

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

ABBREVIATIONS AND ACRONYMS

AAC	Advisory and Arbitration Committee
ADB	Asian Development Bank
AGM	Annual General Meeting
ALICO	American Life Insurance Company
CBR	Central Board of Revenue
CDC	Central Depository Company
CEO	Chief Executive Officer
CHPF	Clearing House Protection Fund
CLA	Corporate Law Authority
CLAD	Company Law Administration Division
CMDP	Capital Market Development Program
COI	Certificate of Investment
Cost Audit Rules	Companies (Audit of Cost Accounts) Rules, 1998
COT	Carry-over Trade/ Transaction
CPA	Claims Paying Ability
CRO	Company Registration Office
CRS	Corporate Registration System
CU	Commercial Union
DFI	Development Finance Institution
EMD	Enforcement and Monitoring Division
FIBV	International Federation of the Stock Exchanges
IAS	International Accounting Standard
ICAP	Institute of Chartered Accountants of Pakistan
ICMAP	Institute of Cost and Management Accountants of Pakistan
ICP	Investment Corporation of Pakistan
ICSP	Institute of Corporate Secretaries of Pakistan
ID	Insurance Division
IFAC	International Federation of Accountants
IFC	International Finance Corporation
IOSCO	International Organization of Securities Commissions
IPF	Investor Protection Fund
IPO	Initial Public Offering
IS	Information System
ISE	Islamabad Stock Exchange
IT	Information Technology
ITCN	Information Technology Commerce Network
JEIS	Junior Executives Induction Scheme
KSE	Karachi Stock Exchange
KSE-100 Index	Karachi Stock Exchange 100 Shares Index
LAN	Local Area Network
LSE	Lahore Stock Exchange
LUMS	Lahore University of Management Sciences
MAP	Modaraba Association of Pakistan
MIS	Management Information System
Modaraba Ordinance	Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980
MSS	Market Surveillance Software
MSW	Market Monitoring and Surveillance Wing
MUFAP	Mutual Funds Association of Pakistan
NAB	National Accountability Bureau
NAV	Net Asset Value
NBFC	Non-bank Finance Company
NBFI	Non-bank Financial Institution
NCEL	National Commodity Exchange Limited
NCSS	National Clearing and Settlement System
NICL	National Insurance Company Limited
NIT	National Investment Trust Limited
NOC	No Objection Certificate
NSS	National Savings Schemes
OECD	Organization for Economic Cooperation and Development
OTC	Over-the-Counter
PILCORP	Pakistan Industrial Leasing Corporation Limited
Policy Board	Securities and Exchange Policy Board
PRCL	Pakistan Reinsurance Company Limited

QCR	Quality Control Review
Rs.	Rupees
SBP	State Bank of Pakistan
SCD	Specialized Companies Division
SLIC	State Life Insurance Corporation
SMC	Single Member Company
SMD	Securities Market Division
SSD	Support Services Division
SPV	Special Purpose Vehicle
TFC	Term Finance Certificate
The Act	Securities and Exchange Commission of Pakistan Act, 1997
The Code	Code of Corporate Governance
The Commission	Securities and Exchange Commission of Pakistan
UNDP	United Nations Development Program
USA	United States of America
UTP	Unit Trust of Pakistan
VCC & VCF Rules	Venture Capital Companies and Venture Capital Funds Rules, 2001
WAN	Wide Area Network

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This report has been prepared in pursuance of Section 25 of the Securities and Exchange Commission of Pakistan Act, 1997 for the purpose of reporting the activities and performance of the Securities and Exchange Commission of Pakistan during the period July 1, 2001 to June 30, 2002.

Our Vision

To promote an efficient and transparent capital market, develop the corporate sector and protect the investor through responsive policy measures, effective regulation and enforcement of best governance practices.

Our Mission

To install and sustain a dynamic, modern and proactive regulatory body that provides impetus for the development of a fair, efficient and transparent capital market and a robust corporate sector.

Chairman's Message



This is the third report of the Securities and Exchange Commission of Pakistan (the Commission) covering the year July 1, 2001 to June 30, 2002.

During the year under review, the Commission managed the aftermath of the unfortunate events of September 11, 2001 through carefully devised and timely regulatory interventions. It was also able to consolidate and deepen the reforms introduced in the securities market in previous years as well as pursue several initiatives covering a wide spectrum of the Commission's responsibilities.

As is well known, the Commission has been assiduously tackling the issue of investor confidence. During the preceding year, the Commission took a number of steps designed to engender faith in the integrity of the market and endeavored to improve the governance and risk management aspects of all the three stock exchanges. Consequently, both price discovery and trade settlement as well as investor dispute resolution have become visibly efficient, fair and transparent. During the year under review, the focus of attention turned to the other significant area affecting investor confidence, namely, corporate governance. The Commission deemed it to be of utmost importance to redress the disconcerting reality that there was little faith as to whether the listed companies were being managed for the benefit of all stakeholders, including minority shareholders.

The Commission was eventually able to finalize and implement a Code of Corporate Governance (the Code) by making it a part of the listing regulations, which consequently became applicable to all listed companies. Essentially based on the Organization for Economic Cooperation and Development's (OECD) principles of corporate governance, the Code acquired its present shape after extensive consultations with the business community. Despite this, implementation of the Code was resisted by some elements in the private sector and the Commission had to stand firm to ensure that the initiative was not derailed.

Other areas related to corporate governance, like dissemination of adequate and timely information as well as the issue of reliable audits, were also addressed by the Commission. Listed companies were directed to:

- publish quarterly financial statements;
- facilitate quality control reviews of auditors by permitting the release of audit working papers for this purpose;
- refrain from engaging their auditors for other services except those specifically permitted; and
- rotate the firm of auditors after every five years (with forbearance in this respect granted up to December 31, 2003).

The observance of International Accounting Standards (IASs) was enhanced further and by end-June 2002, a total of 38 out of 41 IASs had been adopted. Furthermore, the Commission also directed that an auditor found guilty of professional misconduct would not be allowed to audit the accounts of listed companies for a period up to three years, as may be determined by the Commission.

All these measures appear to have had a salutary impact on the level of investor confidence and we are now witnessing a qualitative change in the market, as reflected by a significant rise in the proportion of "real" investments (as distinct from "squared trades" and "carry-over transactions", i.e. trades carried forward to a subsequent settlement period) from as low as 1 to 2 percent of transactions' volume to over 10 percent. The performance of the market was also ranked as among the best in the world, largely, as a consequence of enhanced investor confidence arising out of the proactive regulatory approach adopted as well as the market's visible under-valuation in relative terms. For a variety of reasons, this has yet to translate into an upsurge in new equity offerings albeit there occurred a large number of corporate debt issues (Term Finance Certificates), mobilizing an aggregate of Rs. 10.13 billion, mainly in order to enhance capacity or re-profile balance sheets.

