

Abbreviations and Acronyms 2000-2001

ADB	Asian Development Bank
AGM	Annual General Meeting
ALICO	American Life Insurance Company
CDC	Central Depository Company
CEO	Chief Executive Officer
CLA	Corporate Law Authority
CLAD	Company Law Administration Division
CMDP	Capital Market Development Program
COI	Certificates of Investment
Commission	Securities and Exchange Commission of Pakistan
CPA	Claims Paying Ability
CRO	Company Registration Office
EFU	Eastern Federal Union
EGM	Extraordinary General Meeting
EMD	Enforcement and Monitoring Division
GOP	Government of Pakistan
IAP	Insurance Association of Pakistan
IAS	International Accounting Standards
ICAP	Institute of Chartered Accountants of Pakistan
IC & IA	Rules Investment Companies and Investment Advisors Rules
ICMAP	Institute of Cost and Management Accountants of Pakistan
ICP	Investment Corporation of Pakistan
ICS	Institute of Corporate Secretaries
ID	Insurance Division
IFC	International Finance Corporation
IOSCO	International Organization of Securities Commissions
ISE	Islamabad Stock Exchange
IT	Information Technology
JEIS	Junior Executives Induction Scheme
KSE	Karachi Stock Exchange
KSE-100	Karachi Stock Exchange Index
LAN	Local Area Network
LAP	Leasing Association of Pakistan

LSE	Lahore Stock Exchange
LUMS	Lahore University of Management Sciences
MMS	Market Monitoring and Surveillance Wing
MUFAP	Mutual Funds Association of Pakistan
NAV	Net Asset Value
NBFI	Non-Bank Financial Institution
NCSS	National Clearing and Settlement System
NDLC	National Development Leasing Corporation
NICL	National Insurance Company Limited
NIT	National Investment Trust Limited
NOC	No Objection Certificate
PACRA	Pakistan Credit Rating Agency Limited
PICIC	Pakistan Industrial Credit and Investment Corporation Limited
Policy Board	Securities and Exchange Policy Board
PRCL	Pakistan Reinsurance Company Limited
PSO	Pakistan State Oil
PTCL	Pakistan Telecommunication Corporation Limited
SBP	State Bank of Pakistan
SCD	Specialized Companies Division
SLIC	State Life Insurance Corporation
SMD	Securities Market Division
SSD	Support Services Division
TFC	Term Finance Certificate
The Act	The Securities and Exchange Commission of Pakistan Act, 1997
VCC & VCF Rules	Venture Capital Companies and Venture Capital Funds Rules
WAN	Wide Area Network

Chairman's Statement 2000 -2001

This is the second report of the Securities and Exchange Commission of Pakistan (the Commission) covering the year July 1, 2000 to June 30, 2001.



Mr. Khalid A. Mirza, Chairman

During the year under review, the Commission was able to implement far-reaching reforms over a broad front besides taking several steps to develop its regulatory capacity. As a cumulative result of all these measures, the Commission has advanced closer towards the goal of achieving a fair, transparent and efficient capital market; furthermore, there has been a visible reduction in systemic risk.

The development program agreed with the Asian Development Bank (ADB) under its Capital Market Development Program Loan was faithfully and vigorously pursued. This provided the impetus for the reforms carried out. We are indeed most grateful to the ADB for its assistance.

The stock market crisis of May 2000 - essentially arising out of settlement defaults - occurred as a consequence of excessive overtrading and weak risk management at the stock exchanges. A number of governance issues were also highlighted by the crisis. To remedy the situation, several measures were taken in consultation with the stock exchanges. These included: strengthening of margin requirements; redefining as well as sharply raising net capital requirements for stock brokers and imposing capital adequacy limits on broker exposure; abolishing the system of disclosed trading (a major source of front running); restraining and eventually banning "blank" sales; and implementing the T+3 settlement system in place of the previous archaic system of weekly settlement with all the systemic risks it entailed. Importantly, governance issues were substantially addressed by installing independent, professional Chief Executives at two out of three stock exchanges and ensuring that at least 40 percent of the board members of each stock exchange were independent, "non-broker" professionals.

Apart from these steps, a direct regulatory nexus was established between the Commission and the stock brokerage community by stipulating the registration of stock brokers with the Commission as well as devising a code of conduct for them. Furthermore, the Commission took an important step to achieve financial autonomy by levying a small fee of 0.0009 percent on the value of each concluded stock market transaction - perhaps the lowest transaction fee in the world. All these steps, along with others taken in the recent past, mean that in large measure IOSCO's 30 principles of Securities Regulation have been implemented.

In addition, this year saw fundamental initiatives by the Commission to build its capacity and broaden its reach to more effectively cover all areas of its responsibility. The Commission acquired considerable depth in its organizational structure through setting up of, or adding muscle to, several dedicated units such as a Specialized Companies Division that regulates a variety of financial sector institutions, a Market Monitoring and Surveillance Wing that monitors the market closely, a Vigilance Cell to ensure prompt disposal of complaints, petitions etc. and a Public Relations Cell to deal with media and image issues. The Enforcement and Monitoring Division has been strengthened and has done a remarkable job in enforcing corporate laws as has the Specialized Companies Division in ensuring prudence, discipline and sound conduct amongst non-bank financial institutions. In fact, the year under review probably witnessed unparalleled regulatory steps and enforcement actions to protect the integrity of the corporate sector, promote a sound financial system and safeguard the interests of the investor.

In discharging its regulatory responsibilities, the Commission endeavors to be "firm, helpful and fair" and strives to achieve equitable dispensations through a substantively progressive interpretation of laws and eschewing decisions based on technicalities. The Commission has also emphasized staff training and development; and apart from effectively laying off 80 unsuitable employees inherited from the erstwhile Corporate Law Authority, around 60 relatively young, highly educated persons from the private sector or international institutions were employed - some in leadership positions - which largely constitute the core to spearhead change.

A master corporate plan for the Commission developed with ADB's assistance was implemented. Also, the underlying conceptual scheme of the Commission was fully realized: this envisages the Commission functioning as a collegiate body with the Chairman as Chief Executive, operational authority being largely devolved to departmental heads (Executive Directors) and each Commissioner assigned certain "oversight" responsibilities to assist the Chairman. This together with a new service manual adopting a merit-based orientation (similar to staff rules of private organizations), a salary structure more generous than that applicable to government employees and rapid strides made in automation has meant a visibly more effective regulatory body.

Apart from issuing a plethora of rules and regulations - far more than in any previous year - the Commission sponsored the enactment of significant amendments in several laws administered by it. Importantly, in consultation with the insurance industry, the Commission drafted the necessary rules to implement the new Insurance law. The effectiveness of the Commission's working is gaining public recognition and can be gauged from: (a) its immeasurably greater disposals of complaints and appeals; (b) its ability to take prompt cognizance of corporate lapses or misdemeanors as also untoward stock market developments; (c) the rapidity of its regulatory response; and (d) its expeditious disposal of corporate registration work. It is also noteworthy that the report of the Committee, appointed to inquire into the causes of the stock market crisis of May 2000, was not only published in full but also consequential action has been taken, as appropriate.

During the year, the stock market suffered from the after effects of the May 2000 crisis and was essentially bearish albeit it did display volatility and sporadic bouts of buoyancy. The reforms put in place as well as regulatory vigil prevented the emergence of systemic problems. To impart depth to the market and add another dimension to it, the Commission has encouraged the introduction of derivatives - as a result, trading in stock futures contracts has already begun and, in due course, other types of derivatives are also likely to be introduced with the support of the Commission.

Apart from continuing efforts to deepen the market, improve risk management at the stock exchanges and enhance the Commission's institutional capacity, there are a number of priority aims the Commission intends to pursue as part of its game plan for the immediate future. These include: the strengthening of audit practices and enforcement of International Accounting Standards; facilitating the development of a vibrant primary market with strong underwriting and distributive capacity; ensuring that the national clearing and settlement system gets properly implemented; the development of a second-tier or over-the-counter market; and addressing residual governance issues at the stock exchanges as well as facilitating their demutualization. The Commission is already moving forward in all these areas.

The Organization

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1.1 Organizational Structure

The Securities and Exchange Commission of Pakistan (the Commission) was established in pursuance of the Securities and Exchange Commission of Pakistan Act, 1997 (the Act) and became operational from January 1, 1999. The Act institutionalized certain policy decisions of the Government - particularly those relating to constitution/structure of the Commission and its powers and functions - in connection with the Capital Market Development Program of the Asian Development Bank (ADB). The Commission has succeeded the Corporate Law Authority (CLA), which was a Government department attached to the Ministry of Finance.

The present Chairman, Mr. Khalid A. Mirza, was appointed as the Chairman of the Commission in March 2000. Prior to his present appointment, Mr. Mirza served as a senior official of the International Finance Corporation (IFC) and was posted as Chief of IFC's Regional Mission in Bangkok, Thailand. Mr. Mirza has worked in several countries and possesses extensive experience of capital markets development in the emerging markets.

As of June 30, 2001, the Commission consisted of five Commissioners, including the Chairman, as noted below:

Mr. Khalid A. Mirza
Chairman

Mr. Abdul Rehman Qureshi
Commissioner, Enforcement and Monitoring

Mr. Tariq Iqbal Khan
Commissioner, Specialized Companies

Mr. Zafar-ul-Haq Hijazi
Commissioner, Company Law Administration

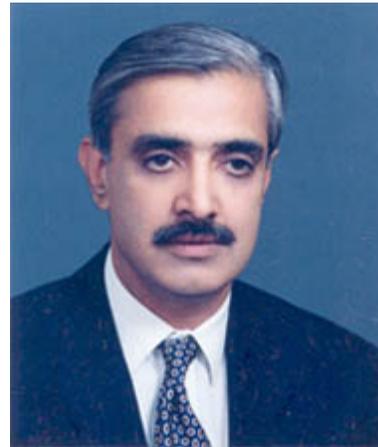
Mr. N.K. Shahani
Commissioner, Securities Market and Insurance



Khalid A. Mirza Chairman



**Abdul Rehman Qureshi Commissioner,
Enforcement and Monitoring**



**Tariq Iqbal Khan Commissioner,
Specialized Companies**



**Zafar-ul-Haq Hijazi Commissioner,
Company Law Administration**



**N.K. Shahani Commissioner, Securities
Market and Insurance**

1.2 Securities and Exchange Policy Board

While ensuring full autonomy of the Commission, the Act provides for establishment of a Securities and Exchange Policy Board (Policy Board). The main objective of the Policy Board is to provide guidance to the Commission in all matters relating to its functions and to formulate policies in consultation with the Commission. The Policy Board is also responsible for advising

the Government on matters falling within the purview of the Act and other corporate laws and to express its opinion on policy matters referred to it by the Government or the Commission.

The Act provides that the Policy Board should consist of a maximum of nine members appointed by the Federal Government, including five members and four from the private sector. The members are: (i) Secretary, Finance Division; (ii) Secretary, Law and Justice Division; (iii) Secretary, Commerce Division; (iv) Chairman of the Commission; and (v) a Deputy Governor of the State Bank of Pakistan (SBP). As of June 30, 2001, the Policy Board consisted of:

- i) Mr. Khalid A. Mirza, Chairman
- ii) Secretary, Finance Division
- iii) Secretary, Law and Justice Division
- iv) Secretary, Commerce Division
- v) Deputy Governor of the SBP
- vi) Mian Mohammad Anwar, Chairman, Crescent Textile Mills

1.3 Policy Board Meetings

During the period under review, six meetings of the Policy Board were held. In these meetings, the Board was briefed about the latest developments in the stock market and measures adopted by the Commission for safeguarding the interests of investors. The Board members appreciated the Commission's efforts and encouraged it to proceed further with reforms designed to improve the working of the market. The main issues discussed and concluded in these meetings were, as follows:

- i) Finalization of the accounts of the Commission for the financial year 1999-2000.
- ii) Approval of the budget for the financial year 2000-2001.
- iii) Approval of the Companies' Share Capital (Variation in Rights and Privileges) Rules, 2000.
- iv) Amendments in the Companies (Buy-back of Shares) Rules, 1999.
- v) Approval of the Leasing Companies (Establishment and Regulation) Rules, 2000.
- vi) Approval of amendments in the Service Manual of the Commission.
- vii) Approval of capital expenditure by the Commission not provided in the budget for the year 2000-2001.
- viii) Approval of the budget for the financial year 2001-2002.

1.4 Divisions and the Management Team

The Commission is a collegiate body with collective responsibility. Operational and executive authority of the Commission is vested in the Chairman who is the Commission's Chief Executive Officer (CEO). He is assisted by the Commissioners, particularly to oversee the working of various operational units as may be determined by him.



A Commission meeting in progress

Senior officials in the Chairman's Secretariat are the Secretary to the Commission and Principal Staff Officer to the Chairman. Mr. Hayat Jasra, at present serving as Secretary to the Commission, has been associated with the Commission and the former CLA for over 25 years. Mr. Haroon Sharif, who joined last year as Principal Staff Officer to the Chairman, brings with him over 12 years of experience in the financial services market.

Apart from the Chairman's Secretariat, the Commission operationally comprises six Divisions, each of which is headed by an Executive Director and divided into Wings for administrative purposes. A synopsis of each Division is as follows:

1.4.1 Securities Market Division

The Securities Market Division (SMD) is responsible for the regulation of all aspects of the securities market. Till his recent elevation as Commissioner, the Executive Director heading the SMD was Mr. Shahid Ghaffar, who has over 20 years of capital market experience. The Division is divided into the following Wings:

- Stock Exchange Regulation
- Market Monitoring and Surveillance
- Investor Complaints
- Beneficial Ownership
- Capital Issues



From left to right: Mr. M. Hayat Jasra, Secretary to the Commission; Ms. Iram Butt, Director (Leasing); Mr. Haroon Sharif, Principal Staff Officer to Chairman; Mr. Khalid A. Mirza, Chairman; and Ms. Sadia Khan, Executive Director (SCD)

1.4.2 Specialized Companies Division

The Specialized Companies Division (SCD) is responsible for regulation of leasing companies, modarabas and modaraba management companies, mutual funds and other specialized companies (except insurance companies). Its functions include licensing, monitoring, regulatory compliance and enforcement of all applicable laws. Ms. Sadia Khan, Executive Director, who heads this Division, has several years of investment banking experience in the United States and was serving as an official of the ADB in the Philippines prior to her current assignment. She is also working as Special Assistant to the Chairman. The SCD is divided into the following Wings:

- Leasing
- Modaraba Companies and Modarabas
- Mutual Funds and Other Specialized Companies

1.4.3 Enforcement and Monitoring Division

The Enforcement and Monitoring Division (EMD) is responsible for review of published accounts of listed companies, investigation, compliance with relevant laws and regulations by listed companies and prosecution (except in relation to specialized companies and insurance companies). Mr. Rashid Sadiq, Executive Director, heads the EMD. He is a Chartered Accountant and has several years of executive experience with leading business groups. The EMD comprises the following Wings:

- Accounts
- Investigation
- Compliance and Prosecution

1.4.4 Company Law Administration Division

The Company Law Administration Division (CLAD) is charged with the responsibility of administering and enforcing the Companies Ordinance, 1984 as well as certain other laws, rules and regulations. The CLAD is also responsible for supervision of the Commission's field offices in various cities i.e. the Company Registration Offices (CROs). Till his recent transfer to another responsible position, Executive Director of the CLAD was Mr. Javed Zafar, a Chartered Accountant with considerable corporate executive and consultancy experience. The Division consists of the following Wings:

- Coordination and Liaison
- Regulation and Compliance
- Enforcement, Investigation and Prosecution
- Licensing, Approvals and Appeals

1.4.5 Insurance Division

The Insurance Division (ID) is responsible for regulating the insurance sector. It administers the law of insurance that covers licensing and supervision of insurers and other entities regulated under this law. Mr. Shafaat Ahmad, Executive Director, heads the ID. He has been a senior Government official, having held the post of Controller of Insurance for five years. The ID is divided into the following Wings:

- Actuarial Services
- Life Insurance Prudential Supervision
- Non-life Insurance Prudential Supervision
- Market Conduct Supervision
- Enforcement and Prosecution

1.4.6 Support Services Division

The Support Services Division (SSD) is responsible for providing efficient support services to the entire Commission. These services include financial management and maintenance of accounts; development and administration of human resources; and maintenance of communication and management information systems through automation and introduction of

new technology. Mr. Javed Panni, Executive Director, who heads this Division, has been associated with the Commission and the previous CLA in different capacities for 25 years. The SSD comprises the following Wings:

- Human Resources
- Administration
- Finance and Accounts
- Information Technology

Recently, the Information Technology Wing was taken out of the SSD and made a separate Division.

