



# SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN INSURANCE DIVISION

[Karachi]

Before Mr. Shahid Nasim, Executive Director (Insurance)

*In the matter of*

M/s East West Life Assurance Company Limited

Date of Show-Cause Notice: July 5, 2012

Date of Hearing: September 13, 2012

Attended by: Mr. Maheen Yunus, Managing Director/Chief Executive  
Mr. Imran Dodani, Chief Operating Officer

Date of Order: September 28, 2012

## **ORDER**

(Under Section 12 Read with Section 11(1)(f) and Section 156 of  
The Insurance Ordinance, 2000)

This Order shall dispose of the proceedings initiated against M/s East West Life Assurance Company Limited (hereinafter referred to as "the Company") for making a default in complying with the requirements of Section 12 and Section 11(1)(f) of the Insurance Ordinance, 2000 ("the Ordinance").

### **Background Facts**

The relevant facts for the disposal of this case are briefly stated as under:

1. Section 11(1)(f) of the Ordinance, states that:

*"An insurer registered under this Ordinance shall at all times ensure that:*

*...  
(f) the insurer meets, and is likely to continue to meet, criteria for sound and prudent management including without limitation those set out in section 12;"*

2. The provisions of Section 12(1) of the Ordinance state that:



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*"Criteria for sound and prudent management.- (1) For the purposes of this Ordinance, the following shall, without limitation, be recognised as criteria for sound and prudent management of an insurer or applicant for registration as a person authorised to carry on insurance business:*

*(a) the business of the insurer or applicant is carried on with integrity, due care and the professional skills appropriate to the nature and scale of its activities;*

*...  
(e) the insurer or applicant maintains adequate systems of control of its business and records."*

3. The provisions of Section 12(2) to Section 12(5) of the Ordinance state that:

*"(2) Accounting and other records shall not be regarded as adequate for the purposes of clause (d) of sub-section (1) unless they are such as:*

*(a) to enable the business of the insurer or applicant to be prudently managed; and*

*(b) to enable the insurer or applicant to comply with the obligations imposed on it by or under this Ordinance.*

*(3) In determining whether any systems of control are adequate for the purposes of clause (e) of sub-section (1), the Commission shall have regard to the functions and responsibilities for those systems which are held by the persons who are responsible for the direction and management of the insurer or applicant and to whom clause (b) of subsection (1) applies.*

*(4) The insurer or applicant shall not be regarded as conducting its business in a sound and prudent manner if it fails to conduct its business with due regard to the interests of policy holders and potential policy holders.*

*(5) The insurer or applicant shall not be regarded as conducting its business in a sound and prudent manner if it:*

*(a) fails to satisfy an obligation to which it is subject by virtue of this Ordinance; or*

*(b) fails to supervise the activities of a subsidiary with due care and diligence and without detriment to the insurer's or applicant's business."*

4. An "Onsite Inspection" of the Company was conducted under the Order of the Executive Director of the Insurance Division dated October 20, 2011, which was issued in exercise of the powers conferred under Section 59A of the Ordinance.



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5. The Company's Guaranteed Income Plan (GIP-term insurance plan for Individual Accident) was allegedly offered to public as investment plan and public in general was misled.

As per the newspaper dated October 4, 2011, the Company's Hyderabad branch was closed down by the management, and staff of the branch was terminated.

Concurrently, different FIRs were lodged by the affectees against Company, whereas management has also lodged against Mr. Dilshad Ali Shaikh ex-branch manager and other staff of Hyderabad branch. Mr. Dilshad Ali Shaikh has also lodged complaint before the National Accountability Bureau (NAB) against the Company's management taking the plea that GIP was sold with the consent of the management, and he and others have not committed any crime. As per management of the Company, the total amount involved in the scam amounted to Rs. 3.139 million.

Federal Investigating Agency (FIA) has investigated this scam in which Mr. Dilshad has been found guilty as a result of preliminary investigation and a challan has been filed against him in the Hon'ble Court of District and Session Judge, (South) Karachi, Sindh.

