



INSURANCE DIVISION
Islamabad

Before Fida Hussain Samoo, Commissioner (Insurance)

In the matter of

SPI Insurance Company Limited

Show Cause Notice No. and SCN NO. ID/Enf/SPI /2017/9061 Dated March
Issue Date: 31, 2017

Date of Hearing: May 10, 2017

Attended By: Mr. Muhammad Akram Shahid
Chief Executive
✓ M/s. SPI Insurance Company Limited

Mr. Ali Ibrahim
(Authorized Representative on behalf of the
Respondents)

Date of Order: May 24, 2017

ORDER

Under Rule 13 of the Securities and Exchange Commission (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. SPI Insurance Company Limited (the "Company"), its Chief Executive and Directors for alleged contravention of Rule 13 of the Securities and Exchange Commission (Insurance) Rules, 2002 (the "Rules") read with Section 11(1)(c), 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. Review of financial statements for the year ended December 31, 2015 of the Company revealed that 'provision for Outstanding Claims' as at December 31, 2015 was understated by an amount of Rs. 69.712 million and the Company *prima facie* did not meet minimum solvency requirements in case of adequate provisioning.



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Insurance Division

Continuation Sheet 1

4. Provision for Outstanding Claims' as at December 31, 2015 was booked at Rs. 88.686 million for the year 2015, which was substantially lower from the previous year's estimates. The final provision for the years 2012, 2013 and 2014 was provided at Rs. 254.871 million, Rs. 128.554 million and Rs. 158.398 million respectively. Accordingly, provision for Outstanding Claims' in the Audited Accounts for the year ended December 31, 2015 was inadequate and understated by an amount of Rs. 69.712 million.

5. As per the Liability Adequacy Test, the provision for Outstanding Claims was not adequately provided as elaborated in the following table:

Claims Development Table						
Analysis on Gross Basis						
Accident Year	<u>2011 and</u> <u>Prior</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>Total</u>
Estimate of Ultimate Claim Costs						
-At end of accident year	186,802,022	112,345,131	52,827,018	83,840,860	88,686,157	
-One year later	177,630,374	241,257,348	125,384,905	158,398,491		
-Two years later	154,829,810	250,687,679	128,554,665			
-Three years later	155,540,696	254,871,389				
-Four years later	161,431,260					
Estimate of Cumulative Claims	161,431,260	254,871,389	128,554,665	158,398,491	88,686,157	791,941,962
Cumulative Payments	(134,541,462)	(253,054,685)	(127,088,680)	(143,835,833)	(79,446,135)	(737,966,795)
Liability recognized in the balance	26,889,798	1,816,704	1,465,985	14,562,658	9,240,022	53,975,167

(Rupees in thousands)

Outstanding claims as at Jan 01, 2015	78,382
Total paid claims in 2015 but reported in the past years	121,449
Outstanding claims as at December 31, 2015 for claims reported in the past years	49,175
Run-off result	(92,242)
Run-off result in %	-118%

6. The excess solvency margin over minimum requirement of the Company for the year ended December 31, 2015 was Rs. 38.713 million, however, considering the impact of understatement of provision for Outstanding Claims amounting to Rs. 69.712 million, the net solvency margin of the Company was negative by an of Rs. 30.999 million.

(Rupees in thousands)

Admissible Assets	638,415
Less: Liabilities	(449,702)
Excess of Assets Over Liabilities	188,713
Solvency	(150,000)
Excess Solvency Margin Over Minimum Requirement	38,713
Less :Understatement of Provision of claims	(69,712)
Net Solvency Margin after Adjustment	(30,999)



7. In view of the deficient provisioning, the Company, vide letter dated October 28, 2016 was advised to provide further information/clarification. In response, the Company submitted its reply vide letter dated November 5, 2016. However, it was noted that the Company provided the methodology and factors of uncertainty rather than giving clarification about understatement of the provision for Outstanding Claims.

8. As per the afore-mentioned provisions, an insurer incorporated in Pakistan, 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.

9. The minimum solvency requirement (i.e. excess of admissible assets over liabilities) for the Company is Rs. 150 million. However, the Company's solvency margin vis-à-vis the minimum solvency requirements falls short by an amount of Rs. 30.999 million.

10. 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.

11. 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;

..... "

12. 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:

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 sub-section 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."

13. 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:

On or After	Rupees
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."



14. 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]16 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."

15. Therefore, a Show Cause Notice (SCN) ID/Enf/SPI /2017/9061 Dated March 31, 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.

16. The Respondents, vide their letter dated April 08, 2017, requested the Commission to extend the date for submission of written comments in response to the aforementioned SCN. Hence, request of the Respondents was acceded to and the Respondents vide Commission's letter no. ID/Enf/SPI/2017/9183 dated April 11, 2017, were allowed a further period until April 24, 2017 to submit their comments.

