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SECP
INSURANCE DIVISION
Islamabad

Before Hasnat Ahmad, Director (Insurance)

In the matter of

M/s. Adamjee Life Assurance Company Limited

Show Cause Notice No. ID/Enf/AdamjeeLife/2019/343
& Issue Date: Dated April 4, 2019

Date of Hearing: May 21, 2019

Attended By: Mr. Jalaluddin Meghani
CFO and Company Secretary/Authorized Representative
M/s. Adamjee Life Assurance Company Ltd.

Date of Order: July 9, 2019

ORDER

Under Rule 16 of the Insurance Rules, 2017 read with Section 35(7) and Section 156 of the Insurance Ordinance, 2000

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This Order shall dispose of the proceedings initiated against M/s. Adamjee Life Assurance Company Limited (the "Company"), its Chief Executive and Directors for alleged contravention of Rule 16 of the Insurance Rules, 2017 (the "Rules") read with Section 35(7) of the Insurance Ordinance, 2000 (the "Ordinance"). The Company and its Directors shall be collectively referred to as the "Respondents" hereinafter.

2. The Company is registered under the Ordinance to carry on life insurance business in Pakistan.

3. While examining the annual audited financial statements of the Company for the year ended December 31, 2017, it was observed that the Company did not comply with the minimum investment requirement in Government Securities as required under Rule 16 of the Rules read with Section 35(7) of the Ordinance. The investments held by the Company in Government Securities as on December 31, 2017 were as follows:

	Rs. in '000'
	Shareholders' Fund as on December 31, 2017
Total Assets	677,806
Government Securities	154,754
Percentage of Govt. Securities in Total Assets	22.8%

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4. As mentioned at Para 3 above, the Company did not comply with Rule 16 of the Rules read with Section 35(7) of the Ordinance in its Shareholders' Fund by investing only 22.8% of assets in the Government Securities. The Company in response to the Commission's letter dated September 28, 2018, submitted its comments vide its letter dated October 31, 2018 as under:-

"For the purpose of the Calculation of above ratio, we have taken total assets net of current liabilities, as investing in Government Securities against current liabilities is not practical.

	Rs. in '000'
	<i>Shareholders' Fund</i>
<i>Total Assets net of Current Liabilities as per Balance Sheet</i>	543.679
<i>Investment in Govt. Securities including accrued interest</i>	157.856
<i>Govt. securities as a proportion of total assets</i>	29.0%

The proportion of investment in Government Securities in Shareholders' Fund is slightly less than the required limit of 30%. We would like to request to take a lenient stance on the meager non-compliance."

5. Previously, the Commission vide letter dated April 30, 2018, warned the Company due to the similar non-compliance. The non-compliance was also noted in the Statement of Assets and Liabilities (unaudited) as on December 31, 2018 submitted by the Company under Section 46(2) of the Ordinance, as the Company invested 19.6% of assets of the Shareholders' Fund in the Government Securities as mentioned below:-

	Rs. in '000'
	<i>Shareholders' Fund as on Dec 31,2018 (unaudited)</i>
<i>Total Assets</i>	756,931
<i>Government Securities</i>	148.116
<i>Percentage of Govt. Securities in Total Assets</i>	19.6%

6. In view of the above, it appeared that the Company failed to meet the mandatory requirements prescribed under Rule 16 of the Rules read with Section 35(7) of the Ordinance.

7. Rule 16 of the Rules requires that:

"Assets to be invested in securities: "(1) Thirty per cent of the assets, excluding inter-fund receivables 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, shall be invested in Government securities, under sub-section (7) of section 35 of the Ordinance.

(2) A further ten percent of the assets, excluding inter-fund receivables 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, shall be invested in a combination of Government securities and other approved securities, sub-section (7) of section 35 of the Ordinance."

8. Section 35(7) of the Ordinance states that:

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"(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."

9. Accordingly, a Show Cause Notice (SCN) No.ID/Enf/AdamjeeLife/2019/343 dated April 4, 2019 was issued to the Respondents, calling upon them to show cause as to why the fine as provided under Section 156 of the Ordinance should not be imposed on them for the aforementioned alleged contraventions of the law.