In addition, the Commission, as a regulator, has been entirely transformed through implementation of a drastic restructuring program that was largely completed during the year under review. The institutional capacity has been greatly strengthened through appropriate re-organization, staffing, training and automation. The Commission now has reasonably well-functioning units that keep the market under surveillance, enforce the laws it administers, closely monitor and try to foster the various specialized institutions it regulates, and keep vigil to ensure that the various activities under the ambit of the Commission are performed effectively and efficiently. While there is considerable ground that is yet to be covered, it is felt that in many respects the Commission is approaching international standards in the discharge of its regulatory responsibilities.

Enforcement of corporate and securities laws (as well as legislation governing institutions within the purview of the Commission) was specifically emphasized during

the year under review. As a result of effective enforcement actions taken by the Commission – vastly exceeding those taken in any previous year – the corporate sector appears to have become much more responsible and disciplined and the quality of corporate disclosure, including financial reporting, has greatly improved. The impact was similar when the Commission tightened its enforcement screws vis-à-vis auditors, stock brokerage houses, modarabas and insurance companies.

It is noteworthy that insurance companies were asked to enter into reinsurance arrangements with reinsurers that had a minimum 'A' rating and later those companies that were unable to do so, possibly due to reduced global reinsurance capacity, were asked to obtain a satisfactory "claims paying ability" or "financial strength" rating from a recognized rating agency. Insurance companies that could not comply with either requirement were barred from engaging in further insurance business, thereby saving the general public from being offered potentially unworkable insurance policies. It is also a matter of satisfaction that the Commission was able to enforce the minimum capital requirement imposed on leasing companies and that the sector is largely in compliance with this stipulation. Further, in order to clean up its corporate registration records, the Commission launched, and successfully implemented, carefully devised schemes to regularize the default of private and non-listed public companies with respect to their reporting requirements and to facilitate dormant companies exit out of the register of companies.

Further, in line with evolving international practice, the Government decided to consolidate the regulation of all financial institutions, other than commercial banks and Development Finance Institutions, under the regulatory purview of the Commission; and also to institute the concept of Non-bank Finance Companies (NBFCs) – essentially an umbrella approach whereby the same institution, i.e. an NBFC, can be licensed to engage in one or more financial services provided it meets the prescribed regulatory criteria for each of these services. In response, the Commission geared itself with staffing readjustments in addition to proposing needed legislative changes and preparing a set of comprehensive rules to serve as the basic regulatory framework for NBFCs.

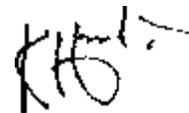
Among a variety of developmental measures taken by the Commission, approval was granted for establishing, under the aegis of the Karachi Stock Exchange, the framework of an over-the-counter, quote-driven market targeting closely held or smaller capitalized companies as well as debt securities. This would appropriately tier the stock market with trading modalities determined to suit each tier. While trading in futures contracts of 13 highly liquid shares commenced in July 2001, towards the end of the year, the Commission approved, in principle, the setting up of an exchange to trade futures contracts in commodities. Also, the Commission was able to see its way around a few impediments and approve the first securitization transaction, which should be a harbinger for others to follow. Overall, the Commission would appear to

have consistently acted in consonance with its declared mission, namely: "to install and sustain a dynamic, modern, and proactive regulatory body that provides impetus for the development of a fair, efficient and transparent capital market and a robust corporate sector".

While a lot has been achieved in the last two and a half years, there is a lot that still needs to be accomplished. Of the three primary drivers of capital market development which constitute the drip feed into the market, i.e. venture capital, securitization and corporate debt, considerable progress has been made with respect to the latter two as a consequence of satisfactory resolution of impeding issues. Only venture capital remains a problem since the tax aspect has not been appropriately addressed so far. The future agenda of the Commission includes continued efforts to:

- deepen the market and improve risk management at the exchanges;
- further strengthen audit practices and enforce IASs;
- clarify, reinforce, and enhance standards of corporate governance;
- facilitate a vibrant primary market with strong underwriting and distributive capacity;
- develop and strengthen the mutual funds, the pension funds and the insurance industry to provide the market institutional underpinning;
- encourage on-line trading, Electronic Communication Networks and Alternate Trading Systems and develop a regulatory framework for on-line trading;
- develop and implement a phased program for replacement of carry-over transactions or "Badla" by margin financing and futures contracts; and
- further strengthen the institutional capacity of the Commission.

In carrying out its regulatory functions, including its developmental agenda, the Commission is fully conscious of the need to adhere to international regulatory benchmarks and to remain in harmony with the convergence in regulatory standards that is evolving in International Organization of Securities Commissions (IOSCO). By proceeding thus, the Commission is likely to move rapidly towards realizing the vision it has set for itself: "to promote an efficient and transparent capital market, develop the corporate sector and protect the investor through responsive policy measures, effective regulation and enforcement of best governance practices".



1. The Organization



- 1.1 **Organizational Structure**
- 1.2 **Securities and Exchange Policy Board**
- 1.3 **Policy Board Meetings**
- 1.4 **Divisions and the Management Team**

1. The Organization

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 on January 1, 1999. The Act institutionalized certain policy decisions of the Government — particularly those relating to constitution of the Commission and its powers and functions — in connection with the Capital Market Development Program (CMDP) 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.

As of June 30, 2002, the Commission consisted of five Commissioners, including the Chairman, as noted below:



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 was serving 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 in capital market development in the emerging markets.



Mr. Abdul Rehman Qureshi is the Commissioner with oversight responsibility for Enforcement and Monitoring Division, Specialized Companies Division and Support Services Division. He has extensive prior experience in the regulation and administration of corporate laws, essentially with the erstwhile CLA.



Mr. Zafar-ul-Haq Hijazi, an experienced practicing chartered accountant, is the Commissioner responsible for overseeing the Company Law Administration Division. He brings with him rich experience of the private sector. Prior to his present assignment, Mr. Hijazi served as the Commissioner of the Enforcement and Monitoring Division and made a significant contribution towards improving the quality of disclosure by listed companies.



Mr. N. K. Shahani, also an experienced practicing chartered accountant, was Commissioner from July 2000 till his retirement in July 2002. He was involved in implementing the Commission's capital market reform program in addition to his oversight responsibilities for the Insurance Division and the Information Technology Wing.



Mr. Shahid Ghaffar, who was Managing Director of the Karachi Stock Exchange (KSE) prior to joining the Commission, is the Commissioner overseeing the Securities Market Division. At present, he holds a dual portfolio as both the Commissioner and the Executive Director of the Securities Market Division.