Securities Market Division

[Overview](#) | [Stock Market Review](#) | [Stock Exchange Wing](#) | [Market Monitoring and Surveillance](#) | [Investor Complaints](#) | [Beneficial Ownership](#) | [Issue of Capital](#)

The regulation of the securities market is the core function of the Commission. The Securities Market Division (SMD) monitors and regulates the securities market through powers vested in the Commission under the Securities and Exchange Ordinance of 1969 and the rules framed thereunder, as well as under The Act. The SMD regulates both the primary and secondary markets including market intermediaries. It also acts as an off-site regulator of the stock exchanges, which includes monitoring their working, particularly with regard to obligations of brokers towards investors, and ensuring smooth functioning of the clearing house and settlement operations. In addition, the Division is entrusted with the task of making appropriate regulatory reforms and proposing measures to deepen the market, restore investor confidence and ensure transparency in stock market operations.



Mr. Shahid Ghaffar, Executive Director (extreme right), with officials of SMD

2.1 Overview

The past year witnessed major developments in the capital market as a consequence of various reforms initiated by the Commission to promote investor confidence and strengthen the integrity of the capital market. The measures undertaken by the Commission were aimed at increasing the demand for and supply of capital that would provide the necessary fillip to promote further investments, expand industrial output and generate employment opportunities.

The stock market crisis of May 2000 revealed structural weaknesses in the system that necessitated implementation of immediate corrective measures by the Commission. The move towards implementation of the T+3 settlement system, substantial increase in net capital requirements, stipulation of capital adequacy requirements for brokers and strengthening of margin requirements were measures aimed at improving risk management at the stock exchanges and addressing issues identified during the May 2000 crisis at the exchanges. The appointment of 40 percent independent directors on the Boards of the stock exchanges and action initiated to ensure independence of the CEO of each exchange, are all measures introduced in line with international best practices and will go a long way in ensuring an efficient and transparent capital market in Pakistan



**Mr. Shahid Ghaffar, Executive Director with Ms. Mehreen Rasheed,
Junior Executive**

Further, the Commission implemented various regulatory reforms during the course of the year that included the issuance of the Brokers and Agents Registration Rules and the Insider Trading Guidelines. All these reforms have been carried out with a view to protect the rights of small investors and restore confidence in the market.

Institutional investment has been another area of focus recently. A major initiative is underway to develop the mutual funds/pension funds industry to give the market institutional underpinning. Also, regulations have been made more flexible to allow flotation of sector-specific funds to cater to different investor preferences and investment guidelines have been made less restrictive. All this provides wider avenues for investment by these funds.

2.2 Stock Market Review (July 2000 - June 2001)

The stock market was in a bear trap during most of the year under review. Between July and October 2000 the KSE-100 index moved up gradually from 1,520 to a high of 1,605 on October 4, 2000. The marginal improvement in the market was mainly attributable to the successful negotiations/settlement of the Hubco-WAPDA issue and a favorable response from the International Monetary Fund (IMF).

From October 5, 2000, the market slid downwards to reach 1,276 in November 2000, thus recording a fall of 329 points (21 percent). The sharp decline during October-November 2000 was on account of the huge accumulation of positions by some major market participants in shares of Pakistan State Oil (PSO) that were rapidly disposed of when the upward momentum in the market could not be sustained. The bearish tempo deepened further due to dividend announcements by PSO and Pakistan Telecommunication Corporation Limited (PTCL) that were much below market expectations. There was panic in the market and the speculators took advantage of the situation by selling "in blank". As a result, the market moved to the verge of collapse. It was only through the intervention of the Commission that a recurrence of a crisis similar to the one in May 2000 was prevented. The Commission, in November 2000, decided that blank sellers would be required to tender actual delivery of shares by borrowing stock. This regulatory action served to bring some stability in the market and the index gradually moved up to the level of 1,508 by the end of December 2000, remaining above the 1,500 level till January 11, 2001. From January 12, 2001 onward, the market remained bearish, gradually slipping from the 1,500 level to 1,366 on June 29, 2001.

Overall, the KSE-100 index dropped by 10 percent during the period July 2000 to June 2001 - from 1,520 on July 3, 2000 to 1,366 on June 29, 2001. The bearish trend in the market could be attributed to several factors such as depreciation of the Pak rupee against the US dollar, continued selling by foreign investors (mainly Morgan Stanley Pakistan Fund and Templeton), the Prudential Group crisis, fear of National Accountability Bureau/Federal Investigation Agency investigations into

the affairs of a few brokerage houses and the lack of support from institutional investors. The pressure on the market from these factors was compounded by the fact that all market participants (whether jobbers, speculators or institutions) were holding positions dependent on short term financing and had no substantive capacity to absorb the foreign selling. It was largely due to these reasons that the market failed to respond to a range of incentives conducive to stock market development announced in the June 2000 budget.

Chart 1 - KSE Aggregate Market Capitalization (US \$ Equivalent) and Spot Rate (Rs. Vs USD) - July 2000 to June 2001

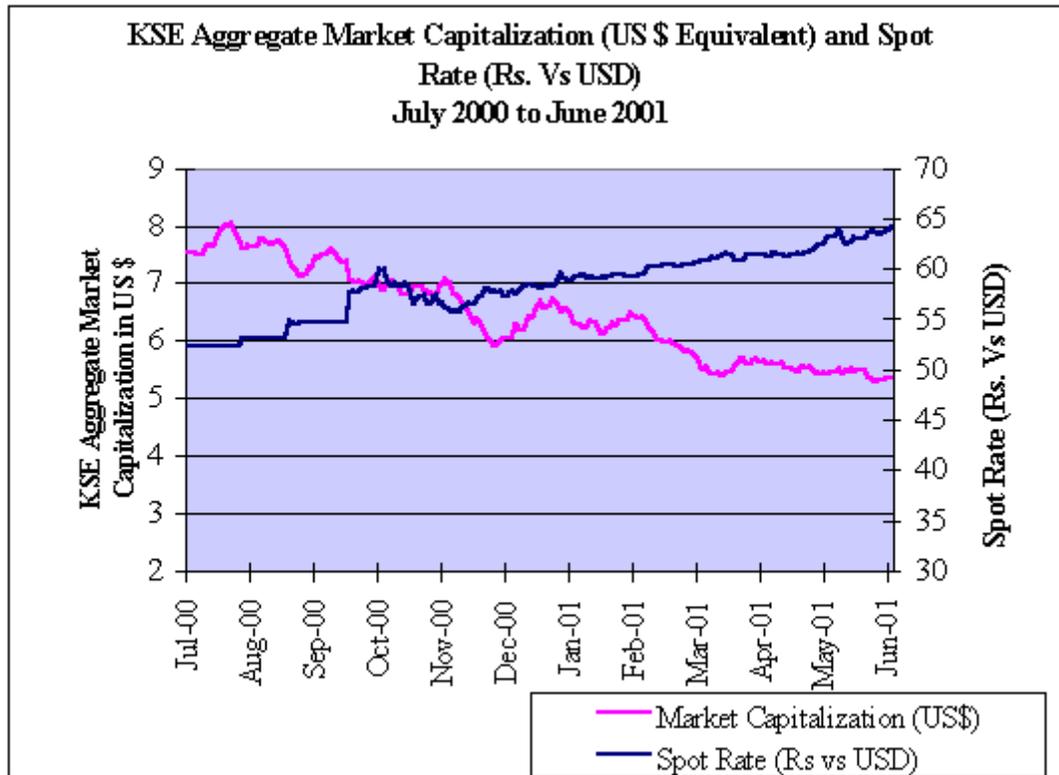
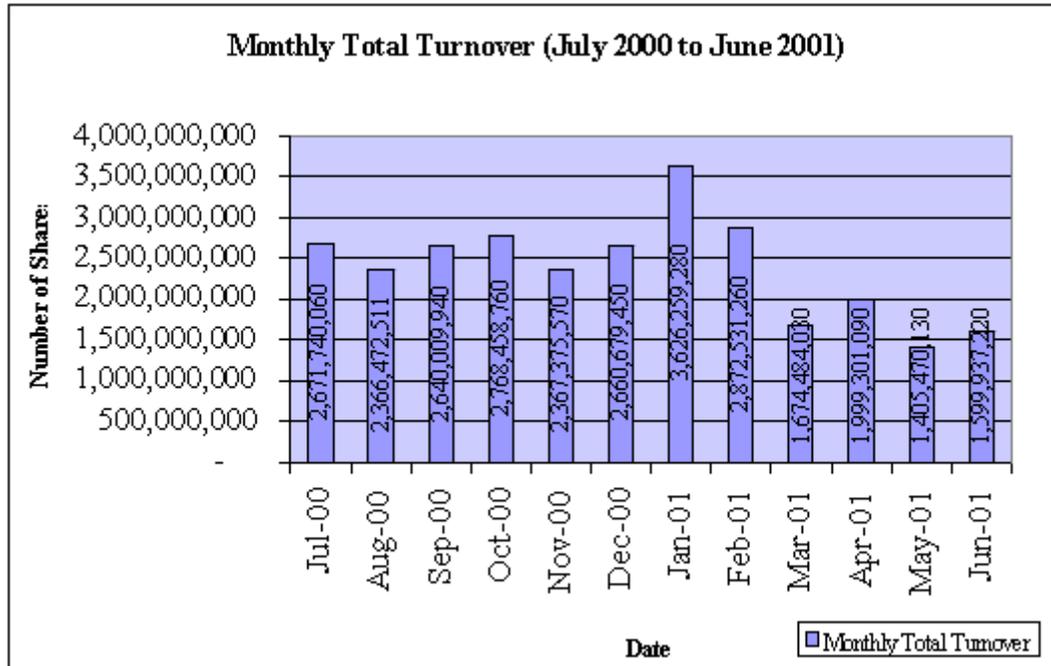


Chart 2 - Monthly Total Turnover - July 2000 to June 2001



2.3 Stock Exchange Wing

2.3.1 Reforms in the Stock Market

The May 2000 crisis highlighted fundamental weaknesses in the stock exchanges, including poor governance, weak risk management as well as lack of market integrity and transparency. The Commission accordingly took a number of important steps in line with a comprehensive reform program to restore investor confidence and to achieve a fair, transparent and efficient stock market. In order to achieve these objectives, the Stock Exchange Wing of the SMD implemented the following measures:

1. i) Improvements in Governance

The following measures have been implemented:

1. The Commission is to nominate 40 percent independent directors on the Board of each stock exchange after due consultation. In 2001, seven non-broker directors were nominated on the Boards of the Karachi Stock Exchange (KSE) and the Lahore Stock Exchange (LSE) and five directors on the Board of the Islamabad Stock Exchange (ISE).
2. Independent, professional management has been ensured on the exchanges by requiring the Managing Director/CEO of each stock exchange to be appointed and removed with the approval of the Commission. Independent CEOs have already been appointed at the KSE and the LSE with prior approval of the Commission.
3. The directors of each exchange have been directed not to delegate operational powers to any person other than the Managing Director.
4. The number of broker-directors in the Central Depository Company (CDC) has been reduced from five to three (out of a total of nine).
5. The Chairman of the CDC is to be a non-broker.
6. The Board of Directors of the CDC are required not to delegate operational authority to anyone except the CEO.
7. The Commission has nominated a director on the Board of the CDC.

2. Risk Management Measures

The following actions were taken and necessary directives issued:

1. The requirement for net capital balance to be maintained by a stock broker has been enhanced by 10 times to Rs. 2.5 million for KSE brokers, Rs. 1.5 million for LSE brokers and Rs. 0.75 million for ISE brokers.
2. A measure of capital adequacy for stock brokers has been stipulated. The exposure of a broker must not exceed 25 times the net capital employed.
3. Margin requirements have been strengthened; notably the brokers' ability to trade up to Rs. 50 million without margin was abolished and all exposure of brokers is now subject to margin.
4. The undisclosed market system whereby the identities of the buyers and sellers are not revealed, in accordance with international practice, has been introduced. This has helped check manipulation and front running to a certain extent.
5. The internationally accepted T+3 settlement system has been introduced and successfully implemented at the three stock exchanges.
6. Blank selling has been prohibited.

2.3.2 Regulatory Actions

In order to strengthen the regulatory framework of the capital market and to facilitate the implementation of the Commission's reform agenda, a number of rules and regulations were issued which included:

1. Members, Agents and Traders (Eligibility Standards) Rules, 2001 - to prescribe minimum standards for market intermediaries.
2. Stock Exchange Members (Inspection of Books and Record) Rules, 2001 - to enhance monitoring of brokers and agents and strengthen the Commission's surveillance capabilities.
3. Public Companies (Employees Stock Option Scheme) Rules, 2001 - to motivate and facilitate employees in acquiring a stake in their company's share capital.
4. Insider Trading Guidelines, 2001 - to protect small investors from the use of privileged information by insiders.
5. Amendments in the Securities and Exchange Rules, 1971 (Net Capital Balance Requirement) - to define "net capital" in line with internationally accepted practice and ensure adequate risk management at the exchanges.
6. Share Transfer Agents, Underwriters, Balloters and Consultants to the Issue Rules, 2001 - to specify and streamline the eligibility criteria for share transfer agents, underwriters, balloters and consultants to the issue.
7. The Companies Share Capital (Variation in Rights and Privileges) Rules, 2000 - to specify rules for issue of different classes of shares.
8. Brokers Agents Registration Rules - to establish a direct regulatory nexus with brokers and agents to ensure investor protection.

In addition, the Listed Companies (Substantial Acquisition of Shares and Takeover) Ordinance, 2000 has been approved by the Cabinet in principle. Once finalized and promulgated, this would facilitate take over bids and protect the rights of minority shareholders.

2.3.3 Developments in the Market

1. Establishment of Futures Contracts Market

A market in futures contracts has been introduced in July 2001. A beginning was made by granting approval to the KSE to commence trading in standard futures contracts in certain shares. The emergence of a market in futures contracts would not only deepen the capital

market in Pakistan but also provide investors with basic hedging instruments and investment alternatives.

2. National Clearing and Settlement System

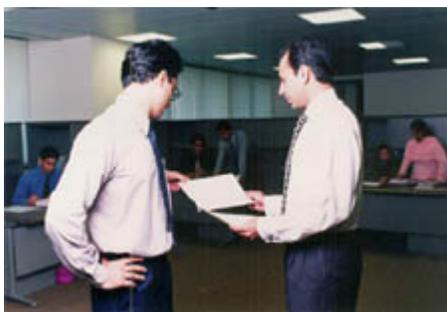
Another development during the year has been the incorporation of the National Clearing Company of Pakistan Limited. The company was incorporated on July 3, 2001. The software of the National Clearing and Settlement System (NCSS) is ready and is being tested. The regulations of NCSS have been finalized and the company is expected to start operations shortly.

2.4 Market Monitoring and Surveillance

Since its establishment in October 2000, the Market Monitoring and Surveillance Wing (MMS) has filled an important regulatory gap in the SMD. The mandate of MMS is to closely track and monitor the market with a view to identifying possible instances of market manipulation and abuse for further investigation and necessary action.

Consisting of a team of six executives, headed by a Joint Director, MMS is entrusted with the responsibility of monitoring different sectors of the market on a real-time basis as well as monitoring developments in these sectors outside the ambit of the market itself. MMS takes note of unusual or abnormal price or volume movements and other developments/variations in market behavior which indicate that an abuse of the market may have occurred.

At present, MMS relies on its constant, real time, watch-and-observe activity as well as such intelligence as it is able to gather from formal and informal sources. This will soon be supplemented by an analysis of real-time trading data through a software program linked to automated trading systems of the stocks exchanges (via a server), which is being designed to evaluate trading data against specified benchmarks. The system would automatically generate "alerts" when any unusual activity or price movement is detected and would obviate the possibility of omitting any action that might have remained otherwise unnoticed.



Officials of Market Monitoring and Surveillance Wing

MMS is the Commission's "eyes and ears" focused on the stock market. It is, in particular, expected to look out for suspected instances of insider trading and market manipulation such as dissemination of false information, cornering and abuse of the trading process to give a fake or misleading appearance in relation to the price of a security and/or its activity.

