



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Adjudication Department- I

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/2019/3421
August 4, 2023

Date of Hearing:

October 24, 2023
November 23, 2023

Present at the Hearing:

Mr. Rizwan Akhtar (Chief Executive Officer)
Mr. Nisar Ahmed Almani (Chief Financial Officer)
Mr. Kashif Naeem (Compliance Officer)
Mr. Tariq Hussain (Counsel for the Respondent)
(Authorized Representatives)

ORDER

Show Cause Notice under Rules 3A, 4(1), 4(2), 6 of the Credit and Suretyship (Conduct of Business) Rules, 2018 and Section 45(4), 45(6) & 46(1) of the Insurance Ordinance, 2000 read with Section 156 thereof

This Order shall dispose of the proceedings initiated against **Shaheen Insurance Company Limited (the Company and/or the Respondent)** under rules 3A, 4(1), 4(2), 6 of the Credit and Suretyship (Conduct of Business) Rules, 2018 and Section 45(4), 45(6) & 46(1) of the Insurance Ordinance, 2000 (**the Ordinance**) read with Section 156 thereof vide Show-Cause Notice No. ID/Enf/Shahen/2019/3421 dated August 4, 2023 (**the SCN**).

2. The Company is registered under the Ordinance to undertake the non-life insurance business in Pakistan. An onsite inspection of the Company was conducted in order to assess its compliance with the applicable AML/CFT framework and Insurance Laws, in pursuance of the Commission's Inspection Order dated January 11, 2023 passed under Section 59A of the Insurance Ordinance, 2000 and Section 6A(2)(f) of the Anti Money Laundering Act, 2010.

3. Rule 3A of the Credit and Suretyship (Conduct of Business) Rules, 2018 (**CSR, 2018**) notified through S.R.O. 1010(I)/2022 dated July 5, 2022 requires that Insurer undertaking credit and suretyship business shall establish and put in place risk assessment mechanism to evaluate the technical and financial strength of the prospective guarantee/bond holders. However, as per the Inspection Report, the Company failed to provide any evidence to the inspection team for ensuring such mechanism to evaluate the technical and financial strength of the prospective guarantee/bond holders during the Inspection.



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4. The Company has responded to the aforesaid observation that although the Company is not treating Afghan Transit Trade under credit & suretyship class, rather it is treated under marine class, yet the below mentioned procedures for risk assessment are being followed:
- The carrier / transporter must have been registered as authorised carriers & transporters on the approved panel of the Customs Department. We place our reliance on Goods Declaration Detail Information (**GDDI**) issued by the custom house at the start of transit.
 - The carrier / transporter detail must be mentioned on GDDI provided by the Customs Department. Copy of GDDI was provided to the Inspection Team.

However, the Company failed to provide any evidence to the inspection team to substantiate any mechanism to evaluate the technical and financial strength of the prospective guarantee/bond holders. Therefore, the Company, *prima facie*, did not ensure compliance with Rule 3A of the CSR, 2018.

5. It has also been noted that the Company issues insurance guarantees to the Directorate of Transit Trade, Custom House on duties and taxes in respect of the goods, which are payable by the importers in case of failure to take the goods out of the territorial jurisdiction of Pakistan. The Company issues such guarantees with policy schedule/document showing the net premium rate of 0.25%. While reviewing the policy cover note, it has been observed that the Company has actually charged premium on significantly lower rate compared to 0.25%, the rate mentioned on such guarantees. The reason for mentioning higher rate of premium on the guarantees while actually charging the lower rate has not been duly explained to the inspection team.

6. The aforesaid practice of actually charging premium in contravention of what has been agreed at the time of issuance of guarantees, as mentioned on such guarantees, constitutes falsification of the records of the Company. Therefore, the Company, *prima facie*, did not ensure compliance with Section 45(6) read with Section 45(4) of the Ordinance.

7. Rule 6 of the CSR, 2018 read with Section 46(1) of the Ordinance requires the Company to submit the duly audited regulatory returns, which included the Statement of Credit & Suretyship Class of Business and Statement of Claims Paid/Outstanding/Rejected under Credit & Suretyship Class of Business "for the year/period" and "As at" basis. However, it was noted that the said Statements were not submitted to the Commission "As at" and "for the year" in respect of 2021 and 2022 pertaining to the policies issued to the custom guarantees/bonds.