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 Policy Board is entrusted with the responsibility to provide guidance to the Commission in all matters relating to its functions and to formulate policies in consultation with the Commission. In addition, it is 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 *ex-officio* members and four from the private sector. The *ex-officio* members are: (i) Secretary, Finance Division; (ii) Secretary, Law, Justice and Human Rights 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, 2002, the Policy Board consisted of:

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

1.3 Policy Board Meetings

During the year under review, four 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, *inter alia*, the following:

- (i) approval of budget for the financial year 2002-2003;
- (ii) review of performance of different Divisions of the Commission during the year;
- (iii) consideration of amendments in the Companies Ordinance, 1984;
- (iv) approval of amendments in the Service Manual of the Commission; and
- (v) fixing the remuneration of the Commissioner, Mr. Shahid Ghaffar and the Ex-Commissioner, Mr. Tariq Iqbal Khan.

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 Executive Director, Chairman's Secretariat. Mr. M. Hayat Jasra serves as Secretary to the Commission. He has been associated with the Commission and the former CLA for over 25 years. Mr. Haroon Sharif is the Executive Director, Chairman's Secretariat. He 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. The Divisions are further subdivided into Wings for administrative purposes. A synopsis of each Division follows.

1.4.1 Securities Market Division

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

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

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 had investment banking experience in the United States of America (USA) and was serving as a senior official of the ADB in Manila, 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



Mr. Khalid A. Mirza, Chairman (centre) with the Executive Directors

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, who heads the EMD, is a chartered accountant with more than 15 years of executive

experience in 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 related laws, rules and regulations. It is also responsible for supervision of the Commission's field offices in various cities, i.e. the Company Registration Offices (CROs). Mr. M. Hayat Jasra, Executive Director, who has vast experience in company law administration, heads the CLAD. 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 Insurance Ordinance, 2000 that covers licensing and supervision of insurance companies and other entities regulated under this law. Mr. Shafaat Ahmad, Executive Director, who heads the ID, had previously 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 recruitment and human resource development, administration as well as financial management and maintenance of accounts. Mr. Javed Panni, Executive Director, who heads this Division, has been associated with the Commission and the erstwhile CLA in various capacities for 25 years. The SSD comprises the following Wings:

- Human Resource
- Administration
- Finance and Accounts

2. Securities Market Division



- 2.1 Overview
- 2.2 Stock Market Review - July 2001 to June 2002
- 2.3 Developments in the Capital Market
- 2.4 Monitoring and Surveillance
- 2.5 Investor Complaints
- 2.6 Beneficial Ownership
- 2.7 Issue of Capital
- 2.8 Review of Prospectuses and Supporting Documents
- 2.9 Inspection of Books and Records of Members

2. Securities Market Division

The regulation of securities market is a core function of the Commission. The Securities Market Division (SMD) monitors and regulates the securities market in pursuance of powers vested in the Commission under the Securities and Exchange Ordinance, 1969 and the rules framed thereunder as well as the Act. The SMD regulates both the primary and secondary markets, including market intermediaries, along with off-site regulation and monitoring of the stock exchanges. Regulatory reforms and monitoring measures are undertaken by the SMD to deepen the market, engender investor confidence, ensure transparency, improve risk management and enhance governance at the stock exchanges.

2.1 Overview

During the year under review, major developments took place in the capital market as a result of far reaching reforms implemented by the Commission. Although the Karachi Stock Exchange 100 Shares Index (KSE-100 index) ranged between 1,075 and 1,930, systemic risk was largely contained due to effective risk management measures introduced at the stock exchanges. The lowest levels witnessed during the year followed the events of September 11, 2001. The market again experienced a sharp decline between May 18 and May 20, 2002, when it lost 252 points owing to tension at Pakistan's border with India. The volatility of the market also exposed certain shortcomings in the Carry-over Trade (COT) system, which prompted both over-trading by weak holders as well as sudden withdrawal of funds by COT financiers. To ameliorate the situation, the Commission introduced several remedial measures during the year that helped in strengthening regulation of the COT market.

The Commission permitted the formation of a quote-driven, Over-the-Counter (OTC) market for listing of smaller enterprises and debt securities. It also allowed establishment of the National Commodity Exchange Limited (NCEL), which will allow trading in futures contracts in commodities. These initiatives will widen the scope of activities in the capital market and encourage investment by facilitating investors with varying risk profiles to enter the market.

Other significant reforms during the financial year 2002 include introduction of a two-tier arbitration procedure at the stock exchanges for settlement of claims and disputes; registration of brokers and agents; and issuance of regulations for short selling whereby short selling in ready market will be permitted and regulated in accordance with well-established norms.

The primary market continued to remain dull. There were only three Initial Public Offerings (IPOs) and three offers for sale during the year. Of these six issues, five remained under-subscribed. Only the offer for sale of 10 percent shares of National Bank of Pakistan elicited substantial interest of investors and was, as a result, over-

subscribed. The debt market, however, remained buoyant with 17 new offerings during the year compared to 10 in the preceding year.

2.2 Stock Market Review - July 2001 to June 2002

The KSE-100 index opened at 1,366 in July 2001 and closed at 1,770 in June 2002, indicating a 30 percent gain. The overall market sentiment was bullish though there was a high degree of volatility.

TABLE 1 KSE Performance at a Glance				
	FY 2001	FY 2002	HIGH FY 2002	LOW FY 2002
KSE-100 Index (At Closing Level)	1,366 (End June 2001)	1,770 (End June 2002)	1,930 (March 14, 2002)	1,075 (October 2, 2001)
Turnover (Shares in Million)	118 (Daily Average for the year)	120 (Daily Average for the year)	419.4 (February 8, 2002)	15.1 (September 3, 2001)
Market Capitalization (Rs. in Billion; at Closing Level)	341.8 (End June 2001)	411.6 (End June 2002)	436.1 (March 14, 2002)	272.6 (October 2, 2001)

During July and August 2001, the market remained rather depressed, witnessing low trading as evidenced by average daily turnover of 62.5 million shares. The index fell from 1,337 to 1,258, thereby losing almost 6 percent (80 points) during the two months.

In September 2002, the market was gripped by a bearish spell as a fall out of the tragic events of September 11, 2001 in the USA – in fact, there was panic in capital markets all over the world and Pakistan’s market was no exception. The stock exchanges remained closed for three days in order to reassess the situation, prevent any runaway sentiment from damaging the market and determine measures to further strengthen the risk management system. The stock exchanges were re-opened with the introduction of new circuit breakers to check market volatility. The KSE-100 index dropped from 1,256 on September 11, 2001 to 1,133 by the end of the month. The sharp decline of about 10 percent in the index was clearly in response to the events of September 11 as well as settlement problems arising out of the over-exposure of Crescent Investment Bank, a major market player, to COT financing.

From October 2001 onwards, the market started picking up and the KSE-100 index recorded an impressive increase of 33 percent during the month - after touching its lowest level of 1,075 points on October 2, 2001, it rose to 1,425 on October 29, 2001. The improvement in market sentiment during the month of October was attributable to a variety of factors such as resolution of over-exposure of Crescent Investment Bank and positive indications about financial assistance to Pakistan, including expectations of a debt write-off and reduction in interest rates.

