

Chairman

Insurance Association of Pakistan

IAP House

Karachi

Dated: 14th March 2025

Subject: Request for Review of Collateral Requirement for Guarantee Business

Dear Sir,

I am writing to formally express concerns regarding the Securities and Exchange Commission of Pakistan's (SECP) requirement for insurers to maintain collateral for Guarantee business. This requirement is inconsistent with the regulatory treatment of other insurance classes, such as Fire, Marine, and Motor, where insurers rely on reinsurance and retention as the primary mechanisms for risk protection. Given this inconsistency, we respectfully urge the SECP to review and reconsider the necessity of collateral for Guarantee business in line with best industry practices.

Inconsistency with Other Insurance Classes

The fundamental principle of insurance risk management relies on an insurer's ability to diversify risk through reinsurance and retention mechanisms. In the case of Fire, Marine, and Motor insurance, insurers are not required to maintain collateral but are permitted to manage risk using well-structured reinsurance arrangements. Guarantee business operates under a similar framework where risk can be effectively mitigated through reinsurance arrangements. The requirement for collateral thus imposes an additional financial burden that is not required for other classes of insurance.

Furthermore, Credit and Surety is a recognized class of insurance business, similar to other insurance classes, and should not be treated separately by imposing an additional burden of collateral. This differentiation creates an unnecessary regulatory disparity that limits the potential of this business line.

Impact on Market Competitiveness and Financial Burden

Mandating collateral for Guarantee business places an unnecessary strain on insurers by restricting their capacity to underwrite new business. This additional financial requirement discourages market participation, reduces competition, and limits access to Guarantee insurance for businesses that require it as part of their operational and financial commitments. In contrast,

Head Office: 2nd Floor, Nadir House, I.I Chundrigar Road, Karachi - 74000, Pakistan

UAN : +92-21-111-274-000 **PABX:** +92-21-32415471-3 **Fax :** +92-21-32415474 **E-mail :** info@cstarinsurance.com

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allowing insurers to rely on risk-based reinsurance strategies, as with other insurance classes, would foster a more competitive and sustainable insurance market.

Guarantees and Economic Growth

Guarantees issued by insurance companies can play a crucial role in fostering economic growth. Insurance-backed guarantees enable businesses to secure contracts for which insurance guarantees are required as well secure funding through factoring and discounting mechanisms. Lending institutions can discount receivables backed by insurance guarantees, providing small and medium enterprises (SMEs) with access to much-needed liquidity. This can significantly ease cash flow constraints for SMEs by allowing them to discount receivables, thereby improving their financial health and supporting business expansion. By removing the collateral requirement, insurers can play a more active role in supporting businesses and driving economic growth.

International Best Practices

Globally, insurance regulators recognize reinsurance as a sufficient safeguard for Guarantee business, without the need for collateral requirements. Many jurisdictions allow insurers to manage Guarantee risk through sound underwriting practices, actuarial assessments, and robust reinsurance structures. Aligning SECP's regulations with international best practices will enhance the competitiveness of Pakistan's insurance sector and attract greater investment into the market.

Recommendation

In light of the above points, we respectfully propose that the SECP:

- Eliminate the collateral requirement for Guarantee business, aligning it with the risk management approach used in other classes such as Fire, Marine, and Motor insurance.
- Allow insurers to rely on well-structured reinsurance arrangements as a risk-mitigating tool, ensuring financial stability while avoiding unnecessary capital constraints.
- Conduct a consultative review with industry stakeholders to ensure that any regulatory adjustments consider the practical implications for insurers and policyholders.

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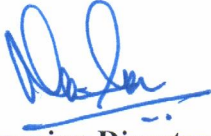
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We trust that the Insurance Association of Pakistan will consider this matter in the best interest of the insurance sector and policyholders. We remain available for further discussion and would appreciate the opportunity to engage in a consultative process to address this issue effectively.

Thank you for your time and consideration.

Yours sincerely

Crescent Star Insurance Ltd



Managing Director & CEO
Naim Anwar

Cc:

- 1) Finance Minister
- 2) Commerce Minister
- 3) SECP Policy Board