The Inspection team uncovered several internal control weaknesses in the operations of the Company which provided opportunity to the ex-employee to indulge in such fraudulent activities. Besides control weaknesses, there was also conflict of interests, which needed to be addressed.

6. During the course of Inspection, it was observed that Ms Shahnaz Parveen has been working as head of underwriting for last seven years. Being the head of underwriting she was responsible to ensure smooth functioning of underwriting business along with application of proper internal control in the process of underwriting.

A Company namely Achers (Pvt) Limited was incorporated on May 31, 2010, to carry out business of manufacturing of pickles, Jellies, Chatni, Murabba. The directors of this company are Mr. Dilshad, his wife (Mrs. Tahira Dilshad), and Ms. Shahnaz Parveen and her son Mr. Mohammad Faisal. The Inspection team was also informed that Mr. Mohammad Faisal was also an employee of M/s. Achers (Pvt) Limited.

Owing to being co-director with Mr. Dilshad in Achers (Pvt) Limited, Ms Shahnaz Parveen would have been obliged to close her eyes on any discrepancy which might have come in her notice.

Similarly, various personal financial transactions were highlighted between Mr. Sohail Nazeer CFO, and Mr. Dilshad. Furthermore CFO has given his

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verbal acceptance that some assets were also exchanged in-between CFO and Mr. Dilshad. It transpires that CFO and Mr. Dilshad were in very good personal relationship. It is well known fact that personal financial relationship is bound to create conflict of interest which hampers the independence of a person.

Mr. Sohail Nazeer, CFO and General Manager of the Company, as a person has official duty to ensure the smooth functioning of operation and application of internal control at all level and highlighting the exception in the operation. This duty may be compromised to a greater extent when there is a conflict of interest and independence of person is in question. Some of the instances of these compromises have been pointed out by the Inspection team in the Inspection Report, which are:

- (i) The Company maintained its account for Hyderabad Branch at Allied Bank - Saddar Branch, Hyderabad since June 2010, only for the collection of premium of the Hyderabad Branch of the Company. Mr. Dilshad sent deposit slip with covering letter (mentioning client's name, the amount and the proposal number) and provisional receipts to the Head Office whenever a substantial amount was deposited. There was no procedure as to when he was required to submit deposit slips to the Head Office.

Similarly, it was observed by the Inspection team that at times the amounts deposited were in excess of the provisional premium receipts and at other times these amounts used to be lesser than the provisional premium receipts issued by the Hyderabad Branch of the Company. No procedure was laid down by the Chief Financial Officer as to the frequency and reconciliation of the amounts against provisional receipts.

- (ii) Inspection Team also observed that time gap between issuance of the original receipt, which is issued by the Head Office upon issuance of the policy, and provisional receipt in most cases is on an average delay of 2 months, which is usually 2 weeks at the most as per the market practice. No action was taken by the Chief Financial Officer to streamline this delay.
- (iii) As signatories for the Bank Account maintained in the Hyderabad Branch are at Head Office, Cheque book requisition slip was forwarded to the bank through Hyderabad Branch. Finance department failed to collect a cheque book (00552851 - 0552900) for which requisition has been issued to Allied Bank, Hyderabad Branch issued on cheque book numbering. Later the Company came to know that the cheque book issued against this requisition slip is under the possession of Mr. Dilshad who has issued cheques for payment of



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profits on fraud scheme with fake signatures. This is gross negligence of the Finance department headed by the Chief Financial Officer and in turn of the management of the Company.

These relationships of Mr. Dilshad with the key officials of the Company show that Mr. Dilshad was able to make inroads in the Head Office, which is also responsible for keeping an eye on activities of employees of the Company.

7. It was also observed during the course of Inspection that the Company has its own Internal Audit Department, which is supposed to carry out Internal Audit of the Company. It is notable that no member of the Internal Audit Department including the Head of Internal Audit has prior adequate experience of Audit.

