



SECP
Insurance Division
Karachi

[Karachi]

Before Tariq Hussain, Director (Insurance)

In the matter of

Crescent Star Insurance Limited

Show Cause Notice Issue Date: December 27, 2013
Date of Hearing: February 26, 2014
Attended By: Mr. Malik Mehdi Muhammad
Chief Financial Officer
M/s Crescent Star Insurance Limited
Date of Order: October 30, 2014

ORDER

(Under Section 36 Read With Section 11(1)(c), Section 63(1) and Section 156 of the Insurance Ordinance, 2000)

.....
This Order shall dispose of the proceedings initiated against M/s Crescent Star Insurance Limited ("the Company") for not complying with the provisions of Section 36 and Section 11(1)(c) of the Insurance Ordinance, 2000 (the "Ordinance").

Background Facts

2. The provisions of Sub-Section (1)(c) of Section 11 of the Ordinance provide that:
"Conditions imposed on registered insurers.-(1) An insurer registered under this Ordinance shall at all times ensure that:

...
(c) the provisions of this Ordinance relating to minimum solvency requirements are complied with;
..."

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3. Section 36 of the Ordinance lays down the provisions relating to the minimum solvency requirement. Section 36 of the Ordinance states that:

“Insurers of non-life insurance business to have assets in excess of minimum solvency requirement.- (1) An insurer registered under this Ordinance to carry on non-life insurance business shall at all times have admissible assets in Pakistan in excess of its liabilities in Pakistan of an amount greater than or equal to the minimum solvency requirement.

(2) An insurer incorporated in Pakistan and registered under this Ordinance to carry on non-life insurance shall at all times have admissible assets in excess of its liabilities of an amount greater than or equal to the minimum solvency requirement.

(3) For the purposes of this section, the minimum solvency requirement is the greatest of:

- (a) such required minimum amount as may be prescribed by the Commission;*
- (b) such percentage as may be prescribed by the Commission of its earned premium revenue in the preceding twelve months, net of reinsurance expense subject to a maximum deduction for reinsurance of fifty per cent of the gross figure; and*
- (c) such percentage as may be prescribed by the Commission of the sum of its liability for unexpired risk and its liability for outstanding claims, net of reinsurance subject to a maximum deduction for reinsurance in each case of fifty per cent of the gross figure:*

Provided that in the case of an insurer incorporated in a jurisdiction outside Pakistan the amounts set out in clauses (b) and (c) of this subsection shall be calculated with reference to the earned premium revenue, unexpired risk liability and outstanding claims liability and related reinsurance balances of that insurer in respect of its insurance business in Pakistan only.”

4. Rule 13 of the Securities and Exchange Commission (Insurance) Rules, 2002 (the “Rules”), as was applicable on December 31, 2011, states that:

“Solvency of non-life insurer.- (1) For the purposes of clause (a) of subsection (3) of section 36 of the Ordinance, the following shall be the prescribed amount, namely:-

- (a) until 31 December 2011, fifty million rupees; and*
- (b) thereafter as per the following table*

<u>On or After</u>	<u>Rupees</u>
'31 December 2012	One hundred million
'31 December 2013	One hundred and twenty five million
'31 December 2014	One hundred and fifty million



(2) For the purposes of clause (b) of sub-section (3) of section 36 of the Ordinance, the following shall be the prescribed percentage, namely:-

- (a) In the case of an insurance company registered after the commencement date, twenty per cent; and
(b) in the case of an insurance company registered at the commencement date-
(i) ten per cent until the 31st December, 2002;
(ii) fifteen per cent until the 31st December, 2004; and
(iii) thereafter the percentage as set out in clause (a) of this sub-rule.

(3) For the purposes of clause (c) of sub-section (3) of section 36 of the Ordinance, the following shall be the prescribed percentage, namely:-

- (a) In the case of an insurance company registered after the commencement date, twenty per cent; and
(b) in the case of an insurance company registered at the commencement date-
(i) ten per cent until the 31st December, 2002;
(ii) fifteen per cent until the 31st December, 2004; and
(iii) thereafter the percentage as set out in clause (a) of this sub-rule."

