



INSURANCE DIVISION
Islamabad

Before Shaukat Hussain, Commissioner (Insurance)

In the matter of

Trafco Insurance Company Limited

Show Cause Notice No.
and Issue Date:

ID/Enf/Trafco/2019/229
Dated January 17, 2019

Date of Hearing:

September 27, 2019

Attended By:

Mr. Sajjad H. Rizvi
Advocate

Mr. Zahid Imran
Advocate

Date of Order:

November 4, 2019

ORDER

Under Section 34 of the Insurance Ordinance, 2000 and SEC Guidelines for IBNR read
with Section 156 of the Insurance Ordinance, 2000

.....
This Order shall dispose of the proceedings initiated against M/s. Trafco Insurance Company Limited (the "Company"), its Chief Executive and Directors for alleged contravention of Section 34 of the Insurance Ordinance, 2000 and SEC Guidelines for IBNR. The Company, its Chief Executive and Directors shall be collectively 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 the business of non-life insurance in Pakistan.

3. As required under clause 3 of the Circular read with Section 34(3) of the Ordinance, an insurer shall determine the amount of IBNR claims in accordance with the Guidelines for preparation of financial statements and regulatory returns under Section 46 of the Ordinance. Furthermore, under clause 4 of the Circular, an insurer shall prepare a Valuation Report on the estimation of the amounts in accordance with these Guidelines and submit to the Commission along with regulatory returns required to be submitted under Section 46 of the Ordinance.

4. During examination of the annual audited accounts and regulatory returns for the year ended December 31, 2017, it was observed that the Company did not submit 'Valuation Report on the Estimation of IBNR claims reserves' as required under clause 4 of the Circular. In this respect, the Commission vide its examination letter dated August 17, 2018 sought explanation from the Company.

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5. The Company vide its letter dated August 27, 2018 submitted its response and stated that:

*"Report is attached, All the claims were certain & their valuation from surveyors was received, we did not received any information, for any claim that was incurred but not reported as on December 31, 2017. " Moreover, attached the following Table as Annexure with reply:
....."*

6. The Company submitted the NIL report without written advice of the actuary, which *prima facie* proved that the report on the estimation of IBNR claims reserve was not prepared in accordance with the requirements of the Guidelines given in the Circular. It also raised doubt that the Company did not maintain the claims record in such a form that adequate data of claims could be made available in an easily understandable and accessible format for any quantitative/qualitative analysis as required under the Guidelines of the Circular. Hence the company did not follow the professional standards and code of conduct while preparing Valuation Report on IBNR.

7. In view of the above, it appeared that the Company and the CEO /Directors failed to comply with the provision of Section 34(3) of the Ordinance and Circular.

8. The provision of Section 34 of the Ordinance state that:

"(1) For the purposes of this Part, assets and liabilities shall, subject to sub-section (2), be valued in accordance with such accounting rules as may be prescribed by the Commission.

(2) For the purposes of this Part, as at any date (the "balance date") to which a statement of assets and liabilities (however called or described) is made up:

(a) no asset of an insurer shall be valued at more than the amount, net of transaction costs incurred by the transferor, at which it could be transferred in an orderly market in a transaction between two willing but not anxious parties;

(b) no liability of an insurer, not being a policyholder liability, shall be valued at less than the amount, including transaction costs incurred by the transferor, at which it could be transferred in an orderly market in a transaction between two willing but not anxious parties;

(c) the liability for outstanding claims of a non-life insurer shall not be valued at less than the expected settlement cost, including settlement expenses, of all claims incurred by the insurer but not paid as at the balance date, whether or not those claims have been reported to the insurer as at that date, and including prudent but reasonable provision for adverse development in that expected settlement cost after balance date; and

(d) the liability for unexpired risk of a non-life insurer shall not be valued at less than the sum of the unearned premium reserve and the premium deficiency reserve, where:



(i) the unearned premium reserve is the unexpired portion of the premium which relates to business in force at the balance date; and

(ii) the premium deficiency reserve is the amount if any by which the expected settlement cost, including settlement expenses but after deduction of expected reinsurance recoveries, of claims expected to be incurred after the balance date in respect of policies in force at the balance date, exceeds the unearned premium reserve.

(3) The Commission may prescribe guidelines for the estimation of amounts set out in sub-section (2)."

9. Clause 3 and Clause 4 of SEC Guidelines for IBNR (Circular 9 of 2016 dated March 9, 2016) (the "Circular") state that:

"3. Determination of IBNR Claims Reserve: (1) An insurer shall determine the amount of IBNR claims in accordance with these Guidelines for the preparation of financial statements and regulatory returns under Section 46 of the Ordinance.