This Department had carried out a total of 3 audits in 3 years; one audit of Rawalpindi Zonal Office was carried out in 2009, the second one of Lahore Zonal Office was carried out in 2010 and the third audit of Hyderabad Regional Office was carried out in 2011, after the scam broke out in the Media. And it was also observed that all the Internal Audit Reports were stereotypes and did not focus on the internal control structure and internal control environment of the Company.

The audit of Hyderabad Regional Office which was carried out by the Company in 2011 revealed that a data of only 1448 cases was collected, which included 1015 cases wherein the Internal Audit department could not establish the authenticity of the amounts claimed by the affectees. Following is the detail extracted from the Internal Audit Report:

Description	Number of Cases	Amounts Involved
Company has issued policies	374	40,960,000
Cheques were issued in the name of Mr. Dilshad	59	4,860,000
Cases with no authenticity	1015	195,470,000
	1448	241,290,000

Essentially, the Internal Audit Department could not uncover the fraudulent scheme.

Therefore, in view of the above, the Internal Audit Department of the Company cannot be termed as satisfactory, which shows the weakness in the internal control system of the Company.

8. The Board of Directors and Audit Committee have not paid attention toward the development and implementation of proper system of internal



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controls. The Audit Committee did not take serious steps towards strengthening the Internal Audit Department. Further it has not paid any consideration towards the development of the operational manuals and guidelines.

9. There is no proper investment decision making mechanism in the Company nor is there any Investment Committee. The investment decisions are made by CEO in consultation with CFO.

10. The surrender value calculation system of the Company needs improvement as for a single policy at a point in time, the system is simultaneously showing that particular policy as lapse/auto-surrender and in-force. This discrepancy may lead to wrong calculation of cash value of the policies.

11. Therefore, in view of the foregoing facts, it *prima facie* appeared that the internal controls system of the Company are very weak particularly due to the absence of operational policies, procedures and manuals that are vital for carrying out the operations of the Company.

This indicates that the business of the Company is not being carried out with due care and professional skills, as required by the abovementioned relevant provisions of Section 11 and Section 12.

***Show-Cause Notice***

12. On July 5, 2012, a Show-Cause Notice under Section 12 read with Section 11(1)(f) and Section 156 of the Ordinance was served to the Directors and Chief Executive of the Company, whereby the Company was asked to clarify their position as to why the penalty under Section 156 of the Ordinance may not be imposed on them for various negligence on part of the management of the Company in respect of inadequate internal control system of the Company and carrying out the business without due care and diligence, thereby contravening the provisions of Section 12 and Section 11(1)(f) of the Ordinance.

***Company's Reply***

13. The Company, in response to the Show-Cause Notice vide its letter no. EWL/HO/MD/SECP/2012-6782 dated August 1, 2012, argued as under:

*"...With regards to para 5 of the show cause notice, the management would like to submit that, as stated in our earlier correspondence with the SECP, one Mr. Dilshad Ali Sheikh was working on contract basis at Hyderabad for our*



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company. He was selling the company's approved policy of Guaranteed Income Plan (GIP) as an investment plan with attractive rate of returns for his ulterior motives and personal gains. Later on, he disappeared and different FIRs were lodged by the public against Mr. Dilshad Ali Sheikh and others including the company at Saddar Cantonment, Hyderabad police station. However, eventually those FIRs were transferred to Federal Investigation Agency (FIA), Corporate Crime Circle for investigation. The company has also lodged an FIR at Kharadar, Karachi police station against Mr. Dilshad Ali Sheikh and others.

The investigation team of FIA has thoroughly investigated the entire case including complete records and bank accounts of the company as well as personal accounts of directors and concerned employees. Accordingly, as also mentioned in your show cause notice, Mr. Dilshad Ali Sheikh has been found guilty and challans have been submitted in the Court against him and his accomplices. It is important to note that these challans do not, in any shape or form, implicate the company or any staff member of the company.

