



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN INSURANCE DIVISION

[Karachi]

Before Nasreen Rashid, Executive Director (Insurance)

In the matter of

M/s. Takaful Pakistan Limited

Show cause notice date
Date of First Hearing

August 15, 2009
September 01, 2009

Attended by

Mr. Zaigham Mahmood Rizvi, Chairman
Mr. Capt. Jamil A. Khan, Chief Executive Officer
Mr. Ashraf Ali Siddiqui, Dy. General Manager (Operation)

Date of Second Hearing

September 17, 2009

Attended by

Mr. Capt. Jamil A. Khan, Chief Executive Officer
Mr. Ashraf Ali Siddiqui, Dy. General Manager (Operation)
Dr. Ludwig Stiffl, CEO of Munich Re Retakaful
Mr. Christopher Burdett (Underwriter – ERV Group)

Date of Order
Date of Appeal
Date of Hearing of Appellate Bench

October 9, 2009
November 05, 2009
March 02, 2010

Attended by

Mr. Muhammad Umer (CFO and Company Secretary),
Mr. Ashraf Ali Siddiqui (DGM Operations and acting CEO)
Mr. Sameer-Uddin Ali Khan, Advocate (Legal Counsel for
the company).

Date of Appellate Bench Order
Date of Hearing

April 30, 2010
May 17, 2010

Attended by

Mr. Muhammad Umer (CFO and Company Secretary),
Mr. Ashraf Ali Siddiqui (DGM Operations and acting CEO)
Mr. Sameer-Uddin Ali Khan, Advocate (Legal Counsel for
the company).

Date of Order

May 21, 2010

ORDER

(under Section 76 (5) read with Section 76(1), 76(4), 95 and 100
of the Insurance Ordinance, 2000)

.....

This Order shall dispose off the proceedings initiated against M/s. Takaful Pakistan Limited (hereinafter referred to as "the Company") for making default in complying with the provisions of Section 76 (1), 76 (4), 95 and 100 of the Insurance Ordinance, 2000 ("the Ordinance").



Background Facts

2. The relevant facts for disposal of this case, briefly stated, are that in pursuance of the following Sections:

- (a) *Section 76 (1) of the Ordinance which provides that an insurer shall not, in the course of its business as an insurer, engage in conduct that is misleading or deceptive or is likely to mislead or deceive; and*
- (b) *Section 76 (4) of the Ordinance which provides that where a policy holder has relied upon any representations by an insurer or by an agent of an insurer which are incorrect in any material particular, inasmuch as it has the effect of misleading or deceiving the policyholder in entering into a policy, the policyholder shall be entitled to obtain compensation from the insurer for any loss suffered; and*
- (c) *Section 95 of the Ordinance which provides that every insurer shall, so far as relates to a contract of insurance entered into by the insurer through an agent, be liable to the policyholder for the acts or omissions of that agent as though that agent were an employee of the insurer, in circumstances where the policyholder has relied in good faith on the agent and as a consequence has suffered loss or damage. Liability shall be absolute and shall not be capable of being contracted out of, either in the agency agreement or on a policy, proposal or other document; and*
- (d) *Section 100 of the Ordinance which provides that that an agent acting for an insurer shall disclose to the policyholder or intending policyholder the fact that he acts as an agent for that insurer and any relationship between the agent and the insurer.*

3. An inspection was conducted by the Insurance Division of the Commission from April 6 to April 10 of 2009 in exercise of the powers conferred under section 59A of the Insurance Ordinance, 2000. The said inspection focused on the Amaan Travel & Health Takaful Package, which is a takaful product launched in October 2008, marketed and sold through Travel Agents (members of Travel Agent Association of Pakistan, TAAP).

4. The said Inspection revealed that the Company's management has failed to meet with the requirements as specified in point No.2 by not giving due regard to the interest of the policyholders in respect to Amaan Travel Takaful Package (Standard) and not making full disclosure of material information to the policyholders by practicing misleading and deceptive market conduct. Beside the said deceptive market conduct, several other non-compliances of the aforesaid Sections of the Ordinance were discovered by the Inspection team which are as follows:

- a) The Travel agents are working in the dual role of the Company's Takaful Agents and also Participants in the Participant Takaful Fund.
- b) The Travel Agents acting as Takaful Agents did not fulfill the basic requirement to complete a contract that is, existence of an "offer" and "acceptance".
- c) Complete disclosure of material information was not made by the Travel Agent to the passenger.
- d) The Company has not maintained separate record for cases in which the amount of premium / contribution was paid by the passenger and by the travel agent.



