



SECP
Insurance Division
Karachi

[Karachi]

Before Tariq Hussain, Director (Insurance)

In the matter of

Pak Kuwait Takaful Company Limited

Show Cause Notice Issue Date: November 19, 2012
Date of Hearing: March 12, 2013
Attended By: Mr. Syed Wajahatullah Quadri
Chief Financial Officer
M/s Pak Kuwait Takaful Company Limited
Date of Order: June 28, 2013

ORDER

(Under Section 156 of the Insurance Ordinance, 2000)

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This Order shall dispose of the proceedings initiated against M/s Pak Kuwait Takaful Company Limited ("the Company") for not complying with the principles of Islamic Shariah, thereby violating the definition of "takaful" business as laid down under Section 2(ixiv) of the Insurance Ordinance, 2000 (the "Ordinance").

Background Facts

2. Takaful is a scheme of mutual assistance to the participants in case of occurrence of certain contingencies and the participants mutually agree to contribute to the common fund for this purpose, in compliance of the principles of Shariah. So, the prime objective of a Takaful Operator is to conduct Takaful Business based on the principles of Islamic Shariah.
3. Takaful has been defined under Section 2(ixiv) of the Ordinance, which states that:

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“Takaful” means a scheme based on mutual assistance in compliance with the provisions of Islamic shariah, and which provides for mutual financial aid and assistance to the participants in case of occurrence of certain contingencies and whereby the participants mutually agree to contribute to the common fund for that purpose;” (Underlined to put emphasis)

4. Rule 26 of the Takaful Rules, 2012 (the “Rules of 2012”) requires that each operator shall appoint a Shariah Advisor who shall be responsible for the approval of the following:

- (a) Products including all related documentation;
- (b) Participants’ Takaful Fund policy;
- (c) Investment policy;
- (d) Re-takaful arrangements; and
- (e) Distribution of surplus to the participants.

Rule 26 of the Rules of 2012 further requires that the Shariah Advisor shall ensure adherence to the conditions specified by the Commission upon advice of the Shariah Advisory Board on all matters.

Similarly, the repealed Takaful Rules, 2005 (the “repealed Rules of 2005”) required that the Shariah Board shall formulated all operational practices. As Rule 34 of the repealed Rules of 2005 required that:

“Shariah Board.-(1) Each Takaful operator shall appoint a Shariah Board (SB) of not less than three members which shall be responsible for the approval of products, documentation as well as approval of all operational practices and investment of funds which shall be filed with the Commission.”

5. In this regard, the Shariah Advisors of the general takaful operators have formulated the Shariah Guidelines, which have been issued by the Shariah Supervisory Board (SSB) of the general takaful operators, wherein they have allowed the co-takaful arrangements with conventional insurers subject to various conditions. These guidelines require that in case of co-takaful arrangements with conventional insurers, the respective operator shall be required to pay its own share of claim directly to the client / participant / policyholder as well as receive its share of contribution directly from the client / participants / policyholder. This means that the Company was not allowed to receive contributions and settle claims through conventional insurers.

However, it has been observed that the Company has violated the Shariah Guidelines relating to co-takaful arrangements with the conventional insurers, which is reflected in the Shariah Audit Report for the year 2011.



6. The same Shariah Audit Report also reveals that the Company has also been accepting inward facultative business from the conventional insurance companies. And, both acts of the Company have been reported as contrary to the Shariah Principles.
7. The said Shariah Audit Activity Report states that:

“Co Takaful or Sharing with conventional insurance companies

The SSB had allowed participating in policies issued by conventional companies as leader. However, the company should deal directly with the participant and issue a separate PMD upon his request. It was also advised that desirably the payment of contribution to the company and claim to the participant should be made directly without involving the conventional leader company.

Later on playing the role of leader for the Takaful company was also allowed by the SSB subject to consultation with SSB member before entering in any real case of this kind.

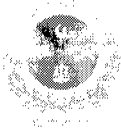
It was noticed during this recent inspection of the activities that the company has started Co Takaful sharing with conventional insurance companies also where the company is playing the leader role, but the documentation apparently does not fulfill the Shariah requirements.

