



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN INSURANCE DIVISION

[Karachi]

Before Ms. Nasreen Rashid, Executive Director (Insurance)

In the matter of

M/s East West Insurance Company Limited

Date of Show-Cause Notice: November 15, 2010
Date of Hearing: January 17, 2011
Attended by: (1) Mr. Naved K. Yunus, Managing Director & Chief Executive
(2) Mr. Kazim Raza, Director (Operations)
Date of Order: January 20, 2011

ORDER

(Under Section 41(1) Read with Section 11(1)(d) and Section 156 of
The Insurance Ordinance, 2000)

This Order shall dispose of the proceedings initiated against M/s East West Insurance Company Limited (hereinafter referred to as "the Company") for making a default in complying with the requirements of Section 41 and Section 11(1)(d) 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)(d) of the Ordinance, states that:

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

...
(d) the provisions of this Ordinance relating to the obtaining of reinsurance arrangements are complied with;"

2. The provisions of Section 41(1) of the Ordinance state that:

"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 this Ordinance relating to solvency."

3. An onsite inspection of the Company was conducted under the Order of the Executive Director of the Insurance Division dated June 23, 2010, in exercise of the powers conferred under Section 59A(1) of the Ordinance.

4. One of the findings of the onsite inspection was that different policies were issued on a single risk, the Company has retained multiple retention of premium per risk instead of single retention which is contrary to the terms and conditions of the treaty. Therefore, it was observed that the Company is in violation of the terms and conditions of the treaty arrangement and may carry a risk of premature cancellation of its reinsurance treaties.

Show-Cause Notice

5. On November 15, 2010, a Show-Cause Notice under Section 41 read with Section 11(1)(d) 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 not maintaining proper accord in respect of the reinsurance treaty arrangements, thereby making contraventions of the provisions of Section 41 and Section 11(1)(d) of the Ordinance.

Company's Reply

6. The Company, in response to the Show-Cause Notice vide its letter of December 3, 2010, argued as under:

"During on site inspection by SECP it was observed that EWI had issued multiple policies of a single risk with separate retention on each policy. According to them it was against the terms of the treaty agreement thereby holding the treaty premium by retaining excess amount to own account. Having received this notice we reviewed our premium register and noticed that our software is incapable of detecting location-wise position of each risk. Simultaneously when different locations are involved in a single risk, multiple retentions had not been applied. This was basically a software error and hence we clarified our position vide letter dated September 16, 2010. However we continued our efforts to improve our system in order to comply the terms of treaty agreement.."

After careful scrutiny of our premium register followed by investigation with our underwriters, we came to know that single risk where divided into number of policies was in accordance with IAP Building Regulations 10 of Fire Tariff. This regulation requires that where buildings and or compartments, having opposite openings with a clear distance between 10 to 20 feet from each other



should be covered under separate policies. Resultantly, retention on each policy is applied separately by the ceding company and the excess amount in each policy is placed under treaty. Hence, there is neither any violation of the treaty agreement nor the reinsurers are being deprived of premium under treaty. As a matter of fact under these arrangements the reinsurer is benefited as some of the facultative premium is also offered to them.

In view of the above clarification, SECP observation with regard to additional retention of Rs.2.9 million is not fair. In fact, treaty premium has also increased proportionately through share in each policy. Hence EWVI has not been in default of treaty terms which would compel the reinsurer for premature cancellation of agreements.

Simultaneously, it may also be mentioned that reinsurance arrangements as per Section 41(1) of the Insurance Ordinance 2000, is the prerogative of the Directors/management of the insurance company and they are the best judge to maintain suitable reinsurance protection for the company to maintain its solvency."

7. The reply of the Company revealed that the Company has been recording the underwriting data on a defective software application, which never enabled the Company to detect the location-wise position of each risk. And, the management of the Company never found out this incapability/limitation of such an important software application before the inspection team dug out the inconsistency in the recording of the underwriting and reinsurance process.

8. Additionally, the Company has assured that they will continue to improve their system in order to comply with the terms & conditions of the treaty arrangement, which further implies that the Company has somehow admitted that they have been contravening the terms & conditions of the reinsurance treaty arrangements.

9. The abovementioned implications of the Company's reply left a question mark on the Company's management as well as its reinsurance treaty arrangements.

10. Initially, the hearing was scheduled for December 28, 2010, which was communicated to the Company vide Commission's letter of December 10, 2010. However, the Company vide their letter of December 13, 2010, authorized Mr. Naved Yunus, Managing Director & Chief Executive of the Company to represent the Company on behalf of the Board of Directors, and requested to reschedule the hearing on any convenient date after January 15, 2010 due to non-availability of the authorized representative of the Company.



11. Therefore, the hearing in the matter was rescheduled for January 17, 2011 at 11:30 a.m., which was communicated to the Company vide Commission's letter dated December 20, 2010

Proceedings of the Hearing

12. At the commencement of the hearing (which was held on January 17, 2011), the Company's representatives presented a "General Power of Attorney" duly authorizing Mr. Naved K. Yunus to be the true and lawful attorney of the Company in the name.

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

- a. The software system was not capable of handling the treatment of Company's retention of the risks being underwritten, in some of the cases, it was picking up multiple retentions on a single risk, whereas on the other hand, a single retention was being picked up on multiple risks. Hence, the software application was not working as it was supposed to.
- b. The Company's representatives admitted that the software system was erroneous, which could lead the Company into deep trouble with regards to the payment of claims to the policyholders of the Company.
- c. The Company's representatives further admitted that the default of the applicable terms and conditions of the reinsurance treaty, and thereby the default of Section 41(1) and Section 11(1)(d) of the Ordinance.
- d. On behalf of the Company, they also admitted that the Company needs to invest more on the acquisition of error-free IT infrastructure, so as to make sure that the Company does not bear any heavy losses due to any such errors in the software system, in future.

Consideration of the Submission

14. 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 41(1) read with Section 11(1)(d) of the Ordinance, therefore, it could be legitimately inferred that the default was committed knowingly and willfully.

Conclusion

15. After carefully examining the arguments and studying the facts and findings of the case as mentioned in the above paras of this Order, the default of Section 41 read with Section 11(1)(d) of the Ordinance is established and the Company has also accepted its default. Therefore, 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

16. In exercise of the power conferred on me under Section 156 of the Ordinance, instead of imposing the maximum penalty, I impose a fine of Rs. 500,000/- (Rupees Five Hundred Thousand Only) due to the fact that the Company has assured that the error in the system shall be fixed without delay. 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.

17. *M/s. East West Insurance Company Limited* are hereby directed to deposit the aforesaid fine of only 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.

Nasreen Rashid
Executive Director