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- e) Complete details of the legal heirs of the passenger were not noted down by the travel agents, even though the Amaan Standard product insures the accidental death of the passenger.
- f) Rs.70 was being set aside by the company from Rs. 600 collected under the SATT from the passengers by way of contribution and was used to build a collateral reserve for the financial default of TAAP.
- g) The Company has violated the basic concept of the law of Contract by issuing the Financial Guarantees without charging any contribution.

5. A Show Cause Notice dated August 15, 2009 under Section 76 (1), 76 (4), 95 and 100 read with Section 76 (5) of the Ordinance was served on the Chief Executive and Directors of the Company, calling upon them to explain as to why appropriate action may not be taken against the Company under the law for the aforesaid contraventions. As the Company was likely to continue in the future with these aforesaid non-compliances, therefore in the best interest of the policyholders and potential policyholder a Directive under section 63 (1) of the Ordinance on the same date was issued to the Company, to cease entering into new contract of this takaful product which would have been effective from September 15, 2009.

6. The management of the Company had requested in its letter dated August 25, 2009 to extend the 30 days time to reply to the said show cause notice and Directive which was not acceded to. In order to provide an initial opportunity to the Chief Executive and Directors of the Company or their authorized representatives for appearing in person to explain the circumstances which had lead to non-compliance with the said provisions of the Ordinance, a hearing in this matter was scheduled on September 01, 2009 and hearing notices were sent to the Chief Executive and Directors of the Company on August 26, 2009.

7. The said hearing was attended by the Mr. Zaigham Mahmood Rizvi (Chairman), Mr. Capt. Jamil A. Khan (Chief Executive Officer), Mr. Ashraf Ali Siddiqui (Dy. General Manager -Operation).

8. The management of the company presented the following evidence in reply to the observations of the Commission:

- a. pictures of the notice board placed in the office of the travel agents.
- b. written proof of a lump sum contribution of Rs. 15ml paid by TAAP.

9. The Commission observed that it was satisfied with their clarification about the contribution. However, by merely placing a notice on the wall, the company had failed to discharge its responsibility of making full disclosure of material information to the policy holders. It should have provided complete written information to the policy holders of all the terms and conditions of the policy as well as the claim settlement procedure.

10. The Company had issued an open policy in the name of the Travel Agents Association of Pakistan, who were the policy holders and the passengers were the beneficiaries. The policy holders (TAAP) were selling this policy to the passengers and charging contribution from them. If the passenger objected and refused to pay, the travel agent would then give the policy on a complimentary basis. The Commission asked the Company to explain why it allowed the policyholder (Travel agent) to sell his policy to the passenger and charge contribution from him. The company could not give a satisfactory reply to this mal-administration.

11. Furthermore, the Company did not maintain separate records for cases in which the passenger had paid the contribution and where the travel agent had paid the premium. The Commission observed that this mal-administration on the part of the Company created ambiguity on whether the passenger or the travel agent would be the recipient of the surplus at the end of the year. The Company accepted the



fact that it has failed to maintain any records to this effect. Neither did the Company give a satisfactory explanation on other related issues of this unethical practice.

12. The Commission asked the Company to explain why information of the 'next of kin' was not procured and documented by them or the travel agents. Due to lack of this essential information, it would not be possible to pay the claim to the legal heirs of the passenger in case of his death. The Company again expressed its ignorance and failed to satisfy the Commission on this account.

Furthermore, the Commission demanded an explanation as to why did the Company's management fail to take any action against the TAAP when it discovered that the 'next of kin' fields were empty and no information was being recorded by the travel agents. The company failed to give an explanation.

13. Accepting its failure to satisfy the Commission on these points, the management of the Company requested the Commission to grant them an extension of 15 days, so that it could rectify the mal-administration which had been established. One more week was allowed by the Commission vide its letter dated September 01, 2009.

14. Mean while, as there is no Shariah expertise available within the SECP, the Insurance Division had referred this case to the Shariah Board of the State Bank of Pakistan in their 29th meeting to check and verify the Shariah based non-compliances. After thoroughly investigating the issues, the State Bank of Pakistan's Shariah Board concluded that there are two important points from Shariah perspective i.e.

