

Before Amir M. Khan Afridi, Director/HOD (Adjudication-I)

In the matter of Show Cause Notice issued to EFU Life Assurance Limited

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Dates of Hearing

March 29, 2022

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**Order-Redacted Version**

Order dated July 27, 2022 was passed by Director/Head of Department (Adjudication-I) in the matter of EFU Life Assurance Limited. Relevant details are given as hereunder:

Nature	Details
1. Date of Action	Show cause notice dated June 18, 2020.
2. Name of Respondent	EFU Life Assurance Limited (the Company) and its Board of Directors.
3. Nature of Offence	<u>Alleged contraventions of clause (1) (lii), (xlv). and (xlix) of the Code of Corporate Governance for Insurers, 2016 (the Code) read with Sections 11(1)(f) and 12 of the Insurance Ordinance, 2000 (the Ordinance); rules 8(2)(c), 8(4), 8(6), 12(1), (2). &amp; (3) of the Unit Linked Products and Fund Rules, 2015 (the Rules); and Sections 183(2)(d) and 208 of the Companies Act, 2017 (the Act).</u>
4. Action Taken	<p>Key findings were reported in the following manner:</p> <p>Review of the written reply of the Respondents and submissions made by the Representatives during the hearing proceedings shows that a number of regulatory requirements were compromised as under:</p> <p style="margin-left: 40px;">a) As per the Company's half-yearly financial statement, the period ended June 30, 2019. "Net Realized Loss on financial assets" of Rs.5.567 billion has been incurred and major portion of the loss i.e. Rs.5.406 billion pertains to the, "Investment Linked Business", of the Company but Company did not report the said loss of Rs. 5.406 billion pertaining to the, 'Investment linked Business', to the Commission. The Company has stated that impact in unit price due to movement in market value of assets is already accounted for whether the loss is realized or not and converting a loss</p>

from unrealized to realized status on a particular date does not have any additional impact on the unit value.

It was further stated that by timely divesting from equities (realizing a loss in the process), during the period from 1/1/2019 to 31/3/2020, the Company has prevented a potential aggregate loss of over Rs. 2 billion to its policyholders.

In this regard, it is stated that, such huge loss is likely to have material adverse impact on the Company's investment portfolio and on its policyholders' benefits and expectations. In terms of clause (l) of the Code. it was obligatory for the Company to report forthwith to the Commission probable effect of any event as soon as it comes to its knowledge, which could have material adverse impact on the investment portfolio with regard to the policyholders' benefits and expectations. However, the Company failed to report the said significant loss to the Commission. which definitely was likely to have material and adverse impact on the policyholders' benefits and expectations, which constitutes violation clause (l) of the Code.

- b) Pursuant to Section 183(2)(d) of the Act, the Board was required to accord approval for investment of funds of the Company. The Company is of the view that Section 183(2)(d) of the Act addresses all the companies and does not provide any further details about the modus-operandi of the investments and approvals required for a life insurance company. The Company has further stated that its board has delegated investment related decisions to the Investment Committee and the Board reviews investing activities and funds' performance just on quarterly basis.

In this regard, it is stated that the provisions of Section 183(2)(d) of the Act are applicable on the companies and the Board of the Company required to pass a resolution in exercise of powers vested in it in respect of investment of the funds of the Company. Moreover, the aforesaid practice adopted by the Company is also contradictory to the provisions of clause xlvi of the Code which requires that.

***"The Investment Policy drawn up by the Investment Committee shall be placed before the Board of Directors of the insurer for approval. The Board shall***

*approve the investment policy in the light of the risk management policy adopted by the insurer."*

Keeping in view the above, it is stated that the Company has failed to approve its investment policy (fund-wise) from its Board in respect of investment of funds, which constitutes non-compliance of Section 183(2)(d) of the Act.

- c) The Company has stated that brokerage transactions with its related party do not attract applicability of Section 208 of the Act as majority of the directors do not have interest in the related party and all the brokerage transactions carried out with it are in the ordinary course of business on an arm's length basis. It has been further stated that the Board approves transactions with related parties for each outgoing quarter in every quarterly meeting.

In this regard, it is stated that approval of the Board was required to be obtained before entering into a contract or arrangement for transactions with related party, irrespective of the fact that majority of the directors of the Company didn't have interest in the related party, as required under Section 208 of the Ordinance.

