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SECP
INSURANCE DIVISION
Islamabad

Before Hasnat Ahmad, Director (Enforcement)

In the matter of

M/s. Asia Insurance Company Limited

Show Cause Notice No. and Date : ID/Enf/Asia/2019/135 Dated March 08, 2019

Date of Hearing: April 23, 2019

Attended By: 1. Mr. Ihtisham-ul-Haq Qureshi
Chief Executive Officer
M/s. Asia Insurance Company Limited.

2. Mr. Muhammad Ali Raza
Chief Financial Officer
M/s. Asia Insurance Company Limited.

3. Mr. Rashid Sadiq
Authorized Representative

Date of Order: July 2, 2019

ORDER

Under Section 217 read with Section 219 of the Companies Act, 2017

.....

This Order shall dispose of the proceedings initiated against M/s. Asia Insurance Company Limited (the "Company"), its Chief Executive and Directors for alleged contravention of Section 217 of the Companies Act, 2017 (the "Act"). The Company and its Directors shall be referred to as the "Respondents" hereinafter.

2. The Company is registered with the Securities and Exchange Commission of Pakistan (the "Commission") under the Insurance Ordinance, 2000 (the "Ordinance") to carry on general/ non-life insurance business and is authorized as Window Takaful Operator in Pakistan.

3. As per Circular 9 of 2014 dated April 22, 2014 and Section 217 of the Act, the Company, any of its officer or agent is prohibited to receive or utilize any money received as security or deposit, except in accordance with a contract in writing. 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 maintained with a scheduled bank. However, during examination of the Annual Audited Accounts and Regulatory Returns for the year ended December 31, 2017, it was observed that the Company utilized the security deposits maintained under Section 217 of the Act without having a contract in writing with the contractors/ depositors.

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4. The Commission vide its letters dated July 26, 2018 and October 12, 2018 advised the Company to provide detail of the bank account(s) along with attested bank statements thereto, for deposit of 'amount available to insurer under guarantee' amounting to Rs. 23.527 million' in compliance with Section 217 of the Act.

5. In response to the aforesaid letters, the Company vide letters dated August 17, 2018 and November 6, 2018 provided the requisite information / explanation along with duly attested bank statements of two bank accounts, maintained for the purposes of security deposits. While reviewing the bank statements, it was observed that the total closing balance of both the accounts was Rs. 11,930,235/- (i.e. Rs. 4,662,176 + Rs. 7,268,059), which did not reconcile with the amount provided in the annual financial statements under the head of 'Amount available to insurer under guarantee' i.e. Rs. 23,527,043/-, and the same was communicated to the Company vide email dated November 22, 2018.

6. The Company submitted its response vide email dated December 10, 2018 and stated that:

"the difference in amount i.e Rs. 11.60 million approx, was transferred to our other bank account, on account of better rate of return and was not consumed by the company. The company had Rs. 243 million in balance in bank accounts other than TDRs of Rs. 125 million and the company was in well versed position of returning the said amount. Also please note that the company has the right to use the security deposit of the client as deposit with any bank of the Company."

7. Accordingly, the Company was advised to provide the written acknowledgements/ consents from the contractors/ depositors as per Section 217(1) of the Act, vide emails dated December 11, 2018, December 14, 2018, and January 9, 2019. The copies of the aforesaid contracts in writing between the Company and the depositors were submitted by the Company vide its emails dated December 12, 2018, January 7, 2019, and January 26, 2019.

8. It is important to note that the Company submitted copies of 68 contract agreements for total amount of Rs. 3,615,968/- , which were merely 31% of the total amount (i.e. Rs. 11.60 million) transferred from the aforementioned bank accounts. However, the Company did not submit information about the remaining amount i.e. Rs. 7,984,032/-.

9. Review of the information revealed that prior to January 1, 2018; the Company only obtained three (i.e. only 4%) written acknowledgements/ consents from the contractors/ depositors out of the 68 contracts/ consents provided to the Commission. Moreover, the Company obtained 44 written acknowledgements/ consents from the contractors after Commission's email dated November 22, 2018. Therefore, it was inferred that the Company did not obtain written acknowledgments/ consents from the contractors/ depositors in almost 96% of the cases, and utilized the deposits of the contractors without any written acknowledgements/ consents in violation of Section 217(1) of the Act.

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10. Therefore, it appeared that the Company failed to comply with the provisions of Section 217 of the Act.

11. Section 217 of the Act provides that:

"Securities and deposits. — (1) Save as provided in section 84, no company or any of its officers or agents shall receive or utilise any money received as security or deposit, except in accordance with a contract in writing.

(2) The money so received shall be kept in a special account maintained by a company with a scheduled bank.

(3) 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."

12. Accordingly, a Show Cause Notice (SCN) No.ID/Enf/Asia/2019/135 dated March 8, 2019 was issued to the Respondents, calling upon them to show cause as to why the fine as provided under Section 219 of the Act should not be imposed on them for the aforementioned alleged contraventions of the law.

13. Thereafter, the Commission, vide its notice no. ID/Enf/Asia/2019/135 dated March 15, 2019, scheduled the hearing for March 22, 2019. The said hearing was adjourned on the request of the Authorized Representative and therefore was rescheduled for April 23, 2019.