MMS's activities also include the preparation of intra-day, daily and monthly internal reports; company and sector specific research; analyzing trading data; and collating data for its information database. Further, since its inception, the Wing has been involved in a number of special assignments. Its analysis of trading data led to the Commission's Restraining Order on Blank Selling

in November 2000. It has also been deeply involved in analyzing trading data of various brokers involved in the May 2000 crisis.

In connection with MMS, it is noteworthy that the Commission is endeavoring to get each stock exchange, as a frontline regulator, to significantly strengthen its monitoring capacity. MMS would then be essentially supplementing the surveillance carried out by the stock exchanges and in close coordination with them. With this system in place, it would be possible for the securities markets to operate in a fair, efficient and transparent manner.

2.5 Investor Complaints

Quick redressal of investor complaints and grievances is an important instrument in restoring investor confidence, thus an Investor Complaints Wing has been set up in the SMD. The complaints are either handled directly by the Commission itself or, if deemed appropriate, passed on to the concerned stock exchange with the Commission taking steps to ensure that these receive proper attention. Following is a statistical overview of this Wing's activities, albeit the data does not capture qualitative improvements in the disposal of complaints which has helped in preventing further abuses in the market.

Table 1 - Investor Complaint Statistics

	KSE	LSE	ISE	Total
Complaints received during the period 1997 to June 2000	29	41	53	123
Complaints resolved during the period 1997 to June 2000	4	2	5	11
Complaints received during the period 1997 to June 2000 but resolved during the period July 2000 to June 2001	4	4	3	11
Complaints received from July 2000 to June, 2001	47	44	44	135
Complaints resolved from July 2000 to June, 2001	12	4	17	33
Complaints against Defaulted Members/ Under Litigation	7	12	22	41
Pending with stock exchanges	19	20	5	44

Under Examination with the Commission

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Chart 3 - Break-up of Total Complaints Received During July 2000 - June 2001

Chart 4 - Break-up of Total Number of Complaints Received During 1997 - June 2000

It is clear from the above that the Commission's vigilance and vigor has resulted in a significantly higher rate of complaints' disposal. There is an increasing confidence in the investor community that their genuine complaints will be addressed in a fair and effective manner. The Investor Complaints Wing is a pillar for investor protection, which the Commission plans to strengthen appropriately in due course.

2.6 Beneficial Ownership

In order to protect the interests of small shareholders and to discourage managements of companies from making windfall gains on the basis of privileged inside information, each director, chief executive, management agent, etc. and holder of more than 10 percent share capital of a company is required to file certain prescribed returns of beneficial ownership. Also, any gain made by a beneficial owner of more than 10 percent equity capital through transactions completed within six months must be reported to the company and the regulators, and tendered as stipulated by law. During the period under review, the Commission was able to finalize cases of tenderable gains aggregating Rs. 2.1 million.

During the period under review, a proposal to amend the relevant rules, in order to exclude the acquisition of right shares from the determination of tenderable gains, was finalized and sent to the Government for necessary clearance and notification.

2.7 Issue Of Capital

The prospectus of any public offer of securities is required to be approved by the Commission prior to its issue, circulation and publication. Due to a variety of reasons (including political uncertainty, rupee devaluation, lack of foreign portfolio investment, etc.), there were only two public equity offerings during the year under review. However, there were 10 offerings of debt capital, i.e. Term Finance Certificates (TFCs), that highlights growing investor interest in these securities.

Table 2 ahead provides a comparison of share capital and TFC offerings during the year.

Table 2 - Share Capital and TFC Offerings

(Rs. in million)

Year	Share Capital	Redeemable Capital
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	No. of Issues	Amount of Capital Offered (at face value)	No. of Issues	Amount Offered	Amount Retained
2000-2001	02	1,984.695	10	5,425.0	5,488.970
1999-2000	03	2,035.031	04	930.0	1,147.720

2.7.1 Share Capital

During the year under review, there was no offering of fresh equity capital. However, four secondary offerings of shares were considered, of which two offerings were finalized involving shares aggregating Rs. 212.50 million in value based on the offer prices achieved. The total capital listed on the stock exchange was Rs. 1.985 billion. The other two offerings considered, but not implemented, pertained to Government of Pakistan (GOP) holdings in two listed companies being offered for sale by the Privatization Commission.

Relevant particulars of the two secondary offerings of equity capital that were actually completed during the year under review are as follows:

Table 3 - Secondary Offerings of Equity Capital

(Rs. in million)

S.No.	Name of Company	Sector	Name of Offerer	Subscription Date	Formal Listing Date	Total Paid-up Capital	Offered Capital	Amount of Premium	Subscription Received (including premium)	Times Subscribed
1	Bestway Cement Ltd.	Cement	M/s Bestway (Holdings) Limited	7-Feb-01	9-Apr-01	1,934.695	200.000	0.000	205.805	1.03
2	Arif Habib Securities Ltd.	Securities companies/banks/investment companies	Mr. Arif Habib	24-May-01	25-June-01	50.000	12.500	87.500	434.640	4.35
	Total					1,984.695	212.500	87.500	640.445	

Particulars of the two privatization offerings that were not completed are given below:

Table 4 Privatization Offerings

S.No.	Name of Company	Sector	Name of Offerer	Date of Approval	Total Paid-up Capital	Capital Offered for Sale	No. of Shares Offered (Million)
1	Muslim Commercial Bank.	Securities companies/banks/investment companies	Govt. of Pakistan	08-Dec-00	2,202.856	528.685	52.869
2	Pakistan Oil	Fuel and Energy	Govt. of	07-May-01	456.300	158.590	15.859

	Fields Ltd.		Pakistan					
	Total				2,659.156	687.275	68.728	

2.7.2 Further Issue of Share Capital

Companies can issue further capital by way of pre-emptive rights and/or bonus issues of shares without the approval of the Commission. However, in certain exceptional circumstances listed companies may be allowed to further raise their capital without the issue of right shares. In this regard, five applications were received, of which four were approved.

During the year, it was observed that some companies had not complied with the requirements of the Companies (Issue of Capital) Rules, 1996 while issuing bonus and right shares. The total number of companies that had issued bonus and right shares was 69 and 35 respectively. 19 companies issuing right shares and four companies making bonus allotments were asked to explain their failure to comply with the disclosure requirements prescribed under the Rules.

2.7.3 Issue of Shares at Discount

Listed companies may issue shares at a discount if so approved by the Commission. During the year, two companies were allowed to issue shares at 60 percent and 30 percent discount, respectively.

2.7.4 Debt Capital

The year under review was the best so far in respect of raising of debt capital by companies. Approvals were granted to 10 debt issues involving an aggregate of Rs. 8.9 billion. Of this amount, Rs. 5.489 billion (inclusive of green shoe option) has already been raised; Rs. 4.295 billion placed privately and Rs. 1.194 billion through public offering. Three companies will raise the remaining Rs. 3.475 billion in subsequent tranches.

Investor interest in TFCs is, among other reasons, attributable to: (i) attractive returns offered to TFC holders as compared to similar savings schemes of public and private institutions; (ii) a substantial fall in returns under various National Savings Schemes; and (iii) restrictions placed on institutional investors from investing in National Savings Schemes.

Table 5 below summarizes the 10 debt issues during the year under review.

Table 5 Debt Issues

Year	Name of Company	Subscription Date	Formal Listing Date	Total Capital allowed to be issued			Subscription Received			Green Shoe Option against public offer	Amount Retained	
				Present	Offer		Pre-IPO	IPO	Total			
		26-27										
1	Atlas Lease Ltd.	September, 2000	06-Nov-00	200.000	150.000	50.000	200.000	150.000	158.870	308.870	N.A	50.000
2	Network Leasing Co. Ltd.	03-04 October, 2000	24-Nov-00	100.000	60.000	40.000	100.000	60.000	68.450	128.450	N.A	40.000
3	Al-Noor Sugar Mills	31st Oct-Ist Nov, 2000	13-Dec-00	200.000	125.000	75.000	200.000	125.000	78.660	203.660	Public	40% of 78.660

Ltd.											Offer	
											30% of	
											Total	
4	Nishat Mills PILCORP (2nd Issue, 1st tranche of Rs. 1.0 billion)	19-20 Dec, 2000	06- Feb-01	350.000	255.000	95.000	350.000	255.000	87.870	342.870	Issue	87.870
5	Orix Leasing Pak. Ltd. (1st tranche of authorized Rs. 1.5 billion)	01-02 March, 2001	23- May-01	1,000.000	175.000	150.000	325.000	175.000	159.130	334.130	Issue	159.130
6	Shakarganj Mills Ltd.	20 Mar-7 Apr, 2001	21- May-01	1,500.000	550.000	150.000	700.000	550.000	191.965	741.965	Offer	191.965
7	Sui Southern Gas Co. Ltd. (1st tranche of authorized Rs. 3.0 billion)	09-10 Apr, 2001	28- May-01	250.000	180.000	70.000	250.000	180.000	70.365	250.365	N.A	70.000
8	Engro Asahi Chem. (Non listed Pub. Co.)	31 May-01 June, 2001	16-Jul- 01	3,000.000	800.000	200.000	1,000.000	800.000	229.600	1,029.600	N.A	200.000
9	Dewan Salman Fibres Grand	14-15 June, 2001	13- Aug-01	500.000	400.000	100.000	500.000	400.000	106.825	506.825	N.A	100.000
10		21-22 June, 2001	06- Aug-01	1,800.000	1,600.000	200.000	1,800.000	1,600.000	216.350	1,816.350	offer	216.350
Total				8,900.000	4,295.000	1,130.000	5,425.000	4,295.000	1,368.085	5,663.085		1,193.970

(Rs. in million)

Note: All issues except Nishat Mills Ltd. have been oversubscribed

Specialized Companies Division

Leasing Wing | Modaraba Wing | Mutual Funds Wing | Oversight of Accountancy Profession |
Cost Audit Records

The Specialized Companies Division (SCD) is responsible for the regulation and monitoring of leasing companies, modarabas, mutual funds and other specialized companies. Accordingly, the SCD is divided into three Wings for operational purposes, i.e. Leasing, Modaraba and Mutual Funds Wings. In addition, the SCD also maintains regulatory oversight of the accountancy profession. A brief review of the activities of the respective Wings is presented below.



Ms. Sadia Khan, Executive Director (extreme left), with senior officers of SCD

3.1 Leasing Wing

3.1.1 Overview

Previously regulated by the SBP, the regulation of leasing companies came under the purview of the erstwhile CLA in 1997 consequent to amendments in the Banking Companies Ordinance, 1962. At present, the Leasing Wing of the SCD monitors and regulates leasing companies in accordance with the provisions of the Leasing Companies (Establishment and Regulation) Rules, 2000 that have been framed under Section 506 of the Companies Ordinance, 1984. The supervision of leasing companies is carried out with the core objective of facilitating and promoting their legitimate operations while at the same time, protecting and safeguarding the interests of minority shareholders and other stakeholders in these companies.

At present, the leasing sector comprises 32 listed companies, of which one is in liquidation. The sector has shown considerable growth since its inception in 1984 with the establishment of the first leasing company - National Development Leasing Corporation (NDLC) - and had an aggregate asset and equity base of Rs. 46.78 billion and Rs. 8.92 billion, respectively, as at June 30, 2011. With nearly 76 percent of assets deployed in its principal line of business, the leasing sector forms an important component of the overall financial sector and plays a significant role in the country's fixed capital formation. The sector, however, depicts high concentration with five large companies representing more than 67 percent of the total leases undertaken by the leasing sector.

The sector had shown significant growth in the late eighties and early nineties owing to burgeoning economic growth, increasing demand for corporate credit, availability of accelerated depreciation allowances that helped in reducing current tax liability, and easy access to multi-lateral and local funding. During this period, leasing of plant and machinery remained the focus of almost all leasing companies. At times, these companies also went into financing development finance projects that are conventionally regarded as not suitable for leasing. Moreover, weak risk assessment and imprudence resulted in over-exposure to certain risk-prone industrial sectors that subsequently became non-performing.

During the last few years, the growth rate of the sector has fallen considerably as a result of the drying up of multi-lateral credit lines and decline in industrial activity - largely stemming from the economic slow down. As demand for corporate credit has been greatly reduced, most leasing companies have shifted their focus from plant and machinery leasing to consumer leasing - mostly vehicles. However, owing to the legacy of imprudent leasing in the past, the asset quality of some leasing companies is adversely impacted with a significant increase in the proportion of non-performing leases. Earnings in the leasing sector have also declined as a consequence of lower margins due to increased competition, especially from investment banks and development finance institutions that have also started leasing operations. The larger leasing companies, however, have managed to weather this difficult period as they were adequately capitalized. On the other hand, the smaller companies, being thinly capitalized, were hit harder by the economic downturn.

3.1.2 Regulatory Actions

1. Requirement for Increase in Paid-up Capital to Rs. 200 million

In view of the fragmented state of the leasing sector, the minimum paid-up capital requirement for leasing companies was raised to Rs. 200 million from Rs. 100 million in 1997. The aim is to enhance financial stability and resource mobilization potential and to encourage consolidation through mergers and acquisitions. All leasing companies were advised to become compliant with the paid-up capital requirement by October 30, 1999. However, in view of the economic stagnation and weak capital market conditions the deadline was extended to June 30, 2001.



Ms. Iram Butt, Director Leasing (extreme right), in a meeting with officers of the Leasing Wing

2.

At the close of the financial year 2000, only nine leasing companies were fully compliant with the minimum paid-up capital requirement of Rs. 200 million and by December 31, 2000, the number had increased to 12. Despite a number of requests, both from the Leasing Association of Pakistan (LAP) as well as individual companies whose paid-up capital was below the stipulated level, the Commission maintained a firm stance that no further relaxation in the time frame for compliance would be granted on an industry-wide basis. However, individual cases were considered on a case-to-case basis and depending on the viability of their plans to meet the regulatory requirement, relaxation was allowed as appropriate.

During the period under review, to provide additional relief to companies whose paid-up capital was below the requisite level, the Commission deemed it fit to consider that the statutory reserves and free reserves available for distribution of bonus shares may be treated as part of capital for meeting the requirement of Rs. 200 million. An amendment to this effect has also been proposed in the Leasing Rules. Consequent to this amendment, two leasing companies would become compliant while five companies are expected to become compliant as a result of mergers and issuance of rights at a discount, thus bringing the number of compliant companies to 19. Meanwhile, the remaining non-compliant companies have also submitted plans to meet the regulatory requirement. Some of these proposals are under consideration of the Commission while companies whose plans were found inadequate have been advised to submit revised plans within the shortest possible time. As a result of these concerted efforts, more than 70 percent of the leasing companies would have met the minimum capital requirement by the end of calendar year 2002. The expected mergers, acquisitions and right issues are likely to lend an element of financial stability to the leasing sector.