After review and discussion SSB directed the company to stop this practice and develop new mechanism with SSB's consultation if there is a need for such product. SSB also instructed the company to cancel all such policies and pay back received contributions to the payers.

Inward Facultative

The Company accepts specific risks from other Takaful/Insurance companies; this arrangement is called “Inward Facultative”. The company is allowed to accept such risks from Takaful companies and not from conventional companies. Based on the inspection and information provided by the management, it was observed that the company enters in such contracts with conventional counterparts too, SSB instructed the company to stop this practice and pay back received contributions to the payers after cancelling all such policies. (Underlined to put emphasis)

8. In view of the above, it appeared that the Company has violated the basic idea and definition of Takaful scheme by acting against the principles of Shariah, as laid down under the guidelines formulated and issued by the Shariah Supervisory Board, which is detrimental to the interests of the participants of the takaful fund, and hence,



attracts penal action against the Company as provided under Section 156 of the Ordinance.

Show Cause Notice

9. Accordingly, the Show Cause Notice was issued on November 19, 2012 under Section 156 of the Ordinance to the Chief Executive and Directors of the Company, calling upon them to show cause 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 the principles of Islamic Shariah as envisaged in the Shariah Guidelines issued by the Shariah Supervisory Board of the general takaful operators, which, as of now, acts as a benchmark for adherence to the principles of Islamic Shariah, as laid down under Section 2(lxiv) of the Ordinance.

Company's Response to the Show Cause Notice

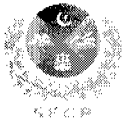
10. In response to the said Show Cause Notice, the Company, vide their letter of December 3, 2012, stated that:

"...1. The Takaful Rules 2012 issued vide SRO 877(I)/2012 published in the Gazette on 16.7.2012 are impugned under Constitution Petition No.D-2791 of 2012 in the Hon'ble High Court of Sindh at Karachi. We alongwith other Takaful Companies in the said petition prayed the Hon'ble High Court of Sindh at Karachi to declare that the Takaful Rules 2012 are arbitrary, discriminatory, ultra vires to the Constitution void ab initio and without lawful authority and be set aside. We also prayed that the authorities in implementing the said rules be restrained.

2. The Hon'ble High Court of Sindh at Karachi was pleased to pass an order on 16.8.2012 in the petition that till the next date of hearing parties are directed to maintain status quo. Rule 26 of the Takaful Rules 2012 cannot be operated in view of the order of the Hon'ble High Court of Sindh at Karachi. Show Cause Notice under Section 156 of Insurance Ordinance is therefore uncalled for till final adjudication of the petition by the Hon'ble High Court of Sindh at Karachi.

3. WITHOUT PREJUDICE to the above, admittedly the Takaful is a scheme of mutual assistance to the participant and has been constituted in compliance with the principle of Sharia as has been defined under Section 2 (LXIV) of the Insurance Ordinance, 2000.

4. Prior to launch any Takaful products the same after deliberation and consultation by the Shariah Supervisory Board (SSB) used to be placed before Commission for approval under the Takaful Rules 2005.



5. Similarly in the matters of coinsurance and Facultative Inward reinsurance SSB had advised to accept coinsurance and Facultative Inward reinsurance under the lead of conventional insurance companies. Extract as well as certificate in this respect have already been submitted for your information and record.

6. Thereafter bulk of correspondence was exchanged with the Commission and queries raised thereon were answered satisfactorily.

7. You may appreciate that we have not violated the Rules. All or any of our products was backed by the recommendation of SSB

8. The provisions of Section 156 of the Insurance Ordinance, 2000 at this juncture when the matter is subjudice before the Hon'ble High Court of Sindh at Karachi and that we have not contravened the provisions of the Ordinance are not attracted.

We, therefore, request you that you may graciously be pleased not to initiate any proceedings under Section 156 of the Insurance Ordinance, 2000 till the petition pending in the High Court of Sindh at Karachi attains finality." (Underlined to put emphasis)

11. The reply of the Company reveals that the Company has shown concerns about the provisions of the Rules of 2012 that have been placed as supportive clauses in the Show Cause Notice dated November 19, 2012, in the light of the Order passed by the Hon'ble Court in the Constitutional Petition No. 2791 of 2012. The sole purpose of the relevance to the Rules of 2012 and the repealed Rules of 2005 is that it has been mandatory for the takaful operators to appoint Shariah Scholars as their Advisors on Shariah matters, and that their responsibilities have been laid down in both i.e. the Rules of 2012 and the repealed Rules of 2005.