" (i) apparent non-disclosure of benefits of the AMAAN Travel Takaful Package to the customers & (ii) treatment of amount collected as contribution during the period from October-2008 to March-2009."

Shariah requires transparency & proper disclosure and TPL is required to explain all the benefits to the customer while selling its products. In order to avoid any ambiguity, a proper mechanism for disclosure need to be developed by TPL which could be provided to customers in printed form. Regarding the status of the fund accumulated during the period i.e. from October-2008 to March-2009 (without getting Shariah approval of the product from TPL's Shariah Board), since Shariah Board of TPL was investigating the matter during such time period, therefore, taking lenient view, TPL may be reprimanded. Though the practice adopted by TPL had its short comings which demands immediate measure. However, keeping in view the infancy stage of Takaful industry any severe or penal action on the above Shariah related matters at this stage against TPL may affect the progress of the Takaful industry.

Therefore, SECP may continue its supportive and facilitative role to strengthen and promote the infant Takaful industry."

15. On September 17, 2009 the management of the Company and its Reinsurance Company (M/s Munich Re) made their presentation to satisfy the Commission that the Company had made effective changes in the product selling and distribution network in order to remove all such discrepancies reported under the aforesaid sections and accepted by the company's management. The Commission accepted the point of view of Munich Re that 'Financial Guarantee' should be treated as a 'default cover'. On the basis of their positive global exposure with affinity groups, Munich Re had extended its Reinsurance protection to this 'default cover'. They had experienced that as affinity groups do not group together only to buy insurance cover but have other common needs and interest, therefore the element of moral hazard and the chances of default are very low.

However, some areas regarding the complete disclosure of the terms and conditions of the policy including the claim settlement procedure and the discretion given to TAAP to charge contribution from the passenger still remained unsatisfactory. The Commission again advised the Company's management to rectify those areas which the management agreed to do. Upon receiving an application dated September 18, 2009 made by the Company requesting the Commission to again extend the time to



remove such discrepancies, the Commission had granted further one week's time upto September 28, 2009.

16. In order to confirm whether the Company has made total compliance of each and every default before the expiry of the deadline, an Order of inspection under section 59A was issued. On 25th September 2009, the Inspection team visited the Company's Head Office located at Office 2nd & 3rd Floors, Dadex House, 34-A/1, PECHS, Block-6, Main Shahra-e-Faisal, Karachi and Shirazi Travels (a travel agent) located at Ground Floor, Mehran Hotel, Shahra-e-Faisal, Karachi. It was verified by the team that full and complete disclosure of the policy terms and conditions and the claim settlement procedure had been made by incorporating the changes in the system of the company and TAAP. The following disclosure had also been incorporated on the face of the Amaan Travel certificate:

"Our standard 'AMAAN' Travel Takaful coverage as indicated on this certificate is offered by our participating Travel Agents to the passengers on complimentary basis".

17. The Commission was satisfied with the changes made therein and accordingly revoked the Directive issued under section 63(1) of the Ordinance.

18. However, due to the fact that the management has accepted their default of committing the aforesaid non-compliances, the Commission is of the view that these defaults are established. During the period from Oct 2008 to September 2009 the Company's management had failed to safeguard the interest of the passengers by practicing misleading and deceptive market conduct.

19. The action against the Company was taken under Section 76 (5) of the Ordinance, and taking a lenient view, a penalty of Rs.5 m (Rupees five million only) was imposed by the Commission instead of imposing maximum penalty under this Section.

Appeal

20. The company filed an appeal no. 63 of 2009 dated November 5, 2009 under section 33 of the Securities and Exchange Commission of Pakistan Act 1997 against the Order (the "Impugned Order") dated October 09, 2009 passed by the Commission.

Hearing against that Appeal

21. The hearing before the Appellate Bench was scheduled on March 02, 2010 which was attended by the Mr. Muhammad Umer (CFO and Company Secretary), Mr. Ashraf Ali Siddiqui (DGM Operations and acting CEO) and Mr. Sameer uddin Ali Khan, Advocate (Legal counsel for the company).