8. As per Note 2.5 of the Regulatory Returns of the Company, the information relating to bonds issued against Afghan transit trade policies have not been included in the Returns as the Company does not hold any cash margin in respect of such policies due to very short risk coverage. However, review of the documents related to Afghan transit trade obtained on sample basis revealed that mostly Afghan transit trade policies were issued under Bond Policy cover.

9. In view of the above, the Company, *prima facie*, did not ensure compliance with Rule 6 of the CSR, 2018 read with Section 46(1) of the Ordinance by failing to file the regulatory returns ("As at" and "for the year/period" basis) in respect of the years 2021 and 2022 pertaining to policies issued to the Custom Department.

10. Rule 4(2) of the CSR, 2018 requires that an insurer shall procure collateral in case of guarantees/bonds of an amount equivalent to at least 80% of the sum insured /amount of bond/guarantee less reinsurance. The requirements for collateral was amended as 10% of the sum insured / amount of bond/guarantee through S.R.O. 1010(I)/2022 dated July 5, 2022. Inspection team noted that the Company issued total 11,765 guarantees amounting to Rs. 84,367.942 million during the year 2022 without obtaining any collateral.

11. The stance of the Company on the foregoing observation is that it covers marine inland transit related to Afghan Transit Marine Cargo/ containers; however, it is evident from review of such policies that the Company actually issued such guarantees to the Custom Department in respect of applicable duties and taxes



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but the Company has not procured any collateral from its clients. Therefore, the Company *prima facie*, did not ensure compliance with Rule 4(2) of the CSR, 2018 and S.R.O. 1010/22 dated July 5, 2022.

12. Rule 4(1) of CSR, 2018 requires that an insurer's net retained exposure under any type of guarantee / bond issued to a party or a group shall not exceed 2.5 percent of the insurer's shareholders' equity as per the latest available audited accounts of the insurer on the date of issuance of a guarantee/bond. However, it has been noted that the Company issued guarantees of Rs. 257.174 million to a party (a private limited company), which constitutes 37.42% of equity of the Company as on December 31, 2021.

| Insured | Bond Issue Date | Amount of Bond/ Guarantee (Rs.) | Collateral (Rs.) | Reinsurance (Rs.) | Net Retained Exposure(Rs.) |
|-------------------------|-----------------|---------------------------------|------------------|-------------------|----------------------------|
| Private Limited Company | 21/09/2022 | 193,000,000 | - | 45,000,000 | 148,000,000 |
| | 21/09/2022 | 154,174,234 | - | 45,000,000 | 109,174,235 |
| Total | | | | | 257,174,235 |

13. In response to the aforesaid observation, the Company stated that the guarantee was ceded by a lead insurer just before its expiry; however, its net exposure was inadvertently overlooked. However, the guarantee matured within two months on November 01, 2022. This error may kindly be condoned. Thus, the Company has agreed with the findings of the inspection team in the matter. Therefore, the Company, *prima facie*, did not ensure compliance with rule 4(1) of CSR, 2018.

14. In view of the above, the Company, *prima facie*, has failed to comply with the requirements of Rules 3A, 4(1), 4(2), 6 of the CSR, 2018 and Section 45(4), 45(6) & 46(1) of the Ordinance, as narrated above.

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

Rule 3A of the CSR, 2018:

An Insurer undertaking credit and suretyship business shall establish and put in place risk assessment mechanism to evaluate the technical and financial strength of the prospective guarantee/bond holders.

Rule 4(1) of the CSR, 2018:

An insurer's net retained exposure under any type of guarantee / bond issued by the insurer to a party or a group shall not exceed 2.5 percent of the insurer's shareholders' equity as per the latest available audited accounts of the insurer on the date of issuance of a guarantee/bond.

Rule 4(2) of the CSR, 2018:

(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 10% of sum insured / amount of bond/ guarantee.