12. Furthermore, the reply of the Company also reveals that the Company admits that the Takaful is a scheme of mutual assistance to the participant and has to be constituted in compliance with the principle of Shariah, and the Company used to place Takaful products before the Commission for its approval after deliberation and consultation by the Shariah Supervisory Board (SSB).

13. Moreover, the Company, in its reply, states that the Shariah Supervisory Board has advised to accept coinsurance and facultative inward reinsurance under the lead of the conventional insurers. However, the Company has not stated the fact that the Shariah Supervisory Board has placed certain conditions for entering into the coinsurance and facultative inward reinsurance, based on which, the Show Cause Notice was issued to the Company and its Directors. The relevant part of the Shariah Audit Activity Report has already been quoted hereinabove.

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Hearing of the Case & Subsequent Developments

14. Although, the Company had not requested for hearing in the matter, the Commission, on its own motion, had scheduled the hearing in the matter for January 11, 2013 at 3:00 p.m., which was communicated to the Company via the Commission's hearing notices no. ID/Enf/PKTCL/2012/15183 dated January 1, 2013.

15. The Company, vide its letter dated February 4, 2013, had requested the Commission not to initiate any proceedings under Section 156 of the Ordinance.

16. It would, however, be pertinent to mention that no one appeared for the hearing in the matter, which was scheduled for February 7, 2013.

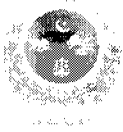
17. Thereafter, in order to provide another hearing opportunity to the Company, the Commission had scheduled the hearing in the matter for March 12, 2013 at 11:00 a.m., which was communicated to the Company via the Commission's hearing notice no. ID/ENF/PKTCL/2013/15766 dated February 28, 2013.

18. Accordingly, the said hearing was attended by Mr. Syed Wajahatullah Quadri, Chief Financial Officer of the Company (who will be referred to as the "Company's representative" hereinafter).

19. Brief proceedings of the hearing of March 12, 2013 are as follows:

- a. Prior to the start of the hearing proceedings, the Company's representative handed over the blanket Power of Attorney to the Commission;
- b. The said Power of Attorney was signed by Mr. Imtiaz Bhatti, Managing Director / Chief Executive Officer of the Company, wherein the reference was made to the resolution of the Board of Directors of the Company dated March 7, 2013, hence accordingly, the extracts of the said resolution of the Board were also provided to the Commission in which Mr. Imtiaz Bhatti, Managing Director / Chief Executive Officer was authorized by the Board to represent the Company and its Directors in any proceedings that may be brought against the Company by any department of the Commission in relation to the manner in which the affairs of the Company have been managed in the past. The said resolution of the Board also empowered / authorized Mr. Imtiaz Bhatti, Managing Director / Chief Executive Officer of the Company to delegate this power to any of the employees of the Company, which was delegated to the Company's representative;

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- c. The Company's representative was asked to present the stance of the Company, to which the Company's representative stated that Shariah Audit also recommended to rectify this issue i.e. to cancel all policies, to which we have complied with, and the Shariah Advisors are now satisfied, as the management has rectified all the anomalies which were supervised / advised by the Shariah Advisors. Furthermore, the Company's representative also mentioned that the Shariah Advisors themselves ensured that the Company has complied with all of their recommendations;
- d. The Company's representative further claimed that the Company had made it good within 6 months of the release of the Shariah Audit Activity Report; and
- e. Thereupon, the Company's representative was asked to provide the following documents for the Commission to verify the claim made by the Company's representative on behalf of the Company:
- i. A clearance certificate from the Shariah Advisors with specific reference to the contents of the Show Cause Notice, stating therein that the Company has rectified all the anomalies that were identified in the Shariah Audit Report; and
 - ii. Shariah Audit Activity Report for the year 2012.