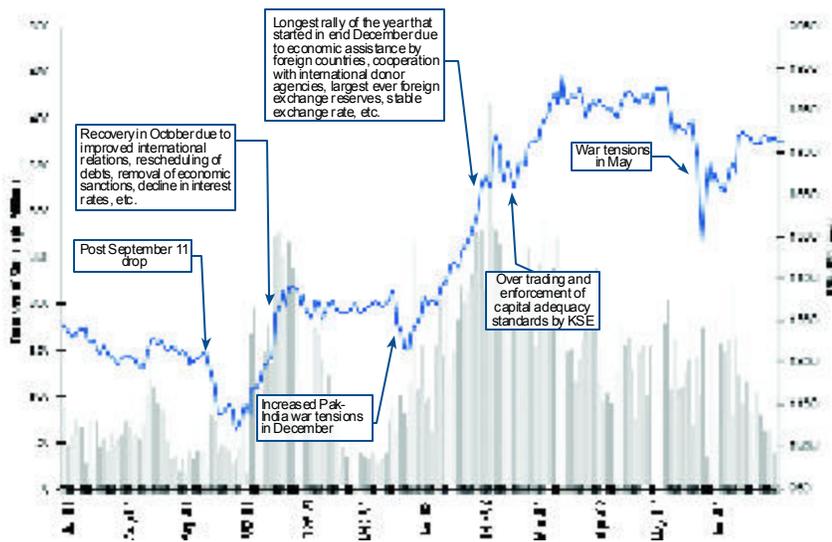
This upward swing of the market was, however, arrested in November and December 2001, owing to increase in cross-border tension and apprehensions regarding an all-out war between India and Pakistan. As a result, the KSE-100 index dropped from 1,425 on October 29, 2001 to 1,269 on December 28, 2001, representing a decline of 11 percent.

There ensued a sustained bull rally from January 2002 onwards when the KSE-100 index moved from 1,322 on January 1, 2002 to as high as 1,930 on March 14, 2002. The market then underwent a few corrections and consolidation, with the index ranging between 1,904 and 1,817 during the period from March 15 to May 9, 2002. Thereafter, the market turned bearish during the remaining part of May 2002, with the index ranging between 1,817 and 1,527 - closing at 1,663 at the end of the month.

During June 2002, the market remained mostly bullish as the KSE-100 index moved up from 1,648 on June 3, 2002 to as high as 1,791 on June 10, 2002 and was 1,770 at the end of June 2002.

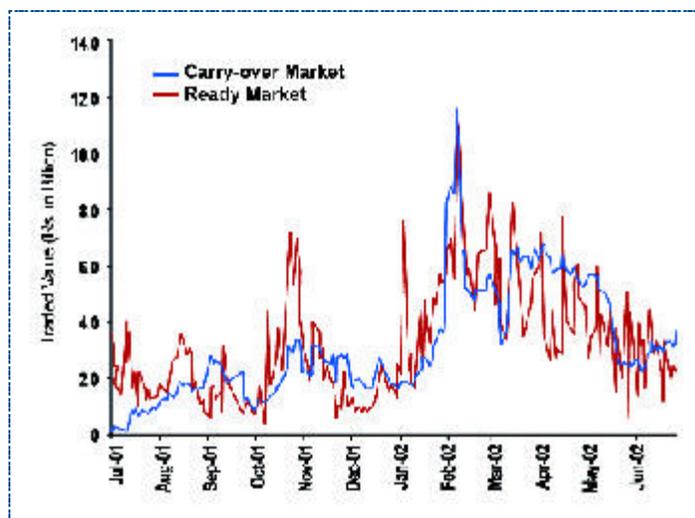
The bullish tendency in the market could be attributed to a number of factors, including improvement in Pakistan's international relations in the post September 11 scenario, rescheduling of international debts, removal of economic sanctions, decline in interest rates, low level of inflation, trade concessions, economic assistance extended by a number of countries, cooperation with international donor agencies, large foreign exchange reserves and a relatively stable exchange rate. The KSE-100 index reached the level of 1,931 on March 14, 2002 and the KSE was ranked by several international economic commentators as one of the best performing markets in the world.

CHART 1 KSE-100 Index and Turnover at KSE (July 2001 to June 2002)



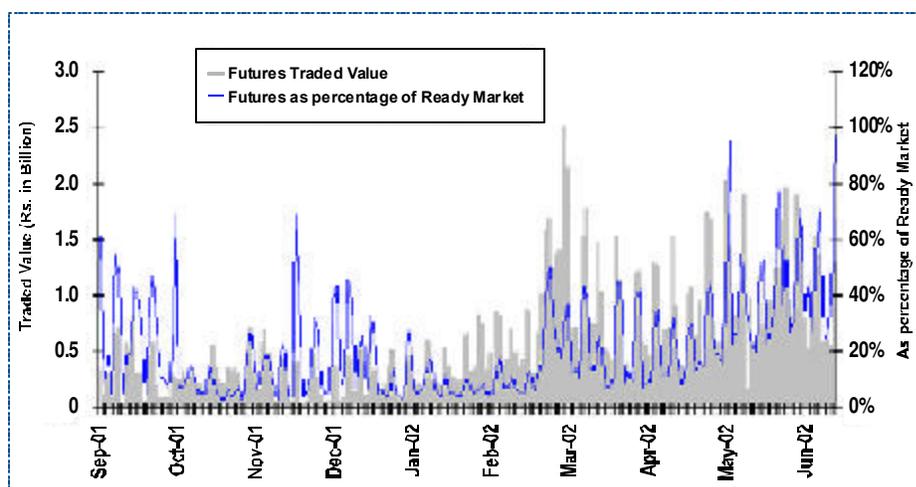
The carry-over market movement closely paralleled that of the ready market. Between September 2001 and June 2002, the daily traded value in COT averaged Rs. 3.5 billion with a low of Rs. 0.03 billion on July 13, 2001 and a high of Rs. 11.5 billion on February 8, 2002.

CHART 2 Traded Value in Ready and Carry-over Market (July 2001 to June 2002)



The newly formed futures contracts market also registered substantial growth. The average daily turnover in futures increased from less than Rs. 0.5 billion in September, 2001 to more than Rs. 1 billion in June 2002. Average traded value of futures, as a percentage of traded value in the ready market, also increased from about 30 percent to 45 percent during the same period.

