

INSURANCE DIVISION
Islamabad

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Before Hasnat Ahmad, Director (Insurance)

In the matter of

Continental Insurance Company Limited

Show Cause Notice Issue Date: ID/Enf/Continental/2017/8429 February 9, 2017

Date of Hearing: April 26, 2017

Attended By: Syed Bulent Sohail
M/s. Hassan & Hassan (Advocates)

Date of Order: May 17, 2017

ORDER

Under Rule 13 of the Securities and Exchange of Pakistan (Insurance) Rules, 2002 read with Section 11(1)(c), Section 36 and Section 156 of the Insurance Ordinance, 2000

.....

This Order shall dispose of the proceedings initiated against M/s. Continental Insurance Company Limited (the "Company") and the Chief Executive and Directors for alleged contravention of Rule 13 of the Securities and Exchange of Pakistan (Insurance) Rules, 2002 (the "Rules") read with Section 11(1)(c) and Section 36 of the Insurance Ordinance, 2000 (the "Ordinance"). The Company, its Chief Executive and Directors shall be collectively referred to as the "Respondents" hereinafter.

2. The Company is registered under the Ordinance to carry on the business of non-life insurance in Pakistan.

3. As per the afore-mentioned provisions, an insurer registered under the Ordinance is required to have at all times admissible assets in excess of its liabilities in Pakistan of an amount greater than or equal to the minimum solvency requirement.

4. The minimum solvency requirement (i.e. excess of admissible assets over liabilities) for the Company is Rs. 150 million.

5. While examining the annual audited accounts and regulatory returns for the year ended December 31, 2015, it was observed that admissible assets of the

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SECURITIES AND EXCHANGE
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SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Insurance Division

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Company were in excess of the Company's liabilities by only an amount of Rs. 24.45 million as at December 31, 2015. Hence, the Company did not meet the minimum solvency requirement by Rs. 125.55 million. The calculation of solvency is given below:

METHOD	HEAD/ACCOUNT	2015
Method A	Section 36 (3a)	
	As Prescribed By The Commission	150,000,000
Method B	Section 36 (3b)	
	Gross Earned Premium	150,044,728
	Less - Reinsurance Expense (Up to 50%)	73,058,261
	Earned Premium	76,986,467
	20% of Earned Premium	15,397,293
Method C	Section 36 (3c)	
	Provision For Unearned Premium (UC)	21,943,316
	Provision For Outstanding Claims (OC)	21,192,111
	Sub-total Provisions	183,135,427
	Less Prepaid Reinsurance Premium (Upto 50%)	310,320
	Less Reinsurance Recoveries Against OC (Upto 50%)	35,139,448
	Less - Sub-total	35,649,698
	Total Unearned Premium & Outstanding Claims (T UC&OC)	147,485,729
	20% of Total UC&OC	29,497,146
Solvency Calculations		
	Admissible Assets As Per Auditor's Regulatory Return	389,310,481
	Liabilities As Per Annual Accounts	364,863,269
	Excess Assets Over Liabilities	24,445,192
Solvency Requirement		
	Solvency Requirement (Greatest of Method A,B & C)	150,000,000
	Excess Solvency Margin Over Minimum Requirement	(125,554,808)
	Solvency Ratio	0.16
	Solvent (Yes/No)	No

6. The Company in its note 1.2 to the financial statements provided the following explanation for not meeting the minimum solvency requirement:

"In accordance with the requirements of the Insurance Ordinance, 2000 and as mentioned in the Securities and Exchange Commission (Insurance) Rules, 2002 "Rules" (amended vide SRO 16(1)/2012 dated January 09,2012), the minimum solvency requirement (i.e. excess of admissible assets over liabilities) is Rs. 150 million. The admissible asset of the Company as at December 31, 2015 are in excess of the Company's liabilities by Rs. 25.11 million. Hence, the Company is not meeting the minimum solvency requirement by Rs. 124.88 million as at December 31, 2015.

The major reason contributed for not meeting solvency requirement was encumbrance of deposit of PKR 177 Million with bank for their issuance of irrecoverable of letter of guarantee during the year 2015 as reported in note 9 & 11 to the financial statement. And in accordance with the provision of the insurance ordinance, 2000, the encumbered assets are inadmissible asset for the purpose of solvency calculation..."

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7. The Company therefore, *prima facie* failed to meet the mandatory requirements relating to the minimum solvency as given under Rule 13 of the Rules read with Section 11(1)(c) and Section 36 of the Ordinance.

8. Section 11(1)(c) of the Ordinance states 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;

..... "

9. The relevant provisions of Section 36 of the Ordinance state 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:

.....