10. Thereafter, the Respondents submitted their reply vide letter dated April 12, 2019, which is reproduced hereunder:

"Refer to your letter No. ID/Enf/AdamjeeLife/2019/343 dated April 4, 2019, on the subject matter, our contentions are summarized as below:

While we acquiesce to the fact that as per the balance sheet of Shareholder's Fund as at December 31, 2018, the balance of Government Securities was Rs. 148.116 million which represents only 19.6% of total assets, we would like to draw your kind attention on the matter already highlighted in our letter dated October 31, 2018, that taking total assets is not practical for the purpose of calculation of this ratio. As manifested in the balance sheet of Shareholders' Fund, out of total assets of Rs. 756.931 million, an amount of Rs. 181.278 million represents the balance of withholding tax (WHT) deducted on securities held by statutory funds which were later transferred to Shareholder's Fund by creating inter-fund balances as the Statutory Funds are not separate legal entities and any tax withheld can only be claimed by Shareholders' Fund against its profits. Resultantly, the volume of assets in Shareholders' Fund has increased many folds over the period of time.

The increasing amount of withholding tax is a serious problem for ALAC as the Company achieved breakeven in two of its Statutory Funds a couple of years ago and so far no surplus has been transferred from Statutory Funds to Shareholders' Fund and hence, ALAC does not have enough profits to adjust the taxes already withheld.

We have also written a letter to SECP on February 15, 2019 regarding the treatment of withholding taxes in solvency statement of Shareholders' Fund.

We therefore, for the purpose of Rule 16 of the Insurance Rules, 2017, have taken total assets net of withholding taxes deducted. On the aforementioned basis, the following results will be achieved:

	Shareholders' Fund
	Rupees (000)
Total assets of Shareholders' Fund (SHF)	756,931
Less: Inter-fund receivable as per Rule 16 of Insurance Rules, 2017	-40,847
Less: Withholding tax	-180,847
Net assets for the purpose of calculation	535,237
Government Securities in Shareholders' Fund (SHF)	148,116
Percentage of Government Securities in total net assets	27.67%



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The above deficiency was rectified during April 2019 by investing further amount of Rs. 30 million in Government Securities, based on which the revised calculations would appear as follows:

	Shareholders' Fund Rupees (000)
Total assets of Shareholders' Fund (SHF)	756,931
Less: Inter-fund receivable as per Rule 16 of Insurance Rules, 2017	-40,847
Less: Withholding tax	-180,847
Net assets for the purpose of calculation	535,237
Government Securities in Shareholders' Fund	178,116
Percentage of Government Securities in total net assets	33.28%

We also want to draw your kind attention to the fact that the initial amount of investment of Rs. 148.116 million was made at a cost of Rs. 156 million in 2017 at a yield of 6.37% and majority of these securities are deposited with State Bank of Pakistan as required under section 29 of Insurance Ordinance, 2000. As you may be cognizant of the fact that interest rates have increased almost two folds during last one and a half year and as a result these securities suffered from heavy unrealized losses. As these securities are marked as pledged in the name of State Bank of Pakistan, no active trading is possible to avoid these losses. We have classified these assets under 'Available for sale' category. Had these securities been recorded at amortized cost, the percentage of Investment In Government Securities would have appeared as below:

	Shareholders' Fund without additional investment of Rs. 30 million Rupees(000)	Shareholders' Fund with Additional investment of Rs. 30 million Rupees (000)
Total assets of Shareholders' Fund (SHF)	765,008	765,008
Less: Inter-fund receivable as per Rule 16 of Insurance Rules, 2017	-40,847	-40,847
Less: Withholding	-180,847	-180,847
Net assets for the purpose of calculation	543,314	543,314
Government Securities in Shareholders' Fund (valued at amortized cost)	156,193	186,193
Percentage of Government Securities in total net assets	28.75%	34.27%

As the deficiency has been rectified subsequent to the year end, we would like to request you again to take a lenient view and condone this noncompliance."

11. Subsequently, the hearing was scheduled on May 21, 2019 at the Head Office of the Commission. The said hearing was held as scheduled and was attended by the Authorized Representative namely Mr. Jalaluddin Meghani for and on behalf of the Respondents.



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12. During the hearing, the Authorized Representative reiterated comments submitted by the Company vide letter dated April 12, 2019 and maintained that the total assets are not defined in the Rules, therefore the Company interpreted it as Net Assets. He further stated that taking total assets is not practical for the purpose of calculation of the investment in Government Securities. Resultantly, the volume of assets in Shareholders' Fund has increased many folds over the period of time. He requested the Commission that more time should be provided to the Company so that in future the Company's tax liability can be adjusted from the withholding tax.