17. Subsequently, the Respondents vide their letter dated April 17, 2017, submitted their comments, which are summarized as under:

- i. 'Provision for the outstanding claims including IBNR' is calculated in accordance with applicable provisions of the Ordinance and Rules;
- ii. Accounting policies, adopted by the Company for the recognition of liability for outstanding claims is fully aligned with provisions of the Ordinance and the Rules;
- iii. Claims on general insurance contracts are payable on claim occurrence basis. The Company is liable for all insured events that occur during the term of the insurance contract.
- iv. The provisioning was made in accordance with the accounting policy / method consistently followed by the Company on the basis of information available at the time of estimation.
- v. The estimate of claim liability comprises of 'Unpaid reported claims', 'Claims incurred but not reported' and 'Expected claims cost'.
- vi. An independent actuary was also engaged for an assessment of outstanding claims related to health and personal accidents
- vii. The Company takes all reasonable measures to mitigate the factors affecting the amount and timing of claim settlements. However, uncertainty prevails



- with estimated claim liabilities and it is likely that final settlement of these liabilities may be different from recognized amounts.
- viii. The provision is estimated on the basis of expected future payments of 'unpaid reported claims', 'claims incurred but not reported' and 'expected claim cost' at a certain date and therefore it is not comparable with the past provisions or the provisions at any other dates.
 - ix. The unpaid reported claims, the major component of provision for outstanding claims, are not comparable with the previous year's unpaid reported claims. They are entirely different from each other because both are different instances at all because of different insurance policies, coverage, the insured, re-insurance coverage etc.
 - x. During the year 2015, keeping in view the claims history of some clients, the Company declined some corporate and group health insurance business which ultimately reduced the claims cost and unpaid claims liability.
 - xi. Moreover, in order to improve the claims turnaround time and to remain competitive in the market, the Company successfully implemented the 'Claim Tracking Module' which ultimately reduced the claims turnaround time and the quantum of unpaid claims at the yearend.
 - xii. Our assessment of estimate was based on the best information available at the time of preparation of financial statements, whereas the corroborative information as produced in claims development table is based on assessment made subsequent to the date of preparation of financial statements on the basis of information which was not available at the time of preparation of financial statements
 - xiii. There are temporary timing differences which ultimately settle in 1st development year or 2nd development year and resultantly claims expense is increased in the relevant year. All the years carry the impact of changes in the estimates of the previous years.
 - xiv. The ground realities and difficulties like non-availability of final survey reports, the involvement of co-insurers and reinsurers and legal disputes and pressures from the financial sectors are the primary impediments, which make outstanding claims estimation cumbersome and uncertain.
 - xv. Further, you will appreciate the fact that the runoff ratios are gradually improving over the years.
 - xvi. It is unjust to conclude that the provisions for the year 2012, 2013 and 2014 are initially recognized at lesser amount.
 - xvii. The estimation and recognition of outstanding liabilities against unpaid claims give rise to right to recovery from the reinsurers and coinsurers at the same time. Therefore, the excess estimation and recognition of unpaid claims liability directly increases the amount of claims recoveries, which are admissible assets. But the recognition of excess outstanding claims have limited impact on the claims expense amount which do not go beyond the retention limit.



- xviii. However, the reporting of exorbitantly high claim estimates to the reinsurers at the intimation time will ultimately increase the cost of procurement of reinsurance arrangements for the ensuing years.
- xix. In accounting terms, the understatement /overstatement of closing provisions is worst form of adjustments because it reverses its impact on the first day of next accounting year or period. Therefore, at entity level, these are not desirable at all.
- xx. Therefore, the estimation of outstanding liability is made with utmost care and in accordance with the best information available on the reporting date because based on the said assessment, the reinsurance / coinsurance recovery is required to be recognized.
- xxi. The guess work based on the historical pattern is not allowed and it is unjust and against the spirit of law if the amount of understatement is quantified without any legal basis.
- xxii. On the same pattern, a claims recovery can also be prepared whereby it can be concluded that the reinsurance claims are understated by Rs. 30 million approximately.
- xxiii. For the year ended December 31, 2016, the provision for IBNR claims is determined and calculated in accordance with the Circular no. 09 of 2016 which has adequately addressed the issue of 'Incurred but not enough Reported Claims' in the past, according to the link ratio method which is stated in said circular.
- xxiv. Moreover, the services of an independent actuaries are acquired for the determination of IBNR provision. Its report will be submitted to the insurance division of SECP along with the statutory returns.
- xxv. As of December 31, 2016 the excess of solvency margin over the minimum requirement is Rs.43.49 million

18. Thereafter, the Commission vide letter no. ID/ENF/SPI/2017/9338 dated April 26, 2017, scheduled a hearing for May 10, 2017 at 03:00 p.m. at the Head Office of the Commission in Islamabad to provide an opportunity of being heard to the Respondents. The hearing was attended by Mr. Muhammad Akram Shahid Chief Executive of the Company and Mr. Ali Ibrahim as a legal counsel for and behalf of the of the Respondents.

19. During the hearing, Respondents requested the Commission to consider their written submissions provided vide letter dated April 17, 2017. They assured the Commission that adequate provisioning would be provided in the future. The Respondents requested the Commission to take lenient view in the matter.

20. 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.



21. The Company highlighted the following factors for reduced provisioning i.e. decline in the corporate and group health insurance business due to which claim cost as well as liability for unpaid claims have been reduced and; introduction of claims tracking module due to which claims turnaround time and the quantum of unpaid claims at the yearend have been reduced. The Company has also stated that it uses best estimates, which take into account past trends, expected future patterns of reporting of claims. The Company requested that Commission should give due consideration to these factors before arriving at a conclusion. The Company assured that adequate provisioning would be provided in the future.

22. 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 Company has underprovided Provision for Outstanding Claims, however keeping in view the submission and assurance given by the Company to comply with the provisions of law and making adequate provisions in future , I hereby warn the Respondents to be careful in future.

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 Chief Executive Officer of the Company) in accordance with the law on matters subsequently investigated or otherwise brought to the knowledge of the Commission.

Fida Hussain Samoo
Commissioner (Insurance)