Rule 6 of the CSR, 2018:

Additional Returns:- (1) *Every insurer offering a guarantee/ bond in a particular financial year, shall be required to submit the statements, for each such financial year, along with the regulatory returns to be filed in pursuance of section 46 of the Ordinance, in the appropriate form set out in the Form GCS in the Annexure hereto in addition to the returns to be lodged under section 46 of the Ordinance and / or any other section of the Ordinance or rule made thereunder.*

Section 45(4) of the Ordinance:

(4) *For the purposes of this Ordinance, the expression "books" includes -*

(a) *a register;*

(b) *accounts or accounting records, however compiled, recorded or stored;*

- (c) a document; and
(d) any other record of information

Section 45(6) of the Ordinance:

(6) An insurer shall take all reasonable precautions, including such precautions, if any, as may be prescribed, for guarding against damage to, destruction of or falsification of or in, and for discovery of falsification of or in, any book or part of a book required to be kept or prepared by an insurer.

Section 46(1) of Ordinance;

46. Accounting and reporting: - (1) Every insurer shall at the expiration of each year prepare and deliver to the Commission with reference to that year annual statutory accounts comprising the following statements duly audited by an approved auditor:

.....

- (b) in the case of a non-life insurer,
- (i) a statement of assets and liabilities;
 - (ii) a statement of profits and losses;
 - (iii) a statement of cash flows;
 - (iv) a statement of premiums;
 - (v) a statement of claims;
 - (vi) a statement of expenses;
 - (vii) a statement of investment income;
 - (viii) a statement of claims analysis;
 - (ix) a statement of exposures; and

(x) such other statements as may be prescribed by the Federal Government;
each in such form as may be prescribed by the Commission and prepared in accordance with such regulations as are issued by the Commission from time to time in this behalf.

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.

16. In response to the SCN, the Company vide letter dated September 1, 2023 submitted its reply, the relevant extracts of which are reproduced as under:

(Quoted):

At the outset, we would like to draw the kind attention of SECP to the substance of Custom guarantees/ bonds transaction, which is our considered opinion is an offshoot of insurance cover for marine inland transit. The transaction provides insurance cover for the duties and taxes on cargoes destined for Afghanistan from any port in Pakistan, in case of failure to take the goods out of the territorial jurisdiction of Pakistan. Insurance companies, are however, bound to provide the insurance cover in the form of insurance guarantee to the Customs House. Moreover, after detailed deliberation, the subject risk is also being covered by the reinsurers under marine segment (relevant portion of reinsurance treaty is attached herewith as annexure A). Company has therefore started to classify these policies under marine class and believe that Credit and Suretyship (Conduct of Business) Rules 2018 and relevant guidelines are not applicable to the instant case.

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

a) Rule 3A of Credit and Suretyship (Conduct of Business Rules 2018) - Evaluation of technical and financial strength of the guarantee / bondholder

It is respectfully submitted that the Company is not treating Afghan Transit Trade under Credit and Suretyship class, rather under marine class due to aforementioned reasons. In addition to our earlier submissions to the inspection team It is further submitted that due to peculiar nature of business i.e. Afghan Transit Trade, importers (on whose behalf guarantee is issued) are based in Afghanistan and, therefore, it is not practical to evaluate the technical and financial strength of the policyholder / bondholder. The Company has however placed reliance on the mechanism of Customs Department to minimize the exposure.

b) Premium Rate of Afghan Transit Business

Being one of the major players of insurance market relating to Afghan Transit Trade, we would like to take this opportunity to draw kind attention of SECP to the anomaly prevailing in the market relating to the subject business. It is submitted that Company never received any notification / guidelines from any competent authority/ department, addressed to insurance companies, for fixing Net Premium Rate. However, Customs Department do not accept Afghan Transit insurance policies / guarantees where net rate of 0.25% and corresponding equivalent amount is not mentioned. On the other hand, clients pay prevailing agreed rate of 0.06% instead of 0.25%. Company, therefore, records premium according to the amount received (prevailing market rate). The only document identified is the office order dated October 18, 2019 (Annexure BJ by the Customs Department addressed to clearing agents, which was vehemently denied / repulsed by them (Letter dated October 30, 2019 and newspaper clippings dated October 31, 2019 attached - Annexure C).

We would also like to respectfully submit here that due to cutthroat competitive insurance market, small sized companies like Shaheen Insurance are left with two options of either declining the business or accepting the same on dictated conditions, which is also a market practice. Nevertheless, the matter was taken up multiple times with the Customs House, verbally with no solution/ guidelines.

As you are aware that Pakistan's insurance market is an open market with open competition, and it would be pertinent to mention here that fixation of rate for any insurance business is not the domain of any government department, besides being not in line with section 3(2) titled "Abuse of dominant position" of Competition Act 2010, which reads as follows;

"An abuse of dominant position shall be deemed to have been brought about, maintained or continued if it consists of practices, which prevent, restrict, reduce, or distort competition in the relevant market."

