



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

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BEFORE APPELLATE BENCH

In the matter of

Appeal No. 41 of 2011

East West Insurance Company Limited Appellant

Versus

Executive Director (Insurance)
Securities and Exchange Commission of Pakistan Respondent

Date of hearing 29-04-11

ORDER

Present:

For the Appellant:

Mr. Rizwan Ali Dodani, Advocate
Mr. Kazim Raza
Mr. Imran Ali Dodani

Department representatives:

Mr. Tariq Hussain, Director
Muhammad Kashif Siddique, Joint Director
Mr. Ameer Hassan, Deputy Director
Mr. Sharick Ather Rahman, Junior Executive



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1. This order shall dispose of appeal No. 41 of 2011 filed under section 33 of the Securities and Exchange Commission of Pakistan (the “Commission”) Act, 1997 (the “SECP Act”) against the order dated 20-01-11 (the “Impugned Order”) passed by the Respondent.
2. Onsite inspection of the Appellant was conducted under order of the Respondent dated 23-06-10, in exercise of the powers conferred under section 59A (1) of the Insurance Ordinance, 2000 (the “Ordinance”). It was revealed that different policies were issued on a single risk; the Appellant had retained multiple retention of premium per risk instead of single retention which was contrary to the terms and conditions of its reinsurance treaty. It was observed that the Company carried a risk of premature cancellation of its reinsurance treaty.
3. Show cause notice dated 15-11-10 (“SCN”) was issued under section 41 read with section 11(1) (d) and section 156 of the Ordinance to the Chief Executive Officer and the directors of the Appellant. The Appellant filed reply to the SCN and hearing in the matter was held. The Respondent, dissatisfied with the response of the Appellant, passed the Impugned Order and imposed a penalty of Rs 500,000.
4. The Appellant has preferred the instant appeal against the Impugned Order. The Appellant’s counsel argued that:
 - a) the Appellant’s reinsurance treaty was executed between the Appellant, as an insurance company, and the reinsurers; hence, the Commission has no jurisdiction as third party to this arrangement;



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- b) the Appellant retained multiple retentions in various policies issued on a single risk since there was no such restriction in the reinsurance treaty clauses. In terms of the Insurance Association of Pakistan (“IAP”) Building Regulation 10 a single risk could be safely divided in various sections where spacing is reasonable and any incident of fire would not affect the surrounding compartments. The aforementioned regulation is reproduced for ease of reference:

“Distances-Separate Buildings: of Classes I-A, 1 and Construction:

Buildings or Compartments, having opposing openings within 10 feet (3M) of each other must not be treated as separate risks for rating purposes unless the openings are protected by Single Fire Proof Doors or Shutters approved by the Insurance Association of Pakistan

Buildings or Compartments of class III construction having opposing openings within 20 feet (6M) of each other must not be treated as separate risks for rating purposes, except in the case of buildings, where one of the opposing walls is of brick, stone or cement set in cement line or mortar with all openings protected by single fire proof doors or shutters approved by the I.A.P”

5. The department representative argued that:

- a) reinsurance treaties form the back bone of insurance business and its execution and the compliance thereof fall within the preview of the Commission;



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- b) in case the insurance company is found in contravention of its reinsurance treaty, the reinsurer at any time during the examination of treaty returns can cancel the reinsurance treaty arrangements, which could have serious consequences for the ceding company. The Appellant's reliance on IAP Building Regulation 10 cannot be accepted as the reinsurance treaty itself defines "Any one risk" in the following terms:

"For the purposes of this Reinsurance "Any one Risk" is defined as any building &/ or complex including all values at adjacent properties and Business Interruption &/or loss of profit in any one compound

The term of "One Compound" used herein is defined as any enclosed space, lot, site, premise &/or enclosure typically fenced in space in which the subject building &/or complex-including adjacent properties stands.

As for Contractor's All Risks, Erection All Risks and Machinery Breakdown, "Any One Risk" is defined as any building &/or complex including all values at adjacent properties or all values in any one compound &/or construction site including Third Party Liability Limit when written in conjunction with the main policy."

6. We have heard the parties and have gone through the law on the subject. Our findings on the issue are:



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- a) Section 20(4) (r) of SECP Act, section 2(xxvii) and section 2(lii) of the Ordinance have been reproduced for ease of reference:

20. Powers and Functions of the Commission (4) The Commission shall be responsible for the performance of the following functions:

(r) exercising all powers, discharging all duties and performing all functions assigned to the Commission under, and generally administering, the Law of Insurance;

Emphasis added

2(xxvii) "insurance" means the business of entering into and carrying out policies or contracts, by whatever name called, whereby, in consideration of a premium received, a person promises to make payment to another person contingent upon happening of an event, specified in the contract, on happening of which the second- named person suffers loss, and includes reinsurance and retrocession:

Provided that a contract of life insurance shall be deemed to be a contract of insurance notwithstanding that it may not comply with the definition setout in this clause;

Emphasis added

2(lii) "reinsurance" means a contract of insurance under which the event, specified in the contract, contingent upon the happening of which, payment is promised to be made to the policy-holder



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thereunder, is payment by the policy-holder of a claim or claims made against that policy-holder under another contract or contracts of insurance, issued by that policy-holder.