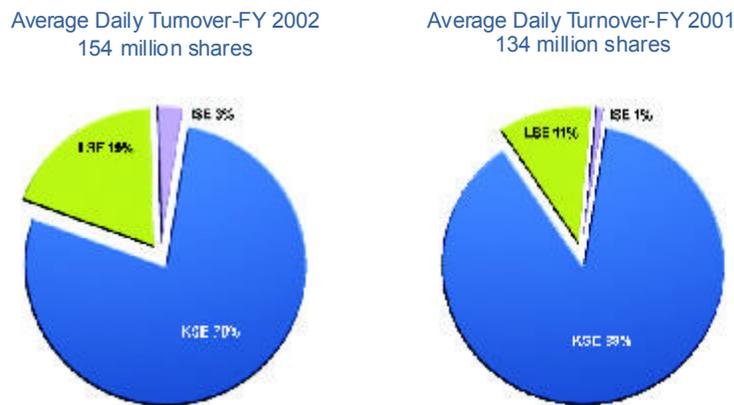
CHART 3 Futures Market (September 2001 to June 2002)



Market volatility during the year remained higher compared to the previous year. During financial year 2002, volatility of the KSE-100 index at closing level, as measured by standard deviation, was 256 points whereas it was 90 points in the preceding year. Despite the increased volatility, serious systemic risk issues did not arise owing to effective risk management measures that lent an element of stability during periods of market turbulence.

Liquidity of the market improved considerably during the year. The average daily turnover of the three stock exchanges for the year 2002 was recorded at 154 million shares as compared to 134 million shares during the previous year.

CHART 4 Average Daily Turnover in Financial Years 2001 and 2002



The KSE continued to have more than 75 percent share of the total turnover of all the three stock exchanges. However, the share of the Lahore Stock Exchange (LSE) increased from 11 percent to 19 percent during the year. Along with turnover, the traded value at the LSE also increased from Rs. 346 million to Rs. 391 million, representing an increase of 13 percent during the year.

However, despite the improved liquidity, the market continues to lack depth as turnover and market capitalization remain concentrated in the top 15 scrips.

2.3 Developments in the Capital Market

Several measures were taken by the Commission during the year to further enhance market efficiency and investor confidence. The important initiatives in this regard are highlighted below.



Mr. Shahid Ghaffar, Commissioner, SMD (extreme left) with officers of the Division

2.3.1 Risk Management Measures

(i) Regulations for Short Selling

In an effort to regulate short selling in the ready market and to bring it in line with international best practice, the Commission approved the Regulations for Short Selling under Ready Market, 2002 in February 2002. Introduction of these Regulations is a significant step towards minimizing market manipulation and ensuring a healthier and more transparent capital market.

(ii) Improvements in COT Regulations

In September 2001 and May 2002, the market witnessed abnormal price fluctuations due to the September 11 events and growing cross-border tension between India and Pakistan, respectively. On both occasions, the risk management measures, earlier introduced by the Commission, worked effectively. However, certain weaknesses were observed in the COT system. These weaknesses were discussed at length with various stakeholders including brokers, investors and stock exchanges' management and also deliberated in meetings of the Stock Exchanges Coordination Committee and the Consultative Group for the Capital Market. Based on these deliberations, the stock exchanges were advised to make the following changes in the COT system:

- (a) COT should be for a minimum period of 10 days with the financee having the option to release it after one day;

- (b) COT should only be allowed in specified liquid shares;
- (c) higher margins should be mandated for COT; and
- (d) COT shares should be kept with the Central Depository Company (CDC) or with the clearing house of the stock exchange and should be pledged in the name of the financier, if the financier were a bank or a financial institution.

(iii) Investor Protection Fund and Clearing House Protection Fund to be Fully Funded

The Investor Protection Fund (IPF) and Clearing House Protection Fund (CHPF) have been set up to ensure effective risk management in the secondary market and to protect investors' interest in case of default by members of the exchanges. The Commission observed that the funds were not fully funded by the exchanges and directed them to ensure that the IPF and CHPF become fully funded by June 30, 2007. The requirement has been phased-in so that by June 30, 2002, the exchanges would have to fund at least 50 percent of the actual contributions made towards IPF and CHPF. Thereafter, the funding requirements would increase gradually so that by June 30, 2007, both funds would be fully funded.

2.3.2 Improvements in Governance

(i) Registration of Brokers and Agents

The Commission promulgated the Brokers and Agents Registration Rules in May 2001 to establish a direct regulatory nexus with brokers and agents for protection of investors' interest. Section 5A of the Securities and Exchange Ordinance, 1969 provides that no person can act as a broker or agent to deal with transactions in the securities market, unless registered with the Commission. The registration of brokers and agents under the Brokers and Agents Registration Rules, 2001 started on November 1, 2001. The statistics with respect to registrations granted up to June 30, 2002 are presented in the table below.

TABLE 2 Registration of Brokers and Agents				
STOCK EXCHANGE	BROKERS		AGENTS	
	Applications Received	Registration Granted	Applications Received	Registration Granted
Karachi Stock Exchange	142	140	53	45
Lahore Stock Exchange	84	82	28	26
Islamabad Stock Exchange	39	39	17	10
TOTAL	265	261	98	81

Registration of brokers and agents has had a positive impact on stock market dealings owing to the enhanced level of awareness created amongst brokers and agents regarding the level of integrity and care required of them in the conduct of their business.

(ii) Regulations for Good Governance at the Stock Exchanges

Recently, the Commission, under the Securities and Exchange Ordinance, 1969, directed the stock exchanges to further improve governance and advised them to reconstitute their Board of directors as under:

- (a) five directors to be elected from amongst the members by the general body of the exchange;
- (b) four non-member directors to be nominated and appointed by the Commission;
- (c) the position of vice-chairman of the exchange to be abolished; and
- (d) the chairman to be elected by the Board from amongst the elected directors.

It is expected that the Boards thus reconstituted and streamlined will not only function better but will also be able to look after the interests of all stakeholders more effectively.

(iii) Revised Arbitration Procedure

In order to ensure expeditious resolution of investors' complaints, the Commission has approved a two-tier arbitration procedure for the KSE. Under the new procedure, all claims and disputes of more than Rs. 0.5 million, which are not amicably settled otherwise, should be referred to an Advisory and Arbitration Committee (AAC) for resolution or decision. The Committee consists of three members, namely, one member director, one non-member director and the Managing Director. A claim or dispute could be referred by the AAC to a panel of arbitrators. However, claims and disputes of up to Rs. 0.5 million would be resolved or decided by the Managing Director of the exchange. It is expected that introduction of the new arbitration procedure will have a positive impact on engendering investor confidence.

2.3.3 Introduction of New Products/ Systems

(i) Trading in Futures Contracts

Derivative products give depth to the capital market, providing investors with basic hedging instruments and investment alternatives. The Commission approved the regulations governing futures contracts trading on June 9, 2001. Trading in futures contracts made its debut at the KSE on July 5, 2001. Currently, 13 scrips are being traded at both the KSE and the LSE. Stocks are selected for futures trading primarily on the basis of their liquidity.

Regulations for futures contracts have been approved for the Islamabad Stock Exchange (ISE) and trading is expected to commence shortly.

The Commission is currently working closely with the stock exchanges for development of a wider range of derivative products, such as options, index futures, swaps, etc.

(ii) Regulations for Futures Trading in Provisionally Listed Companies

In order to regulate futures trading in provisionally listed securities, i.e. securities that have applied for listing but have not yet been listed, it was considered essential to frame new regulations. Consequently, in February 2002, the Commission approved the Regulations for Futures Trading in Provisionally Listed Companies, 2002 for the KSE.