Further, the management would like to inform you that Mr. Dilshad Ali Sheikh and his accomplices have been arrested by the FIA and, presently, they are in jail custody while their bails have been rejected by the Court. In the light of the above, it can be confirmed that the incident was an individual act of the fraud committed by an agent, for which the Company could not be held responsible.

It is submitted that the management has placed proper internal control over the operation in order to safeguard the assets of shareholders and policyholders. However, at the same time, the Commission would agree that system of internal control is subject to inherent limitations. For example, the person responsible to exercise internal control may override it. Further, one of the main reasons behind the fraud was the acceptable industry practice of taking premium in cash, which again was beyond the control of the management. However, the management is further improving internal controls and taking all possible steps, which are being described below in this reply, to minimize the occurrence of such fraud in the future.

With regard to para 6 of the show cause notice, the management would like to submit that Ms. Shahnaz Parveen has been working as Head of Underwriting Department for the last seven years and has been a trusted person as such accusations were never before laid on her during or before her tenure with the company. Before this incident, the working of the Underwriting Department was being run smoothly and no issues of internal controls were found. Further, the company was not aware of the fact that she and her son, Mr. Faisal, had accepted directorships of Achers (Pvt.) Limited.

Similarly, some financial transactions were detected by the inspectors between Mr. Sohail Nazeer (CFO) and Mr. Dilshad Ali Sheikh. In this regard, the Commission can realize that when any person is dealing with the field staff of

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the company, such relations could develop, but these were all at a personal level.

In order to check the issue in terms of conflict of interest and involvement of both of these persons in the fraud scam, the FIA has investigated the matter thoroughly from all angles while they have also interrogated and recorded statements of both of these persons, but they could not find any material evidence to implicate either of them in the challans.

Moreover, it is important to note that there is no provision or mechanism in the law, Insurance Ordinance or any other regulation, which can guide the company to monitor or uncover personal relationships between employees/persons working within a corporate entity. Nevertheless, this observation has been noted by the Board of Directors of the company and necessary changes in policies, internal controls and monitoring measures are being taken as well as further considered. In this connection, the following steps have been already taken:

- a) Appointment of Chief Operating Officer (COO) to handle all affairs of day-to-day operations and close supervision of field personnel activities. The COO's appointment has already been communicated to SECP.
- b) Modification in appointment letters of employees clarifying serious consequences in case the concerned person is found involved in any personal activity with any agent or field member.

In connection with para 7 of the show cause notice regarding working of the company's Internal Audit Department, the management would like to clarify that the head of the company's Internal Audit Department, Mr. Nadeem Akhter, is a member of Corporate Bodies of Pakistan while also having ACMA as well as ACSP qualifications and more than five year of auditing experience at Singer Pakistan Limited. Other members of the department are B.Com graduates and have knowledge of auditing procedures. The management encourages improvement of their skills through education and technical training. The management of the company has encouraged higher foreign qualification within all departments of the company and bears education expenses according to policy. Numerous personnel are taking classes of CIA or ACCA to acquire higher education in their field.

The Internal Audit Department works under the control of the Audit Committee, which comprises of more than two non-executive directors and being headed by Chief Justice (R) Mian Mahboob Ahmed, Chairman of the company. Similarly, Mr. Nadeem Akhter is working directly under the supervision of the Audit Committee and reports to the same.

The Board of Directors (BoD) of the company encourages the strict monitoring of corporate affairs through Internal Audit Department. After the events that have unfolded at the company's Hyderabad Branch, the Audit Committee and

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the BoD are taking further necessary actions to make the department more effective to achieve the desirable objectives and fulfill the requirements and spirit of Code of Corporate Governance as well as Insurance Ordinance, 2000. The board also realizes that regardless of how effective the internal control policies may be, the inherent risk of fraud always remains. However, that risk must be minimized through improved audit policies and procedures. To further improve the performance of the Internal Audit Department, the following measures are being taken and considered for implementation:

- a) Expansion in scope of Internal Audit Department in terms of internal controls and compliances levels.
- b) Hiring of more qualified and experienced professional personnel to perform audit procedures in effective and efficient manners.
- c) The board has encouraged the management to provide further opportunity for higher education and proper training of Internal Audit Department personnel.
- d) The Term of References (ToR) of the Audit Committee is also being reviewed.
- e) Further development and improvement of audit manuals and guidelines as a major step in revamping of the Internal Audit Department.
- f) Outsourcing internal audit services may also be considered from one of the big four audit firms in order to improve results of internal audit activities.
- g) Increase the frequency of meeting of Audit Committee and other operational committees.
- h) Increase the quality and frequency of audit reports and implement proper feedback system of those reports.