Company's arguments

22. In the said appeal, the arguments put forward by the Appellant were as follows:

a) The Commission misunderstood the scheme that is being operated by the Company with respect to the package. Each travel agent has a two week credit line with the airline in which it has to make the payment to the airline for all tickets that had been issued by the travel agent on behalf of the air line. The travel agent instead of making payment to each airline separately makes payment to a central body by the name of International Air Transport Association ("IATA"), which processes the payment and



then remits it to each airline. In order to provide two week credit line IATA requires a financial guarantee from the travel agent in case of the travel agent defaults on its obligations. Previously TAAP, which represents more than 300 travel agents in Pakistan, provided a single large bank guarantee to IATA on behalf of its member travel agents. In 2007 IATA changed the rule and since then it does not accept a single guarantee from a central body or organization and requires a separate guarantee from each travel agent. The new arrangement created problem for majority of small agents who could not afford to provide a bank guarantee or an insurance guarantee on their own.

The Company introduced the package which was agreed to by the travel agents under an agreement dated 11-03-09 between the Company and TAAP. Each travel agent purchases the package for each ticket it issues. Thus, the travel agent pays Rs.600 to the Company for each international ticket. At all times the beneficiary of the package are the passengers. It is up to the travel agent to charge a passenger for the benefits of the Package, or to give it for free. As far as the Company is concerned, the Company issues the policy to the travel agent for the benefit of passengers, for whom the travel agent pay Rs.600 to the Company, hence the travel agent is the policy holder and the beneficiary of the policy is the passenger.

b) The Commission had observed in the Impugned Order that the management had accepted the default of committing the non-compliances, therefore the defaults are established. It was argued by the Appellant that all conciliatory actions undertaken by the Company were without prejudice to the fact that it had not committed any violation.

c) The Commission had revoked the Directive, which shows that the Commission was satisfied with the Package and the Company did not file reply to the SCN considering that the issue was settled with the revocation of the Directive.

d) The fine of Rs.5 million had been imposed pursuant to Section 76(5) of the Ordinance states that:

"Notwithstanding the provisions of the foregoing sub-section, the Commission shall also have the power to levy a fine on the insurer which shall be equal to the lesser of twice the loss determined to be suffered by the policy holder under the foregoing sub-section and ten million rupees".

The Respondent could not have imposed a fine of Rs.5 million as the loss suffered by the policyholder was not calculated. The figure of Rs.5 million is arbitrarily imposed and should be waived.

Commission's Reply against Company's arguments

23. Against the Company's arguments stated in the above paras of the order, the representative of the Insurance Division replied as follows:

a) Making proper disclosure of the Package to the passengers was the foremost requirement, which was also identified by the Shariah Board. The package was sold by the Company without making any disclosure and in a deceitful way. The passengers were over charged and in case any passenger objected to the charges, the passenger was informed of the package and the amount was deducted from the invoice. In such an eventuality the Package was given on a complimentary basis.

b) The efforts to mend the ways of the deceptive practice of the Company cannot be termed as conciliatory. Time and again the Company was asked to undo the irregularities in the Package, however,



the Company did not pay heed to the directions of the Commission and finally Directive under section 63 of the Ordinance was passed. The defaults were accepted by the Company and it cannot be allowed to back track from its admission in the hearings.

c) The revocation of the Directive was done on the basis of inspection and assurance of the Company that it has made the required disclosures. The revocation of the Directive does not of itself absolve the Company from its past malpractices. Further, even after revocation of the Directive, complaints have been received against the Company that it has been selling the Package to passengers without making disclosures.

d) The penalty was also rightly imposed. However it was very lenient keeping in view the recommendation of the Shariah Board of State Bank of Pakistan and also to encourage the growth of fledgling Takaful Industry in Pakistan.

Appellate Order

24. After hearing both the parties, the Appellate Bench ordered to uphold the Impugned Order on the merits of the case and directed the respondent to re-calculate the fine and issue a fresh Order.

Hearing against Appellate Order

25. In order to provide an opportunity to the Chief Executive and Directors of the Company or their authorized representatives for calculating the fine, a hearing in this matter was scheduled on May 17, 2010 and hearing notices were sent to the Chief Executive and Directors of the Company on May 07, 2010.

26. The said hearing was attended by the Mr. Muhammad Umer (CFO and Company Secretary), Mr. Ashraf Ali Siddiqui (DGM Operations and acting CEO) and Mr. Sameer-Uddin Ali Khan, Advocate (Legal Counsel for the company).