(iii) OTC Market

A quote-driven OTC market, essentially for small-cap stocks and debt securities, provides investors with an alternative, convenient and efficient avenue to make investments. Moreover, promoters can set up new projects or expand their operating activities by raising finance in a cost-effective manner in the OTC market where regulatory requirements are less stringent than in case of regular listing. An OTC market provides several benefits to investors and issuers that include the following:

- (a) it provides liquidity to illiquid shares;
- (b) it is cost effective for issuers;
- (c) it affords opportunities to young companies, without a proven track record, to raise risk capital for making productive investment;
- (d) it enables access to a wide spectrum of financial intermediaries; and
- (e) it provides venture capital and private equity funds an exit route for their investments.

The proposed minimum capital requirement for a company to be listed on the OTC market is Rs. 10 million as compared to Rs. 50 million for the regular market. The minimum public offering will be Rs. 5 million or 25 percent of the capital, whichever is higher.

In May 2002, the Commission approved, in principle, the concept of an OTC market and the stock exchanges are currently in the process of drafting the necessary regulations.

(iv) Formation of NCEL

The Commission has approved the establishment of NCEL for trading in futures contracts in commodities. The NCEL will be the first demutualized

exchange and will be sponsored by the KSE, LSE, ISE and other premier institutions of the country. It will be the first exchange of its kind in Pakistan and will consolidate commodity futures trading at the national level. The introduction of futures contracts in commodities will offer the investors basic hedging instruments, enabling them to lock-in costs, and will also provide the necessary stimulus to boost investment. The NCEL is expected to be fully operational by the end of December 2002. The rules and regulations governing the futures contracts are currently under preparation by the NCEL.

(v) National Clearing and Settlement System

The National Clearing and Settlement System (NCSS) commenced operations on December 24, 2001. Companies are being inducted in the NCSS in a phased manner. By September 30, 2002, the total number of companies inducted into the system was 150.

2.3.4 Investor Education

Various efforts are underway to educate investors about the significant aspects of investing in securities. The Commission has published a series of Investor Guides to educate existing and potential investors about the investment risks and rewards, the importance and significance of financial planning and, most importantly, the rights and responsibilities of investors and the recourse available to them. The preparation of the Investor Guide series is a part of the Commission's investor awareness program. Information asymmetries provide undue advantages to certain market participants in case of market failure. The Commission, therefore, aims to achieve maximum dissemination/ disclosure of information to all investors.

2.3.5 Formation of a Consultative Group for the Capital Market

The Commission, in February 2002, formed a Consultative Group for the Capital Market. The Group acts as a think-tank for the Commission through regular and wide ranging deliberations on policies and issues currently impacting the capital market. The Consultative Group is headed by the Chairman of the Commission and includes leading experts and practitioners drawn from the capital market along with senior officials of the Commission.

2.3.6 Demutualization of the Stock Exchanges

In response to technological advances, globalization, growing competition and, more significantly, concern for investors' interests, stock exchanges worldwide are embarking upon a process of demutualization. Out of the 52 exchanges, represented at the 2001 meeting of the International Federation of the Stock Exchanges (FIBV), 32 had demutualized while 20 had approved plans for demutualization.

Demutualization transforms an exchange from an entity owned by its members into a commercial, shareholder-owned company. A demutualized stock exchange has a

clear commitment to generate competitive returns for its shareholders as well as to protect the interests of all its customers and those of the broader investor community. Mr. Alan Cameron, former Chairman of the Australian Securities and Investment Commission, conducted a seminar on “Demutualization of Stock Exchanges” in Islamabad in April 2002, which was attended by capital market experts, representatives of the three stock exchanges as well as officials of the Commission. He outlined the reasons, importance and likely benefits of demutualization and informed that all members of the FIBV had either completed, or were in the process of, demutualization.

The three stock exchanges in Pakistan are, at present, considering demutualization and are engaged in analyzing different models/ structures of demutualized exchanges.

2.4 Monitoring and Surveillance

The Market Monitoring and Surveillance Wing (MSW) was set up within the Commission in October 2000 to facilitate initiatives in risk management. The MSW has two specific functions: (i) monitoring of systemic risk at the exchanges; and (ii) surveillance to detect general or specific instances of market abuse. The MSW monitors the market by using on-line data available on the websites of the exchanges. It takes cognizance of price and turnover aberrations to determine possible market malpractices, such as blank selling, insider trading, etc.

The MSW issues a comprehensive market report at the end of every day, which focuses on the latest market information and risk parameters. In view of the importance of risk management in the COT market, a daily report specific to the COT market is also prepared and distributed within the Commission.

The MSW steered the investigation committee formed to determine violations of the Commission’s restraint order with respect to blank selling on September 12, 2001. The committee pointed out various weaknesses within the prevalent system at the stock exchanges that made it difficult to check the violations and highlighted the need for forming specific regulations governing blank and short selling. These regulations were subsequently framed with the assistance of the MSW and have been in force since March 2002.

In May 2002, when the market witnessed a sharp decline, the MSW played a key role in collection and analysis of the COT market data. Based on the conclusions drawn in that study, a number of important risk management practices have been proposed by the Commission for the COT market.

The MSW is also spearheading the establishment of surveillance wings at the stock exchanges so that they can work closely with the Commission to enhance the effectiveness of monitoring and surveillance exercises.

In order to enhance its monitoring and surveillance capacity, the MSW is in the process of developing the Market Surveillance Software (MSS). The project has been assigned to a leading IT firm and will be fully operational by the end of December 2002. This software will not only enhance the ability of the MSW to procure near real-time information from all the three exchanges but will also generate alerts whenever an unusual trading pattern is detected. The MSS will also be used by the surveillance wings at the three exchanges, which will work in close coordination with the MSW.

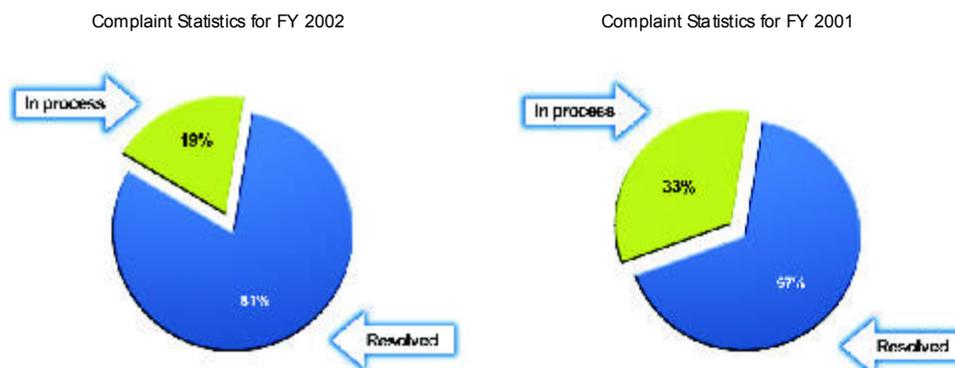
2.5 Investor Complaints

The Investor Complaints Wing within the SMD has emerged as an efficient and effective instrument for the protection of investors' interests, in particular, those of small investors. The Wing has successfully brought about quantitative as well as qualitative improvements to redress investor grievances, which are partly reflected in the statistics presented below.