In view of the forgoing submissions, Company continue to underwrite this business in line with prevailing market rate, and the collections it receives.

c) Regulatory Returns - Afghan Transit Business

In continuation to our submissions in opening para vis a vis "at the outset, we would further like to draw your attention to note no. 2.5 of Regulatory Returns for the period ended December 31, 2021 and 2022 respectively disclosing rationale for not procuring collateral with regard to Afghan Transit Trade. In this respect, it is further submitted that these policies provide coverage against loss of duties / taxes during inland transit from a port in Pakistan to Pak Afghan border. As the duration of transit is very short and lasts only up to 5 to 10 days coupled with risk coverage of inland transit only, customers are unwilling to furnish collaterals, leaving the company with two options of either declining the business or underwriting the same. It may not be out of place to mention here that the company has



been underwriting this business since 2015 with only one reported loss of Rs 15 Million which was paid in a timely manner.

d) Rule 4(2) of CSR, 2018 - Collateral equivalent to 10% of sum insured on Afghan Transit Business
We would like to draw the kind attention of SECP to the substance of Custom guarantees/ bonds transaction, which is our considered opinion is an offshoot of insurance cover for marine inland transit as discussed above in detail. As per the practice of custom house, all insurance covers (fire and marine) submitted to customs department need to be supported by a bond/ guarantee. Moreover, our reinsurers also treat this business (Afghan Transit) under marine inland transit class (pls. see annexure A).

Besides our above submissions, we would further like to draw your attention to note no. 2.5 of Regulatory Returns for the period ended December 31, 2021 and 2022 respectively disclosing rationale for not procuring collateral with regard to Afghan Transit Trade in addition not treating this business under Credit and Suretyship Class.

e) Rule 4(1) of CSR, 2018 - Net retained exposure not to exceed 2.5% of shareholders' equity
It is respectfully submitted that the guarantee was ceded by a leader just before its expiry, however, net exposure was inadvertently overlooked. The guarantee, however matured within two months on November 01, 2022. The error may kindly be condoned.

As the SECP observations and Company's response thereof related to one of its important business segment, which has contributed to its wellbeing over the years and kept it afloat, we request the guidance of apex regulator pertaining to typical anomalies specially relating to Afghan Transit Business, which by nature is different from other businesses and may not exist in other parts of the world.

(Unquote)

17. In order to provide the Respondent an opportunity of personal representation, hearing in the matter was fixed for October 24, 2023. The said hearing was attended by Mr. Rizwan Akhtar (CEO), Mr. Nisar Ahmed Almani (CFO) and Mr. Kashif Naem (Compliance Officer) as the Authorized Representatives of the Respondent (**the Authorised Representative**). 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.

18. Subsequent to the hearing, the Company vide its revised reply dated November 10, 2023 made further submissions in the matter as under:

(Quoted):

Pursuant to abovementioned Show Cause Notice (SCN), we submit our response as under;

Whereas section 3A (Risk Assessment of Guarantee/Bond Holder) the Credit and Suretyship (Conduct of business) Rule 2018. States that;

" (1) An Insurer undertaking credit and suretyship business shall establish and put in place risk assessment mechanism to evaluate the technical and financial strength of the prospective guarantee/bond holders.

(2) The risk assessment mechanism to be devised by the insurer to undertake assessment of the prospective guarantee/bond holder, shall at a minimum cover the following

(a) measures to gauge the ability to meet current and future obligations;

(b) experience and expertise in respect of the contract requirements for which guarantee/ bond is being solicited; and

(c) financial strength to carry on the project work."



And Whereas Section 4 (Net Retained Exposure Limit and Collateral Requirement) of the Credit and Suretyship (Conduct of business) Rule 2018 stated that;

" (1) An insurer's net retained exposure under any type of guarantee / bond issued by the insurer to a party or a group shall not exceed 2.5 percent of the insurer's shareholders' equity as per the latest available audited accounts of the insurer on the date of issuance of a guarantee/bond"

(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 percent of the sum insured / amount of bond/guarantee less reinsurance in respect of a particular guarantee / bond.