Fully Compliant Companies	
Sl. No.	Paid-up-Capital & Admissible Reserves (Rupees in thousands)
1	585,653
2	267,932
3	323,591
4	328,326
5	296,382
6	1,166,396
7	872,229

8	Pak Apex Leasing Company Limited	231,046
9	Paramount Leasing Limited	235,557
10	PILCORP	515,093
11	Saudi Pak Leasing Company Limited	319,581
12	Union Leasing Company Limited	297,655

Deemed Compliant Through Treatment of Reserves

13	Trust Leasing Corporation Limited	399,964
14	Pakistan Industrial and Commercial Leasing Limited	235,557

Expected to Become Compliant as a result of Merger / Issuance of Right Shares

15. Ghandhara Leasing Company Limited merging with Al-Zamin Leasing Modaraba (merger in progress).

16. Ibrahim Leasing Limited merging with Ibrahim Modaraba (merger approved by High Court)

Mercantile Leasing Company Limited merged with Universal Leasing Corporation Limited (merger approved by High Court)

19 Pacific Leasing Company Limited has been granted no-objection for issuance of 100% Rights with a discount of 30%.

3. Suspension of License to Issue Certificates of Investment
Certificates of Investment (COI) remained a significant source of mobilizing short and medium term funding for 21 companies in the leasing sector and as at June 30, 2001, the aggregate amount raised through this source was Rs. 11.5 billion II. A number of leasing companies were issued licenses to issue COIs in the past when the requirement of having a minimum investment grade rating was not mandated by the Commission since no credit rating company was in existence. However, subsequent to the establishment of credit rating agencies and the promulgation of Leasing Companies (Establishment and Regulation) Rules, 1996, the condition of obtaining a minimum investment grade credit rating was imposed for seeking permission to issue COIs. In order to ensure uniform applicability of the Leasing Rules, it was deemed necessary that all leasing companies, which are mobilizing deposits through the issuance of COIs, must obtain a minimum investment grade credit rating.
4. Until recently, six leasing companies had credit ratings that were below investment grade. As such, issuance of COIs by these companies was in violation of the Leasing Companies (Establishment and Regulation) Rules, 2000. Therefore, in the interest of the depositors and prospective COI holders, the Commission suspended their licenses to issue COIs. In case these companies fail to obtain an investment grade credit rating within a period of two years (i.e. by June 30, 2003), their licenses would be cancelled. During this two-year period, these companies have been advised neither to issue any

- new COIs nor roll-over the existing COI deposits upon maturity. The companies whose licenses to issue COIs have been suspended are as follows:
5.
 - a) National Assets Leasing Company Limited
 - b) Natover Lease and Refinance Limited
 - c) English Leasing Limited
 - d) First Leasing Corporation Limited
 - e) InterAsia Leasing Company Limited
 - f) Lease Pak Limited
 6. Promulgation of Leasing Rules, 2000
The Leasing Companies (Establishment and Regulation) Rules, 2000 were notified and published in the official Gazette of September 25, 2000. These Rules provide a comprehensive regulatory framework for leasing companies as both establishment rules and SBP's Prudential Regulations applicable to leasing companies have been combined in one document.
 7. Permission to Investment Banks and Development Finance Institutions to Undertake Leasing Business
During the year under review, after deliberations with representatives of various professional bodies and associations, the Commission acceded to the long standing request of investment banks and development finance institutions and granted them permission to undertake leasing business, strictly within the terms of the regulatory framework for leasing, including compliance with the stipulated minimum capital requirements. Consequent upon this decision, licenses to undertake leasing business have been accorded to Saudi Pak Investment and Agricultural Company (Pvt.) Limited, Al-Meezan Investment Bank Limited and Pakistan Industrial Credit and Investment Corporation Limited (PICIC).
 8. Approval of Directors
The Commission approved the appointment of 52 Directors and four CEOs in response to requests received from 15 leasing companies. In addition, appointments of Chief Operating Officers of Saudi Pak Investment and Agricultural Company (Pvt.) Limited, Al-Meezan Investment Bank Limited and PICIC were also cleared by the Commission.
 9. Grant of Permission to Issue COIs
Security Leasing Company Limited and Sigma Leasing Corporation Limited applied for grant of permission to issue COIs, which was granted by the Commission after all regulatory conditions in this regard had been fulfilled by these companies.
 10. Working Paper for Amendments in Leasing Rules
To make Leasing Companies (Establishment and Regulation) Rules, 2000 more comprehensive and practicable, certain amendments were proposed after extensive discussions with LAP in different forums. These amendments aim not only to provide a level playing field to leasing companies vis-à-vis other Non-Bank Financial Institutions (NBFIs) but will also serve to promote the legitimate operations of leasing companies. The amendments, as finally approved by the Commission, are with the Ministry of Finance for clearance before publication to solicit public opinion.
 11. Budget Proposals for the Finance Ordinance, 2001
Tax proposals in respect of leasing companies, after consultation with LAP, were forwarded to the Central Board of Revenue for their consideration and eventual conclusion in the Finance Ordinance, 2001. As a result of concerted efforts of the Commission, First Year Allowance at the rate of 30 percent has been allowed to leasing companies and modarabas. Also, the ceiling on cost of vehicles for depreciation allowance has been revised upward from Rs. 600,000 to Rs. 750,000. These measures

are expected to give a significant boost to the performance of leasing companies through tax deferrals and reduced current tax liabilities.

3.1.3 Monitoring and Enforcement

1. **Prescription of New Periodic Statements and Returns**
The format of periodic statements and returns to be filed by leasing companies was revised in line with the Leasing Companies (Establishment and Regulation) Rules, 2000. As a result of revision and consolidation, the total number of statements has been reduced from 25 to 10. These were circulated vide circular No.21/2000 dated December 26, 2000 to all leasing companies for compliance with effect from January 1, 2001. This has resulted in not only reducing unnecessary paperwork for leasing companies but has also improved the quality of surveillance by the Leasing Wing.
2. **Special Audit of Leasing Companies**
During the year under review, all leasing companies were subjected to independent Special Audits in terms of Rule 19 of the Leasing Companies (Establishment and Regulation) Rules, 2000. In this regard, comprehensive terms of reference were prepared and Special Auditors appointed to complete the task. The Special Audit Reports received were duly reviewed and appropriate proceedings initiated wherever deemed necessary.
3. **Investigation into the Affairs of Leasing Companies**
After an investigation conducted under Section 265 of the Companies Ordinance, 1984, the Commission initiated court proceedings against the ex-management of Universal Leasing Corporation Limited for misappropriation/misapplication of funds and to seek reimbursement of losses suffered by the company. It has also been decided after necessary due process to investigate into the affairs of National Assets Leasing Corporation Limited under Section 265 of the Ordinance.
4. **Show Cause Notice Under Section 208 of the Companies Ordinance, 1984**
On the basis of the review of annual accounts and Special Audit Reports, Show Cause notices under Section 208 of the Companies Ordinance, 1984 have been issued to two leasing companies for allegedly investing more than 30 percent of their equity into associated undertakings/companies. Consequential proceedings are in progress.
5. **Order Under Rule 7 (1)(i) of Leasing Rules, 1996**
Each leasing company is required to invest at least 70 percent of its assets in its principal line of business in terms of Rule 7(1)(i) of the Leasing Rules, 1996. Continued violation of this Rule was observed in the case of a leasing company, the Directors of which were imposed a penalty of Rs. 57,200 under Rule 14 (1) of the Leasing Rules, 1996.

3.2 Modaraba Wing

3.2.1 Overview

The Islamic concept of 'modaraba' was first introduced in the financial sector in Pakistan in 1980 with the promulgation of the Modaraba Companies and Modaraba (Floatation and Control) Ordinance. The Modaraba Ordinance provides for an Islamic mode of business termed 'modaraba' in which one party (the modaraba management company) contributes its skills and efforts while the other (the modaraba certificate holders) provides the required capital/funds, the profits earned being shared between them in a pre-agreed proportion. A modaraba may be multi-purpose or specific purpose, and may be perpetual or floated for a specified period.

Representing the first step towards Islamization of the economy, this sector has come a long way since its inception in 1980 and modarabas have contributed considerably towards the economic development of the country. The modaraba, being essentially an Islamic corporate form akin to a two-tier fund structure, derives its strength and vitality from the capability of its management company. This calls for a stricter code of corporate governance in order to safeguard the interests of the modaraba certificate holders. With better monitoring and surveillance methods recently instituted by the Commission, compliance with the Prudential Regulations has improved. Also, the enhanced disclosure requirements have helped in maintaining greater transparency in the sector.

The modaraba sector has suffered chronically from the problem of resource mobilization resulting in limited opportunities for growth. The Commission is aware of the difficulties being faced by the sector in this respect and plans to take effective steps in collaboration with the SBP to improve the operating environment of the sector. Meanwhile, the recent mergers in the sector are also indicative of a general strategic shift towards consolidation that is expected to usher in greater financial stability and operational flexibility.

At June 30, 2001, there were 47 modarabas in existence, of which 41 were operational with paid-up capital aggregating Rs. 7.4 billion. Total assets of the modaraba sector stood at Rs. 17.12 billion while their aggregate equity amounted to Rs. 8.1 billion^{III}. The difficult operating environment prevailing in the recent past has also had an adverse impact on the performance of a number of modarabas. However, despite the long economic recession, the sector has performed reasonably well and out of 41 operational modarabas, 35 were profitable with 23 paying cash dividends during the financial year 2001. The Net Asset Value (NAV) of the majority of the modarabas remained above par value. The average dividend payouts of the modaraba sector can be compared favorably with any other segment of the corporate sector.

Key statistics of the modaraba sector as on June 30, 2001, based on unaudited statements, are given in Table 7 ahead.

Table 7 - Key Statistics of Modaraba Sector
(Rs. in million)

S. No.	Name of Modaraba	Paid-up Fund (Rs.in million)	Reserves (Rs.in million)	Equit (Rs.in million)	Assets(Rs.in million)
1	Al-Noor Modaraba	210.00	45.16	255.16	280.41
2	Allied Bank Modaraba	350.00	79.47	429.47	704.00
3	Al-Zamin Modaraba	126.50	36.18	162.68	546.52
4	B.F. Modaraba	51.41	(7.85)	43.56	44.92
5	B.R.R. International Modaraba	481.94	273.16	755.10	2,582.63
6	Constellation Modaraba	64.63	6.75	71.38	107.128
7	Crescent Modaraba	226.19	97.72	323.91	2,402.95
8	Elite Capital	113.40	(14.96)	98.44	108.27

	Modaraba				
9	Equity Modaraba	262.20	127.00	389.20	405.00
10	Fidelity Leasing Modaraba	206.33	56.24	262.57	438.00
11	Financial Link Modaraba	100.00	(95.28)	4.72	5.25
12	General Leasing Modaraba	56.25	(31.16)	25.09	77.94
13	Grindlays Modaraba	374.20	445.00	819.20	2,175.00
14	Guardian Leasing Modaraba	100.00	(25.52)	74.48	248.83
15	Habib Bank Modaraba	397.07	199.14	596.21	697.72
16	Habib Modaraba	252.00	105.00	357.00	1,004.00
17	Hajveri Modaraba	205.32	89.00	294.32	330.00
18	IBL Modaraba	116.87	26.12	143.00	258.75
19	Imrooz Modaraba	30.00	31.34	61.34	108.44
20	Industrial Capital Modaraba	94.88	(17.93)	76.95	83.04
21	Interfund Modaraba	77.55	(51.18)	26.38	46.33
22	Islamic Modaraba	100.00	7.24	107.24	121.09
23	LTV Capital Modaraba	395.90	(426.5)	(30.60)	319.48
24	Mehran Modaraba	83.16	(51.13)	32.03	33.48
25	Modaraba Al-Tijarah	75.77	(45.70)	30.08	38.72
26	Modaraba Al-Mali	182.57	48.57	231.14	324.00
27	National Modaraba	51.80	(36.68)	13.12	31.76
28	Pak Modaraba	125.40	(20.80)	104.60	111.49
29	Paramount Modaraba	50.00	14.29	64.29	75.52
30	Professional Modaraba	78.00	17.00	95.00	107.00
31	Providence Modaraba	63.13	9.03	72.16	85.94
32	Prudential Modaraba, 1st	232.56	(12.13)	220.43	231.16
33	Prudential Modaraba, 2nd	212.36	(42.76)	169.59	171.24
34	Prudential Modaraba, 3rd	255.99	(91.86)	164.13	178.25
35	Punjab Modaraba	340.20	99.72	439.92	459.54

36	Tri-Star Modaraba, 1st	140.80	23.90	164.70	168.98
37	Tri-Star Modaraba, 2nd	128.70	17.03	145.73	149.21
38	Trust Modaraba	273.00	151.79	424.79	667.89
39	UDL Modaraba	263.86	108.62	372.49	1,165.96
40	Unicap Modaraba	136.40	(127.39)	9.01	16.37
41	Unity Modaraba	300.00	(297.85)	2.15	3.73
	Total	7,385.64	715.79	8,101.43	17,115.96

3.2.2 Regulatory Actions

1. Registration of New Modaraba Company
During the year under review, a new modaraba company was registered under the Modaraba Ordinance. The company intends to float a specific purpose manufacturing modaraba with a paid-up fund of Rs. 800 million, which is the largest in the sector so far.
2. Mergers and Consolidation
In the modaraba sector, mergers are being encouraged as they are expected to enhance the performance through improved economies of scale and operational synergies. During the period under review, the High Courts approved two cases of mergers in the modaraba sector. The Commission has also given its clearance for another merger that would occur upon completion of the prescribed judicial process.
3. Annual Review Meetings of Modarabas
Prudential Regulations for modarabas that were prescribed and issued by the Commission in April 2000 provide for the holding of annual review meetings in which modaraba certificate holders can express and share their views with the modaraba management companies regarding the affairs of the modaraba. During the financial year 2001, such annual review meetings were held by all modarabas, thus providing, for the first time, a forum for the certificate holders to voice their views about the performance of the modarabas and their respective management companies.
4. Issuance of Circulars
During the year under review, the Modaraba Wing prescribed policy guidelines for modarabas issuing bonus and right certificates and guidelines for the holding of annual review meetings by modarabas in terms of Prudential Regulations. The circulars prescribing these guidelines have also been placed on the Commission's website.

3.2.3 Monitoring and Enforcement

1. Penal Actions Against Delinquent Modarabas
Monitoring and surveillance activities were enhanced during the year. The Modaraba Wing maintained effective off-site monitoring of the sector by reviewing periodic returns/ information submitted by each modaraba. On-site monitoring was conducted through appointment of Special Auditors in the case of six modarabas. Show Cause notices were issued to two modarabas on account of non-submission of half-yearly accounts for the six months ended December 31, 2000. An investigation into the affairs of a modaraba was ordered under Section 21 of the Modaraba Ordinance. Also, based on the results of inquiries ordered previously, penalties were imposed on

directors of three modarabas under Section 32 of the Modaraba Ordinance.

During the year under review, two cases against sponsors/directors of modarabas on account of mismanagement and embezzlement of funds were filed in the Modaraba Tribunal. The Commission also granted permission for voluntary change of management of two modarabas.

2. Prescription of New Periodic Statements and Returns
The formats of periodic statements and returns to be filed by modarabas under the Prudential Regulations were prescribed through a circular. As a result of revision and consolidation, these returns were reduced from 32 to seven. At the same time, the returns became more informative and useful as a basis for taking proactive measures. This, in turn, has served to increase the operational efficiency of the Modaraba Wing.

Prudential Regulations for modarabas issued by the Commission prescribed a mandatory reserves requirement of up to 10 percent of profits. This limit was increased to 20 percent vide circular dated June 14, 2001, with a view to increasing the equity of the certificate holders and to encourage the growth of modarabas.

3.3 Mutual Funds Wing

3.3.1 Overview

Mutual funds serve as an effective vehicle for mobilizing and channeling savings towards productive sectors. Realizing the importance of this industry, the Government set up the National Investment Trust Limited (NIT) in 1962 to manage an open-end mutual fund. NIT has since been investing in stocks of different companies and, at present, it is the single largest investment institution with a net worth of more than Rs. 16 billion. In 1966, the Government set up another institution - Investment Corporation of Pakistan (ICP) - to float and manage closed-end funds. ICP has launched 26 closed-end mutual funds and the listed capital of ICP mutual funds stands at Rs. 3.1 billion as on June 30, 2001. Around 10-15 percent of the available floating stock has always been held by ICP which also offered certain other services for growth of the corporate sector that included bridge financing, underwriting of issues and facilities for investors to open and operate discretionary and non-discretionary investment accounts.

In 1971, the Government cleared the way for entry of private entrepreneurs in the closed-end segment of the industry by notifying the Investment Companies and Investment Advisors Rules (IC & IA Rules), 1971. However, it was during the period 1991 to 1996 that the industry attracted the attention of investors. So far, the private sector has established a total of 13 funds under the IC & IA Rules, of which 12 were floated during 1991 to 1996. In view of the receptivity to mutual funds, the Government notified another set of rules, namely, Asset Management Companies Rules, 1995 to provide the necessary legal framework for launching and managing open-end funds by the private sector. One such fund has already been established and applications from four private corporate houses are under consideration of the Commission.

The mutual funds industry with a total size of Rs. 24 billion represents around 7 percent of the total market capitalization of the stock market. However, until now the industry has not developed to its full potential owing to poor management as well as adverse stock market conditions. Mutual funds in Pakistan are around 2.5 percent of bank deposits, which is quite low compared to other countries in the region and insignificant compared to the size of mutual funds in developed countries, like the USA, where mutual funds amount to approximately 112 percent of bank deposits. Keeping in view the size of our economy and bank deposits, the

mutual funds industry should grow to over Rs. 100 billion in a favorable investment environment. Recent reduction announced by the Government in the rates of return applicable to various National Savings Schemes and Government debt instruments is expected to generate interest in mutual fund investments.

Key statistics of the public sector closed-end mutual funds as on June 30, 2001, based on audited accounts, are given in Table 8.