5. As per the Statement of Assets for Solvency Purpose (Form GJ) of the Company as on December 31, 2012, the total admissible assets were Rs. 134,686,193/- and as per the Statement of Assets and Liabilities (Form GA) as on December 31, 2012, the total liabilities were Rs.88,742,542/-. Thus, the net admissible assets would be Rs. 45,943,651/-. The minimum solvency requirement as prescribed under the Rules (as at December 31, 2012) was Rs. 100,000,000/-. Therefore, the Company stood out to be insolvent by an amount of Rs. 54,056,349/-. The calculation is as follows:

Reported Solvency Position As on December 31, 2012	
Admissible Assets as per Form GJ	134,686,193
Total Liabilities as per Form GA	88,742,542
Net Admissible Assets (Excess Assets over Liabilities)	<u>45,943,651</u>
Minimum Solvency Requirement	<u>100,000,000</u>
Excess / (Short) Net Assets Over/Below Minimum Solvency Requirement	<u>(54,056,349)</u>

6. In view of the above, it appeared to the Commission that the Company has contravened the provisions of Section 36 and Section 11(1)(c) of the Ordinance relating to the minimum solvency requirements for the non-life insurers registered under the Ordinance, for which the Company may be punished under Section 63(1) or Section 156 of the Ordinance.

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Show Cause Notice

7. Accordingly, the Show Cause Notice was issued on December 27, 2012 under Section 36 read with Section 11(1)(c), Section 63(1) and Section 156 of the Ordinance to the Company, its Chief Executive Officer and the Directors, calling upon them to show cause as to why the direction, as provided under Section 63(1) of the Ordinance, should not be issued to the Company, and as to why the penalty, as provided under Section 156 of the Ordinance, should not be imposed upon the Company and/or its Directors for not complying with provisions of Section 36 and Section 11(1)(c) of the Ordinance.

Company's Response to the Show Cause Notice & the Hearing

8. The Company submitted their response to the Show Cause Notice vide their letter dated January 6, 2014, in which the Company stated as follows:

"...we would like to draw your kind attention to our Business Plan submitted during the hearing proceedings and our application for the issuance of right share. We are thankful to you for allowing us to implement our BUSINESS PLAN. Through which the paid up capital requirement will be made. Accordingly through the plan, the SOLVENCY REQUIREMENT will also be met as detailed in our projected figures attached with the BUSINESS PLAN SUBMITTED and kindly approved by the commission.

We were granted approval through Commission's letter dated 13th November 2013, and upon receipt of the same we initiated the implementation plan immediately. Accordingly we submitted the tentative schedule to the Assistant Director through letter dated 9th December 2013, a copy of the schedule is attached herewith for your kind and ready reference.

We are pleased to confirm that the process has started as detailed in the schedule attached and the Book Closed between 2nd Jan 2014 to 8th Jan 2014 as indicated.

In light of the above explanation and facts, we request you to treat this as reply to the SHOW CAUSE under reference and grant us the required time to meet the SOLVENCY REQUIREMENT through already approved BUSINESS PLAN under implementation. We shall remain grateful to you for the kind co-operation."

9. The Company has linked its solvency with the raise in their paid up share capital, which has been dealt with separately in the Commission's Order under Section 28 read with Section 11(1), Section 63(4), Section 63(1) and Section 156 of the Ordinance dated September 4, 2014. In the light of the said Order, the Company's paid up share capital has increased to Rs. 620,125,000/-.

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10. In this view, the solvency position subsequent to the abovementioned increase in the Company's paid up share capital has to be taken into account, in order to effectively assess the response of the Company.

11. The Company's financial statements for the Half Year ended June 30, 2014 reflect that an amount of Rs. 299,475,000/- was received in consideration for right issuance, which would surely have positive impacts on the solvency position of the Company.

12. Although the Directors of the Company, through their response letter dated January 6, 2014, have not requested to appear in person, the Commission, on its own motion, had scheduled the hearing for February 26, 2014, which was communicated to the addressees of the Show Cause Notice vide the Commission's hearing notice no. ID/Enf/Crescent Star/SCN-36/2014/18953 dated February 20, 2014.