6. Additional Returns

(1) Every insurer offering a guarantee I bond in a particular financial year, shall be required to submit the statements, for each such financial year, along with the regulatory returns to be filed in pursuance of section 46 of the Ordinance, in the appropriate form set out in the Form GCS in the Annexure hereto in addition to the returns to be lodged under section 46 of the Ordinance and I or any other section of the Ordinance or rule made thereunder.

(2) Any document to be submitted by an insurer under this rule shall be submitted in the manner as is applicable on the regulatory returns required to be submitted under section 46 and section 51 of the Ordinance. (5)

Definition of credit and suretyship

"Surety refers to the guarantee that a person or party or company will pay off the loans of another party. They take responsibility in case the other fails to abide by the conditions of a bond. Surety bonds are contracts that tie the principal, the obligee (a government entity or a private organization) and the surety."

Whereas in para 3 & 4 of the SCN, Commission explains what is credit and suretyship business and what are the requirements of an insurer to fulfill its obligation but regulator's understanding related to our business is not correct as we are not doing credit and suretyship business neither provide any guarantee or surety related to goods or loss of performance related to supply or services but only issuing guarantee to the custom authorities that if an insured fail to pay duty and taxes the insurance company will pay it to the custom authorities.

The transaction provides insurance cover for the loss of duties and taxes on cargoes from any port in Pakistan, Insurance companies, are however, bound to provide the insurance cover in the form of insurance guarantee to the Customs House. Moreover, after detailed deliberation, the subject risk is 'also being covered by the reinsurers under marine segments (relevant portion of reinsurance treaty is attached herewith as annexure A). Company has therefore started to classify these policies under marine class and believe that Credit and Suretyship (Conduct of Business) Rules 2018 and relevant guidelines are not applicable to the instant case due to the nature of transaction and its substance. It is therefore not required to conduct detailed technical and financial evaluation; however, we ensure that carriers must be in the approved panel of custom authorities and also verify information from Custom GDs etc. to assess the insured position applying for insurance coverage / guarantee to the extent of duties etc.

The Commission itself accepted that the company has relied upon the process carried out by the custom department assessment. The Custom department is a very important department having appropriate technical expertise to assess requirements.

Please note that it was a multiparty transaction one is the Insurer, second is Custom department, third is clearing agent and fourth one is the Insured. Basically, this policy to cover duty and taxes due to lost arises in transit due to theft of goods or vehicle (Duty and taxes coverage) in the form of policy followed by a bond (required by custom to maintain transparency in the policy documents) which conform that the insurer has ensured payment of loss of duty to the custom department and issue policy to clearing agent on payment of premium by clearing agent to the insurer. In this case no possibility of financial



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and technical check of insured due to its outreach / accessibility and wholly reliance on customs and clearing agent.

a) **Premium Rate of Afghan Transit Business**

Being one of the major players of insurance market relating to Afghan Transit Trade, we would like to take this opportunity to draw kind attention of SECP to the anomaly prevailing in the market relating to the subject business. It is submitted that Company never received any notification / guidelines from any competent authority/ department, addressed to insurance companies, for fixing Net Premium Rate. However, Customs Department do not accept Afghan Transit insurance policies / guarantees where net rate of 0.25% and corresponding equivalent amount is not mentioned. On the other hand, clients pay prevailing agreed rate instead of 0.25%. Company.

Whereas section 4.5 Books and records stated that;

(4) For the purposes of this Ordinance, the expression "books" includes –

- (a) a register;
- (b) accounts or accounting records, however compiled, recorded or stored; \
- (c) a document; and
- (d) any other record of information.
- (5)

(6) An insurer shall take all reasonable precautions, including such precautions, if any, as may be prescribed, for guarding against damage to, destruction of or falsification of or in, and for discovery of falsification of or in, any book or part of a book required to be kept or prepared by an insurer.

Whereas Section 45(4) & (6) of the insurance ordinance is concerned company is compliant and have all records as stated in the section 45(4) (6) of the Insurance Ordinance 2000.

The only document identified the premium is the office order dated October 18, 2019 (Annexure B) by the Customs Department addressed to the Clearing Agents (not to Insurance company) which was in writing denied by the clearing agent vide their letter dated October 30, 2019 and also published in the newspapers on dated October 31, 2019 attached -Annexure C).