However, in the absence of approval of the Board of the Company in respect of related parties' transactions and submissions of the Company, it is considered necessary that an in-depth and objective analysis of the related parties' transactions be carried out in light of the provisions of Section 208 of the Act to evaluate whether the aforesaid trading transactions were carried out in ordinary course of business on arm's length basis or otherwise. Therefore, the Offsite-I Department, Supervision Division of the Commission may re-examine the trading transactions and initiate necessary action in terms of Section 208 of the Act, if deemed appropriate. Moreover, the implications of the Prohibitory order also need to be kept in view while re-examining this matter;

- d) The Commission vide letter dated January 2, 2020 required the Company to provide necessary documents as evidence of compliance with clause xlv of the Code and in response, the Company vide letter dated January 7, 2020 shared its Investment policy. It was observed that the Fund-wise Investment Policy (which was subsequently shared on June 01, 2020)

even did not exist at that time, contrary to the requirements of clause (xlv) of the Code. Further, it was also observed that the Investment Policy submitted on January 7, 2020 was found to be deficient in the following areas:

- i. allowable exposure to various asset classes,
- ii. allowable exposure in single entity;
- iii. minimum rating/ rating/ another investable criterion;
- iv. policy for ineligible asset classes/ securities;
- v. monitoring frequency of performance measurement, monitoring the asset mix and mechanism used for portfolio balancing;
- vi. allowable exposure in related parties;
- vii. disclosure of corporate governance and voting policies as an institutional investor;
- viii. issues relating to liquidity, stop loss limits including securities trading, management of all investment risks, management of assets and liabilities, scope of internal or external audit of investments and investment statistics, and all other internal controls of investment operations, the provisions of the Insurance ordinance, 2000; and
- ix. ensuring an adequate return on policyholders (in case of life insurer underwriting respective policies) and shareholders' funds consistent with the protection, safety and liquidity of such fund (s).

Cause xlv of the Code states that:

*"the Investment Committee shall draw up an investment policy and fund-wise investment policy, in case of life insurance business (shareholders fund and statutory funds) or takaful business (shareholders fund and participants investment fund) which shall be reviewed annually."*

Keeping in view the above provision, it is stated that fund-wise investment policy is an integral part of the investment policy and cannot be segregated from it, had there been fund-wise investment policy in place at the Company, the Company would have shared it on January 7, 2020 when it was called upon to submit evidence of compliance with clause xlv of the Code. However, the Company vide letter dated January 7, 2020

submitted its investment policy without fund-wise investment policy. Therefore, non-compliance of the clause xlv of the Code is established

e) Clause xlix of the Code stipulates that:

*'The Board shall review its investment policy and its implementation on yearly basis or at such short intervals as it may decide and make such modifications to investment policy as it deems fit, while keeping the interests of policyholders in view.'*

As per the Company's half-yearly financial statements for the period ended June 30, 2019, "Net Realized Loss on financial assets", of Rs.5.567 billion was incurred and major portion of the loss i.e. Rs.5.406 billion pertained to the, "Investment linked Business", of the Company

In this regard, it was observed that after incurring the aforesaid huge loss, the Board did not review the Company's investment Policy and implementation thereof on yearly basis or short intervals in order to make modification to the investment policy considering the interest of policyholders, which is contrary to the requirements of clause (xlix) of the Code. Therefore, non-compliance of the clause xlix of the Code is established.

f) Under rule 8(2)(c) of the Rules, the Investment Committee of the Company was required to document all procedures relating to investment decisions, investment transactions, accrual and receipt of investment income, pricing, and preparation of statements. However, the Statutory Auditors of the Company in their Management letter to the Company FTY ended December 31, 2018 pointed out that:

*"the Company has sizable treasury operations which are managed by a single dealer (investment manager), who manages both money market and stock market portfolios. These activities are carried out based on the decisions of investment committee. The sale and purchase transactions are recorded through emails with brokers or when broker confirmations are received. The operating procedures related to buying and selling of investment are not formally documented. We consider that due to size of its activities these operations should be formalized."*

	<p>In this regard, it was noted that absence of rule 13 of Rules does not absolve the Company from its obligations of documentation of all procedures relating to investment decisions, investment transactions, accrual and receipt of investment income, and pricing under rule 8(2)(c) of the Rules. The Company failed to provide evidence that its operating procedures related to buying and selling of investments are formally documented. <u>The Company's this failure establishes violation of rule 8(2)(c) of the Rules.</u></p> <p>Before proceeding further, it is relevant to discuss the duties and obligations of an insurer registered under the Ordinance. In addition to day to day management of its business, there are certain 'fiduciary' duties i.e. duties held in trust and statutory obligations imposed on the insurer such as prudent management of investment of funds of the Company with a sense of accountability, ensuring compliances with the best practice as envisaged under the Code and ensuring transparency of its transactions through proper documentation. The insurer is required to be well aware of its fiduciary duties towards its policyholders and shareholders and statutory obligations along with the consequences of the default thereof.</p> <p>Therefore, I in exercise of the powers conferred under Section 479 of the Act and Section 156 of the Ordinance hereby impose a fine of <u>Rs. 500,000/- (Rupees Five Hundred Thousand Only)</u> on the Company on account of the aforesaid established non-compliances/ contraventions, default of the provisions of the law, as mentioned in the above paras and the rest of the Respondents are hereby warned to ensure compliance with all the regulatory requirements including all the aforementioned legal provisions of the Act, the Securities Act, the Ordinance, the Rules, and the Code in letter and spirit, in future.</p>
5. Penalty Imposed	Rs. 500,000/-
6. Current Status of Order	Penalty not deposited and No Appeal has been filed by the respondent.