Table 8 - Key Statistics of Public Sector Close-End Funds

S.No.	Name of Fund	Listed Capital	Par Value	NAV	Market	Dividend Payout (%)		
		(Rs. in million)	(Rs.)	(Rs.)	Value	1999	2000	2001
				(Rs.)				
1	1st ICP	50.00	10.00	10.78	4.25	0.00	12.00	13.00
2	2nd ICP	50.00	10.00	10.20	4.95	10.00	0.00	12.00
3	3rd ICP	50.00	10.00	10.49	7.25	15.00	10.00	16.00
4	4th ICP	50.00	10.00	11.13	15.00	20.00	30.00	37.00
5	5th ICP	50.00	10.00	11.87	4.25	0.00	0.00	11.00
6	6th ICP	50.00	10.00	10.88	12.50	20.00	10.00	25.00
7	7th ICP	50.00	10.00	10.66	10.00	10.00	0.00	9.00
8	8th ICP	50.00	10.00	11.45	10.20	35.00	20.00	32.00
9	9th ICP	50.00	10.00	12.85	21.50	50.00	50.00	60.00
10	10th ICP	50.00	10.00	10.42	10.00	10.00	15.00	18.00
11	11th ICP	50.00	10.00	10.69	6.55	15.00	15.00	17.00
12	12th ICP	50.00	10.00	11.02	5.05	15.00	0.00	19.00
13	13th ICP	50.00	10.00	11.07	13.75	25.00	20.00	28.00
14	14th ICP	50.00	10.00	12.02	8.00	10.00	10.00	18.00
15	15th ICP	50.00	10.00	11.16	4.30	0.00	0.00	10.00
16	16th ICP	50.00	10.00	10.21	4.00	0.00	7.00	7.50
17	17th ICP	50.00	10.00	10.53	4.75	0.00	12.00	10.00
18	18th ICP	50.00	10.00	10.75	3.00	0.00	0.00	9.00
19	19th ICP	50.00	10.00	10.26	6.05	10.00	0.00	17.00
20	20th ICP	50.00	10.00	10.70	5.25	10.00	0.00	16.00
21	21st ICP	100.00	10.00	4.81	1.35	0.00	0.00	5.00
22	22nd ICP	200.00	10.00	8.12	2.15	0.00	0.00	6.00
23	23rd ICP	200.00	10.00	4.03	1.35	0.00	3.50	0.00
24	24th ICP	400.00	10.00	4.94	1.35	0.00	4.50	0.00
25	25th ICP	400.00	10.00	8.73	2.05	0.00	0.00	6.00
26	SEMF	840.00	10.00	10.29	13.40	18.00	12.00	22.00
	Total	3,140.00						

Key statistics of the private sector closed-end mutual funds as on June 30, 2001, based on audited accounts, are given as follows:

Table 9 - Key Statistics of Private Sector Close-end Funds

(Unit)									
Trust	16,062.00	10.00	9.16	10.20	9.75		3.85	4.62	9.78
Private									
2 Sector									
Unit Trust									
of Pakistan	749.00	5,000.00	5,201.00	5,822.00	5,721.00		13.37	21.23	11.54

3.3.2 Regulatory Actions

The Commission, since its inception in 1999, has been conscious of the importance of the mutual funds industry in channeling savings to productive sectors of the economy and bringing qualitative improvement in stock market operations. The Mutual Funds Wing of the SCD has, therefore, taken necessary steps to create an environment conducive to the growth of the industry. Various internal and external factors inhibiting growth of the industry have been identified and measures are being taken to introduce necessary reforms.

i) Notification of Amendments in the IC & IA Rules, 1971

Through amendments made in 1999, mutual funds were allowed to diversify their portfolios by investing in fixed income securities besides investing in equities. Another set of amendments, notified in 2001, are expected to further facilitate the industry in view of the following:

- a) Floatation of special purpose funds has been permitted.
- b) The CDC, whose charges are lower than those of banking companies, has been allowed to function as custodian.
- c) Remuneration of management companies of closed-end mutual funds has been brought at par with that of management companies of open-end mutual funds.
- d) Reporting of NAV to the Commission, stock exchanges and their representative body has been made mandatory for monitoring purposes.

ii) Notification of Amendments in the Asset Management Companies Rules, 1995

During the year, amendments in the Asset Management Companies Rules with the following salient features were notified:

- a) Allowing asset management companies to launch additional schemes with reduced minimum capital requirement subject to fulfillment of the prescribed performance criteria.
- b) Allowing the establishment of sector-specific funds, thus encouraging investment in certain priority areas such as information technology.
- c) Enabling the Commission to relax certain requirements of the Rules in the interest of the capital market.

iii) New Registrations

There is considerable interest amongst corporate houses for launching open-end funds and five applications for registration of companies under the Asset Management Companies Rules, 1995 were received during the year. After reviewing the proposals, registration was granted in one case while promoters of the remaining four companies were asked to complete requisite formalities to become eligible for registration. The documents for launching the scheme by the new asset management company are currently under the scrutiny of the Commission.

The Commission also received and processed applications from three different corporate houses for registration of companies as investment advisors under the IC & IA Rules.

Registration was granted to one of the applicants while the remaining two were advised to fulfill the criteria stipulated in the Rules. At present, 59 companies are registered as investment advisors. The number of closed-end mutual funds remained 13 owing to lack of investor interest in new funds under existing market conditions.

iv) Update of Record of Investment Advisors

Recent amendments in the IC & IA Rules have raised the minimum paid-up capital requirement for investment advisors to Rs. 20 million and for investment companies to Rs. 100 million. Compliance with this stipulation is expected by January 14, 2002. Registration of three investment advisors was cancelled due to non-compliance with certain provisions of the IC & IA Rules while one company is in voluntary liquidation. A No Objection Certificate (NOC) issued to promoters of an investment advisory company was withdrawn since they failed to incorporate the company within the validity period of the NOC.

v) Mergers and Consolidation

A trend of consolidation was also witnessed in the mutual funds industry during the period under review and two closed-end funds applied for merger. In view of the complementarities and synergies noted, the Commission cleared the scheme of merger. In line with the policy to encourage consolidation in the corporate sector, the minimum capital requirement was increased for investment advisors and investment companies as noted above.

vi) Other Regulatory Actions

The Commission approved, after due examination, advertisements submitted by fund managers of open-end mutual funds ensuring that no misleading information was passed on to investors while inviting investment in the schemes. Similarly, requests received for appointment of directors by investment companies and investment advisors were examined and approved after ensuring that the new directors fulfilled the criteria prescribed in the Rules. As a consequence of allowing CDC to act as custodian of mutual funds, several requests were received for change of custodian which were approved after necessary scrutiny.

vii) Registration of Mutual Funds Association of Pakistan

The mutual funds sector has also formed a representative body, namely, Mutual Funds Association of Pakistan (MUFAP). The Commission has cleared the Memorandum of Association of MUFAP and asked the Ministry of Commerce to register it under the Trade Organization Ordinance, 1961.

3.3.3 Monitoring and Enforcement

i) Development of New Monitoring System

During the period under review, a new system was devised for monitoring the performance of mutual funds that was hitherto being monitored solely on the basis of annual and half-yearly accounts. The new monitoring system has the following features:

- a) Performance of each mutual fund is analyzed in terms of NAV, profitability, payout and market price. Changes in NAV of different funds are also compared with the KSE-100 Index. Managements of funds, whose performance is found unsatisfactory, are called upon to explain their investment strategy and future business plans to improve performance.
- b) In the light of provisions contained in the Rules, a checklist of indicators for performance evaluation has been devised. On the basis of these indicators, most mutual funds have been asked to explain their position with regard to issues like inadequate disclosure, incorrect calculation of remuneration fee of investment advisors, investments in associated undertakings, incorrect treatment of investments in annual accounts, insufficient provisioning

against diminution in the value of investments, poor trading results, imprudent deployment of funds and unusual increase in administrative expenses.

c) To standardize the monitoring system, Prudential Regulations have been drafted for the mutual funds industry and will be notified for public opinion shortly. The Regulations define investment valuation, investment policy, diversification, restrictions on certain types of transactions, transactions with directors/connected persons, distribution of profits, provision for inspection/special audit, code of conduct, internal control, etc. The Regulations also contain formats of periodic statements to be submitted by the companies to the Commission for monitoring purposes.

ii) Enforcement Actions

The following major irregularities on the part of investment advisors and funds were observed during the period under review:

- a) Irregularities in appointment of directors.
- b) Late filing of accounts.
- c) Non-holding of Annual General Meetings (AGMs).
- d) Continuous deterioration in financial position.
- e) Mismanagement of funds.

Non-compliant funds and investment advisors were issued Show Cause notices to explain their position with regard to the above violations. After necessary due process, orders were issued against those funds and investment advisors which were found to be persistent defaulters. Penal actions taken include the following:

- a) A fine amounting to Rs. 100,000 under the Securities and Exchange Ordinance, 1969 was imposed on the CEO of an investment advisory company for not seeking approval of the Commission, as required under the IC & IA Rules, for appointment of directors.
- b) A penalty amounting to Rs. 20,000 under the Companies Ordinance, 1984 was imposed on each of the directors of a mutual fund for failing to hold the AGM and file annual accounts within the stipulated time.
- c) An investigation was ordered into the affairs of an investment advisory company and a mutual fund under Section 265(b) of the Companies Ordinance, 1984 for reported mismanagement and financial irregularities.
- d) Registration of certain investment advisory companies was cancelled due to violation of IC & IA Rules, 1971.

3.3.4 Other Specialized Companies

The Mutual Funds Wing also looks after the affairs of the following specialized companies other than mutual funds:

i) Credit Rating Companies

At present, there are two credit rating companies, namely, Pakistan Credit Rating Company (Pvt.) Limited (PACRA) and JCR-VIS Credit Rating Company (formerly DCR-VIS) operating in Pakistan, which were registered in 1996 and 1997, respectively, under the Credit Rating Companies Rules, 1995. The Commission renews their registration annually on the basis of performance and compliance with the registration criteria. Fitch Ratings is a shareholder and technical partner of PACRA while Japan Credit Rating Agency has similar arrangements with JCR-VIS. JCR-VIS had technical collaboration with Duff & Phelps Credit Ratings till the latter merged with Fitch IBCA in June 2000 and withdrew its technical collaboration with DCR-VIS. Consequently, the promoters of DCR-VIS were directed to conclude a joint venture agreement with an international credit rating agency to stay eligible for renewal of registration. The

company's registration certificate was renewed after it entered into a technical assistance agreement with Japan Credit Rating Agency.

Credit ratings serve as a useful tool for investment evaluation especially for investors in the corporate debt market. The Commission has made it mandatory for the issuers of corporate bonds/TFCs to get these instruments rated by recognized credit rating agencies. The SBP has also made it obligatory for commercial banks and NBFIs under its purview to get themselves rated. With the development of the corporate bond market, it is anticipated that the role of rating agencies would also assume greater significance in the future.

ii) Venture Capital Companies and Venture Capital Funds

The Commission notified the Venture Capital Companies and Venture Capital Funds Rules (VCC & VCF Rules) in February 2001. These Rules provide the legal framework to govern licensing, operations, resource generation and investment avenues for venture capital companies and venture capital funds. The Rules - framed under the Securities and Exchange Ordinance, 1969 - are expected to facilitate investment in business ventures such as information technology companies. Companies licensed under the VCC & VCF Rules have been granted tax exemption for a period of seven years by the Government, effective from July 1, 2000. The text of the Rules is available at the Commission's website.

3.4 Oversight of Accountancy Profession

The Commission has been entrusted with oversight of the accounting profession, in particular the Institute of Chartered Accountants of Pakistan (ICAP). The Chairman is a nominee of the GOP on the Council of ICAP. This enables the Commission to contribute to, and remain abreast of all major policy decisions of the Institute.

3.4.1 Chartered Accountants (Amendment) Ordinance, 2001

The draft Chartered Accountants (Amendment) Ordinance, 2001 submitted by ICAP to the Commission was, after due consideration, sent to the Ministry of Finance for clearance. This Ordinance envisages a number of amendments in the Chartered Accountants Ordinance, 1961 and primarily seeks to enhance self-regulation of the profession through a more effective regulatory framework. The proposed amendments are essentially designed to convert the Chartered Accountants Ordinance, 1961 into an 'enabling law' that lays down the basic framework leaving all operative matters to be covered in the bye-laws.

3.4.2 Corporate Secretaries Ordinance, 2001

The Commission has also drafted and proposed promulgation of Corporate Secretaries Ordinance, 2001 to the Ministry of Finance. This Ordinance seeks to grant the Institute of Corporate Secretaries (ICS) the status of a statutory body. ICS is, at present, operating as a company limited by guarantee under the repealed Companies Act, 1913. It is a professional institute, representing corporate secretaries in Pakistan, with membership strength of about 550.

3.4.3 Adoption of International Accounting Standards

The Commission has approved the notification for adoption of International Accounting Standards (IAS) 22, 36 and 39, pursuant to the recommendations of ICAP. Effectively, the Commission has adopted all IAS issued so far with the exception of two that are yet to be recommended by ICAP and another two that are not relevant to the circumstances in Pakistan.

3.4.4 Amendments in the Companies Ordinance, 1984

During the year, amendments were considered in Section 254 of the Fourth Schedule to the Companies Ordinance, 1984, as discussed below.

i) Section 254

The Companies Ordinance, 1984 lays down the qualification of auditors of private companies with paid-up capital of Rs. 3 million or more. No qualification criterion has, however, been prescribed for auditors of private companies with paid-up capital of less than Rs. 3 million. After a public hearing at which all aspects of this matter were debated, the Commission announced its considered view that private companies with paid-up capital of less than Rs. 3 million but with both turnover and total assets exceeding Rs. 21 million should have their accounts audited by a Chartered Accountant. Necessary amendments to this effect, in the Companies Ordinance, 1984, have been proposed.

ii) Fourth Schedule

The Commission has undertaken to remove obsolete clauses in the Fourth Schedule to the Companies Ordinance, 1984, which is titled "Requirements as to Balance Sheet and Profit and Loss Account of Listed Companies". The purpose is to bring the disclosure and presentation requirements for financial statements of listed companies in line with IAS.

3.4.5 Amendments in the Companies (General Provisions and Forms) Rules, 1985

During the year, two significant amendments were made in the Companies (General Provisions and Forms) Rules, 1985 whereby Form 35-A "Auditors' Report to the Members" and Form 35-B "Auditors' Report to the Members or Directors in case of Branches of Foreign Banks" were substituted. The purpose was to ensure that financial statements conform with approved accounting standards, as applicable in Pakistan, and to delineate the responsibilities of auditors and management. In addition, auditors of banks are now required to verify more than 60 percent of the loans and advances of the bank and a necessary statement to this effect has been included in Form 35-B.

3.5 Cost Audit Records

3.5.1 Companies (Audit of Cost Accounts) Rules, 1998

Audit of cost accounts by a Chartered Accountant or a Cost and Management Accountant is a statutory requirement contained in the Companies Ordinance, 1984 under Section 230(1)(e). The rules framed under this Section were notified in 1998 as the Companies (Audit of Cost Accounts) Rules, 1998.

Cost Audits in all major industries would help the companies to identify the inefficiencies in their costing mechanisms and pave the way for rationalization of costs thereby increasing profitability and enhancing shareholder value. Cost Audits have already been enforced in Vegetable Ghee and Cooking Oil Industry since January 1991 and in Cement Industry since July 1994. The Sugar Industry came under the ambit of Cost Audits with effect from October 2001.

Table 11 - Enforcement of Cost Audits

No.	Name of Industry	Draft /Final Notification	Date of Enforcement	No. of Companies	Listed Companies
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1	Vegetable Ghee and Cooking Oil	SRO#1131(I)/ 90 dated 05-11-90	January-91	36	21
2	Cement	SRO#386(I)/94 dated 14-05-94	July-94	25	20
3	Sugar	SRO#1102(I)/95 dated 7-11-95	October-2001	140	39

3.5.2 Enforcement Actions

During the year under review, 35 Show Cause notices were issued to companies within the Vegetable Ghee and Oil and Cement Industries for non-compliance with the Cost Audit Rules. Most of these companies were found in violation of sub-Rule 3, which relates to the appointment of Cost Auditor within 60 days of the end of the financial year and sub-Rule 4, which pertains to submission of the Cost Audit Report within 60 days of the appointment of the Cost Auditor. After necessary due process, appropriate penal actions were taken in accordance with the law. The monitoring and enforcement of the Companies (Audit of Cost Accounts) Rules, 1998 have recently been transferred to the Enforcement and Monitoring Division and the Company Law Administration Division within the Commission.