Consideration of Submission

27. During the hearing, the management of the company said that there were no unsettled outstanding claims against the Company, hence no loss was suffered by the policyholders, therefore penalty should not be imposed. Had any claims been lodged on the company by the passengers, the company would have honoured its liabilities.

Furthermore, they stated that the default of complete / proper disclosure of the said takaful cover to the passengers was made by the travel agents rather than the Company. They further stated that their liability was only towards travel agents, who were the policyholders and once the Company had issued the policy, it was not their concern to get involved in the selling techniques used by travel agents, or their relationship with the beneficiary.

Conclusion

28. The Insurance Division has concluded that:

a) As the policy holders were sold 'Amaan Travel Takaful Package-Standard' disguised as 'Takaful Tax', without their knowledge, neither were they given the insurance policy document



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or certificate. In the absence of this document they were not aware of the terms and conditions of the insurance cover. Additionally, the information of the 'next of kin' was not procured and documented by the travel agents or the Company. Due to the lack of this essential information, the legal heirs of the passengers were not able to lodge a claim on the company. The abnormally low claims ratio of the Company as compared to the market average loss ratios, establishes the fact that passengers or their legal heirs could not lodge the claim because they were not aware of this cover. The Company made windfall profits due to this malpractice and their collaboration with the Travel Agents Association of Pakistan.

b) In a few cases, if the passenger found out about this cover and refused to pay the Insurance contribution, the travel agent would then agree to give the policy on a complimentary basis. But the Company did not maintain separate records for cases in which the passenger had paid the contribution and where travel agents had paid the contribution. This mal-administration on the part of the company created an ambiguity on whether the passenger or the travel agent would be the recipient of the surplus at the year end.

c) The Commission observed that in such innovative arrangements, the travel agents were the corporate policyholders (for administrative ease only) but the real policyholders were the individual policyholders, the passengers. Therefore, under no circumstances can the company walk out of or restrict its liability towards the real policyholders. Hence the Company should have laid down the specific roles and responsibilities of travel agents in the MoU which it had signed with the TAAP.

29. In view of the above, and the company's acceptance of committing these acts of mal-administration, it has been determined that thousands of policyholders suffered a huge loss because they were fleeced and forced to pay the contribution without getting anything in return. Furthermore, they could not even lodge the claims because they were not aware of the existence of the cover. This malpractice which has been established from October 2008 to September 2009, generated huge revenue from the "Aman Travel Takaful Package-Standard", as per the figures provided to us by the company's management.

Gross Contribution up to Dec 2008	Rs.	35,382,921	
Gross Contribution up to Sep 2009	Rs.	121,928,380	
Total Gross Contributions			Rs. 157,311,301
Gross Claims Incurred up to Dec 2008	Rs.	(123,000)	
Gross Claims Incurred up to Sep 2009	Rs.	(391,022)	
Total Gross Claims			Rs. (514,022)
Total Loss suffered by the policy holders			Rs. <u>156,797,279</u>

30. Whereas Section 76(5) of the Ordinance provides that:

"Notwithstanding the provisions of the foregoing sub-section, the Commission shall also have the power to levy a fine on the insurer which shall be equal to the lesser of twice the loss determined to be suffered by the policy holder under the foregoing sub-section and ten million rupees".



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31. As per this Section 76 (5) the calculation of fine on the Company is as follows,

Total loss suffered by the policyholder = Rs.156,797,279

Twice of loss suffered by the policyholder = Rs.313,594,558

Whereas the fine that can be imposed, is lesser of twice the loss suffered by the policy holder and Rs.10 million, which shall be Rs.10 million in this case.

Order

32. Based on the facts and findings of the case as mentioned in the above paras of this Order, the default of Section 76(1), 76(4), 95 and 100 of the Ordinance is established. Therefore action against the Company should be taken by imposing a fine under Sub-section (5) of Section 76 of the Ordinance. In exercise of powers conferred on me, I impose a fine of Rs.10 m (Rupees ten million only) on the Company, as that is the lesser amount. In the Impugned Order, the penalty was also rightly imposed. However it was very lenient keeping in view the recommendation of the Shariah Board of State Bank of Pakistan and also to encourage the growth of fledgling Takaful Industry in Pakistan.

33. *M/s. Takaful Pakistan Limited* are hereby directed to deposit the aforesaid fine of Rs. 10 m (Rupees ten million 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 (Insurance)