With reference to the para 8 of the show cause notice, the management would like to clarify that the Board of Directors (BoD) includes two independent directors, namely Chief Justice (R) Mian Mahboob Ahmad and Mr. A. K. M. Sayeed, as they do not have any family relationship with other directors on the board. The board has formed all required committees to fulfill the requirement of Code of Corporate Governance for the life insurance companies, which includes:

- a) Underwriting committee
- b) Claim committee
- c) Reinsurance committee
- d) Audit Committee

In this connection, the BoD conducts meetings of above committees on at least a quarterly basis. The BoD and Audit Committee have already taken serious steps in order to strengthen the overall control environment and internal control system of the company. For this purpose, they have established an Internal Audit Department consisting of qualified personnel. Further, they

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have also developed certain policies, such as Underwriting guidelines, etc., in order to improve the efficiency and effectiveness of the operations of the company. Therefore, the BoD is well aware regarding their responsibilities as stated in the Companies Ordinance, 1984 and performs their duties in term of development and implementation of controls as well as enhanced compliances level of the company. However, in order to further strengthen internal controls, the BoD and Audit Committee are in the process to implement additional measures.

With reference to para 9 of the show cause notice, the management would like to clarify that there is an Investment Committee working within the company's Executive Committee comprising of Executive as well as Non-Executive Directors. After the stock market crash in 2008, the company has (on advice of Executive Committee members) greatly reduced exposure in equity-related investments and has decided to primarily invest in safe government securities, T-Bills and TFCs. As a result of safe investments, return on policyholders' funds, which is based on investment earnings of the company, will be safer as well as higher in the long-run. Moreover, based on this broad approval from the Executive Committee, the management with express approval of the company's Managing Director and Chief Executive makes investment decisions within this area.

The Insurance Ordinance, 2000 in conjunction with its rules and solvency regulations has clearly identified all possible investment avenues for a life assurance company and narrowly restrict the options in terms of investment instruments. The management of the company has primarily obtained guidelines from these possible avenues regarding its investment decisions and maintenance of the solvency margin throughout the year.

Nevertheless, based on the observation of SECP's Inspection team, the management is considering to take more effective measures by developing an independent Investment Committee having a proper role within the company even though formation of such a committee is not required by law or Code of Corporate Governance.

In connection to para 10 of the show cause notice, it is submitted that this observation is due to a misunderstanding since the said system was not yet fully implemented at the time that the Inspection team reviewed its results. It is important to note that up to full implementation of any IT system, the manual working is continued simultaneously for at least a period of 3 months until all results of the computerized system are completely checked as well as verified by both the in-house actuary and Internal Audit Department personnel. Unfortunately, the Surrender Value Calculation System, being discussed in this observation, was still at the verification stage when it was reviewed by the Inspection team. Moreover, the team also subsequently ensured the results through the system at the IT Department to confirm that the software is working properly.

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After completion of Inspection, the Surrender Value Calculation System and all other policyholder-related systems were completely reviewed by our IT, PHS and Internal Audit personnel and no discrepancies were found in the results of any software. Consequently, the management assures that all systems are working properly and effectively upon final implementation, orientation and training of staff members.