Enforcement and Monitoring Division

[Overview](#) | [Regulatory Actions](#) | [Monitoring and Enforcement](#)

1. Overview

The Enforcement and Monitoring Division (EMD) is responsible for the enforcement of corporate laws in respect of listed companies (other than insurance companies and specialized companies). The EMD endeavors to protect the interests of minority shareholders, creditors and other stakeholders by ensuring full and fair disclosure - in terms of the Fourth Schedule to the Companies Ordinance, 1984 and the IAS adopted in Pakistan. During the year under review, the EMD focused its attention on ensuring timely holding of AGMs by companies and circulation of annual and interim accounts amongst their shareholders within the prescribed period. Unauthorized and unlawful inter-corporate financing, non-payment of dividends, irregularities and malpractices in accounts, non-compliance with statutory requirements, mismanagement, oppression and poor financial results also remained focal points of the EMD's surveillance activities. During the year, the EMD ordered several investigations into the affairs of listed companies and based on the findings of the inspectors' reports, appropriate penal actions were taken. Recently, the EMD has also initiated action against auditors for negligence and professional misconduct on their part. Proactive monitoring by the EMD resulted in improving corporate governance in listed companies to a considerable extent that in turn helped in bolstering the confidence of investors and the general public.



Mr. Rashid Sadiq, Executive Director (extreme right), with officials of EMD

2. Regulatory Actions

i. Unauthorized Inter-corporate Financing

During the period under review, the EMD initiated action against 10 companies for violation of the provisions of Section 208 of the Companies Ordinance, 1984. While penalties aggregating Rs. 7.3 million were imposed on two companies, the other cases were at different stages of

processing at the close of the period under review. To minimize the incidence of excessive inter-corporate financing, the EMD issued a notification during the year whereby all listed companies were advised to annex a statement with the notice of meeting giving detailed information about the investments proposed to be made in their associated companies/undertakings. The objective of such disclosure is to improve transparency in corporate transactions and to ensure that vital information about proposed investments in associated companies is communicated to the shareholders.

ii. **Notifications and Circulars**

During the year under review, a number of notifications and circulars were issued by the EMD, the salient ones among which were as follows:

- a. Notification No. 865 (1)/2000 dated December 07, 2000 requiring listed companies to provide detailed information at the time special resolutions are passed in regard to investments in associated companies.
- b. Circular No. 8/2000, dated July 6, 2000 requiring listed companies to follow the requirements of IAS 34 notified vide SRO No. 33(1)/2000 dated January 27, 2000 while preparing half yearly accounts under Section 245 of the Companies Ordinance, 1984.
- c. Circular No. 14/2000 dated November 14, 2000 prescribing procedures for disposal of cancelled share certificates of listed companies that were entered at the Central Depository System (CDS).
- d. Circular No. 2/2001 dated February 22, 2001, directing listed companies to transmit copies of notices of AGMs/Extraordinary General Meetings (EGMs) to the Commission on the same day that the notices of meetings are issued to the shareholders.
- e. Circular No. 3/2001, dated April 13, 2001 clarifying that listed companies, among others, may dispatch dividend warrant and share certificates through courier services.

3. **Monitoring and Enforcement**

i. **Holding of AGMs and Circulation of Accounts**

Companies are required to hold their AGMs within six months of the close of the financial year and to circulate annual reports among the shareholders along with notices of meetings at least 21 days before the date of AGMs. In this connection, the EMD issued Show Cause notices to 54 companies and imposed penalties on 34 companies, which had failed to hold their AGMs within the prescribed period. Warnings were also issued to 78 companies, which failed to submit their annual accounts to the

Commission. The Commission has also started the practice of sending its representatives to attend general meetings of certain companies as observers. This initiative has resulted not only in the orderly holding of meetings but also in enhancing shareholder confidence. A larger number of shareholders are now motivated to attend such meetings and to discuss the company's affairs with the management.

ii. **Extension in Holding of AGMs**

During the period under review, the Commission received 76 applications for extension in holding of AGMs, out of which 20 were rejected, as the grounds for seeking extensions were found inadequate.

iii. **Examination of Annual and Interim Accounts**

Listed companies are required to submit annual and half-yearly accounts to the shareholders, stock exchange(s) and the Commission as per the requirement of the Companies Ordinance, 1984. To examine these accounts, a standardized checklist was devised keeping in view the disclosure requirements under the Companies Ordinance, 1984, its Fourth Schedule and the IAS. During the year under review, published accounts of companies were thoroughly examined and the managements of several companies were called upon to explain their position with regard to deficiencies noticed in the financial statements. As a result of strict monitoring by the EMD, the quality of financial reporting by companies and its presentation has improved substantially.

iv. **Circulation of Half-yearly Accounts**

Half-yearly accounts of listed companies are required to be circulated within two months of the close of first half of the financial year. During the year under review, 64 Show Cause notices were issued to directors of companies who failed to circulate half-yearly accounts within the prescribed period. Penalties were imposed on the directors/CEOs of 23 companies while warnings were issued to 41 companies.

v. **Publication and Circulation of Notices of Meetings to Shareholders**

To ensure timely issuance and publication of notices of meetings, all listed companies were directed to transmit copies of notices of AGMs and EGMs to the Commission through fax message on the same day that these notices were issued to the shareholders. This directive helped the EMD to take timely corrective measures in cases where certain resolutions were proposed to be passed by companies in violation of the statutory requirements. Consequently, the concerned companies were directed, in time, by the EMD either not to pass such resolutions or to proceed only after removing the deficiencies noted.

vi. **Unauthorized Sale of Assets**

It was observed that managements of a number of companies that intended to close-down their operations would sell off their plant and machinery

and other valuable assets in order to settle outstanding debts, including amounts borrowed from sponsors. Effectively, this practice resulted in a loss in the value of investment of the minority shareholders. Taking heed of notices published in the press regarding sale of assets by the managements of such companies, the EMD took a number of remedial measures to discourage this practice, e.g. directing the concerned managements to ensure that minority shareholders were adequately compensated. This policy was adopted in the case of those companies in which there was either no chance of revival or the possibility of potential return to the shareholders was considered remote.

vii. **Investigations into the Affairs of Companies**

The EMD orders investigations into the affairs of such listed companies in which there are apprehensions regarding mismanagement, continuous deprivation of a reasonable return to the shareholders or violation of statutory provisions. During the period under review, the EMD strengthened its surveillance activities and investigation proceedings were initiated in 79 cases. These investigations were mainly related to companies in the textiles and sugar sectors in which there had been a turnaround due to robust cotton and sugarcane crops. The Division, therefore, focused on companies whose performance had either improved or which had sufficient reserves but their shareholders were being deprived of any return on their investment.

Inspectors were appointed in the case of 11 companies out of which three companies filed appeals in the concerned High Courts challenging orders of the Commission to appoint inspectors. In one case, the Peshawar High Court upheld the order of the Commission while in another, the Appellate Bench of the Commission set aside the order. The remaining cases are in progress at various stages. Investigations have been ordered mainly on the following grounds:

- a. Non-compliance with statutory requirements.
- b. Complaints by shareholders about mismanagement.
- c. Inconsistencies in operating results.
- d. Consistent default in payment of dividends.
- e. Deterioration in performance after listing and privatization; non-payment of dividends.
- f. Oppression of minority shareholders.

The ensuing investigation reports are being processed and appropriate action in accordance with the law will be taken.

viii. **Improvement in Payment of Dividends**

As a result of proactive surveillance by the EMD, the number of companies that paid dividends to the shareholders increased substantially during the last two years. A large number of companies also came out of

the defaulter counter of the KSE due to resumption of dividend payments. The pattern of payment of dividend by listed companies during the last three years is presented as follows:

Chart 5 - Year-wise Position of Dividend Payment by Companies



ix.

x. **Directives Issued to Listed Companies**

During the period under review, the EMD issued directives to the following nine companies whose accounts indicated irregularities and, possibly, fraudulent transactions that adversely affected interests of the minority shareholders.

- a. The directors of Ghani Textile Mills Limited were directed to deposit into the company's account an amount of Rs. 9.6 million on account of an undue gain that they had made when they sold to themselves a part of the company's investments in an associated company, namely, Ghani Glass Mills Limited.
- b. The directors of Pioneer Cement Limited were directed to return an amount of Rs. 11 million to the company that had been erroneously paid to its Chairman on account of reimbursement of medical expenses.
- c. The directors of Husein Sugar Mills Limited were directed to deposit in the company's account an amount of Rs. 15 million on account of the sale of shares of its subsidiary to the directors of the same subsidiary at an inadequate price.
- d. Six companies, namely Dewan Sugar Mills Limited, Dewan Mushtaq Textile Mills Limited, Dewan Khalid Mills Limited, Dewan Textile Mills Limited, Haji Muhammad Ismail Mills Limited and National Tannery of Pakistan Limited, were refrained from passing special resolutions, for inter-corporate investments or the disposal of their assets, which were not in conformity with the law.

xi. **Actions Against Auditors**

During the year, it was observed that several auditors had failed to act in

conformity with the statutory requirements and that material facts had not been brought to the notice of the members. The Commission initiated action against several auditors in this regard. These cases were also referred to ICAP for taking necessary disciplinary action against the concerned auditing firms. Referrals were made to ICAP mainly on account of the following:

- a. Failure to point out factual position regarding supplier's credit.
- b. Taking up the audit assignment without prior intimation to the previous auditor.
- c. Failure to report improper books of accounts maintained by the companies.
- d. Failure to report non-compliance with IAS.
- e. Violation of the requirements of Generally Accepted Accounting Principles and ICAP's circulars.

xii. **Investors' Grievances**

To afford greater protection to investors and minority shareholders, immediate steps were taken on receipt of their complaints against listed companies. Greater emphasis was placed on the representations from shareholders and an attempt was made to redress their grievances in the minimum possible time. During the period under review, 159 complaints were received from investors/shareholders, out of which 152 were resolved.

xiii. **Status of Cases with Appellate Benches**

During the year, 10 companies filed petitions with the Appellate Benches of the Commission against orders of the Commissioner/Executive Director, EMD. In five cases, the decisions were upheld while in three cases, relief was granted. In the remaining two cases, necessary proceedings are in progress.

Company Law Administration Division

Overview | Improvements in the Administration of Company Law | Regulatory Actions | Monitoring and Enforcement

Overview

The Company Law Administration Division (CLAD) is primarily responsible for administration of the Companies Ordinance, 1984 and the Companies (Appointment of Legal Advisors) Act, 1974. It discharges its functions with the objective of achieving healthy growth of corporate enterprises, providing protection to investors and creditors and creating incentives for investment. Incorporation and registration of companies is carried out at the CROs located in seven major cities of Pakistan, i.e. Karachi, Lahore, Islamabad, Peshawar, Quetta, Multan and Faisalabad. These offices also function as registrars of company records. The CLAD also grants licenses and issues approvals in certain matters, as provided in the Companies Ordinance, 1984. Additionally, to improve corporate governance, a system has been put in place to ensure that companies comply with all statutory requirements, particularly with regard to disclosure and fulfillment of obligations towards their members. During the period under review, the CLAD's main activities included proposing amendments in the corporate laws and introducing information technology in all its functions for facilitating the general public.



Mr. Javed Zafar, Executive Director (extreme right), with officials of CLAD

The CLAD's main functions include the following:

- i. Supervision of the working of all CROs.
- ii. Coordination and liaison with other Divisions within the Commission through periodic reports.
- iii. Framing of rules/regulations and recommending amendments in the relevant laws.
- iv. Regulation and supervision of non-listed and private companies, the responsibilities for which include:
 - a. Ensuring corporate compliance with statutory requirements.
 - b. Encouragement of practices towards better corporate governance.

- c. Penal actions against management of companies which were non-compliant with the provisions of law.
- d. Disposal of complaints from investors and general public.
- e. Protection of the rights of investors and creditors.

The CLAD supervises and coordinates the working of the CROs and issues them instructions relating to the administration of the Companies Ordinance and the Legal Advisors Act.

The CROs are responsible for performing the following functions:

- i. **Public Facilitation Work**
 - a. Availability of name certificate.
 - b. Incorporation of companies.
 - c. Registration of mortgages/charges.
 - d. Inspection of documents.
 - e. Supplying certified copies of documents.
- ii. **Regulation and Enforcement**
 - a. Filing of annual returns by companies to give proper disclosure of their respective authorized capital, paid-up capital, financial statements, auditors, chief executive, directors, shareholding pattern, etc.
 - b. Filing of returns regarding change in directors, auditors, legal advisors, etc.
 - c. Filing of returns regarding allotment of shares, further issue of capital, etc.
 - d. Holding of Statutory Meetings/AGMs/EGMs.
 - e. Filing of accounts by public companies.
 - f. Monitoring of non-compliance with statutory requirements and other irregularities.
- iii. **Investigation and Prosecution**
 - a. Recommendations to the Commission for investigation into the affairs of companies.
 - b. Court cases and winding up petitions.

During the period under review, 1,169 companies were registered under the Companies Ordinance, 1984. These included 27 public and 1,099 private companies limited by shares. 14 companies were incorporated as not-for-profit associations and 29 as foreign companies. This brought the total number of companies registered in Pakistan to 42,863, as at June 30, 2001. Province-wise particulars of companies registered up to June 30, 2001 is given in Table 12 as follows:

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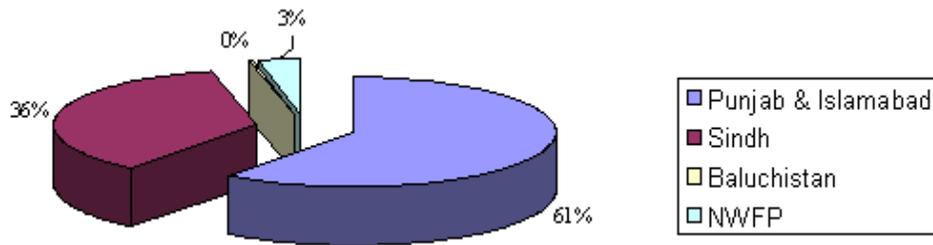
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Table 12 - Province-wise Position of Companies, as at June 30, 2001

**Province -wise Position of Companies
(as at June 30 2001)**

Nature of Companies	Punjab and Islamabad	Sindh	Baluchistan	NWFP	Total
Companies limited by shares	1,435	1,280	56	124	2,895
Public	20,848	15,232	331	2,475	38,886
Private					
Companies limited by guarantee and associations not for profit	167	231	13	14	425
Foreign companies	311	328	3	9	651
Companies with unlimited liability	5	-	1	-	6
Total	22,766	17,071	404	2,622	42,863

Chart 6 - Registration of Companies (July 2000 - June 2001)



Of the total 1,126 companies limited by shares, incorporated during the financial year 2001, 45.6 percent had authorized capital ranging between Rs. 1.0 and Rs. 2.5 million while 21.7 percent companies had authorized capital of Rs. 10 million and above, indicating that these companies intended to transact business on a larger scale. The pattern of authorized capital of incorporated companies is presented below:

Chart 7 - Pattern of Authorized Capital

The sector-wise classification of companies, limited by shares, incorporated during the financial year 2001 is presented below:

Table 13 - Sector-wise Pattern of Registered Companies Limited by Shares

Auto and Allied	6
Brokerage Houses	54
Chemical & Pharmaceuticals	82
Communication	187
Construction	18
Electrical & Electronics	15
Engineering	10
Food & Allied	51
Fuel & Energy	24
Ghee & Cooking Oil	7
Housing & Real Estate	1
Investment Advisory Companies	2
Investment Banks/Companies	1
Leather & Tanneries	12
Miscellaneous	522
Modaraba Management Cos.	2
Mutual Funds Management Companies	3
Paper & Board	8

Sugar & Allied	4
Synthetic Rayon	1
Textile Composite & others	58
Textile Spinning	18
Textile Weaving	12
Tobacco	2
Transport	25
Woolen	1
Total	1,126

Improvements in the Administration of Company Law

During the year under review, the CLAD took several steps to create a congenial and investor friendly atmosphere at the CROs through direct interaction with the general public and sponsors of companies.

