SECP
Insurance Division
Karachi

[Karachi]

Before Mohammed Asif Arif, Commissioner (Insurance)

In the matter of

Crescent Star Insurance Company Limited

Show Cause Notice Issue Date: February 1, 2012

Date of Order: September 4, 2014

ORDER

(Under Section 28 Read With Section 11(1), 63(4), Section 63(1) and Section 156 of the Insurance Ordinance, 2000)

....

This Order shall dispose of the proceedings initiated against M/s Crescent Star Insurance Company Limited ("the Company") for not complying with the provisions of Section 28 and Section 11(1) of the Insurance Ordinance, 2000 (the "Ordinance").

Background Facts

2. The provisions of Sub-Section (1)(a) of Section 11 of the Ordinance provide that:

*"**Conditions imposed on registered insurers.-(1)** An insurer registered under this Ordinance shall **at all times** ensure that:*

(a) the provisions of this Ordinance relating to minimum paid-up share capital requirements are complied with;"

3. The relevant provisions of Section 28 of the Ordinance provide that;

*"**Requirements as to capital.-(1)** An insurer registered under this Ordinance to carry on insurance business shall have a paid-up capital of not less than the required minimum amount.*

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(2) For the purposes of this section, the required minimum amount is:

(a) one hundred and fifty million rupees, or such higher amount as may be prescribed by the Federal Government, for an insurer carrying on life insurance business; and
(b) eighty million rupees, or such higher amount as may be prescribed by the Federal Government, for an insurer carrying on non-life insurance business;"

4. The Notification S.R.O. 291(I)/2007 dated March 26, 2007 requires every insurer, registered under the Ordinance, to raise its paid up share capital in the manner given hereunder, which is stated against the status of the Company's paid up share capital on the given deadline:

As At	Required Paid Up Capital	Company's Paid Up Capital	Excess / (Shortfall)
December 31, 2007	120,000,000	96,800,000	(23,200,000)
December 31, 2008	160,000,000	121,000,000	(39,000,000)
December 31, 2009	200,000,000	121,000,000	(79,000,000)
December 31, 2010	250,000,000	121,000,000	(129,000,000)
December 31, 2011	300,000,000	121,000,000	(179,000,000)

5. In view of the above, it appeared to the Commission that the Company has contravened the provisions of Section 28 and Section 11(1) of the Ordinance read with S.R.O. 291(I)/2007 relating to the requirements of paid up share capital for the insurers registered under the Ordinance, for which the Company may be punished under Section 63(1) or Section 156 of the Ordinance.

Show Cause Notice

6. Accordingly, the Show Cause Notice was issued on February 1, 2012 under Section 28 read with Section 11(1), Section 63(4), Section 63(1) and Section 156 of the Ordinance to the Company, its then Chief Executive Officer and the then Directors, calling upon them to show cause as to why the direction, as provided under Section 63(1) of the Ordinance, should not be issued to the Company, and as to why the penalty, as provided under Section 156 of the Ordinance, should not be imposed upon the Company and/or its Directors for not complying with provisions of Section 28 and Section 11(1) of the Ordinance.

Company's Responses to the Show Cause Notice & Hearings

7. In the Company's letter of February 24, 2012, the Company placed adherence on the declining and unfavorable market conditions, which led them to contravene the provisions of the Ordinance relating to the paid up share capital. Furthermore, the

Company, while referring to the extensions given to the other sectors by the Commission and other regulators, expressed that they have written several letters to the Commission for relaxation / extension of the requirement of the paid up capital, which was not responded to by the Commission, and in this way, the insurance sector remained deprived of any such relaxation / extension, especially for the insurance companies that are doing small scale business. Thereafter, the Company referred to the Suit No. 857/2009 in the Honorable High Court of Sindh, which was decreed in favor of the Company.