20. Thereafter, the Company had submitted a letter / certificate, dated March 19, 2013, which was issued by the Shariah Advisors of the Company, in which the Shariah Advisors of the Company had stated as follows:

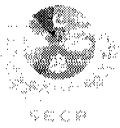
"We refer to Shariah Audit Activity Report for the year ended December 31, 2011 and the exceptions highlighted as part of the review. Those exceptions were came out of the review and reflect areas of improvement, where management has to either rectify or to put certain controls for better application of Shariah guidelines.

We are pleased that errors as referred above, which were not significant in nature, have been appropriately rectified in accordance with guidelines provided by the Shariah.

We further state that management adopted the required procedures and made the rectifications, cancellations or reversals, where required, for all the matters mentioned in the report including matter of Inward Facultative and Co Takaful Sharing with conventional insurance companies.

To conclude we may say that all the matters, reported earlier for improvement, have satisfactorily been resolved. (Underlined to put emphasis)

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21. Moreover, the Company, vide its email transmission of April 1, 2013, had provided the Shariah Report, which was signed by Mr. Muhammad Hassaan Kaleem, Shariah Advisor of the Company. The said Report stated that:

"...During the year the Company executed variety of established Takaful transactions after due approval from Shariah Supervisory Board. The Company is offering Shariah Compliant services in the following areas:

- Fire and Property Takaful
- Marine
- Motor
- Miscellaneous

The Company invests its funds with the approval of Shariah Supervisory Board in Shariah Compliant Instruments.

Conclusion & Recommendations

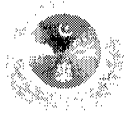
The services provided by the Company were reviewed on random basis and activities and transactions undertaken by the Company during the year ended on December 31, 2012 were found in conformity with the Principles and guidelines of Islamic Shariah, issued and provided by Shariah Supervisory Board of the Company. However, the following is recommended :

- *Necessary steps should be taken to develop Shariah training program in order to educate the staff about the very concept of Takaful and Shariah requirements of its practice.*
- *Internal Shariah Department with knowledge and dedicated staff should be instigated under the supervision of SSB to help the management in assuring Shariah compliance at all levels of the operation..." (Underlined to put emphasis)*

Consideration of Company's Submissions

22. I have carefully examined and given due consideration to the written and verbal submissions of the Company (through the Company's representative, Mr. Syed Wajahatullah Quadri, Chief Financial Officer of the Company), and have also referred to the provisions of the Ordinance and the issues identified in the Shariah Audit Activity Report for the year 2011. I am of the view that there has been an established default of the Shariah Guidelines, issued by the Shariah Supervisory Board of the general takaful operators read with Section 2(ixiv) of the Ordinance i.e. the idea and definition of the takaful business.

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23. However, before proceeding further, I find it relevant to discuss that the Company has complied with the guidelines and recommendations of the Shariah Advisors of the Company, which is evident from the certificate issued by the Shariah Advisors of the Company, and the Shariah Report for the year 2012.

Conclusion

24. After carefully examining the arguments and studying the facts and findings of the case as mentioned in the above paras hereof, the default of Section 2(ixiv) of the Ordinance was there. Therefore, the penalty as provided under Section 156 of the Ordinance can be imposed onto the Company and/or its Directors.

25. 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, 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

26. In exercise of the power conferred on me under Section 156 of the Ordinance, I, instead of imposing the penalty, take a lenient view, and thus, condone the Company due to fact:

- a. THAT the Company's management has adopted the required procedures and made the rectifications, cancellations or reversals, where required, for all the matters mentioned in the Shariah Audit Activity Report for the year 2011 including matter of Inward Facultative and Co-Takaful sharing with conventional insurers; and
- b. THAT, as per the Shariah Advisors of the Company, the errors identified in the Shariah Audit Activity Report for the year 2011 were not significant in nature, and the Shariah Advisors have made those recommendations to reflect areas of improvement, where management has to either rectify or to put certain controls for better application of Shariah guidelines, which have now been rectified.

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SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Insurance Division

Continuation Sheet 9

27. However, the Company is hereby advised to ensure compliance with the recommendations of the Shariah Advisors of the Company, which were made vide their letter / certificate dated March 19, 2013.

28. 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