Availability of Company Name Through Web Access

Detailed information about availability of companies' names has been put on the Commission's website. This facility allows sponsors to confirm availability of the name of a company electronically.

Information about Incorporation of Companies on the Commission's Website

Detailed guidelines on procedure for company incorporation and fee structure has been placed on the Commission's website. Dissemination of this information is expected to create awareness among sponsors/consultants regarding procedure for incorporation of new companies.

5.2.3 Fast Track Incorporation of Companies and Other Facilities

The Commission set up an information desk at the ITCN Conference in Karachi in March 2001 for providing information to the general public about incorporation of companies. At the counter, 15 applications for incorporation of companies were received and these companies were incorporated on the same day. General information regarding procedure for incorporation of companies and benefits of establishing limited companies was also provided to a large number of people who attended the Conference. Encouraged by the results of the Conference, the Commission is actively considering sending out Mobile Teams of its officers to remote areas for incorporation of companies on the spot. It is expected that this measure will result in increasing the number of incorporated entities.

5.2.4 Creation of Database of Incorporated Companies

An exercise has been undertaken to create a central database of essential information relating to all companies registered at the various CROs. The information includes name of the company, its board of directors, authorized capital, paid-up capital, loans taken by the company, name of the auditors/company secretary, etc. Easy access to such information is expected to improve significantly the monitoring of company affairs.

5.2.5 Other Improvements

A number of other steps were taken during the year by the CLAD. These included:

- i) Allowing fee payments at any authorized branch of Habib Bank Limited.
- ii) Substantial reduction in stamp duty on Memorandum and Articles of Association of

companies registered in the province of Sindh. Other provinces are likely to follow Sindh's example.

5.3 Regulatory Actions

5.3.1 Amendments in the Companies Ordinance, 1984

The CLAD continued its efforts to update and refine the provisions of the Companies Ordinance, 1984 to improve corporate governance and accountability among corporate managers and sponsors and to ensure healthy growth of the corporate sector. In this regard, a committee was constituted, which after a careful review of the Companies Ordinance, 1984 proposed comprehensive amendments in 92 sections of the Ordinance. These amendments are expected to substantially strengthen the framework of law and also encourage compliance with statutory provisions.

5.3.2 Amendments in Companies (Appointment of Legal Advisors) Act, 1974

The Companies (Appointment of Legal Advisors) Act was promulgated in 1974 to ensure that companies registered under the Companies Ordinance, 1984, with paid-up capital of Rs. 500,000 and above, appoint at least one legal advisor to advise such companies in the performance of their functions and duties. With the passage of time, the limit of minimum capital has become too low. The Commission has, therefore, proposed that this limit be raised to Rs. 2.5 million. Further, the manner of taking cognizance of default (by a Court not inferior to that of a magistrate of First Class) is cumbersome and expensive. For proper enforcement of this law, the default is proposed to be made cognizable by the Registrar of Companies with a right of appeal to the Commission.

5.3.3 Approvals, Permissions and Extensions Granted

The Companies Ordinance, 1984 provides for approvals to be accorded by the Commission, the Registrar and the concerned officers in charge of the CROs in various matters pertaining to the incorporation of companies. During the period under review, 1,169 companies were incorporated, 2,810 certificates for availability of name under Section 37 of the Companies Ordinance, 1984 were issued, 3,072 mortgage/charges were registered, 16,292 certified copies of documents were supplied and 6,916 inspections of records were permitted. An important function of the CROs is to ensure that the companies registered with them comply with all statutory requirements under the Companies Ordinance, 1984. Public companies are required to hold their AGM once in a calendar year. During the period under review, the Registrar of Companies allowed extension in 40 cases for holding AGMs. Further, for holding overdue meetings, the Registrar gave directions under Section 170 of the Companies Ordinance, 1984 to 19 companies.

During the year, the Commission received 203 applications for amendments in Memorandum of Association, of which 153 cases including two rejections were disposed of. At the year end, 50 cases were pending owing to shortcomings already pointed out to the companies concerned. Approval was also granted in one case for appointment of sole purchase and sale agent under Section 206 of the Companies Ordinance, 1984.

5.4 Monitoring and Enforcement

5.4.1 Notifications, Circulars and Press Releases

To streamline the working of local registration offices, several notifications and circulars relating to administrative, legal and other matters were issued during the period under review. Among these, the salient ones are as follows:

1. Order No.600(33)RCP/2000 dated 25.7.2000 - Non-holding of AGM by non-listed public companies, cases to be sent to Headquarter for issuance of direction under Section 170 of the Companies Ordinance, 1984.
2. Order No.21(1)A.ACR/96-305 dated 19.9.2000 - Instructions regarding change of management in the companies providing security services.
3. Order No.602(6)RCP/88-585 dated 21.11.2000 - Disposal of complaints on priority basis.
4. Order No.470(1)RCP/90-646 dated 28.11.2000 - Revision of Sixth Schedule to the Companies Ordinance, 1984 (notification).
5. Order No.37(14)RCP/2000-734 dated 13.12.2000 - Availability of name with the word "Pakistan" in certain cases.
6. Order No.602(6)RCP/88 dated 10.1.2001 - Instructions regarding winding up of companies.
7. Order No.470(1)RCP/90-215 dated 9.2.2001- Clarification regarding Sixth Schedule to the Companies Ordinance, 1984.
8. Order No.5-69/73-CL/99 dated 21.2.2001- Adjudication of default in filing of statutory forms/returns under the Companies Ordinance, 1984.
9. Order No.13(72)RCR/42/2000 dated 15.3.2001- Information about associations registered under Sections 42 and 43 of the Companies Ordinance, 1984.
10. Order No.600(2)RCP/2001 dated 10.5.2001- Revised statements to be furnished by the CRO to Headquarter. The number of monthly statements was reduced from 31 to 13 only.
11. Order No.602(82)RCP/2001 dated 1.6.2001- Instructions regarding arrangements/procedures for data entry for Corporate Registration System at the CROs.
12. Order No.470(1)RCP/90 dated 15.6.2001- Clarification regarding registration of particulars of mortgages/charges and related documents.
13. Order No.600(2)RCP/2001 dated 25.6.2001- Instructions regarding furnishing of relevant data pertaining to new incorporations and investment made by foreign investors to Board of Investment.
14. Order No.602(6)RCP/88 dated 27.6.2001-Instructions regarding approval of Headquarter for filing Court cases.

5.4.2 Imposition of Penalties

Under various provisions of the Companies Ordinance, 1984, companies registered at the respective CROs are required to file documents relating to change in directors, change in authorized/paid-up capital, change in registered office and election of directors. A large number of notices were issued for late filing of these documents and in certain cases, penalties were eventually imposed by the concerned Registrars. Penalties were imposed in 88 cases for late submission of Form-III relating to allotment of shares and non-holding of Statutory Meetings under Section 157 of the Companies Ordinance, 1984.

5.4.3 Investigation into the Affairs of Companies

In several cases where affairs of companies were not being managed in accordance with prudent commercial practices, investigations were ordered and inspectors appointed. The cases of National Technology Development Corporation Limited, Shaheen Pay T.V. Limited and Barex Limited are mentionable in this regard. Investigations were ordered on the following grounds:

- i) Mismanagement and oppression of minority shareholders.
- ii) Irregularities in shareholding and election of directors.
- iii) Non-compliance with statutory provisions and disputes regarding shareholding.

5.4.4 Amalgamation/Merger of Companies

Amalgamations/mergers of companies are approved by the High Courts under Sections 284 to 287 of the Companies Ordinance, 1984 after filing of comments by the Registrar of Companies. Written representations were filed and verbal comments made in Courts in a number of cases. A total of 16 merger applications are pending in various High Courts.

5.4.5 Striking off the Names of Companies

Section 439 of the Companies Ordinance, 1984 provides that where the Registrar has reasonable cause to believe that a company is not carrying on business or is not in operation, he may, by following the procedure prescribed in the Ordinance, strike off the names of such companies from the Register of Companies maintained by him. During the year, a large number of notices were issued to companies that were found non-operational. After completion of legal formalities, the concerned Registrars struck off 29 companies from the Register of Companies.

5.4.6 Liquidation of Companies

Out of 725 companies under liquidation at the beginning of the period under review, 125 companies were finally wound up during the year. The break-up of the remaining 600 companies in various stages of liquidation is as follows:

Under voluntary winding up 429
Under winding up by Court 171
Total 600

The Commission is actively following up the issue of slow liquidation process and has initiated a dialogue with the respective Courts in this regard.

5.4.7 Expeditious Disposal of Court Cases

To expedite the cases of companies pending in the Courts for adjudication, senior officials of the Commission held a series of meetings with the authorities at the Lahore High Court drawing attention to Companies (Court) Rules, 1997 that needed to be fully implemented. As a consequence of these parleys, there has been a noticeable improvement in the pace of court decisions.

Insurance Division

[Overview](#) | [Regulatory Actions](#) | [Monitoring of Private Sector Insurance Companies](#)

6.1 Overview

The promulgation of the Insurance Ordinance in August 2000 heralded the beginning of a new regulatory regime for the insurance sector, which had previously been regulated under the Insurance Act of 1938. The Insurance Ordinance, 2000 aims to protect the interests of policyholders and to develop the insurance market by raising capitalization standards and strengthening the solvency of insurers. The new law also provides for the redressal of policyholders' grievances pertaining to non-settlement of claims by insurers. For this, the office of Insurance Ombudsman has been instituted under the Insurance Ordinance. The Ombudsman will take cognizance of an insurer who has (a) failed to comply with the Ordinance; (b) failed to act in good faith; or (c) acted in such a manner as to disrepute the insurance industry. New provisions have been included in the Ordinance to regulate the market conduct of insurers. Another salient feature of the Ordinance is that it brings public sector organizations, namely, State Life Insurance Corporation (SLIC), National Insurance Company Limited (NICL) and Pakistan Reinsurance Company Limited (PRCL) within its purview. Under the new Insurance Ordinance, the Commission has been delegated the power to regulate the insurance industry.

Consequent to the promulgation of the Insurance Ordinance, 2000, the Insurance Division (ID) of the Commission was established on January 1, 2001, which replaced the Department of Insurance under the Ministry of Commerce. The ID is now responsible for regulating and monitoring the performance of insurance companies through powers vested in the Commission under the Insurance Ordinance, 2000.

The main functions of the ID are:

- i) Registration of insurance companies under the Insurance Ordinance, 2000.
- ii) Framing of new Insurance Rules under the Insurance Ordinance, 2000.
- iii) Regulation and monitoring of insurance companies.
- iv) Monitoring of reinsurance arrangements/treaties.
- v) Supervision of insurance intermediaries (insurance agents).

Some 50 years ago, foreign insurance companies dominated the Pakistani insurance market, there being just seven local insurance companies. This situation changed significantly over the years. The growing pace of economic development in the country lent impetus to local enterprises to enter into the insurance arena and by 1970 local insurance companies outranked their foreign competitors, both in terms of number as well as volume of business. In 1972, with nationalization of the life insurance business, the number of insurance companies was drastically reduced to 22 comprising seven foreign and 15 local insurance companies. At that time, 27 companies underwriting life

insurance business were merged into the state-owned SLIC. In August 1990, the life insurance business was deregulated and opened once again to the private sector.

At present, there are 55 private insurance companies, of which five are foreign while the rest are local enterprises. The majority operates in non-life and general insurance business while only four underwrite life insurance business. The public sector consists of three state-owned entities, i.e. SLIC, NACL (formerly National Insurance Corporation), and PRCL (formerly Pakistan Insurance Corporation). While SLIC continues to concentrate on the business of life insurance, NACL provides insurance coverage to other public sector entities and PRCL remains the only local enterprise in the business of reinsurance. Every insurer in Pakistan is required to cede a certain proportion of sums assured on all policies to reinsurance, which has to be ceded to PRCL. The insurance sector is represented on the stock exchanges with 39 listed companies having a market capitalization of about Rs. 9.9 billion as at June 30, 2001. The market shares of the private and public sector enterprises in terms of premium income are graphically presented as follows:

Chart 8 - Life Insurance Business

Chart 9 - General Insurance Business

During the year under review, general insurance business fared well with around 12 percent growth in gross direct premium. Local companies registered a growth of 12.6 percent in gross direct premium, while for foreign companies growth remained low at 4 percent. Life insurance business remained dominated by the state-owned SLIC. Insofar as life insurance business in the private sector is concerned, the performance of American Life Insurance Company (ALICO), Commercial Union and Metropolitan remained less than satisfactory - Eastern Federal Union (EFU) was the only profitable enterprise.

A major development during the year was the joint venture between ALLIANZ AG of Germany and EFU Group of Pakistan to provide health insurance in Pakistan. This is expected to attract more foreign investment not only in the health insurance business but also in other areas of general insurance, particularly crop insurance.

Another significant change during the year was the reduction in the compulsory reinsurance with PRCL. General insurance companies in Pakistan had been demanding abolition of compulsory cession of 20 percent to PRCL. This demand had engaged the attention of the Federal Government and it was finally decided in January 2001 to reduce the proportion of compulsory cession from 20 to 15 percent, with effect from January 1, 2001. This will be further reduced to 10 percent with effect from January 1, 2003 and altogether abolished from the following year, i.e. January 1, 2004.

6.2 Regulatory Actions

6.2.1 New Insurance Rules Framed

The Insurance Ordinance, 2000 is yet to be fully implemented due to lack of the required rules. Realizing the urgency for introduction of these rules, immediate attention was directed to the task. Draft rules have been framed in consultation with the representatives of the insurance industry and the Insurance Association of Pakistan (IAP) and are pending clearance by the Government prior to notification.

6.2.2 Registration of Companies Under the Insurance Ordinance, 2000

All existing insurance companies were required to submit applications for obtaining fresh registration from the Commission under the new Insurance law. During the period under review, 55 companies were accorded registration certificates, of which 51 are non-life/general insurance companies while four are life insurance companies. On the basis of a detailed scrutiny of the financial statements, returns and reinsurance treaties, six insurance companies were refused registration and were served Show Cause notices on account of the deficiencies noted.

6.2.3 Requirement to Enhance Paid-up Capital

To improve and strengthen the capital base of general insurance companies operating in the country, the Insurance Ordinance, 2000 stipulates that these companies must enhance their paid-up capital to Rs. 50 million by December 31, 2002 and to Rs. 80 million by December 31, 2004. At present, about 35 non-life insurance companies are still maintaining paid-up capital below Rs. 50 million. A detailed action plan is being prepared to facilitate these companies to comply with the statutory requirement. The ensuing re-capitalization is expected to strengthen the financial health of the insurers. Regarding life insurance companies, except one all the other three companies meet the minimum paid-up capital requirement laid down under the new Insurance Ordinance.

6.2.4 Reinsurance Arrangements

To safeguard the interests of policyholders, effective measures are being taken to enhance the capacity of the local insurance industry to enable it to honor the claims made on it. This is expected to be achieved through adequate reinsurance treaties executed by the insurers. In this connection, all insurance companies operating in the country have been directed to make reinsurance arrangements through at least 'A' rated international reinsurers.

6.3 Monitoring of Private Sector Insurance Companies

The ID currently supervises 55 life and non-life/general insurance companies in the private sector. The Division examines the statutory returns and audited accounts of these companies to determine their financial position and the course of action, as envisaged in the Insurance Ordinance, 2000. The Special Audit - as provided in the Ordinance - of all the companies has also been assigned to a panel of independent auditors and their respective reports are under preparation.

6.3.1 Development of New Formats for Periodic Reports/Financial Statements

About 24 new periodical reports/financial statements for different classes of insurance

business have been introduced under the new Insurance Ordinance, 2000. The ID is actively engaged in developing the formats of such returns/statements with the help of a Committee comprising Chartered Accountants and Actuaries, appointed by ICAP and the Society of Actuaries, respectively.

6.3.2 Examination of Reinsurance Arrangements/Treaties

Insurance is generally considered a risk coverage system and is incomplete without adequate reinsurance arrangements. As reinsurance forms an insurance company's first line of defense, the law envisages that sound reinsurance arrangements should be in place. Under the Insurance Ordinance, 2000, insurance companies are required to annually furnish necessary details in respect of the reinsurance arrangements made by them. To satisfy itself that sound reinsurance arrangements have been made, the ID examined all reinsurance treaties submitted by insurance companies for the current year. Based on this information, separate reporting forms are being developed for non-life reinsurance arrangements, to be filed by companies for the next year in January 2002. The new reporting forms would help in determining company exposures and retention ratios, thereby outlining their respective risk profiles. The ID has also initiated steps to monitor the financial position of reinsurers with special focus on their Claims Paying Ability (CPA) ratings assigned by international rating agencies.