Emphasis added

In terms of section 20 (4) (r) of SECP Act, the *Laws of Insurance*, including the Ordinance, are administered by the Commission. Section 2(xxvii) and section 2(lii) of the Ordinance categorize insurance and reinsurance respectively as a contract. The Commission, thus, has been given the powers to regulate the contract of insurance including reinsurance. Section 41 of the Ordinance deals with reinsurance, which has been reproduced for ease of reference:

41. Requirement to effect and maintain reinsurance arrangements.-

(1) *An insurer shall effect and shall at all times maintain such reinsurance arrangements as are, in the opinion of the directors (or such other person or body responsible for conducting the management and business of the insurer), formed on reasonable grounds, having regard to the exposures of the insurer in respect of individual contracts accepted and in respect of aggregate losses arising out of individual events, adequate to ensure continuing compliance by the insurer with the provisions of the Ordinance relating to solvency.*

2) *Every insurer shall submit to the Commission, in the manner prescribed by the Commission and not less than one month prior to the coming into effect, or as soon as practicable thereafter, of any treaty reinsurance arrangement entered into by the insurer as*



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cedant, such features of that reinsurance arrangement as may be prescribed by the Commission.

(3) Where any reinsurance treaty the particulars of which have been submitted to the Commission under sub-section (2) is altered or any new treaty reinsurance arrangement is made after the submission of the information under sub-section (2), the insurer concerned shall submit to the Commission, in the manner prescribed by the Commission, particulars of such alteration in the treaty or such new treaty reinsurance arrangement within one month of such alteration or arrangement and shall submit such further information or clarification as the Commission may require.

(4) The Commission may, at any time and after giving the insurer an opportunity of being heard, for reasons to be recorded in writing, direct the insurer to make such modifications in his reinsurance arrangements as the Commission may specify.

(5) The Federal Government may make rules, not inconsistent with subsection (1), governing the reinsurance outside Pakistan, other than on a treaty basis, of insurance business underwritten by an insurer in Pakistan.

Explanation:- For the purposes of this section, "reinsurance" includes "retrocession"

Emphasis added

The Commission has been entrusted with powers to oversee reinsurance arrangements outlined in section 41 of the Ordinance: *firstly*, the



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reinsurance treaties are to be submitted to the Commission by the insurer in terms of section 41(2) of the Ordinance, *secondly*, the insurer concerned shall submit to the Commission particulars of alteration in the treaty or new treaty entered into in terms of section 41(3) of the Ordinance and *finally* the Commission may direct the insurer to make modifications in its reinsurance arrangements in terms of section 41(4) of the Ordinance.

Section 41(1) of the Ordinance gives the prerogative to the directors of a company to decide as to whether or not the re-insurance arrangements are adequate in order to ensure continuing compliance by the insurer with the provisions of the Ordinance relating to solvency. We do not see any violation of section 41 of the Ordinance in the instant case. Be that as it may, the *compliance* of re-insurance treaty cannot be left at the sole discretion of the directors of the company. The Commission has been entrusted with the powers to oversee the *contract of insurance* in terms of 20 (4) (r) of SECP Act read with 2 (xxvii) and 2 (lii) of the Ordinance and as and when the directors transgress their powers, the Commission can take action against the directors to ensure the interest of the policy holder.

- b) the Appellant was in contravention of its reinsurance treaty as the Appellant was not complying with the definition of 'risk' given in the reinsurance treaty and as a result was retaining multiple retention of premium per risk instead of single retention. The Appellant counsel's reliance on IAP Building Regulation 10 to justify multiple retentions cannot be accepted as in terms of reinsurance treaty "*Any One Risk*" was defined as *any building &/or complex including all values at adjacent properties or all values in any one compound &/or construction site*, thus, defeating the argument of Appellants counsel on multiple retentions in various policies issued on a single risk.



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In view of the above, the Appellant is directed to comply with the requirements of the reinsurance treaty in letter and spirit. The Impugned Order is set aside to the extent of the penalty as violation of section 41 could not be established. Parties to bear their own cost.

(MUHAMMAD ALI)
Chairman

(MR. TAHIR MEHMOOD)
Commissioner (CLD)

Announced on: 17th June 2011