TABLE 3 Investor Complaint Statistics (July 1, 2001 – June 30, 2002)

	KSE	LSE	SE	TOTAL
Complaints received (July 1, 2000 - June 30, 2001)	47	44	44	135
Complaints resolved (July 1, 2000 - June 30, 2001)	16	8	20	44
Carried forward	31	36	24	91
Complaints received (July 1, 2001 - June 30, 2002)	129	49	23	201
Total complaints dealt with (July 1, 2001 - June 30, 2002)	160	85	47	292
Complaints under litigation/against defaulted and suspended members	6	19	33	58
Complaints pending with stock exchanges	2	3	0	5
Complaints under examination of the Commission	24	16	3	43
Complaints resolved (July 1, 2001 - June 30, 2002)	128	47	11	186

CHART 5 Investor Complaint Statistics for Financial Years 2001 and 2002



As a result of expeditious resolution of investors' complaints, there is greater awareness amongst investors and brokers regarding their rights and obligations as well as enhanced confidence in the enforcement of these rights and obligations. This is a significant achievement of the Investor Complaints Wing. By gradually channeling investors' complaints to the relevant stock exchanges and monitoring the resolution of these complaints, the Wing is also attempting to develop the institutional capacity of the stock exchanges to handle and resolve the complaints. As a result of these efforts, the stock exchanges have started addressing investors' complaints in a more effective manner. Further, as a priority, the Wing seeks to eliminate basic anomalies within the systems, procedures and relevant regulations of the stock exchanges to achieve more efficient redressal of investors' complaints.

2.6 Beneficial Ownership

In order to protect the interests of minority shareholders and to discourage the management of listed companies from making windfall gains on the basis of privileged inside information, every director, chief executive, management agent and person holding 10 percent or more shares in a listed company is required to file certain prescribed returns for beneficial ownership. Also, any gains made by beneficial owners in transactions completed (purchase and sale or sale and purchase) within a six-month period are to be reported to the issuer and the Commission and tendered as stipulated in the law. During the year under review, the Commission finalized five cases of tenderable gain, aggregating Rs. 9.5 million, out of which Rs. 6.6 million have been tendered to the Commission while two beneficial owners have filed appeals before the Appellate Bench of the Commission.

During the year, Rule 16 of the Companies (General Provisions and Forms) Rules, 1985 was amended in order to exclude acquisition of right shares from the determination of tenderable gain.

2.7 Issue of Capital

The Capital Issues Wing of the SMD deals with approval of prospectuses for public offer of securities. Under the Companies Ordinance, 1984, the prospectus of any company inviting public subscription for its securities is required to be approved by the Commission prior to its issue, circulation and publication. The Wing also deals with cases relating to further issue of capital and inter-corporate financing.

During the year under review, there were six public equity offerings as compared to two in the preceding year. In addition, there were 17 offerings of debt instruments in the form of Term Finance Certificates (TFCs) as compared to 10 in the preceding year, which is a clear illustration of growing investor interest in TFCs.

The table below provides a comparison of share capital and TFC offerings during the year.

YEAR	EQUITY ISSUES		D E B T I S S U E S			
	Number of Issues	Amount of Capital (at Face Value)	Number of Issues	Amount Allowed	Amount Offered	Amount Retained
2001-2002	6	7,338.3	17	12,960.0	9,710.0	10,125.9
2000-2001	2	1,984.7	10	9,000.0	5,425.0	5,488.9

2.7.1 Share Capital

During the financial year 2002, there were three offerings of fresh equity capital. The total amount offered to the general public was Rs. 944.5 million whereas the amount of capital listed on the stock exchanges stood at Rs. 2,807.6 million. The relevant details of the three offerings are given below.

S. NO.	NAME OF COMPANY	SECTOR	SUBSCRIPTION DATE	FORMAL LISTING DATE	TOTAL PAID-UP CAPITAL	OFFERED CAPITAL	SUBSCRIPTION RECEIVED
1	Fayzan Manufacturing Modaraba	Modaraba	October 9-10, 2001	December 20, 2001	900.000	540.000	6.075
2	WorldCALL Multimedia	Transport and Communication	November 7, 2001	January 4, 2002	530.000	132.000	21.140
3	Bosicar Pakistan Limited	Fuel and Energy	May 17-18, 2002	July 15, 2002	1,377.566	272.500	42.225
TOTAL					2,807.566	944.500	69.400

Further, during the year, there were three secondary offerings of shares (disinvestments) involving shares aggregating Rs. 341.5 million in value based on the offer prices. The total capital listed on the stock exchanges was to the tune of Rs. 4,530.7 million. Details of the secondary offerings are presented in Table 6.

TABLE 6 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	SUBSCRIPTION RECEIVED
1	First Capital Equities Limited	Securities companies/ Banks/ Investment companies	First Capital Securities Corporation Limited	August 28, 2001	October 1, 2001	120.035	55.000	3.095
2	National Bank of Pakistan	Securities companies/ Banks/ Investment companies	Government of Pakistan	November 19-22, 2001	February 18, 2002	3,730.383	186.520	1,040.959
3	Attock Cement Pakistan	Cement	Pharaon Commercial Investment Group Limited	June 18, 2002	June 24, 2002	680.302	100.000	30.940
TOTAL						4,530.720	341.520	1,074.994

2.7.2 Further Issue of Share Capital

Companies can raise further capital by way of pre-emptive rights and/ or bonus issue of shares without the approval of the Commission. In certain exceptional circumstances, listed companies may also be allowed to raise capital without the offer of right shares. In this regard, the Commission received 11 applications, of which seven were approved during the year.

2.7.3 Issue of Shares at a Discount

Companies may issue shares at a discount to face value, if so approved by the Commission. During the year, seven listed companies were allowed to issue shares at varying discounts to the respective face values of their shares.

2.7.4 Issue of Preference Shares

Under Section 90 of the Companies Ordinance, 1984, read with Companies Share Capital (Variation in Rights and Privileges) Rules, 2000, companies can issue more than one kind of share capital. During the year under review, three companies, namely, Security Leasing Corporation Limited, Fauji Cement Company Limited and Natover Lease and Refinance Limited were allowed to issue preference shares.

2.7.5 Investment in Associated Companies

The law restricts companies to invest in their associated companies/ undertakings up to 30 percent of their paid-up capital and free reserves. However, in certain exceptional cases, this limit can be relaxed. In this regard, the commission received 12 cases for relaxation, of which eight were approved.