6.3.3 Insurance Intermediaries (Insurance Agents)

With the repeal of the Insurance Act 1938, licensing of insurance agents - that was done by the Controller of Insurance under the repealed Act - has also been abolished. Insurance companies will now register their own agents and will be responsible for their conduct. However, the ID shall exercise a supervisory role to ensure compliance by each company with statutory provisions relating to appointment, qualifications, supervision and payment to agents so that the interests of policyholders remain protected. The ID is developing necessary guidelines in consultation with the Pakistan Insurance Institute and IAP for effective oversight of the process of appointment of agents by insurance companies.

Support Services Division

[Human Resources Wing](#) | [Administration Wing](#) | [Finance and Accounts Wing](#)

The Support Services Division (SSD), as the name indicates, facilitates the working of the operational Divisions within the Commission and focuses its attention on achieving an environment conducive to efficient and stress-free functioning. Staff recruitment and development, maintenance of office premises, procurement and disbursement and preparation of financial accounts fall within the purview of the SSD. It has been organized into the following wings:

- [Human Resources](#)
- [Administration](#)
- [Finance and Accounts](#)

The Information Technology (IT) Wing, which was part of the SSD, has recently been restructured as a separate Division. An overview of IT activities is given in the following chapter. Presented ahead is an overview of the significant activities of each Wing within the SSD.



Mr. Javed Panni, Executive Director (extreme left), with officials of SSD

Human Resources Wing

7.1.1 Induction of Qualified Staff

The recruitment process has been formalized in order to make it more objective and transparent. Selection of suitable candidates is based purely on merit and successful candidates are offered salaries at rates competitive with the market. Equal opportunities are given to female applicants. During the year under review, 21 female candidates were recruited, some at senior positions. This represents one-third of the overall recruitment

for the year and is a significant increase over previous years. In compliance with the corporate plan, there was an emphasis on recruitment of qualified professionals during the year. There were 60 new appointments of professionally qualified individuals, of whom 14 were Chartered Accountants, 12 Cost and Management Accountants, 10 law graduates while 24 had other post-graduate degrees. With its renewed vigor and improved public awareness about its role and responsibilities as an autonomous body, the Commission generated considerable interest among professionals. This was evident from the interest shown in jobs advertised by the Commission - applications received from professional accountants, lawyers and post-graduates against each advertised position averaged more than 200 per post.

7.1.2 Junior Executives Induction Scheme

The Commission has formulated a Junior Executives Induction Scheme (JEIS) as a starting point for careers at the Commission. The scheme is designed for highly motivated young individuals who hold postgraduate degrees from reputable institutions. The selected junior executives will be placed in major operational areas of the Commission, namely, regulation of securities market, specialized companies, insurance, enforcement of corporate laws and administration of the Companies Ordinance. The program will provide excellent opportunity for professional growth through on-the-job training and exposure to the Commission's functioning and policies. Each year, five to ten junior executives are expected to join the Commission under this scheme through a very competitive selection process. The junior executives will start their assignments with a brief orientation program followed by two rotations in different Divisions during the first 12 months. During this period, these officers will get a broad overview of the Commission's working and are expected to make a notable contribution to the working of their respective Divisions. In addition to working in the office, the junior executives will also undertake field trips to stock exchanges, CROs and other relevant institutions. The choice of assignments is based on academic background, personal preference and Commission's internal staffing requirements. After successful completion of assignments in the first year, and based on their evaluation, these officers would be offered permanent positions in different Divisions. In a pilot phase of this scheme, 10 junior executives were hired by the Commission this year. However, the formal launching of the newly designed JEIS will take place in the financial year 2002.

7.1.3 Training Programs

The Commission is emphasizing staff training as an integral part of its program to build institutional capacity. To this end, the Human Resources Wing arranged well-developed and comprehensive training programs for officers of the Commission. These programs were intended to supplement on-the-job training and aimed at updating the professional knowledge and expertise of the officers, in order to enable them to discharge their responsibilities efficiently and effectively. The training courses were designed and conducted in-house as well as in collaboration with recognized academic and professional institutions.

Training courses and sessions arranged during the year included the following:

- i. An exclusive Staff Development Program was held in March 2001 in collaboration with the Lahore University of Management Sciences (LUMS) for about 30 middle and junior cadre officers of the Commission. The Program was conducted at LUMS and covered topics relating to accounting, stock market regulations and corporate laws.
- ii. A series of in-house Information Technology Training Programs for officers and staff were conducted by the IT Wing in which 75 officials at headquarters and 67 officials at regional offices were imparted training in basic and intermediate computer skills, including use of Windows and Microsoft Office.
- iii. A training program, titled The Cutting Edge of Performance was held in July 2000 by the Organization Development Group. The program was attended by officers of the Commission and provided meaningful information regarding managerial practices to improve corporate performance.
- iv. A Computer Learning Program was conducted at the National Training Bureau in October 2000 to impart computer skills to the officers of the Commission.
- v. A National Workshop on Office Automation was held in November 2000 by the Management Services Wing of the Cabinet Division to acquaint the participants with core automation packages such as database management.
- vi) Short term Computer Courses were carried out under the IT Training Program for Government officials at the Pakistan Computer Bureau. The Courses were held in February 2001.

The Commission also arranged overseas training for its officers in order to keep them abreast with international developments on regulatory and institutional activities. The major training sessions held abroad were the 2000 IOSCO Training Program, held in Canada; Regional Training Program on Investigation, Enforcement and Prosecution, held in Indonesia; the APEC Financial Regulators Training Initiative Regional Seminar - Supervision of Market Intermediaries, held in Philippines; and a training course on Overview of Financial Sector Issues and Analysis, held in USA. Officers of the Commission who availed foreign training facilities were encouraged to share the relevant information and experience gained through such visits with their colleagues through follow-up seminars organized in-house.

As a part of on-going institutional strengthening, the Human Resources Wing plans to organize training courses and workshops throughout the following year on topics including Change Management, Financial Analysis and International Accounting Standards, Securities Market Regulation and Time Management.

The Commission also participated in a series of seminars and conferences to ensure that effective dialogue takes place between the regulator and the corporate sector. During the year, the Human Resources Wing arranged participation of nominated officers of the

Commission in the following significant seminars and conferences, locally as well as abroad:

- IFAC-IT Committee - SAFA Joint Conference and Golden Jubilee Seminar in November 2000, in Lahore;
- Golden Jubilee Seminar by the Institute of Cost and Management Accountants of Pakistan (ICMAP) in September 2000, in Karachi;
- Seminar on International Public Sector Accounting by ICMAP in February 2001, in Islamabad;
- 6th Annual Conference on Alternative Structures for Securities Market, sponsored and held by Georgetown University, Washington DC in September 2000; and
- Workshop on Non-Bank Financial Institutions Development and Regulation in February/ March 2001, in Washington DC.

7.1.4 Staff Welfare and Development

A Service Manual with a private sector orientation has been developed and implemented and includes guidelines on appointment and promotion, pay scales and allowances, training and career planning, terminal benefits, medical facilities, retirement and dismissal as well as conduct, efficiency and discipline. The manual was reviewed during the course of the year and amendments are being proposed by way of further improvement rendering it more conducive to staff development and welfare.

A Manual of Human Resources Policies and Procedures is being developed that will document the significant policies formulated by the Commission for guiding decisions and actions in the Human Resources Wing. In addition, an Operations Training Manual is being compiled to present the legal framework and procedural guidelines applicable to the respective functions of the Commission. These manuals are designed to assist employees in the effective discharge of their duties and responsibilities.

The format of a new performance evaluation report has been introduced based on international best practices. The process of performance assessment has been made more participatory and meaningful and is expected to result in a more objective basis for grant of promotions and increments.

7.2 Administration Wing

The Administration Wing is entrusted with the responsibility of handling matters relating to purchase and lease of vehicles, equipment, furniture and fixtures; hiring and maintenance of office premises; transportation; administration of the Receipt and Issue branch of the Commission; printing; and maintenance of record and library. It has been working actively to provide an adequate level of administrative services to the Commission.

A manual of Administrative Policies and Procedures is under preparation by a team of consultants hired under a technical assistance project of the ADB. This manual will present the policy framework and procedural guidelines applicable to the administration function. It will

include, in documented form, significant policies formulated by the Commission from time to time for guiding decisions and actions in administration related activities and will describe the procedures to be followed by the Divisions in implementing the prescribed policies.

7.3 Finance and Accounts Wing

7.3.1 Finance and Accounts Wing

The Finance and Accounts Wing is primarily responsible for preparation and maintenance of the books of account of the Commission. It has implemented an effective accounting system for the purpose. A multi-user accounting software relating to General Ledger, Fixed Assets and Payroll is also being implemented and will help to further streamline the functions of the Wing. A sound system of internal control has been developed and policies and procedures aimed at safeguarding the interests of the Commission have been put in place. These policies and procedures have been documented in the form of an 'Accounting Procedures and Policies Manual' and 'Purchase Policy'.

7.3.2 Financial Statements and Budgetary Reports

The financial statements of the Commission for the financial year 2000-2001 were audited by the joint auditors, A.F. Ferguson & Co., Chartered Accountants and Taseer Hadi Khalid & Co., Chartered Accountants, and submitted to the Federal Government within the statutory time limit.

Budget for the financial year 2001-2002 was duly prepared by the Finance and Accounts Wing, cleared by the Commission, and its approval obtained from the Policy Board under Section 24 of the Act.

With the implementation of the new accounting system, it is expected that the reporting system of the Wing will improve significantly.

Appendix - B: Significant Developments in Legal Framework

A synopsis of the main amendments made in laws administered by the Commission during the period under review is as follows:

1. Securities and Exchange Ordinance, 1969

(Amendments made through the Securities and Exchange (Amendment) Ordinance, 2000 dated September 07, 2000)

Section 2

New terms, as noted below, have been defined:

- a) agent
- b) associate
- c) asset management company
- d) balloter
- e) commission
- f) dealer
- g) sub-underwriter
- h) transfer agent
- i) underwriter
- j) venture capital company

Section 5A

A new Section 5A has been inserted providing that no person shall act as a broker or agent to deal in the business of effecting transactions in securities, unless the person is registered with the Commission.

Section 7

The Commission has been empowered to suspend a director, officer or member of a stock exchange, besides the original power to remove them.

Section 8

The words 'bonus entitlement voucher' have been deleted from the Section, which originally exempted such vouchers from the requirement of listing on stock exchanges.

Section 9

a) The powers of the Federal Government for directing a stock exchange to list or not to delist or for hearing appeal against the order on the stock exchange have been assigned to the Commission.

b) The powers of the Commission to suspend the trading in any listed security for 60 days and to extend the period for another 60 days at any time have been specifically provided.

Section 10

The powers of compulsory listing of securities have been assigned to the Commission.

Section 21

The original provision that enquiry may be conducted by the Federal Government on the representation of one-fifth of the members of the stock exchange has been amended so that the Commission may conduct enquiries on the representation of one-tenth of the members of the stock exchange.

Section 22

The power of the Federal Government to impose fines in case of violations of law has been assigned to the Commission. Additionally, the maximum amount of fine amounting to Rs. 30,000 has been enhanced to Rs. 100,000.

Section 24

The maximum amount of fine amounting to Rs. 30,000 has been enhanced to Rs. 500,000.

Section 26

This Section, containing provisions relating to 'revision and review', has been deleted in view of the specific provisions of the Act.

Section 28

This Section, containing provisions relating to delegation of powers, has been deleted due to specific provisions of the Act.

Section 32

This Section has been substituted. The new Section provides for the regulation of venture capital companies, besides the regulation of the business of asset management companies, investment advisors and investment companies.

Section 32C

A new Section 32C has been inserted, which provides that the business of transfer agents, balloters, underwriters, sub-underwriters and consultants shall be regulated in the manner provided in the rules to be prescribed.

Section 33

Sections 5A, 32A, 32B and 32C have been added to the list of sections in which case rules are to be made.

2. Securities and Exchange Commission of Pakistan Act, 1997

(Amendments made through the Securities and Exchange Commission of Pakistan (Amendment) Ordinance, 2000)

Section 2

Interpretation of "Law of Insurance" has been inserted.

Section 5

- a) Requirement of having experience in 'insurance' has been added for the eligibility of a person to be appointed as a Commissioner.
- b) The Commission has been empowered to make regulations relating to the conduct of its meetings.
- c) The Commission has been empowered to determine the remuneration of the Commissioners and the Chairman, with the approval of the Policy Board.

Section 12

- a) Number of total members of the Policy Board has been increased from seven to nine.
- b) Number of • members has been increased from four to five, after including • Secretary, Commerce Division, as one of the members.
- c) Number of members from the private sector has been increased from three to four and the requirement of having experience in 'insurance' has been added to determine the eligibility of a person to be appointed as a member.
- d) Maximum age for the appointment of a member of the Board has been fixed at 65 years.

Section 20

- a) Clause (o) of sub-Section (4) has been made more specific by incorporating all the relevant laws in which powers of the Commission are extended.
- b) Law of Insurance has been brought within the powers and functions of the Commission.
- c) A new sub-Section (7) has been inserted empowering the Commission to call for any document or information from the companies.

Section 21

Insurance industry and its law have been brought within the functions and powers of the Policy Board.

Section 22

Insurance business has been brought within the regulatory control of the Commission.

Section 23

Ambiguity in the law as regards sources of income of the Commission has been removed.

Section 24

Anomaly in the text has been removed to provide that the Commission shall submit its budget to the Policy Board for approval not later than 30 days before expiry of each financial year.

Section 25

a) Law of insurance has been included in the activities of the Commission for preparing the annual report.

b) The original provision that there shall be joint auditors of the Commission has been substituted with the new provision that auditor shall be appointed by the Commission with the approval of the Federal Government.

Section 26

The words "if so decided by the Board and" have been deleted so as to make the provision more specific.

Section 28

The Commission has been allowed to open its accounts with a scheduled bank with the approval of the Policy Board.

Section 39

The minimum period of 60 days for publication of rules, for eliciting public opinion, has been reduced to 30 days.

Section 40

a) The words • have been deleted and the Board may make regulations on the recommendations of the Commission and in consultation with the Federal Government.

b) The Commission may make its regulations in consultation with the Board against the original provision, which required approval of the Board.

c) The minimum period of 60 days for publication of draft regulations, for eliciting public opinion, has been reduced to 30 days.

Section 43

Amendment has been made in clause (b) to remove ambiguity in the law. According to the amended provision, the rules under all corporate laws are to be made by the Commission with the approval of the Federal Government.

Section 43A

A new Section 43A has been inserted in line with Section 43, to deal with the matters relating to abolition of the Department of Insurance and rights and privileges of its employees.

New Rules/Regulations Framed

In addition to amendments in laws, a number of new rules/regulations have been framed and existing rules amended during this period to facilitate the administration of relevant laws. These are:

Under the Companies Ordinance, 1984

1. Companies (General Provisions and Forms) Rules, 1985
 - a) Amendments made vide Notification No. S.R.O. 594(I)/2000 dated 25.8.2000
 - b) Amendments made vide Notification No. S.R.O. 259(I)/2001 dated 30.4.2001
2. Leasing Companies (Establishment and Regulation) Rules, 2000
3. The Companies (Buy-back of Shares) Rules, 1999
 - a) Amendments made vide Notification No. S.R.O. 830(I)/2000 dated 16.11.2000
4. The Companies Share Capital (Variation in Rights and Privileges) Rules, 2000
5. Public Companies (Employees Stock Option Scheme) Rules, 2001

Under the Securities and Exchange Ordinance, 1969

1. Venture Capital Companies and Venture Capital Funds Rules, 2001
2. Stock Exchange Members (Inspection of Books and Records) Rules, 2001
3. Brokers and Agents Registration Rules, 2001
4. Listed Companies (Prohibition of Insider Trading) Guidelines, 2001

Under the Securities and Exchange Commission of Pakistan Act, 1997

1. Securities and Exchange Commission of Pakistan (Conduct of Business) Regulations, 2000
2. Securities and Exchange Policy Board (Conduct of Business) Regulations, 2000
3. Members, Agents and Traders (Eligibility Standards) Regulations, 2001

Appendix - C: Management Directory

Name	Designation	E-mail address	Telephone No.s
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