13. The hearing in the matter of the aforesaid Show Cause Notice was attended by Mr. Malik Mehdi Muhammad, the Chief Financial Officer of the Company, who was authorized to represent the Company and its Directors in the instant matter, through a Power of Attorney dated NIL. Accordingly, Mr. Mehdi shall be referred to as the "Company's representative" hereinafter.

14. The brief proceedings of the hearing of February 26, 2014 were as follows:

- a. The Company's representative, while admitting that the Company was insolvent as on December 31, 2012, stated that subsequent to the increase in the paid up capital, the solvency requirements would be met automatically;
- b. The Company's representative further stated that they will not be able to meet the solvency requirements as on December 31, 2013, as it has direct linkages with the increase in the Company's paid up share capital, which is going to increase in 2014, and that by March 2014, the Company will be compliant with respect to the minimum solvency.

Consideration of Company's Submissions

15. I have carefully examined and given due consideration to the written and verbal submissions of the Company, its Directors and the Management of the Company, and have also referred to the provisions of the Ordinance. I am of the view that there has been an established default of Section 36 and Section 11(1)(c) of the Ordinance appertaining to the minimum solvency requirement till the issuance of right shares, as aforesaid.



16. However, before proceeding further, I find it relevant to comment on the duties of the Directors. The Directors, in addition to the day-to-day running of the Company and the management of its business, also have some 'fiduciary' duties i.e. duties held in trust and some wider duties imposed by statute and breach of these statutory duties will usually be a criminal offence, punishable by fine or imprisonment. Hence, the Directors are gauged against a higher standard of accountability which requires them to be vigilant and performing their duties with due care. In the instant case, however, the Company and its Directors have failed to perform their duties with due care and prudence. As the Directors are supposed to be well aware of their legal obligations in connection with the aforesaid statutory requirement of Section 36 and Section 11(1)(c) of the Ordinance, therefore, it could be legitimately inferred that the default was committed, and that a considerable time was gained in attempting to ensure compliance of the said requirement of the law.

Conclusion

17. After carefully examining the arguments and studying the facts and findings of the case as mentioned in the above paras of this Order, the defaults under Section 36 and Section 11(1)(c) of the Ordinance are established, which have now been rectified. Therefore, the direction under Section 63(1) of the Ordinance can be issued to the Company and / or the penalty as provided under Section 156 of the Ordinance can be imposed onto the Company, its Directors and/or its Management for the aforementioned prolonged contravention of the provisions of the Ordinance.

18. Section 63(1) of the Ordinance states that:

"Power of Commission to issue direction to cease entering into new contracts of insurance.- (1) The Commission may issue a direction to cease entering into new contracts of insurance if it believes on reasonable grounds that an insurer registered under this Ordinance has failed, or is about to fail, to comply with the conditions of registration set out in section 11."

And, Section 156 of the Ordinance states 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."

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Order

19. In exercise of the power conferred on me under Section 63(1) and Section 156 of the Ordinance, I, instead of imposing the maximum penalty as provided therein, take a lenient view, and thus, condone the Company's Directors and the Chief Executive Officer due to the fact that the solvency position of the Company has arrived at a level where the Company becomes compliant, as mentioned hereinabove. Moreover, the matter of non-compliance with the minimum solvency requirements was directly linked to the increase in the Company's paid up capital through the issuance of right shares which were issued during the first quarter of the year 2014 and that the matter of compliance with the minimum paid up share capital of the Company was subsequently dealt with by the Commission through the Order of the Commissioner (Insurance) under Section 28 read with Section 11(1), 63(4), Section 63(1) and Section 156 of the Insurance Ordinance, 2000, which was passed / announced on September 4, 2014.

However, the Company is hereby issued a stern warning that in case of similar non-compliance in future a stronger action against the Company will be taken.

20. This Order is issued without prejudice to any other action that the Commission may initiate against the Company and / or its management (including the Chief Executive Officer of the Company) in accordance with the law on matters subsequently investigated or otherwise brought to the knowledge of the Commission.

Tariq Hussain
Director - Insurance