With regards to the observation regarding internal controls of the company in para 11 of the show cause notice, the management of the company is already fully aware about the issues and, accordingly, it has developed and is further improving and implementing additional sound and errorless controls at every level of the company through the application of advance IT environment, qualified and skilled personnel and comprehensive cash management system. In this connection, the following steps have already been adopted to eliminate the factor of fraud and increase control on collection of premium:

- a) Clear written instructions have been given to all agents that the premium amount should be deposited in the company's bank account as soon as it is received by them with proper notification to the Head Office on the same day.
- b) Policyholders are being informed via written notices and through notice board in every branch that they should demand the PR (Provisional Receipt) as soon as they pay the premium to any agent of the company.
- c) The specimen of the PR is printed on the Proposal Form for further understanding of the policyholders.
- d) All documents of the company, including Proposal Form and PR, clearly mention all contacts numbers of the company's Head Office, website and e-mail address for guidance of the policyholders so that they may easily contact the Head office in respect of any issue.
- e) The role of Zonal Heads has been expanded to increase communication with policyholders to make certain that proper briefing about products, premium and other benefits of the policy has been given by the agent to the policyholder.
- f) Premium in every PR would be deposited through a single deposit slip.
- g) The concerned department confirms the content of each proposal and PR, such as amount of premium, type of plan, name of agent, sum assured, illustration particulars, benefits of the plan, etc., directly with the proposed through telephone calls and completion of confirmation sheet by the concerned department, which becomes part of the policyholder's file.
- h) For proper guidance and clarity, detailed English and Urdu documents with Role and Responsibilities of the Agent have been prepared and circulated to each agent for their understanding as well as guidance.
- i) Increased direct contact with policyholders has been established via Customer Relation Officers (CROs) as well as SMS Alert System.

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Besides the above measures, the management of the company intends to further improve and adopt additional more effective and strict controls in premium collection through the following suggestions being considered at the current time:

- a) The company is considering to stop the acceptance of premium in cash. In this case, policyholder of the company would be required to pay their premium through a financial instrument, such as cheque, pay order, demand draft, etc. in favor of East West Life Assurance Company Limited.
- b) Marketing personnel selection criteria is being revised to make certain that fraudulent and/or criminal elements do not enter the company at the initial stage.
- c) The company is considering to adopt a cash management system for the collection of premium through a single bank account from all over the country. In this regard, correspondence with major banks, such as MCB Bank Limited, Habib Bank Limited, etc., is in process and, after consultation with Zonal Heads, it will be implemented.

In addition to the above steps being contemplated at this time, the company is improving their operational manuals, constituting an independent Investment Committee, increasing the frequency of BoD as well as Audit Committee meetings, developing a separate Actuarial Services Department supervised by the company's Consulting Actuaries, M/s Akhtar and Hasan (Pvt.) Limited and improving the overall compliance level of the company.

Furthermore, the management sincerely appreciates the role of SECP in development of an enhanced corporate culture within the insurance industry and, in this regard, assure you that the management will further improve our internal control mechanisms and procedures in a more effective as well as efficient manner in view of the observations mentioned in the show cause notice.

The above submissions/clarifications abundantly indicate that proper system of internal control was in place and operational in the company. An occurrence of fraud committed by an employee of the company does not necessarily indicate weakness in internal control system as system of internal control is subject to some inherent limitations, which can never be avoided. For example, control system can be circumvented by employee collusion. Further, the Insurance Ordinance has not provided any minimum set of criteria / benchmark to evaluate internal control system of a company, which, consequently, makes it difficult to establish objective non-compliance of the company with Insurance Ordinance, 2000 regarding weak internal control system. However, at the same time, it is reiterated that the Board of Directors, Audit Committee and management has always taken proper steps in order to ensure the smooth, efficient and effective functions of the company. The business of insurance has always been carried out with due care and

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*professional skills as required by sections 11 and 12 of the Insurance Ordinance, 2000. As there is always room for improvement, some additional steps are being taken, as discussed in proceeding paragraphs, in order to further strengthen the overall internal control system of the company..."*  
*(Underlined to put emphasis)*

14. The reply of the Company revealed that the Company still considers that if an employee / agent of the Company commits fraud then the Company should not be held responsible for such a fraud, which is in contradiction with the provisions of Section 95 of the Ordinance.