The Company further stated in their reply that the Company had informed the Commission through their letter dated October 31, 2008 that the Board of Directors of the Company had approved the issue of right shares and the management of the Company had sought certain clarification from the Commission. The said letter, addressed to Mr. Ali Azeem Ikram - Director (Enforcement), stated:

> *"...I am pleased to inform you that the board of Directors in their meeting held on 30th Oct.2008 have approved the issuance of Right shares at a discount to meet the paid up capital requirements as demanded by SECP.. in this connection the Managing Director has been asked to comply with all necessary formalities and take steps as directed.*
>
> *In this connection the Management and the Board Members reviewed the economic conditions as obtaining in the country and were of the opinion that the due to continued closure of the Stock Exchanges and dismal economic conditions, there remains very little investor's confidence and that those shareholders who wish to trade their shares will no longer be able to trade their Right shares in view of continued market closure and as such will face losses in their investment. The company will also loose its image by offering the shares at a discount. There was an opinion that the SECP should extend the date for meeting the capital requirements by at least a year till such time investor's confidence is restored in the economy..."*

The Board of Directors' decision of October 30, 2008 to issue right shares was realized to be defective immediately after their decision, which is quite evident from the Company's letter of October 31, 2008.

8. Through the Company's letter of April 27, 2012, the Company has stressed upon introduction of risk-based capital regime, rather than the minimum capital requirement for consideration of the Commission.

9. Previously, through the Company's letter of December 1, 2011, the Company had mentioned that they were in the process of merger / acquisition of M/s Agro General Insurance Company Limited, which cannot be pursued without a revised timeframe for the minimum capital requirement, for which the Company offered the Commission for developing a joint strategy to revise the requirements. The Company further informed that their lead reinsurer (Mitsui Sumitomo) has placed a

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requirement for renewal of the Company's reinsurance treaty arrangements that the Company must obtain license for doing business in 2012. Thereafter, the Company requested a three years' extension for meeting the requirement of Rs. 300 million.

10. Thereafter, the Company, vide their letter of June 6, 2012, again requested for a relaxation of at least three to five years to meet the minimum capital requirement. Moreover, vide the Company's letter of June 15, 2012, the Company informed the Commission that an investor has been located.

11. Subsequently, vide the Company's letter of April 18, 2013, the Company had informed that the new management has taken over, the Board of Directors have changed and the new Chief Executive Officer was appointed on February 8, 2013, approvals of which are pending before the Commission and further requested to expedite the same. The Company further drew the attention of the Commission to their application for extension in time for holding of the Company's Annual General Meeting (due to the Company's software reporting module's issues appertaining to claims and reinsurance), which would be held on approval of the Board who would be approving and signing the financial statements as well as the grant of requisite extension.

12. On April 22, 2013, the Company's Board of Directors, through circulation, had nominated Mr. Naim Anwar to attend the hearing in the matter of the aforesaid show cause notice and had further authorized him to submit a business plan in respect of capital enhancement to the Commission and / or to any other related authority and get a workable plan approved by the Commission.

Initial Plan of the Company:

13. Vide the Company's letter of April 22, 2013, the Company had submitted their business plan, as directed by the Commissioner (Insurance) during the course of hearing in the matter of the aforesaid show cause notice.

14. Under the said business plan, the Company had discussed the induction of more capital by amalgamation of the Company with M/s Weavers (Pvt) Ltd and M/s Elahi Noor (Pvt) Ltd, whose estimated net asset value was more than Rs. 200 million. The Company further mentioned that the Board of Directors of both the companies will transfer the properties on irrevocable power of attorney in the favor of the Company before merger application, in order to substantiate the capital enhancement in substance. For this, the Company demanded a timeline of around eighteen months, subject to approval of the Board and the Chief Executive Officer of the Company and the legal process before the Commission and the High Court of Sindh.

Business Plan:

15. During the hearing of July 24, 2013, the representatives of the Company had showed their intention to issue right shares and utilize the proceeds of right issue for acquisition of the property / land. Thereupon, during the same hearing, the Company was advised to submit a revised business plan showing the implications of the plan on the solvency position of the Company and the effect of amortization of discount on right issue, for the next three years.

