty and take a lenient view;

Consideration of Company's Submissions

13. I have carefully examined and given due consideration to the written and verbal submissions of the Company, and have also referred to the provisions of the Ordinance. I am of the view that there has been an established default under the relevant provision of the Ordinance. The Respondent of the notice have also admitted the default as well and explain the situation faced by the Company in detailed and also assured that the Company will follow the mandatory requirements of law in letter and spirit.

14. 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 over looked and failed to perform their duties with due care and prudence. As the Directors are supposed to be well aware of their legal obligations in connection with the aforesaid statutory requirement of the Section 35 read with Section 11(1) of the Ordinance i.e. the Directors of the Company were required to maintain adequate solvency so as to comply with the minimum solvency requirement as on December 31, 2012 and even thereafter, which was grossly overlooked and mismanaged by the Directors of the Company, and that the Company was required to

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act proactively for maintaining the minimum solvency requirement as stipulated in the law, therefore, it could be legitimately inferred that the default was committed.

Conclusion

15. 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 35 read with Section 11(1)(c) of the Ordinance is established, and to a greater extent, the Company has also accepted its default. Therefore, the penalty as provided under Section 63(1) and Section 156 of the Ordinance can be imposed on the Company.

16. Section 63(1) of the Ordinance states that:

"Power of Commission to issue direction to cease entering into new contracts of insurance.- (1) The Commission may issue a direction to cease entering into new contracts of insurance if it believes on reasonable grounds that an insurer registered under this Ordinance has failed, or is about to fail, to comply with the conditions of registration set out in section 11."

17. And, 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 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."

Order

18. In exercise of the power conferred on me under Section 63 (1) and 156 of the Ordinance, I, instead of imposing the penalty, take a lenient view, and thus, condone and warned the Company due to fact that the Company's management took remedial measures to become solvent and immediately issued right shares and become solvent in the all statutory funds and shareholder fund of the Company as at September 30, 2013, the Company also got permission on February 10, 2014 from SECP to maintain Solvency on aggregate basis under the applicable Solvency Rules, and also has assured adherence of the applicable laws rules in this regards at all times in future and have assured that it will follow the requirements of laws in letter and spirit.

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

Tariq Hussain
Director