10. The relevant provisions of Rule 13 of the Rules state 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:



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

(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."

11. Therefore, a Show Cause Notice (SCN) Id/Enf/Continental/2017/8429 dated February 9, 2017 was issued to the Respondents, calling upon them to show cause as to why the fine as provided under Section 156 of the Ordinance should not be imposed on them for the aforementioned alleged contraventions of the law.

12. Upon non-receipt of reply to the SCN, the Commission vide letter dated February 28, 2017 bearing no. ID/Enf/Continental/2017/8655 scheduled the hearing on March 20, 2017. However, Syed Bulent Sohail from M/s. Hassan & Hassan (Advocates), the "Authorized Representative" of the Company, vide letter dated March 18, 2017 sought additional time. Hence, request of the Authorized Representative was acceded to, and the Commission vide letter dated March 20, 2017, allowed a period of one week (i.e. till March 27, 2017) to submit the comments. Further period of one week (i.e. till April 7, 2017) was allowed on request of the Authorized Representative.

13. Thereafter, the Commission vide letter dated April 17, 2017 bearing no. ID/Enf/Continental/2017/9244 scheduled the hearing on April 26, 2017 at 3:30 pm. Subsequently, response of the Respondents to the aforesaid SCN was received vide letter dated April 19, 2017, which is summarized as under:

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- i. The termination of a reinsurance contract by 'Kuwait Re' presented a sudden and serious challenge to the business of the Company (i.e. default insurance cover to the members of International Air Transport Association (IATA) in Pakistan). The Respondents made hectic efforts to seek an alternate re-insurer (both foreign and local), including Hannover Re. However, the process was frustrated due to stringent requirements for reinsurance by IATA, namely, that reinsurer must be internationally "A" rated reinsurance company, local insurer must cede 100% to reinsurer and the most unusual requirement of executing a separate "Cut-Through Agreement" between re-insurer and IATA, thereby local insurer may be bypassed in certain circumstances. This requirement was found excessive by the prospective re-insurers and was accordingly rejected by all the re-insurers approached by the Company.
 - ii. Unable to secure a re-insurer at the relevant time by meeting IATA's stringent and unusual requirements, the Company had no option but to take drastic actions in order to preserve its insurance business in order to protect the interests of its existing and future policyholders. The Company, therefore, provided equivalent security arrangement to IATA in the form of a Standby Letter of Credit (SBLC) for an amount of Rs. 300 million (US \$3 million) on a temporary basis. IATA, through the said SBLC, was allowed to settle its losses directly from the bank up to the said amount. The Company encumbered an amount of Rs. 150 million with the bank as part of security for issuance of said SBLC.
 - iii. Resultantly, deficit in solvency margin for Rs. 125 million arose due to the inadmissibility of Company's liquid asset of Rs. 150 million which in essence was held with the bank for paying off Company's claim liability to IATA from time to time.
 - iv. The Company's solvency issues were temporary and were subsequently resolved by the Respondents, prior to issuance of the instant SCN. Reliance is placed in the matter of Saudi Pak Insurance Company Limited reported in 2014 CLD 549 (Commissioner Insurance SECP). In this decision, the insurance company had taken proactive and remedial measures to meet the solvency by injecting further capital and the adjudicating authority considered the same as a positive step towards compliance and self-regulation. The adjudicating authority closed the matter by taking a lenient view and no penalties were imposed on the insurer under Section 156 of the Ordinance.
 - v. Moreover, the solvency issues had arisen from the factors, which were beyond the control of the Company, as fully explained above. Further, in the given circumstances, the Company had no alternative but to safeguard the interests of its policyholders and to remain competitive, such measure was taken.
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- vi. The rationale for the requirement of minimum solvency is to ensure that the interest of policyholders and general public is not prejudiced unfairly. In the instant case, because of the Respondents' proactive action, the Company has not failed to meet any liability and all relevant claims were duly settled.
 - vii. It is a matter of record that the policyholders of the Company have not lodged any complaint to the SECP regarding non-payment of claims or other grievances.
 - viii. The Respondents and the Company took immediate corrective and remedial measures to enhance the paid up capital of the Company and injected Rs. 100 million. Resultantly, the Company is solvent and fully compliant prior to the institution of the instant SCN. In this respect, reliance is placed on *United Bank Limited Insurers vs. Executive Director (Insurance) SECP* reported in 2010 CLD 379 (SECP Appellate Bench).
 - ix. The facts, circumstances and grounds need to be taken into consideration in adjudicating the instant matter in light of past orders of the SECP in similar matters.
 - x. As per the audited Regulatory Returns for the year ended December 31, 2016, the Company has met the minimum solvency requirement.
 - xi. The Respondents have demonstrated a track record of beneficial actions in respect of the Company, which has led to the turn around of the Company in a period of less than 7 years. Consistent with their track record, the Respondents took immediate actions to ensure compliance with the applicable laws relating to solvency.
 - xii. The preamble to the SECP Act, 1997 calls for "beneficial regulation of the capital markets, superintendence and control of corporate entities and for matters connected therewith and incidental thereto". Moreover, pursuant to Section 22(4) of the SECP Act, 1997, it is humbly requested that the adjudicating authority takes into consideration the facts and circumstances of the instant case, the viability of the Company and the quality and capability of the Respondents as beneficial contributors to the insurance industry and the interests of existing and potential policyholders. It would, therefore, serve the ends of justice if a benign view is taken, and the beneficial actions of the Respondents appreciated in the instant case.
 - xiii. In light of the foregoing facts and circumstances, it is humbly submitted that a lenient view be taken in this matter in accordance with the SECP's past decisions and the SCN be withdrawn with no order as to penalty or cost.
14. The hearing of April 26, 2017 at 03:30 p.m. was held at the Head Office of the Commission in Islamabad in order to provide the Respondents final