13. In terms of Section 35(7) of the Ordinance, 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 have been prescribed under Rule 16 of the Rules. As per Rules 16(1) of the Rules Thirty per cent of the assets, excluding inter-fund receivables 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, shall be invested in Government Securities. Moreover, Rule 16(2) of the Rules requires that a further ten percent of the assets, excluding inter-fund receivables 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, shall be invested in a combination of Government Securities and other approved securities.

14. However, perusal of the annual audited financial statements of the Company for the year ended December 31, 2017, revealed that the Company did not adhere to the minimum prescribed percentage of 30% and further 10% of assets to be invested in a combination of Government Securities and other approved securities in its "Shareholders' Fund" and "Statutory Funds" as required under Rule 16 of the Rules read with Section 35(7) of the Ordinance.

15. The Company invested 22.8% of assets in the Government Securities in its Shareholders' Fund. It is pertinent to mention here that the Commission had issued a warning letter to the Company on April 30, 2018 for a similar non-compliance. It is also observed in the Company's Statement of Assets and Liabilities (unaudited) as on December 31, 2018 that it invested 19.6% of assets of the Shareholders' Fund in the Government Securities, which was again in contravention of Rule 16 of the Rules read with Section 35(7) of the Ordinance.

16. The Respondents in their written and oral submission have argued that taking total assets is not practical for calculating investment in the Government Securities and other approved securities. The Respondents are of the view that Statutory Funds are not separate legal entities and any tax withheld can only be claimed by the Shareholders' Fund against its profits, resultantly, the volume of assets in Shareholders' Fund has increased many folds over a period. The Respondents maintained that the increasing amount of withholding tax is a serious problem for the Company and hence, the Company does not have enough profits to adjust the taxes



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already withheld. For the purpose of Rule 16 of the Rules, the Respondents have taken total assets net of withholding taxes deducted. The Respondents have intimated that the deficiency has been rectified subsequent to the year-end, and have requested the Commission to take a lenient view and condone this non-compliance.

17. It is observed from the calculation provided by the Company that it has deducted inter-fund receivable and withholding tax from the total assets of the Shareholders' Fund. Although, deducting inter-fund receivable appears to be the correct treatment in accordance with Rule 16 of the Rules. However, Company cannot deduct withholding tax from the total asset for calculating percentage of investment in Government Securities.

18. It has been apprised in response to the Show Cause Notice that 'deficiency has been rectified subsequent to the year-end'. The Company has apparently made an additional investment of Rs. 30 million in its Shareholders' Fund. Revised calculation of the investment in Government Securities is as follows:-

	Calculation of the Company Rupees (000)	Calculation of the Commission Rupees (000)
Total Assets of Shareholders' Fund	756,931	756,931
Less inter-fund receivable	-40,847	-40,847
Less withholding tax	-180,847	-
Net asset for purpose of calculation	535,237	716,084
Government Securities in Shareholders' Fund	178,116	178,116
Percentage of Government Securities in total net assets	33.28%	24.87%

19. As mentioned above, investment held by the Company in Government Securities in its Shareholders' Fund until April 2019 is 24.87% and not 33.28% as calculated by the Company. The above calculation shows that investment in Government Securities has little improved, however it still does not comply with the requirement of Rule 16 of the Rules.

20. In view of the above explanation, it appears that the Company has failed to meet the mandatory requirements prescribed under Rule 16 of the Rules read with Section 35(7) of the Ordinance.

21. 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 Ordinance, the Rules made thereunder and/or other legal references. I am of the view that the default of Rule 16 of the Rules read with Section 35(7) of the Ordinance is clearly established, for which the Respondents may be penalized in terms of Section 156 of the Ordinance.

22. Section 156 of the Ordinance provides 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

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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."

23. In exercise of the power conferred on me under Section 156 of the Ordinance, I, instead of imposing the fine as provided under the said provision, take a lenient view, and issue a warning that in case of similar non-compliance in future a strict action will be taken against the Respondents. The Company is further directed to submit compliance report with the minimum prescribed percentage of assets to be invested in a combination of Government Securities and other approved securities in its "Shareholders' Fund" and "Statutory Funds" as required under Rule 16 of the Rules read with Section 35(7) of the Ordinance within one month of the date of this Order.

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

Hasnat Ahmad

Director/HoD (Enforcement)