16. Thereafter, in pursuance of the advice during the course of hearing, the Company had submitted its revised business plan. In the said business plan, the Company had showed their intent to raise the paid up share capital of the Company by way of right issue of Rs. 200,000,000/- at Rs. 6 per share (i.e. 40 percent discount) to fulfill the minimum capital requirement.

17. The Company had claimed that the right issue would increase the paid up share capital to Rs. 453,750,000/-. The offer price of the right shares was decided based on the book value per share of Rs. 5.74 per share as of March 31, 2013 and the weighted average price for the preceding six months (January 1, 2013 to June 19, 2013) of Rs. 5.88 per share.

18. Subsequent to the aforementioned claims of the Company, the Company stated that the management of the Company plans to issue 275 percent of the issue capital of the Company as right shares amounting to 33.275 million shares.

19. Thereafter, vide the Commission's letter of August 1, 2013, the Company was advised to meet all the legal and statutory requirements before issuance of right shares at discount, as envisaged in the Company's business plan. It was also emphasized that the Company must ensure adherence to the new solvency regime as laid down in the Securities and Exchange Commission (Insurance) Rules, 2002. Vide the same letter, the Company was strongly advised that all the legal and regulatory requirements be met with regard to the Company's notice to the Karachi Stock Exchange thereby showing its interest in acquisition of twenty one percent shares of M/s Shaheen Insurance Company Limited.

20. However, the approval of the business plan was also given thereby subject to the condition that the decisions of the Board of Directors of the Company are taken diligently in line with the investment policy of the Company and that these decisions do not negatively affect the financial position or the solvency position of the Company. A timeframe of up till November 30, 2013 was thereby granted for the Company to implement the business plan with regard to the minimum paid up and minimum solvency requirements.

Conditional Approval of Right Issuance at Discount:

21. The Company through their letter of September 9, 2013 had submitted an application for approval of the Commission regarding issuance of right shares at a discount of Rs. 4/- per share. The approval in this regard was granted by the Commission on November 13, 2013, thereby the Commission had allowed the Company to issue 49,912,500 ordinary shares (having par value of Rs. 10 per share) at Rs. 6 per share amounting to Rs. 299,475,000 by way of right issue at discount (40%) to the existing shareholders.

22. However, it would be important to state that the approval granted vide the Commission's letter of November 13, 2013 imposed certain requirements and conditions onto the Company, which amongst others were:

(i) The issuance of shares shall be in cash and the Company is required to submit bank statement with this office upon receipt of the subscription money from the shareholders and the underwriters to the issue;

(ii) On the receipt of the share subscription amount, the Company will first meet the requirements of maintaining minimum statutory deposits with the State Bank of Pakistan before investing it elsewhere;

(iii) The Company shall within 15 days of the completion of process of right issuance at discount, submit documentary evidence before the Commission reflecting maintenance of minimum statutory deposit, as required under Section 29 of the Insurance Ordinance, 2000;

(iv) The shares allotted to the directors, their spouses and minor children at discount shall not be disposed of for a period of three years;

(v) The percentage of shares held by the directors shall not increase as a consequence of allotment made otherwise than by way of right offer within a period of three years;

(vi) The Company shall submit before the Commission within 15 days of the completion of right issue at discount process reflecting shares subscribed by:

a. The directors and their families;
b. Banks and financial institutions;
c. General public;
d. Number of shares taken up by the underwriters.

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Schedule of Process of Right Issuance:

23. Thereafter, on December 2, 2013, a follow-up was made with the Company in respect of the deadline of November 30, 2013 as given in the Commission's letter of August 1, 2013, whereby the business plan was approved by the Commission.

