



INSURANCE DIVISION
Islamabad

Before Tahir Mahmood, Commissioner (Insurance)

In the matter of

M/s. Adamjee Insurance Company Limited

Show Cause Notice No. & Issue ID/Enf/Adamjee/2018/13548
Date: Dated February 2, 2018

Date of Hearing: May 14, 2018

Attended By: Mr. Rashid Sadiq
M/s. RS Corporate Advisory (Pvt.) Ltd.
(for and behalf of the Respondents)

Date of Order: June 4, 2018

ORDER

Under Section 226 read with Section 229 of the Companies Ordinance, 1984 and
Circular 9 of 2014.

.....

This Order shall dispose of the proceedings initiated against the Chief Executive and Directors of M/s. Adamjee Insurance Company Limited (the "Company") for alleged non-compliance with Section 226 of the repealed Companies Ordinance, 1984¹ (the "Ordinance"). The Chief Executive and Directors of the Company shall be referred to as the "Respondents" hereinafter.

2. During examination of Annual Audited Accounts and Regulatory Returns for the year ended December 31, 2016, it was noted that M/s. Adamjee Insurance Company Limited (the "Company") did not maintain the deposits in accordance with the provisions of Section 226 of the Ordinance.

3. The statutory auditors of the Company, in their board letter, highlighted this matter by stating that;

"deposits amounting to Rs. 806 million are held by the company from several contractors against surety of performance of contracts and have not been kept as per the requirements of the Companies Ordinance, 1984"

4. The Company, vide letter dated December 8, 2017, was advised to submit comments on the subject matter. The Company, vide letter dated December 28, 2017, stated that:

¹ Section 217 of the Companies Act, 2017



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"...since January 30, 2016, we have implemented a practice of obtaining written acknowledgement / consent from the customers that the cash margin will be utilized by the Company for operational purposes for the duration of the policy and would be fully refunded after the expiry of the bond.... As per our practice, we receive deposits against cash margins in a separate bank account but subsequently use those funds in our operational activities.

..... The separate bank account opened for collection of deposits against cash margin had a balance of Rs. 21,609/- as at December 31, 2016 and the rest of the cash margin of Rs. 806,365,440/- was held in mutual funds. The arrangement is such that any clear balance held in this separate bank account at the day end is swept across in to a high interest yielding bank account where any surplus funds are invested in to mutual funds or other investment products. Hence, the balance in this bank account remains negligible. The throughput in this separate bank account from January 30, 2016 to December 31, 2016 amounted to Rs. 165,042,205"

5. The Company was further advised to provide client wise schedule of deposits along with the date of deposit, which the Company provided vide its email dated January 17, 2018.

6. Review of the Company's response revealed that for deposits amounting to Rs. 672,167,953/- obtained prior to January 30, 2016, the Company neither obtained the written acknowledgement/consent from the contractors nor maintained the deposits in a separate bank account in accordance with the provisions of Section 226 of the Ordinance. Hence, it appeared to the Commission that the Company violated the provisions of Section 226 of the Ordinance read with Circular 9, 2014 .

7. Section 226 of the Ordinance:

"Securities and deposits, etc.- No company, and no officer or agent of a company, shall receive or utilise any money received as security or deposit, except in accordance with a contract in writing; and all moneys so received shall be kept or deposited by the company or the officer or agent concerned, as the case may be, in a special account with a scheduled bank:

Provided that this section shall not apply where the money received is in the nature of an advance payment for goods to be delivered or sold to an agent, dealer or sub-agent in accordance with a contract in writing."

8. In view of the violations highlighted in the preceding paras, the Commission initiated penal action by issuance of a Show Cause Notice (SCN) on February 2, 2018 bearing No. Id/Enf/Adamjee/2017/13548 to the Respondents, calling upon them to show cause as to why the fine, as provided under Section 229 of the Ordinance should not be imposed for non-compliance with Section 226 of the Ordinance.

9. In response to the said SCN, Mr. Rashid Sadiq, CEO, M/s. RS Corporate Advisory (Pvt.) Ltd. the ("Authorized Representative"), vide email dated February 14, 2018 sought an extension of two weeks to submit the comments. The request was



acceded to and the Respondents were allowed to submit their response until February 28, 2018.