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opportunity of being heard. The hearing was attended by the Authorized Representative to represent the Respondents before the Commission in the instant matter.

15. During the proceedings of the hearing, Authorized Representative reiterated the stance submitted through letter dated April 19, 2017. He stated that IATA does not accept re-insurance but guarantees secured by the Company. The Authorized Representative apprised that the Company has complied with the minimum solvency requirements as on December 31, 2016. The Authorized Representative was clarified that the SCN was issued to the Company on the basis of its non-compliance with the minimum solvency requirements for the year ended December 31, 2015 and at that time, the Company did not meet the said requirements. The Authorized Representative maintained that the situation was beyond the control of the Company and arose because of a third party i.e. IATA. He requested the Commission to take lenient view in the matter.

16. The Respondents were required to ensure compliance with the mandatory provisions of Rule 13 of the Rules read with Section 11(1)(c) and Section 36 of the Ordinance. However, the Company failed to meet the minimum solvency requirements. The SCN was issued on the basis of violation of aforementioned provisions of the law. It is not relevant here for the Commission to consider factors such as how the Company's management has turned around the business, no complaints against the Company have been lodged/filed or the Company has a good track record.

17. Through the written as well as verbal responses of the Respondents, it is quite evident that the Company proceeded to inject additional capital of Rs. 100 million in order to meet the shortfall in minimum solvency requirements, the resolution of which was passed on May 19, 2016 (Form 7 and 26 filed on December 30, 2016) i.e. after realizing that the Company has failed to meet the said requirements as on December 31, 2015. Therefore, it is quite evident that the Company failed to meet the minimum solvency requirements as on December 31, 2015.

18. 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 Rule 13 of the Rules, Section 11(1)(c) and Section 36 of the Ordinance is established. Therefore, the fine as provided under Section 156 of the Ordinance can be imposed onto the Respondents i.e. the Company, its CEO and Directors.

19. However, before proceeding further, I find it relevant to discuss the duties of the Directors who are, 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. Hence, the Directors are gauged against a higher standard of accountability which requires them to be




vigilant and perform their duties with due care. In the instant case, however, the Directors have failed to perform their duties with due care and prudence by proactively complying with the minimum solvency requirements i.e. by taking appropriate measures (including injection of additional capital) to meet the minimum solvency requirements as laid down under the Ordinance and Rules made thereunder. As the Directors are supposed to be well aware of their legal obligations in connection with the aforesaid statutory requirement of Rule 13 of the Rules, Section 11(1)(c) and Section 36 of the Ordinance, therefore, it could be legitimately inferred that the default concerning the minimum solvency was committed.

20. In exercise of the power conferred on me under Section 156 of the Ordinance read with S.R.O. 122(I)/2016 dated February 12, 2016, I, instead of imposing the maximum fine as provided under the said provision, impose a fine of Rs. 50,000/- (Rupees Fifty Thousand Only) on the Company due to the default of Rule 13 of the Rules, Section 11(1)(c) and Section 36 of the Ordinance, as mentioned in the above paras hereof, However, I take a lenient view and do not impose any fine on the CEO and Directors of the Company. The Respondents are hereby warned to ensure full compliance with the Ordinance, rules, regulations and directives of the Commission in future.

21. 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.

22. 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.


Hasnat Ahmad
Director