14. Meanwhile, the Authorized Representative of the Respondents submitted the comments to the aforesaid SCN vide letter dated April 19, 2019, which is reproduced below;

"... that the provisions of Section 217 of the Act do not apply to the circumstances particular to the Company and, therefore, the Company and its directors cannot be penalized. 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 217 of the Act and, therefore, the provisions of Section 219 of the Ordinance do not become applicable to the case at hand. It is added that 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

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received by the Company fall in a category not subject to the provisions of Section 217 of the Ordinance.

4. 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...

5. 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 217 of the Act by requiring all such margins to be deposited in a separately marked account in contrary to the spirit of Section 217 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 Repealed Companies Ordinance, 1984 '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 217 of the Act.

6. Another consideration the Commission may kindly take into account when seeking to impose the provisions of Section 217 of the Act 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 provides as under:

'(4) Nothing contained in this rule shall apply to the following types of deposits, namely:

(f) security deposits in connection with the execution of contracts'

...."

15. The hearing of April 23, 2019 was attended by Mr. Ihtisham-ul-Haq Qureshi (Chief Executive Officer), Mr. Muhammad Ali Raza (Chief Financial Officer) and Mr. Rashid Sadiq, hereinafter referred to as 'Authorized Representatives'.

16. During the hearing, the Authorized Representatives reiterated their comments submitted vide letter dated April 19, 2019. They apprised that the Company has not contravened any provisions of the Act and is in compliance with the applicable provisions of the law. The Authorized Representatives further emphasized that the audited accounts are open for review and that the Company has not used the money received as deposits/ cash margins.

17. I have perused the written and verbal comments of the Respondents. As regards the claim of the Company that the 'cash margin' received by it against issuance of performance guarantees on behalf of the contractors cannot be classified as 'security or deposit' for the purposes of Section 217 of the Act, it is clarified that performance guarantees are issued by the Company on behalf of contractors only after retaining a

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certain cash margin, which in essence is a 'security' in nature. Similar practice is also prevalent in commercial banks whereby a cash margin is retained in the form of a security by the bank and performance guarantee is issued on behalf of the customer. Therefore, the Company's stance regarding 'cash margins' not being classified as 'security or deposit' is not tenable. In addition, the Commission in Rule 5 of the Credit and Suretyship (Conduct of Business) Rules, 2018 has explained that the amount of collateral procured by an insurer shall be kept by the insurer in compliance with Section 217 of the Act. The aforesaid Rule is reproduced below;

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

18. Furthermore, it is also pertinent to mention here that subsequent to the Appellate Bench's order as referred to by the Authorized Representative in his written response, the Commission issued a Circular No. 9 of 2014 dated April 22, 2014, in respect of compliance with Section 226¹ 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.

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 utilised 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."

19. 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.

20. Moreover, the Company also failed to provide the Commission with the written acknowledgments/ consents from the depositors/ contractors for Rs. 11.60 million that the Company claimed to have transferred to another bank account for obtaining better rate of return. In response to the Commission's various emails, the Company could only submit copies of 68 written agreements for a total amount of Rs. 3,615,968/-, which were merely 31% of the total amount (i.e. Rs. 11.60 million). However, it failed to provide the written agreements in respect of the remaining amount of Rs. 7,984,032/-. Further, review of the information also revealed that prior to January 01, 2018; the Company only obtained three (i.e. only 4%) written acknowledgments/ consents from the depositors/ contractors out of the 68 contracts provided to the Commission.

¹ Section 217 of the Companies Act, 2017

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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 Act, the Rules made thereunder and/or other legal references. I am of the view that the Company has deliberately contravened the provisions of Section 217 of the Act, for which the Respondents may be penalized in terms of Section 219 of the Act.

22. Section 219 of the Act provides that:

"Penalty for contravention of section 217 or 218.—Any contravention or default in complying with requirements of sections 217 or 218 shall be an offence liable to a penalty of level 1 on the standard scale and shall also be liable to pay the loss suffered by the depositor of security or the employee, on account of such contravention."

23. Penalty of 'Level 1' as provided under Section 479 of the Act states that:

"479. Adjudication of offences and standard scale of penalty. – (1) There shall be a standard scale of penalty for offences under this Act, which shall be known as "the standard scale".

(2) The standard scale consists of –

<i>Level</i>	<i>Limit of penalty</i>	<i>Per day penalty during which the default continues</i>
1	Upto Rs.25,000	Upto Rs.500
2	Upto Rs.500,000	Upto Rs.1,000
3	Upto Rs.100 million	Upto Rs.500,000
....."		

24. In exercise of the power conferred on me under Section 219 of the Act, I, take a lenient view and do not impose fine on Board of Directors of the Company. However, I impose a fine of Rs. 25,000/- (Twenty Five Thousand only) on the Company under the said provision of the Ordinance, due to the non-compliances, as mentioned hereinabove. Furthermore, the Respondents are hereby warned and directed to ensure full compliance with the Ordinance, rules, regulations and directives of the Commission in future.

25. Hence, the Company is hereby directed to deposit the applicable fine in the designated bank account maintained in the name of Securities and Exchange Commission of Pakistan with MCB Bank Limited within thirty (30) days from the date of this Order and furnish receipted vouchers issued in the name of the Commission for information and record.

26. 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)