10. The Authorized Representative vide letter dated February 28, 2018 submitted response to the SCN which is reproduced below:

".....With regard to the specific facts and law dilated in the SCN, our para-wise response to the contents of the SCN is as follows:

- i) *Para 1 of the SCN reproduces the provisions of Section 226 of the Ordinance and, therefore, requires no response. It is, however, submitted that the provisions of Section 226 of the Ordinance do not apply to the circumstances particular to the Company and, therefore, the Company and its directors cannot be penalized.*
- ii) *Para 2 of the SCN asserts that 'deposits' received by the Company were not maintained in accordance with the provisions of Section 226 of the Ordinance. We respectfully submit that 'cash margins' as retained by the Company against issuance of performance guarantees on behalf of contractors in the ordinary course of business cannot in any way be classified as 'deposits' for the purposes of Section 226 of the Ordinance and, therefore, the provisions of Section 226 of the Ordinance do not become applicable to the case at hand.*
- iii) *Para 3 of the SCN reproduces comments of the statutory auditors of the Company in relation to perceived violations of provisions of the Ordinance in relation to deposits. It is submitted that the auditor report incorrectly refers 'cash margins' as 'deposits'. It is reiterated that 'cash margins' are neither 'security' nor 'deposit' as stipulated under Section 226 of the Ordinance and, therefore, the Company may not be penalized for any perceived violations of the aforesaid provision.*
- iv) *Paras 4 to 7 of the SCN relate to the evidence relied upon by the Commission, pertaining to 'cash margin' collected by the Company, for establishing grounds for issuance of the SCN for violation of Section 226 of the Ordinance. For reasons as provided hereunder, we are of the considered view that the provisions of Section 226 of the Ordinance do not become applicable to the circumstances of the Company and that the SCN should be withdrawn without any adverse findings against the Company and its directors.*
- v) *Where, in para 8 of the SCN, the Commission asserts a prima facie failure of the Company to meet the requirements of Section 226 of the Ordinance read with Circular 9 of 2014 (hereinafter the 'Circular'), we rebut such assertion by clarifying as follows:*
 - a) *The Company, in accordance with its Memorandum of Association, issues performance guarantees in the ordinary course of business to secure the performance obligations of contractors as owed to their clients. For the issuance of such performance guarantees a cash margin is obtained from*



the contractor by the Company for the issuance of such guarantees. Such practice is not dissimilar to that employed by commercial banks where banks issue guarantees and disclose any margin received as margin accounts in their books and accounts. Additionally, we may also refer to the cash margins retained by brokerages for the purpose of margin trading and note that there is no prohibition against brokers accepting margins from investors against which an investor participates in trades amounting to more than the amount of the margin deposited on the understanding that the securities, thus, purchased would form the collateral for any further margin trading. We are of the view that the cash margin received are not in the nature of security or deposit and, therefore, such cash margins received by the Company fall in a category not subject to the provisions of Section 226 of the Ordinance.

- b) *Likewise, you will appreciate that the retention by the Company of a cash margin in no way secures the 100% value of the performance guarantee to be issued by the Company on behalf of the contractor in favour of his client for securing his performance obligations. Our understanding is bolstered by an Appellate Bench decision in the matter of Appeal No. 45 of 2012 whereby the Appellate Bench found that the Director (Enforcement) had erred in judgment in the case of Brae Pakistan (Guarantee) Limited*
- c) *The Appellate Bench categorically reversed this finding of the Director (Enforcement) and decided expressly that the receipt of cash margins retained out of loan disbursement did not attract the provisions of Section 226 of the Ordinance by Ruling*
- d) *Accordingly, where the Company is issuing performance guarantees and obtaining cash margins, it is our submission that such margins cannot be classified as security or deposit and that the Circular seeking to encompass 'cash margins' within the remits of the provisions of Section 226 of the Ordinance by requiring all such margins to be deposited in a separately marked account in contrary to the spirit of Section 226 of the Ordinance so far as cash margins are concerned. However, you will appreciate that in light of the decision of the Appellate Bench of the Commission which provides that strictly in accordance with the literal approach to interpretation of Section 226 of the Ordinance 'margins' cannot be classified as 'security' or 'deposit', such an interpretation may not be possible and that in fact the cash margins obtained are a category on their own not subject to the provisions of Section 226 of the Ordinance.*
- e) *Another consideration the Commission should take into account when seeking to impose the provisions of Section 226 of the Ordinance on cash margins received by the Company, is the provisions of the Companies (Invitation and Acceptance of Deposit) Rules, 1987 (hereinafter the 'Rules') issued pursuant to Section 88 of the Ordinance. Specifically, Rule 3 of the Rules prohibits the acceptance by a company of deposits, however, Rule 3(4) of the Rules expressly recognizes certain types of deposits are*



exempt from the application of this prohibition. In particular Rule 3(4)(f) of the Rules

- f) *The Indian commentary on the Indian counterpart of the Rules, by A Ramaiya in the 18th Edition of his book Guide to the Companies Act, notes as under:*

"Amounts received towards security. Rule 2(b)(vi) of the Companies (Acceptance of Deposits) Rules, 1975 specifically excluded any amount received by a company by way of security in the course of and for the purpose of business was not treated as a deposit. As per Rule 2(1)(c)(xiii)(c) of the Companies (Acceptance of Deposits) Rules, 2014 any amount received by a company by way of security in the course of and for the purpose of business, shall not be treated as a deposit" (emphasis provided)