Please note that price is determined through market mechanism. It is therefore, received and premium recorded on the basis of actual receipt form the customers /insured (the price determined through market mechanism). We have been charging customers (insured) amount / price which is determined through market force and making policy as per the custom's/ insured requirements 0.25% which actually giving discount to the customer. Please note that no misstatement or misrepresentation of facts exist as both of the situation and documents disclosed and nothing hidden, and all facts disclosed to the inspection team as well as to the Commission. However, SECP can guide us by considering the ground realities etc. for the future course of action.

All above facts corroborate that the company has not made any non-compliance of the Insurance Ordinance 2000 as the price is not regulated under the Insurance Ordinance 2000. Hence, it may be considered that the company is prima facie compliant with respect to insurance laws and regulations.

We would also like to respectfully submit here that due to cutthroat competitive insurance market, small sized companies like Shaheen Insurance are left with two options of either declining the business or accepting the same on dictated conditions, which is also a market practice.

As you are aware that Pakistan's insurance market is an open market with open competition, and it would be pertinent to mention here that fixation of rate for any insurance business is not the domain of



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any government department, besides being not in line with section 3(2) titled "Abuse of dominant position" of Competition Act 2010, which reads as follows;

"An abuse of dominant position shall be deemed to have been brought about, maintained or continued if it consists of practices, which prevent, restrict, reduce, or distort competition in the relevant market." In view of the forgoing submissions, Company continue to underwrite this business in line with prevailing market rate, and the collections it receives.

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b) Regulatory Returns - Afghan Transit Business

We would like to draw your attention to note no. 2.5 of Regulatory Returns for the period ended December 31, 2021 and 2022 respectively disclosing rationale for not procuring collateral with regard to Afghan Transit Trade. In this respect, it is further submitted that these policies provide coverage against loss of duties / taxes during inland transit from a port in Pakistan to Pak Afghan border. As the duration of transit is very short and lasts only up to 5 to 10 days coupled with risk coverage of inland transit only, customers are unwilling to furnish collaterals, leaving the company with two options of either declining the business or underwriting the same. It may not be out of place to mention here that the company has been underwriting this business since 2015 with only one reported loss of Rs 15 million which was paid in a timely manner.

c) Rule 4(2) of CSR, 2018 - Collateral equivalent to 10% of sum insured on Afghan Transit Business

Please note that the guarantee provided is not like a guarantee where insurer has insured to pay the loss of any damage of goods / vehicles etc. but only guarantee the taxes and duties and it is fall under fire and marine cover which has been accepted by the custom authorities. These bonds cannot be treated at par with the guarantees issued against any assets / performance of an assets or issue to secure any kind of assets or any value of assets.

We would like to draw the kind attention of SECP to the substance of Custom guarantees/ bonds transaction, which is our considered opinion is an offshoot of insurance cover for marine inland transit as discussed above in detail. As per the practice of custom house, all insurance covers (fire and marine) submitted to customs department need to be supported by a bond/ guarantee. Moreover, our reinsurers also treat this business (Afghan Transit) under marine inland transit class (pls. see annexure A).

Besides our above submissions, we would further like to draw your attention to note no. 2.5 of Regulatory Returns for the period ended December 31, 2021 and 2022 respectively disclosed rationale for not procuring collateral with regard to Afghan Transit Trade in addition not treating this business under Credit and Suretyship Class.

d) Rule 4(1) of CSR, 2018 - Net retained exposure not to exceed 2.5% of shareholders' equity

It is respectfully submitted that the guarantee was ceded by a leader just before its expiry, however, net exposure was inadvertently overlooked. The guarantee, however matured within two months on November 01, 2022. The error may kindly be condoned.

As the SECP observations and Company's response thereof related to one of its important business segments, which has contributed to its wellbeing over the years and kept it afloat, we request the guidance of apex regulator pertaining to typical anomalies specially relating to Afghan Transit Business, which by nature is different from other businesses and may not exist in other parts of the world.

(Unquote)

19. On the request of the Respondent, the second hearing in the matter was held on November 23, 2023. The said hearing was attended by Mr. Rizwan Akhtar (CEO), Mr. Nisar Ahmed Almani (CFO), Mr. Kashif



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Naeem (Compliance Officer) and Mr. Tariq Hussain (Counsel for the Respondent) as the Authorized Representatives of the Respondent. The Authorized Representatives reiterated the submissions and arguments made in written reply dated November 10, 2023.