24. In response, the Company, through their letter of December 9, 2013, had informed the Commission that the plan to raise the capital is underway and the Company had applied before the Commission for approval of issuance of right shares at discount, which was approved vide the Commission's letter of November 13, 2013 which was received by the Company on November 18, 2013, and attached therewith the tentative schedule for issuance of 412.5 percent ordinary shares at discount.

25. However, subsequently the schedule for issuance of letter of rights as per the Karachi Stock Exchange's letter no. KSE/-10-03 dated January 1, 2014, there has been a slight difference in the tentative schedule provided by the Company, as aforesaid. The schedule given by the Karachi Stock Exchange showed the following picture:

Post-Right Issuance Submissions:

26. In order to inquire about the updated status on issuance of right shares, as stipulated in the aforementioned letter of the Karachi Stock Exchange, the Commission had sent a letter to the Company on April 21, 2014, calling upon the Company to furnish the documentary evidences of the said right issuance.

27. Through the Company's letter of April 20, 2014, which was received on April 23, 2014, following documents were submitted by the Company:

a. Auditor's certificate in respect of right issue;
b. Form 3;
c. Approval of the Karachi Stock Exchange; and
d. Confirmation from the State Bank of Pakistan regarding pledge of PIB's as statutory deposit under Section 29 of the Insurance Ordinance, 2000;

28. The Company had also disclosed the shares subscribed by the Directors and their families, Banks and financial institutions, General public and the Underwriters, as follows:

Shares Subscribed By	No. of Shares
Directors and their families	1,512,375
Bank and financial institutions	5,568
General public	9,257,591
Underwriters	39,136,966
Total Right Shares Issued	49,912,500

29. The Auditor, M/s Rahman Sarfaraz Rahim Iqbal Rafiq, Chartered Accountants, vide their letter of March 18, 2014 (issued in Duplicate), had confirmed that an overall amount of Rs. 299,475,000/- has been received in the Company's bank account maintained with UBL Bank at I. I. Chundrigar Road - Karachi bearing account no. 06051348268, as per the confirmation from the said Bank received / looked at by the said Auditor. The Auditor further confirmed that the underwriters have deposited a payment of Rs. 234,821,796/-. The Auditor had also confirmed that after the issuance of the right shares, the revised paid up share capital of the Company has reached to an amount of Rs. 620,125,000/- (i.e. 62,012,500 shares of Rs. 10/- each).

30. If the issuance of right shares, as disclosed by the Company in their letter of April 20, 2014 is taken as final, the payment credited into the bank (as per the Auditor) would be as follows:

Shares Subscribed By	No. of Shares	Payment Credited into the Bank
Directors and their families	1,512,375	9,074,250
Bank and financial institutions	5,568	33,408
General public	9,257,591	55,545,546
Underwriters	39,136,966	234,821,796
Total Disclosed	49,912,500	299,475,000

31. It would be most important to state that the Company was required to provide the bank statement of account in which the proceeds of the right issuance were received, which was not provided by the Company. This condition was placed by the Commission vide the Commission's letter of November 13, 2013, through which the right shares issue at a discount of Rs. 4/- each share was approved .

32. Hence, regardless of whether the proceeds of the said right issue were actually received by the Company in a special account for this purpose, non-compliance of the conditions imposed vide the said approval of the Commission seems to be quite obvious.

33. On perusal of the copy of the bank statement of account no. 060501348268 from March 10, 2014 to March 12, 2014, it further appeared that it is the same bank account in which the proceeds of right shares were received and that the Company had incurred transactions and made payments for the purchase of properties, during the period of the said bank statement. Thus, the purpose of No Objection Certificate from the Karachi Stock Exchange for allowing the Company to utilize the proceeds of the right shares greatly fails.

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34. The Karachi Stock Exchange, vide their letter no. KSE/C-10-1961 dated March 20, 2014, had issued a No-Objection Certificate to the Company for release of the subscription amount received in respect of the subject right issue.

35. An unregistered copy of the Form 3 provided by the Company, shown as filed by the Company on March 31, 2014 with the relevant Company Registration Office of the Commission through eServices, showed that 49,912,500 shares were allotted in cash at an overall discount of Rs. 199,650,000/- (i.e. Rs. 4/- per share).