15. The reply further reveals that one of the main reasons behind the fraud was the acceptance of premium in cash, which is the industry practice. This is one of the major weaknesses in the internal controls, as it increases the likelihood of frauds committed by the agents of the insurer.

16. It was also revealed that the Company was not aware of the activities of its employees, including the departmental heads, whether they are, in any way, involved in any other business activity. In this case, the Company was not aware of the fact that their Head of Underwriting and her son were the directors in M/s Achers (Private) Limited, where Mr. Dilshad Ali Sheikh and his wife were also the directors. This relationship amongst the Head of the Underwriting Department and the Branch Managers may hamper the independence of the underwriting decisions.

17. Similarly, Mr. Sohail Nazeer, the Chief Financial Officer of the Company had certain financial transaction with Mr. Dilshad Ali Sheikh, which may hamper the independence of their decision making even though these transactions were of personal nature.

Chief Financial Officer has the responsibility to ensure smooth functioning of operation and application of internal controls at all level and highlighting the exceptions in the operation. Hence, it is likely that the core duties of the Chief Financial Officer may be compromised when there is a conflict of interest and independence of person is in question.

18. It is important to note that the Company has not made any counter-arguments on as to why the Internal Audit Department has carried out only 3 audits during the previous 3 years.

However, the Company has mentioned in their response that the Internal Audit Department reports to the Audit Committee, which comprises of more than 2 non-executive Directors, headed by the Chairman of the Board.

19. The reply of the Company also confirms that the Company's Board of Directors has recently formed all the required committees to fulfill the



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requirement of the Code of Corporate Governance for the life insurance companies, which includes:

- a) Underwriting Committee
- b) Claims Committee
- c) Reinsurance Committee
- d) Audit Committee

The reply also confirms that the Company has recently developed its operational policies such as Underwriting Guidelines etc., which may have implications that these policies were not framed / devised before the conclusion of the Onsite Inspection.

20. The reply clearly states that previously the Company's investment decisions were made by the Managing Director and Chief Executive Officer, based on the broad approval from the Executive Committee. Moreover, the Company is considering to form an independent Investment Committee.

21. The Company in their reply states that at the time of Inspection, the Company's IT System was not fully implemented and hence the Surrender Value Calculation System was at the verification stage when it was reviewed by the Inspection team.

22. In the later paras of the reply of the Company, the Company has elaborated various steps that the Company has already taken or intends to take in order to streamline the processes and overcome the weaknesses in the internal control system, duly supported by an argument that all internal control system have certain weaknesses and inherent limitations, which can never be avoided.

23. Finally, the Company's management requested for a personal hearing before the Commission to plead their stance. Accordingly, the hearing in the matter was scheduled for September 13, 2012 at 11:00 a.m, which was communicated to the Company vide the hearing notice dated August 27, 2012.

*Proceedings of the Hearing*

24. The hearing in the matter was held on September 13, 2012, wherein the Company and its Directors were represented by Mr. Maheen Yunus, Managing Director and Chief Executive Officer of the Company and Mr. Imran Dodani, the Chief Operating Officer of the Company (both will be referred to as the "Company's representatives" hereinafter).



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25. Following arguments were made by the Company's representatives during the course of the hearing:

- a. The Company's representatives briefed about the position of the Company and the crisis that the Company is facing due to the Company's Hyderabad office scam;
- b. They further argued that the Company cannot be held responsible for the fraud committed by one of their contractual employees. Then, it was clarified to the Company's representatives that the Company is equally liable and responsible for committing such fraud in terms of Section 95 of the Ordinance that the agents were working / selling the insurance policies on behalf of the Company, and that it was the Company's product (GIP) which they were selling in the market.