- g) *It is our submission that the Rules are instructive in the treatment of amounts received for the purposes of a specific business of a company. We therefore, reiterate that where the Company is in the business of issuing performance guarantees on behalf of contractors seeking to secure their performance obligations and the law provides an exemption from treatment of amounts advanced by clients in support of services to be provided by a company, the cash margin so provided may not be classified as a deposit or security which is subject to the provisions of Section 226 of the Ordinance where through express provisions of the same law the cash margin may not be classified as a deposit having been provided in connection with the execution of the contract for issuance of a performance guarantee.*

- h) *The Company does, however, take all reasonable steps to demarcate the cash margins retained by it and the utility of the cash margins is strictly in accordance with standard operating procedures implemented by the Company supplemented by written consent by contractors.*

- (vi) *Para 8 of the SCN reproduces the text of Section 229 of the Ordinance which needs no reply. It is, however, contended that none of the directors has either permitted or contravened Section 226 of the Ordinance and, therefore; Section 229 of the Ordinance is not attracted."*

11. Thereafter, the Commission vide letter dated May 9, 2018 scheduled the hearing on May 15, 2018 at 11th Floor, NIC Building, Jinnah Avenue, Blue Area, Islamabad. However, the hearing was rescheduled on the request of the Authorized Representative and was held one day earlier i.e. on May 14, 2018. The said hearing was attended by the Authorized Representative for and behalf of the Respondents.

12. During the hearing, the Authorized Representative reiterated his written comments and stated that the Appellate Bench of the Commission in Appeal No. 45 of 2012 decided that receipt of cash margins retained out of loan disbursement did not



attract the provisions of Section 226 of the Ordinance. He maintained that in light of the decision of the Appellate Bench cash margins cannot be classified as security or deposit.

13. In terms of Section 226 of the Ordinance, the Company was required to obtain consent/ acknowledgment from the contractors to utilize any money received as security or deposit, and also place the deposits in a special account with a scheduled bank. Out of the total deposits, Rs. 672,167,953/- pertained to the years prior to the year 2016 it was observed that the Company neither obtained any consent/ acknowledgment from the contractors nor the deposits were placed in a separate bank account in accordance with the provisions of Section 226 of the Ordinance.

14. It is pertinent to mention here that subsequent to the Appellate Bench order as referred to by the Authorized Representative, the Commission issued a Circular No. 9 of 2014 dated April 22, 2014. This circular was issued in respect of compliance with Section 226 of the Companies Ordinance, 1984 regarding maintenance of Securities and deposits. In the aforesaid circular, it was stated that:

.....It has been noted that some insurance companies and insurance brokers do not adhere to the provisions of Section 226 of the Ordinance , in respect of the security deposits, cash margins against guarantee business and/or any other such deposits that they receive. The insurance companies and brokers receive and maintain these security deposits, cash margins against guarantee business and/or any other such deposits in their normal operational accounts, thus, the true essence of the provisions of Section 226 of the Ordinance is not complied with.

3. Henceforth, all insurance companies and insurance brokers are required to observe strict compliance with the said Section, and that no such deposit shall be received or utilized except in accordance with a contract in writing. However, if any money is received as a result of any contract in writing, then all such deposits shall be kept in a special account with a scheduled bank and no portion thereof should be utilized, except as stated in the underlying contract.

15. Therefore, in light of the excerpt reproduced above, the whole premise taken by Authorized Representative that cash margins cannot be classified as deposits is invalid. Thus, it can be inferred, the Company deliberately contravened the provisions of the Section 226 of the Ordinance.

16. However, the Company has assured that since January 30, 2016, it is implementing a practice of obtaining written acknowledgement / consent from the customers that the cash margins would be utilized by the Company for operational purposes for the duration of the policy and would be fully refunded after the expiry of the bond. Furthermore, the Company has apprised that it receives deposits against cash margins in a separate bank account and subsequently uses those funds in its operational activities.

17. I have carefully examined and given due consideration to the written and verbal submissions of the Respondents, and have also referred to the provisions of the



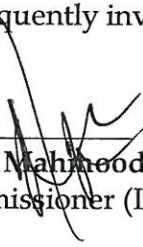
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Ordinance and other legal references, I am of the view that the element of default of Section 226 of the Ordinance, is there, for which the fine/penalty as provided under 229 of the Ordinance can be imposed onto the Company and/or its Directors.

18. In view of the foregoing, I, in exercise of the powers conferred on me under Section 229 of the Ordinance, take a lenient view and instead of imposing a fine, hereby, warn the Respondents to be careful in future whilst complying with the requirements of the Ordinance rules, regulations and directives of the Commission.

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.


Tahir Mahmood
Commissioner (Insurance)