(2) These Guidelines encourage an insurer to determine the amount referred in sub-clause (1) above based on the written advice of an actuary.

4. Submission of Valuation Report: (I) An insurer shall submit a Valuation Report on the estimation of the amounts referred under clause 3 above, prepared in accordance with these Guidelines, to the Commission along with annual regulatory returns required to be submitted under Section 46 of the Ordinance. The Valuation Report shall include amongst others the quantitative reports as described in Annexure I and elaborated in Annexure II and Annexure III.

(2) If an insurer has hired the services of an actuary for the purpose of these Guidelines, the actuary shall prepare the Valuation Report in accordance with requirements of these Guidelines as well as the applicable professional standards and code of conduct which shall be mentioned in his/her Valuation Report."

10. Accordingly, a Show Cause Notice (SCN) No. ID/Enf/Trafco/2019/229 dated January 17, 2019 was issued to the Respondents, calling upon them to show cause as to why action under Section 156 of the Ordinance should not be taken for the aforementioned alleged contraventions of the law.

11. The Company Secretary vide letter dated January 31, 2019 requested to allow further two (2) weeks to submit reply to the SCN. The Respondents were thus allowed extension till February 14, 2019 for submission of reply.

12. Thereafter, the Authorized Representative of the Respondents vide letter dated February 28, 2019 submitted the reply to the SCN, which is reproduced below:-

".....

It is submitted that entire proceedings as confronted in show cause notice are initiated on the basis of assumption rather than any wrongdoing on the part of insurance



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company. The main objection raised by your office relates to preparation of Valuation Report on the Estimation of IBNR claims reserves' without advice of actuary.

The guidelines for the preparation of valuation report on the estimation of IBNR claims reserves are provided under circular 9 of 2016. As per these guidelines appointment of actuary is not mandatory. The intent of the regulatory body is manifested from section 3 of these guidelines which provide that:

"These guidelines encourage an insurer to determine the amount of IBNR claims reserve based on the written advice of actuary"

Though the regulations emphasize upon the need of actuary however its nature is directory and not mandatory. The same is also reflected in section 6 of these guideline which requires that certain data relating to these claims shall be provided to actuary if an insurer has hired him for this purpose. The scheme of guidelines nowhere provides that either appointment of actuary or his advice is mandatory.

The Honorable Islamabad High Court has held in judgment reported as 2018 PTD 966 that where consequences were not provided regarding doing of something within time prescribed, such provision was directory and not mandatory. Similarly in another reported judgment of 2015 YLR 1433 it was held that operation of rules would be directory in nature and not mandatory when no penal provision had been provided in the same for non compliance of rules. As the guidelines don't anticipate the consequences or penalty for failing to appoint actuary or seek his advice, therefore, penalty cannot be imposed for an action which is not mandatory under the guidelines.

With regard to your observation that company did not maintain the claims records in such form that adequate data of claims was available, the same is against the record and unfounded. The requirement concerning maintenance of claims data is contained under section 6 of SEC guideline which provide that an insurer shall at all times maintain adequate data of claims capturing the data field as provided in said section. Keeping in view the requirements of this section the company is maintaining data in such a format which is both understandable and assessible.

In light of above given submissions it is evident that charges levelled against the insurance company are based on presumptions and conjectures. The imposition of penalty on the basis of presuppositions is not sustainable. It is, therefore, respectfully prayed that keeping in view the above submissions the proceedings initiated may kindly be dropped."

13. Hearing in the matter was scheduled for August 7, 2019 at the Commission's Head office at Islamabad. However, the Company Secretary vide letter dated August 3, 2019 stated that:-

"It is submitted that our company has engaged legal firm M/s. Rizvi & Company for presentation of the case before your office.



The partner of the Firm Mr. Sajjad Haider Rizvi, who has to represent the case is outside the country and will be back on 10th August, 2019. In the absence of our legal counsel our Company will not be in a position to represent adequately.

It is, therefore, respectfully prayed that keeping in view the above submissions the proceedings may kindly be adjourned for a period of 15 days."

14. Considering the above-mentioned request of the Company, hearing was rescheduled for August 28, 2019. However, Authorized Representative again requested to adjourn the hearing to another date. Accordingly, a final hearing notice was issued on September 18, 2019, through which hearing was fixed on September 27, 2019 at the Head Office of the Commission. The aforesaid hearing was attended by the Authorized Representatives of the Respondents namely Mr. Sajid H. Rizvi and Mr. Zahid Imran, representing the Respondents in the instant matter.

