



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN INSURANCE DIVISION

[Karachi]

Before Shahid Nasim, Executive Director (Insurance)

In the matter of

Saudi Pak Insurance Company Limited

Show Cause Notice Issue Date: January 20, 2011

Written Reply Date: January 27, 2011

Date of Hearing: March 18, 2011

Hearing Attended by: Capt. Azhar Ehtesham Ahmed (CEO)
Mr. Mohammad Imtiaz A. Aziz (CFO & Company Secretary)

Date of Order: May 30, 2011

ORDER

(Under Section 208 Read With Section 476 of the Companies Ordinance, 1984)

This Order shall dispose of the proceedings initiated against Saudi Pak Insurance Limited ("the Company") for not complying with Section 208 of the Companies Ordinance, 1984 ("the Ordinance").

Background Facts

2. The relevant provision of Section 208 of the Ordinance state:

"Investments in associated companies and undertakings.- (1) Subject to sub-section (2A) a company shall not make any investment in any of its associated companies or associated undertakings except under the authority of a special resolution which shall indicate the nature, period and amount of investment and terms and conditions attached thereto.

Provided that the return on investment in the form of loan shall not be less than the borrowing cost of investing company

Explanation.- The expression 'investment' shall include loans, advances, equity, by whatever name called, or any amount which is not in the nature of normal trade credit".

3. The relevant provision of Section 2(2) of the Ordinance states:



"associated companies" and "associated undertakings" mean any two or more companies or undertakings, or a company and an undertaking, interconnected with each other in the following manner, namely:

- (i) if a person who is the owner or a partner or director of a company or undertaking, or who, directly or indirectly, holds or controls shares carrying not less than twenty per cent of the voting power in such company or undertaking, is also the owner or partner or director of another company or undertaking, or, directly or indirectly, holds or controls shares carrying not less than twenty per cent of the voting power in that company or undertaking

4. During the examination of the Annual Accounts of Saudi Pak Insurance Company Limited ("the Company") for the year ended December 31, 2009, it was observed that the Company had invested Rs. 10 million in a "certificate of placement" with Saudi Pak Leasing Company Limited ("the Associated Company") with a return of 15%.

5. The Company had two directors, i.e. Mr. Muhammad Rashid Zahir and Mr. Farrukh Shauket Ansari, on its board of directors who were also on the board of directors of the Associated Company as on December 31, 2009.

6. No special resolution had been filed with the Commission or the Registrar pertaining to the said investments.

7. The Company was asked to provide a copy of the special resolution which authorized the Company to undertake investments in the Associated Company, via letter dated November 22, 2010.

8. The Company, in its reply to the aforementioned letter stated:

"The amount deposited with Saudi Pak Leasing Co. Ltd. was carrying a return in the form of profit on a fixed rate and was therefore considered a fixed deposit. Considering it to be a fixed deposit no special resolution was adopted. We regret the omission and request you to kindly condone the oversight. The present amount of deposit is Rs. 3 million."

9. On further examination it appears that the Company had made similar investments in the Associated Company in the past. In the Annual Report of the Company for the year 2008, Note 9.2 stated that Rs. 10 million were placed with the Associated Company at a rate of 15% in 2008 and were due to mature by May 28, 2009. This amount appeared to have been reinvested as stated in Para 4 above.

10. Note 9.2, of Annual Report of the Company for the year 2008, also disclosed that Rs. 25 million had similarly been invested by the Company at a rate of 10% in the year 2007 as well.

11. According to the Annual Report for the year 2008 and 2007, Mr. Muhammad Rashid Zahir and Mr. Farrukh Shauket Ansari, were both on the board of directors for both the Company and the Associated Company.

12. The applicable penal provision is Section 208(3) of the Ordinance, which states:



"If default is made in complying with the requirements of this section, or the regulations, every director of a company who is knowingly and wilfully in default shall be liable to fine which may extend to ten million rupees and in addition, the directors shall jointly and severally reimburse to the company any loss sustained by the company in consequence of an investment which was made without complying with the requirements of this section."

Show Cause Notice

13. In view of the above, a Show Cause Notice was issued to the Company, the Chief Executive Officer (CEO) and its Directors, calling upon them to show cause as to why the penalty, as provided in sub-section (3) of Section 208 of the Ordinance, should not be imposed upon them for contravening the provisions of Section 208 of the Ordinance.

Company's Response to the Show Cause Notice

14. The CEO of the Company, via his letter dated January 27, 2011, in response to the abovementioned Show Cause Notice stated:

"Reference to your show cause notice dated 20th January 2011, kindly allow me to appear before you for a compassionate hearing on a date and time convenient to you, for which I will be greatly obliged."