20. Subsequent to the second hearing held in the matter on November 23, 2023, the Respondent vide letter dated November 30, 2023 stated that the submissions made vide letter dated November 10, 2023 may be considered as final. The Respondent has also stated that the Returns with regard to Afghan transit trade business have also been subsequently filed with SECP on December 1, 2023. The Respondent has further stated that effective October 1, 2023, all insurance policies relating to Afghan transit trade have been amended, wherein the rate of premium of 0.25% along with disclosure of discount has been specified in order to arrive at actual premium amount collected.

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

(a) **Incorrect Classification of Bonds/Guarantees pertaining to Afghan Transit Trade as Marine Class of Business:**

The Respondent while explaining the nature of insurance guarantee to the Customs Department stated that it is a multi-party transaction i.e. first party is the insurer, second is Customs Department, third is clearing agent and fourth one is the insured. The transaction provides insurance cover for the loss of duties and taxes on cargoes from any port in Pakistan. Insurance companies are bound to provide the insurance cover in the form of insurance guarantee to the Customs Department. Moreover, after detailed deliberation, the subject risk is also being covered by the reinsurers under marine segments. The Respondent has therefore started to classify these policies under marine class and believe that Credit and Suretyship (Conduct of Business) Rules 2018 are not applicable to the instant case due to the nature of transaction and its substance. It is therefore not required to conduct detailed technical and financial evaluation; however, the Respondent ensures that carriers must be in the approved panel of the customs authorities and also verify information from Customs Department and Goods Declaration Detail Information, etc. to assess the insured's position applying for insurance coverage / guarantee to the extent of taxes, duties, etc.

In this regard, it has been noted that the insurance policies in respect of Afghan transit trade were issued by the Respondent as Bond Policy cover. Rule 3(1)(h) of CSR, 2018 defines Custom Bonds as "*obligations to guarantee Pakistan Customs that if it cannot collect monies due from the Principal (who is required to file the bond) it can seek remedy, upto the bond amount, from the insurer*". In view of the foregoing, the Respondent has been providing insurance guarantees in the form of customs bonds, which is definitely part of credit and suretyship business, as recognized under sub-section (4)(f) of Section 4 of the Ordinance. Therefore, it would be incorrect approach that the Respondent has started classifying its insurance guarantee business pertaining to Afghan transit trade as Marine inland transit. Therefore, the Credit and Suretyship (Conduct of Business) Rules 2018 definitely apply on the said insurance guarantee business.

(b) **Absence of Any Mechanism for Technical and Financial Evaluation of Prospective Guarantee/ Bond holders:**

With regard to absence of any mechanism for technical and financial evaluation of policyholders/ bondholders, the Respondent has stated that due to peculiar nature of business i.e. Afghan Transit Trade, the importers (on whose behalf guarantee is issued) are based in Afghanistan and it is not practical to evaluate the technical and financial strength of the policyholder/ bondholder. However, the Respondent has placed reliance on the mechanism of Customs Department to minimize its exposure.

It is worth mentioning that the Respondent merely relies on the registration process of the Customs Department, which is used for authorising any transporter through scrutiny of certain



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documents. However, the Respondent has admitted that evaluation of the technical and financial strength of the prospective guarantee/bond holders is not being carried out, whereas, Rule 3A provides for technical and financial evaluation of the prospective guarantee/bond holders. Therefore, the Respondent has failed to ensure compliance with Rule 3A of CS Rules, 2018.

(c) **Variance in the Amount of Premium Disclosed on the Insurance Guarantee Documents and the Amount of Premium Recorded the Books of Accounts:**

With regard to the observation that the Respondent has actually charged premium on significantly lower rate compared to 0.25%, mentioned in the insurance guarantees issued to the Customs Department, the Respondent has stated that Customs Department does not accept Afghan transit trade insurance policies / guarantees, where net rate of 0.25% and corresponding equivalent amount is not mentioned. On the other hand, clients pay prevailing agreed rate of 0.06% instead of 0.25%; hence, the Respondent records premium revenue according to the amount received i.e. prevailing market rate. The Respondent has stated that necessary rectification for variance in rate of premium has subsequently been made on such policies w.e.f. October 1, 2023.

