



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN INSURANCE DIVISION

[Karachi]

Before Nasreen Rashid, Executive Director (Insurance)

In the matter of

Reliance Insurance Company Limited

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| Show Cause Notice Date | May 3, 2010 |
| Date of Company Reply Letter | May 11, 2010 |
| Date of Order | June 1, 2010 |

ORDER

(Under Section 99(5) read with Section 156 of the Insurance Ordinance, 2000)

This Order shall dispose of the proceedings initiated against Reliance Insurance Company Limited ("the Company") for not complying with the provisions of Section 99(5) read with Section 156 of the Insurance Ordinance, 2000 ("the Ordinance").

Background Facts

2. An Onsite Inspection of the Company was conducted under the Order of the Executive Director of the Insurance Division, in exercise of powers conferred under Section 59A(1) of the Ordinance, on February 1, 2010, which commenced on February 15, 2010 and completed on March 30, 2010. The Onsite Inspection Report ("the Report") was issued on April 15, 2010. According to the Report, during the course of the Onsite Inspection, it was found that, among other non-compliances, agency commission amounting to about Rs. 12 million was paid to the Company's insurance agents by cash during FY 2009 which was in direct contravention of Section 99(5) of the Ordinance and can be penalized under Section 156 of the Ordinance.

3. The Report, in its Executive Summary, states:

"It was noted that during FY 2009, an amount of Rs. 12 million was paid to agents on account of commission otherwise than by a cross cheque, pay order or electronic funds transfer which is a violation of Section 99(5) of the Insurance Ordinance."

4. Section 99(5) of the Ordinance states:

"No payment of commission or other remuneration to an insurance agent shall be made otherwise than by a crossed cheque, pay order or electronic funds transfer or in such other manner as may be prescribed:

Provided that this sub-section shall not apply to payments to an agent which do not in the aggregate in one year exceed the sum of five thousand rupees."

[Signature]



5. The penal provision of the Ordinance, Section 156, states:

“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.”

Show Cause Notice

6. Accordingly, a Show Cause Notice dated May 3, 2010 under Section 99(5) read with Section 156 of the Ordinance was issued to the Chief Executive and Directors of the Company, calling upon them to show cause as to why the penalty, as provided in Section 156 of the Ordinance, should not be imposed upon them for not complying with provisions of section 99(5) of the Ordinance.

Company's Response to the Show Cause Notice

7. The Company, via its letter dated May 11, 2010, filed on May 12, 2010, in response to the abovementioned Show Cause Notice stated:

“We take due care to make all our payments through crossed cheques as required by law. We may confirm that most of the amounts paid on account of commissions & development charges to our insurance agents were made vide cross cheques. However, a few of our branches were paying such amounts in cash. After coming into our knowledge we immediately took up the matter with them and were apprised that some of their agents working on cash & carry basis were asking their settlements only in cash.”

8. The Company added that the payments in cash were made due to their agents being under-pressure and due to the mistaken impression that other companies in the market were willing to accommodate them by making cash payments. The Company claims that as soon as the matter was brought to the knowledge of the Company on March 3, 2010 a circular was issued to its branches to ensure strict compliance of Section 99(5) and that this was being monitored by the Company.

Consideration of Company's Response

9. I have given due consideration to the written submissions of the respondents. The Onsite Inspection found the Company contravening Section 99(5) of the Ordinance and the Company admitted both during the Onsite Inspection, when a working of the amount paid in cash was duly confirmed by the management of the Company and is attached in the Onsite Inspection Report, and in its letter, in response to the Show Cause Notice, as reproduced above.

10. According to the Report, however, the Board of Directors had not taken an interest on control related issues of the Company nor had it bothered to formulate any significant policies with its role limited primarily to financial information of the Company. Only one policy had been formulated since 1981 showing the lack of interest of the Management and the Board of Directors in formulation and implementation of policies and procedures. Additionally, according to the Report, the Audit Committee had not fulfilled its responsibilities as well. The semi-manual system, lack of significant policies and



manuals and the fact that the internal audit department consisted of only one person working without any job description for the past two years, all stand as testimony to the lack of interest of the Audit Committee on these issues.

11. The situation of the internal audit department has already been stated above; the Report further adds that the scope of the internal audit department is limited to verification of branch expenses. According to the Report:

"During the last two years (2007 & 2008) internal auditor visited only four branches out of twenty-eight branches of RICL. According to the minutes of the audit committee, internal auditor never attends the meeting of Audit Committee. This is in contravention of clause xxxii of code which requires that:

"The CFO, the head of internal audit and a representative of the external auditors shall attend meetings of the Audit Committee at which issues relating to accounts and audit are discussed. Provided that at least once a year, the Audit Committee shall meet the external auditors without the CFO and the head of internal audit being present. Provided further that at least once a year, the Audit Committee shall meet the head of internal audit and other members of the internal audit function without the CFO and the external auditors being present."

The business of the company is being carried out without vital policies and manual. The overall control environment of the company is weak. The financial statements for FY 2008 were materially misstated."

12. It should not have taken an Onsite Inspection by the Securities and Exchange Commission of Pakistan ("the Commission") to identify the issues. The Company's own control mechanism should have ensured that this non-compliance was dealt with. However, this was not the case. Clearly, there was an absence of proper adequate control mechanisms and negligence on the part of the management and directors who did not fulfill their responsibilities due to which this non-compliance occurred, especially when considering that internal audit should have detected and dealt with this non-compliance had it been adequately staffed and provided with the required resources. As stated above, internal audit had only audited four out of twenty-eight branches in the last two years. It appears obvious that such lapses would have occurred eventually leading to the contravention of Section 99(5) of the Ordinance

Conclusion

13. Hence, it is established that the Company was acting in contravention of Section 99(5) of the Ordinance when it made commission payments other than by a crossed cheque, pay order or electronic funds transfer to its insurance agents. The Company can be held liable under Section 156 of the Ordinance as stated above.

14. The Company requested that their case be decided sympathetically on the basis of their written submissions. Accordingly, the case was finalized on the basis of their written reply.

Order

15. In view of the foregoing conclusion, I, in exercise of powers conferred on me under Section 156 of the Ordinance, hereby impose a fine of Rupees Five Hundred Thousand (Rs. 500,000) on the Company.



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Insurance Division

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16. *Reliance Insurance Company Limited* are hereby directed to deposit the aforesaid fine of Rupees Five Hundred Thousand (Rs. 500,000) in the designated bank account maintained in the name of the Commission with MCB Bank Limited within thirty (30) days from the receipt of this Order and furnish receipted vouchers issued in the name of the Commission for information and record.

(Nasreen Rashid)
Executive Director (Insurance)