Hearing of the Case

15. In order to provide an opportunity to Company, the CEO and the Directors of the Company or their authorized representative for appearing in person to explain the reasons for not complying with the said provisions of the Ordinance, the hearing of the case was fixed for March 18, 2011 before Executive Director (Insurance).

16. On the date of the hearing Capt. Azhar Ehtesham Ahmed, the CEO of the Company appeared with a Power of Attorney to represent the Company, its Directors and himself. He was accompanied by Mr. Mohammad Imtiaz A. Aziz, the Chief Financial Officer (CFO) & the Company Secretary.

17. During the hearing of the case, the CEO of the Company stated that the said requirements of the investments were overlooked by the Company, its Board of Directors and 4 sets of Auditors. The investment was in a fixed deposit on a fixed interest rate.

18. According to the CEO, practically speaking, the shareholders were represented on the Board of Directors; only a general meeting had not been called. The information on the investments was with the shareholders.

19. According to the Company, the Associated Company was giving them a better return than any return offered by any bank. The return was also higher than the market rate. The Company also added that it had not incurred any loss due to the investments in the Associated Company but had made profits and had fully recovered the principal amount which had been invested.



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20. The Company's representative admitted that their perception about the law was wrong. They thought that investments constituted only investment by way of shares rather than fixed deposit investments. He stated that when the Commission had pointed out the issue, the matter was looked into by the CEO and the Company promptly admitted its mistake. They added that the Company had recovered the principal amount of investments from the Associated Company as well.

21. The Company stated that the Management Letter, issued by the Auditor, was issued late to them and as a result, with regards to the investments in question, the provisioning could not be done as was recommended by the Auditors in the Management Letter.

Conclusion

22. It has been established that the Company had acted in contravention of Section 208 of the Ordinance when it made investments in the Associated Company in the year 2009, 2008 and 2007 without fulfilling the requirements of Section 208 of the Ordinance.

23. However, the examination of accounts and related records revealed that the Company had secured good rate of returns from the Associated Company and was able to recover the principal amount of its investments along with return/mark-up thereon at the market rates.

24. In addition to the above, the Company also recognized its mistake, which was due to their misunderstanding regarding what constitutes investment. They admitted that they thought of investments in associates as investments by way of shareholding only and it did not occur to them that placement of fixed deposits would also constitute investment in associates under the Ordinance. Their admission of the mistake and the views they have shared suggest that there was no *mala fide* intent in the actions of the Company.

25. However, it is the Company, its Management and their Directors responsibility to ensure that they should properly understand the laws under which they are operating. A misunderstanding of the law and its application on the Company has led the Company into this situation. Luckily, the Company did not incur losses from this endeavor.

26. A responsible company ensures that such incidents do not occur. This reflects badly on the Management and on the Board of Directors of the Company while raising questions about whether they are aware of their obligations and responsibilities under the law.

27. Before deciding the case, I deem it necessary to make some observations on the role of directors viz-a-viz their fiduciary duties and responsibilities to the Company. A relationship of fiduciary nature is characterized as a person who undertakes to act for another in circumstances that give rise to a relation of trust and confidence. The directors of a company are charged with an unyielding fiduciary duty to the company and its shareholders. The scope of the duty is cast variously as one requiring utter good faith, honesty, loyalty, candor, due care and fair dealing among others. Operating as a director requires not only a duty of loyalty towards the Company but also a concurrent duty to act within the legal confines of the law. Directors are expected to perform their duties in good faith and with honesty, integrity and openness. Directors should exercise prudence and act in a manner which is in the best interests of the mission, goal, purposes and interests of the Company while staying within the parameters of the law. Given the high standard of the duty owed, it is not surprising that directors have been held liable for a breach of trust even without willful action or malicious intent; negligence or inaction is



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considered sufficient to constitute a breach of a director's fiduciary duty in the court of law. It is pertinent to point out that the Securities and Exchange Commission of Pakistan had been established for, among others things, superintendence and control of corporate entities and for matters connected to therewith and incidental thereto. In this context, the Commission endeavors to ensure that the conduct of directors is within the legal framework and that they do not violate their fiduciary duty to a company

Order

28. In view of the foregoing material information & conclusion, I, in exercise of powers conferred on me under Section 208 the Ordinance, take a lenient view and hereby, **CONDONE** the Directors and the Chief Executive of the Company. The Chief Executive, the Directors and the Company itself are, hereby, **WARNED** and advised, to exercise due caution in the future and comply with the requirements of the law.

Shahid Nasim
Executive Director (Insurance)