As evident from the aforesaid reply, the Respondent has admitted existence of variance of 0.19% in recording premium revenue compared to the premium rate disclosed in policy documents. The policy documents and policy schedule are part of underlying record for books of the Respondent in terms of Section 45(4) of the Ordinance. Therefore, variance in disclosing the amount of premium on the insurance guarantee documents and in recording the same in its books of accounts exists, which constitutes violation of Section 45(6) read with Section 45(4) of the Ordinance.

(d) **Statement of Credit & Suretyship Class of Business (Customs Bonds/Guarantees) for 2021 and 2022 Not Filed within Due Dates:**

The Respondent did not file the Statement of Credit & Suretyship Class of Business and Statement of Claims Paid/Outstanding/Rejected under Credit & Suretyship Class of Business in respect of the years 2021 and 2022 pertaining to the policies issued to the Customs guarantees/ bonds within respective due dates. The Respondent has stated that the substance of custom guarantees/ bonds transaction is an offshoot of insurance cover for marine inland transit. The transaction provides insurance cover for the loss of duties and taxes on cargoes destined for Afghanistan from any port in Pakistan in case of failure to take custody of the goods out of the territorial jurisdiction of Pakistan. Insurance companies provide the insurance cover in the form of insurance guarantees to the Customs Department. The Respondent has, therefore, started to classify these policies under marine class and believe that Credit and Suretyship (Conduct of Business) Rules 2018.

In this context, it needs to be noted that Rule 3(1)(h) of CSR, 2018 has categorically recognized Custom Bonds providing insurance cover against loss of duties and taxes as one of the types of guarantees/bonds that can be issued under Credit and Suretyship Business. Therefore, there is no doubt that customs bonds/guarantees issued by the Respondent during the years 2021 and 2022 definitely fall under credit and suretyship business. Therefore, the Respondent's failure in filing the prescribed Statements for 2021 and 2022 pertaining to the Credit & Suretyship Business within due dates constitutes violation of Rule 6 of the CSR, 2018 read with Section 46(1) of the Ordinance.

(e) **Bonds/Guarantees issued without Obtaining the Required Collateral:**

The Respondent issued 11,765 insurance guarantees/bonds amounting to Rs. 84,367.942 million during the year 2022 without obtaining any collateral. The Respondent, while defending its position, has stated in its reply that the guarantee provided under these bond/policies is not like a guarantee where the Respondent has insured to pay the loss of any damage of goods/ vehicles, rather, these bonds/policies only guarantee the taxes and duties payable by the insured;



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therefore, such bonds/policies fall under fire and marine cover. These bonds/policies cannot be treated at par with the guarantees issued to secure any value of assets.

In this connection, it is asserted that customs bonds/guarantees issued by the Respondents against loss of duties and taxes are duly recognized as Credit and Suretyship business under Rule 3(1)(h) of the CS Rules, 2018. Accordingly, the Respondent was required to obtain collateral from its clients in respect of the bonds/guarantees issued during the year 2022. The amount of collateral required was an amount equivalent to at least 80% of sum insured/amount of bond/guarantee less reinsurance in respect of each guarantee/bond issued prior to July 5, 2022. The required collateral was an amount equivalent to at least 10% of sum insured/amount of bond/guarantee w.e.f. July 5, 2022. Therefore, failure in obtaining the said amount of collateral against bonds/guarantees constitutes violation of Rule 4(1) of the CS Rules, 2018.

- (f) **Net Retained Exposure Against A Party Exceeded Maximum Limit of 5% of Equity:**
The Respondent issued guarantees of Rs. 257.174 million to a specified party, which constitutes 37.42% of equity of the Respondent as on December 31, 2021. The Respondent has replied that *"the guarantee was ceded by a leader just before its expiry, however, net exposure was inadvertently overlooked. The guarantee, however matured within two months on November 01, 2022. The error may kindly be condoned."* Thus, the Respondent has admitted that its net exposure under bond/guarantee issued to the specified party exceeded the prescribed maximum limit of 5% of its equity. Therefore, the Respondent has violated the requirements of Rule 4(1) of the CS Rules, 2018.

22. Keeping in view the aforesaid contraventions/ non-compliances, I, in exercise of the powers conferred under Section 156 of the Ordinance and other enabling provisions of the law, hereby impose an aggregate penalty of **Rs. 300,000/- (Rupees Three Hundred Thousand Only)** on the Respondent.

23. 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.

24. 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:
January 29, 2024
Islamabad