Statutory Deposit:

36. The status of statutory deposit under Section 29 of the Insurance Ordinance, 2000 to be deposited / pledged with the State Bank of Pakistan can be seen from the State Bank of Pakistan's letter no. Bkg. U-10/Sec./7754/Ins-95-2014 dated April 4, 2014, which shows that the Company pledged / deposited 11.25% 3-Years' PIB's having market value on the day of deposit as Rs. 49,325,635/- i.e. March 31, 2014, thereby making up the total statutory deposits of Rs. 61,425,635/-, and hence, leaving a shortfall of Rs. 586,865/-, as 10 percent of the paid up share capital would arrive at Rs. 62,012,500/-.

Hence, as per the status provided by the State Bank of Pakistan, the Company appeared to be non-compliant with respect to the statutory deposits as on April 4, 2014.

37. However, as per the State Bank of Pakistan's letter no. Bkg. U-10/Sec./16655/Ins-95-2014 dated August 5, 2014, the Company had additionally deposited the Pakistan Income Fund units having market value of Rs. 624,941.26/- on the day of deposit i.e. July 15, 2014.

Consideration of Company's Submissions

38. I have carefully examined and given due consideration to the written and verbal submissions of the Company, its Directors and the Management of the Company, and have also referred to the provisions of the Ordinance and S.R.O. 291(I)/2007 dated March 26, 2007. I am of the view that there has been an established default of Section 28 and Section 11(1) of the Ordinance appertaining to the minimum paid up capital requirement till the issuance of right shares, as aforesaid.

39. However, before proceeding further, I find it relevant to comment on the duties of the Directors. The Directors, in addition to the day-to-day running of the Company and the management of its business, also have some 'fiduciary' duties i.e. duties held in trust and some wider duties imposed by statute and breach of these statutory duties will usually be a criminal offence, punishable by fine or

imprisonment. Hence, the Directors are gauged against a higher standard of accountability which requires them to be vigilant and performing their duties with due care. In the instant case, however, the Company and its Directors have failed to perform their duties with due care and prudence. As the Directors are supposed to be well aware of their legal obligations in connection with the aforesaid statutory requirement of Section 28 and Section 11(1) of the Ordinance, therefore, it could be legitimately inferred that the default was committed knowingly, and that a considerable time was gained in attempting to ensure compliance of the said requirement of the law.

Conclusion

40. After carefully examining the arguments and studying the facts and findings of the case as mentioned in the above paras of this Order, the defaults under Section 28 and Section 11(1) of the Ordinance are established. Therefore, the penalty as provided under Section 156 of the Ordinance can be imposed onto the Company, its Directors and/or its Management.

41. Section 156 of the Ordinance states that:

> *"**Penalty for default in complying with, or acting in contravention of this Ordinance.-** Except as otherwise provided in this Ordinance, any insurer who makes default in complying with or acts in contravention of any requirement of this Ordinance, or any direction made by the Commission, the Commission shall have the power to impose fine on the insurer, and, where the insurer is a company, any director, or other officer of the company, who is knowingly a party to the default, shall be punishable with fine which may extend to one million rupees and, in the case of a continuing default, with an additional fine which may extend to ten thousand rupees for every day during which the default continues."*

Order

42. In exercise of the power conferred on me under Section 156 of the Ordinance, I, instead of imposing the maximum penalty as provided therein, take a lenient view, and thus, impose a fine of Rupees Five Hundred Thousand Only (Rs. 500,000/-) onto the Company due to the reasons that the basis for default was laid down by the previous Board of Directors of the Company and that the current Directors have now complied with the minimum paid up capital requirements.

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

43. *M/s. Crescent Star Insurance Company Limited* is 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 a receipt thereof..

44. 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.

Mohammed Asif Arif
Commissioner - Insurance