However, the Company's representatives have assured that the Company will follow the requirements of the law in letter and spirit;

- c. The Company's representatives further mentioned that the Company has devised certain new policies and restructured its operational activities so as to enhance the effectiveness of the Company's internal controls, and they are hopeful that within a period of 2 to 3 years, the Company will be in a position to cope up with the issues currently faced by it;
- d. The Company's representatives further mentioned that amongst other steps which the Company has taken, Mr. Imran Dodani has been appointed as the Chief Operating Officer to maintain checks on the operations of the Company and to point out all the anomalies and discrepancies in the Company's current operating procedures;
- e. Upon making an inquiry regarding the Code of Conduct for the Company's Internal Audit Department, the Company's representatives mentioned that they already have one, however, they are in a process of improving it side-by-side with the capacity building within the Internal Audit Department;
- f. Furthermore, the Company's representatives have admitted that there are certain major problems and deficiencies in the Company's existing internal control system, and they have assured that they will overcome the issues pointed out by the Commission;

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- g. Thereupon, it was clarified to the Company's representatives that the responsibility of establishing and enforcing effective and efficient internal controls so as to mitigate the risks of frauds lies with the Board of Directors itself.
- h. The Company's representatives further mentioned that they will also investigate the activities of the officers as pointed out by the Commission, while stating that since the matter rests with FIA for investigation, the Company might not be able to remove them from service;
- i. Thereafter, the Company's representatives have stated that the Company has already submitted its reply to the Show Cause Notice vide letter no. EWL/HO/MD/SECP/2012-6782 dated August 1, 2012, which covers the stance of the Company in totality, contents of which have been reproduced in the previous part of this Order;

*Consideration of the Submission*

26. Before proceeding further, I find it relevant to discuss 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 perform their duties with due care. In the instant case, however, the 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 the Section 12 read with Section 11(1)(f) of the Ordinance i.e. the Directors of the Company were required to put in-place formal policies and procedures covering all the operational aspects and decision making, especially in the case of making investments, and they were required to establish and maintain effective as well as efficient internal controls with a strong Internal Audit Department, which was grossly overlooked by the Directors of the Company, which led to the Company's Hyderabad office fraud scam, therefore, it could be legitimately inferred that the default was committed.

*Conclusion*

27. After carefully examining the arguments and studying the facts and findings of the case as mentioned in the above paras of this Order, it has been found that the Company has failed to maintain adequate system of controls of its business and record, which has led to financial scam in the Hyderabad Branch of the Company and a number of individuals have been defrauded.





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Therefore, the default of Section 12 read with Section 11(1)(f) of the Ordinance is established. Hence, the penalty as provided under Section 156 of the Ordinance can be imposed on the Company, which 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, 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."*

**Order**

28. In exercise of the power conferred on me under Section 156 of the Ordinance, instead of imposing the maximum penalty, I impose a nominal fine of Rs. 500,000/- (Rupees Five Hundred Thousand Only) due to the fact that the Company had not complied with the provisions of Section 11(1)(f) read with Section 12 of the Ordinance, by not establishing and maintaining proper system of internal controls all across the Company.

Further, the Company is hereby directed to:

- (a) take immediate measures for the establishment of the effective and efficient system of internal controls so as to comply with the requirements of Section 11(1)(f) read with Section 12 of the Ordinance;
- (b) conduct a thorough inquiry into the matter and investigate the role of Chief Internal Auditor, Chief Financial Officer, Head of Underwriting and any other officer who is directly / indirectly responsible or involved in the fraud, and if found guilty, take appropriate action(s) under intimation to the Commission within 90 days from the date hereof; and
- (c) compensate all the affected policyholders of the Company who have suffered losses due to the fraudulent activities at the Company's Hyderabad Regional Office.

29. *M/s. East West Life Assurance Company Limited* are hereby directed to deposit the aforesaid fine of Rs. 500,000/- (Rupees Five Hundred Thousand Only) 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 receipt of this Order and furnish receipted vouchers issued in the name of Commission for information and record.

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30. This Order is issued without prejudice to any other action that the Commission may initiate against the Company in accordance with the law on matters subsequently investigated or otherwise brought to the knowledge of the Commission.

**Shahid Nasim**  
Executive Director