15. During the hearing, the Authorized Representatives stated that the Company has appointed an actuary for preparation of the Valuation Report in accordance with requirements of the Guidelines. They claimed that the Company underwrites motor insurance business only, therefore, NIL report for IBNR was issued. The Authorized Representatives requested to make additional submissions within one week of the hearing.

16. The Respondents undertook to furnish further evidence within one week of the date of hearing to substantiate their claim that corrective measures have been taken. However, they failed to submit the response within the stipulated time. In this regard, a reminder was also issued on October 17, 2019 whereby the Respondents were advised to submit the requisite information within 7 days of the date of the said letter. Accordingly, the Authorized Representatives submitted the response vide letter dated October 24, 2019 (received on October 28, 2019). Contents of the letter are reproduced below:-

"We are pleased to approach you on behalf of the insurance company with following submissions;

The company has appointed M/S Anwar Associates as its actuary for determination of Incurred but not reported claims (IBNR) claims reserve. The purpose of the appointment of the actuary is to determine IBNR reserve claims as per guideline of SECP.

The IBNR Valuation report as prepared by actuary Is attached herewith for your kind perusal. The company will continue to avail the services of actuary in future for determination of IBNR claims in light of guidelines issued by SECP.

As the company has appointed actuary, therefore. It is requested that show cause notice may kindly be withdrawn."

17. In terms of Clause 3 of SEC Guidelines for IBNR an insurer shall determine the amount of IBNR claims in accordance with these Guidelines for the preparation of



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financial statements and regulatory returns under Section 46 of the Ordinance. These Guidelines encourage an insurer to determine the amount of IBNR claims based on the written advice of an actuary. Furthermore, Clause 4 of the Guidelines states that an insurer shall prepare a Valuation Report on the estimation of the amounts of IBNR claims in accordance with the Guidelines and submit to the Commission along with annual regulatory returns required to be submitted under Section 46 of the Ordinance. The Valuation Report shall include amongst others the quantitative reports as described in Annexure I, Annexure II and Annexure III. Moreover, if an insurer hires the services of an actuary for the purpose of these Guidelines, the actuary shall prepare the Valuation Report in accordance with requirements of these Guidelines as well as the applicable professional standards and code of conduct which shall be mentioned in his/her Valuation Report.

18. Whereas, the Company initially did not submit 'Valuation Report on the Estimation of IBNR claims reserves' for the year ended December 31, 2017 along with annual regulatory returns as required to be submitted under Section 46 of the Ordinance. IBNR report was submitted by the Company vide letter dated August 27, 2018 in response to the Commission letter dated August 17, 2018. It was observed that the Company submitted NIL report on the estimation of IBNR claims reserve. There was no detailed working and methodology to support the Company's stance of Nil Report. Nil Report raised doubt that the Company did not maintain the claims records in such a form that adequate data of claims could be made available in an easily understandable and accessible format for any quantitative/qualitative analysis as required under the Guidelines of the Circular. Hence, it appeared that the company did not follow the professional standards and code of conduct while preparing Valuation Report on IBNR.

19. The Authorized Representatives have stated that the Company has now appointed M/S Anwar Associates as its actuary to determine IBNR reserve claims as per guideline of the SECP. In this context, it has provided IBNR Valuation Report for the year ended December 31, 2018 prepared by the actuary. The Respondents have assured the Commission that they would comply with all requirement of the law including Section 34(3) of the Ordinance and Circular.

20. 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 Section 34(3) of the Ordinance and Circular is established. The Company has also accepted its default. Therefore, fine as provided under Section 156 of the Ordinance can be imposed on the Company and/or its Directors & Chief Executive Officer.

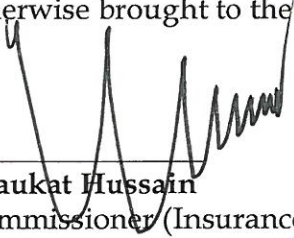
21. Section 156 of the Ordinance provides that:

"Penalty for default in complying with, or acting in contravention of this Ordinance.- Except as otherwise provided in this Ordinance, any insurer who makes 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."

22. 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 stern warning to the Company to comply with the applicable laws and that in case of similar non-compliance in future strict action against the Respondents will be taken.

23. 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.


Shaukat Hussain
Commissioner (Insurance)