2.7.6 Redeemable Capital

The year under review was the best so far in respect of raising funds through debt instruments in the form of TFCs. The TFCs are gaining popularity among investors due to a number of factors, like (i) attractive rate of return and safety of principal amount invested; (ii) substantial decline in returns offered by the National Savings Schemes (NSS); and (iii) restrictions imposed on institutional investors for investing in NSS.

During the year, approval was granted to 17 companies to issue TFCs involving an aggregate amount of Rs. 12.9 billion. Of this amount, Rs. 10.1 billion (inclusive of green shoe option) has already been raised: Rs. 7.4 billion through private placement and Rs. 2.8 billion from the general public. The balance will be raised through floatation of subsequent tranches of TFCs. While TFCs are mostly offered on the basis of floating returns with a specific floor and ceiling, Sitara Chemical Industries Limited issued a debt instrument on a profit and loss sharing basis.

Table 7 summarizes the relevant details of the 17 debt issues offered for public subscription during the year under review.

TABLE 7 Debt Issues													
S. NO.	NAME OF COMPANY	SUBSCRIPTION DATE	FORMAL LISTING DATE	TOTAL CAPITAL ALLOWED TO BE ISSUED	PRESENT OFFER			SUBSCRIPTION RECEIVED			GREEN SHOE OPTION	AMOUNT RETAINED	
					Pre-IPO	PO	Total	Pre-IPO	IPO	Total			
1	Pakistan PTA Limited (I.C.I)	August 1-2, 2001	October 1, 2001	1,600.000	1,100.000	500.000	1,600.000	1,100.000	230.295	1,330.295	80% of IPO	1,600.000	
2	Atlas Lease Limited (2nd tranche of total authorized Rs. 300 million)	August 15-16, 2001	October 29, 2001	—	75.000	25.000	100.000	75.000	25.9550	100.9550	N.A.	100.000	
3	Packages Limited	August 20, 2001	October 5, 2001	700.000	550.000	150.000	700.000	550.000	410.735	960.735	100% of IPO	850.000	
4	Gulistan Textile Mills Limited	September 4-5, 2001	November 5, 2001	300.000	200.000	100.000	300.000	200.000	120.665	320.665	100% of IPO	320.665	
5	Dawood Leasing Limited (1st tranche of total authorized Rs. 500 million)	September 11-12, 2001	November 5, 2001	500.000	175.000	75.000	250.000	175.000	78.050	253.050	20% of IPO	253.050	
6	First International Investment Bank (Inter-bank) (1st tranche of total authorized Rs. 500 million)	September 15-29, 2001	November 5, 2001	500.000	—	100.000	100.000	—	192.900	192.900	100% of IPO	192.900	
7	Nishat Mills Limited (Second Issue)	September 18-19, 2001	November 19, 2001	600.000	450.000	150.000	600.000	450.000	10.045	460.045	N.A.	600.000	
8	Engro Chemicals (1st tranche of total authorized Rs. 1.5 billion)	November 26-27, 2001	January 11, 2002	1,500.000	400.000	100.000	500.000	400.000	290.160	690.160	N.A.	500.000	
9	Pak-Arab Refinery Limited (Non-listed public company)	December 12, 2001	January 21, 2002	2,500.000	2,000.000	500.000	2,500.000	2,000.000	540.130	2,540.130	N.A.	2,500.000	
10	Crescent Leasing (1st tranche of total authorized Rs.900 million)	December 26-27, 2001	March 4, 2002	900.000	175.000	75.000	250.000	175.000	86.785	261.785	40% of IPO	261.785	
11	Security Leasing (1st tranche of total authorized Rs.500 million)	December 28-29, 2001	February 11, 2002	500.000	160.000	40.000	200.000	160.000	40.505	200.505	125% of IPO	200.505	
12	*Reliance Weaving Mills (1st tranche of total authorized Rs.300 million)	February 6-7, 2002	May 13, 2002	300.000	120.000	30.000	150.000	120.000	46.350	166.350	50% of IPO	150.000	
13	**Union Leasing Limited (1st tranche of total authorized Rs. 1 billion)	April 9-19, 2002	June 12, 2002	1,000.000	200.000	50.000	250.000	200.000	157.070	357.070	100% of IPO	357.070	
14	Shahmurad Sugar Mills Limited	May 21, 2002	June 24, 2002	200.000	125.000	75.000	200.000	125.000	18.220	143.220	40% of IPO	200.000	
15	Saudi Pak Leasing Limited (1st tranche of total authorized Rs.1.5 billion)	May 31 – June 1, 2002	July 15, 2002	1,500.000	320.000	80.000	400.000	320.000	262.755	582.755	25% of total first tranche	430.000	
16	Sui Southern Gas Company Limited (2nd tranche of authorized Rs. 3.0 billion)	June 3 – 4, 2002	July 24, 2002	—	1,050.000	200.000	1,250.000	1,050.000	350.540	1,400.540	N.A.	1,250.000	
17	Sitara Chemical Industries Limited	June 19-20, 2002	July 24, 2002	360.000	255.000	105.000	360.000	255.000	224.105	479.105	N.A.	360.000	
TOTAL				12,960.000	7,355.000	2,355.000	9,710.000	7,355.000	3,085.265	10,440.265		10,125.975	

*The green shoe option was not exercised.

**The company was allowed to retain the entire over-subscribed amount.

CHART 6 TFCs Issues During the Years 1995-96 to 2001-02

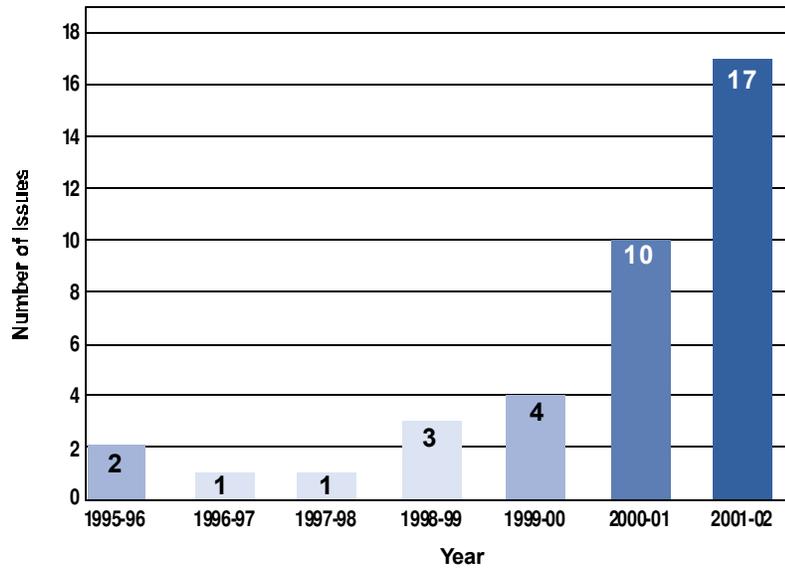
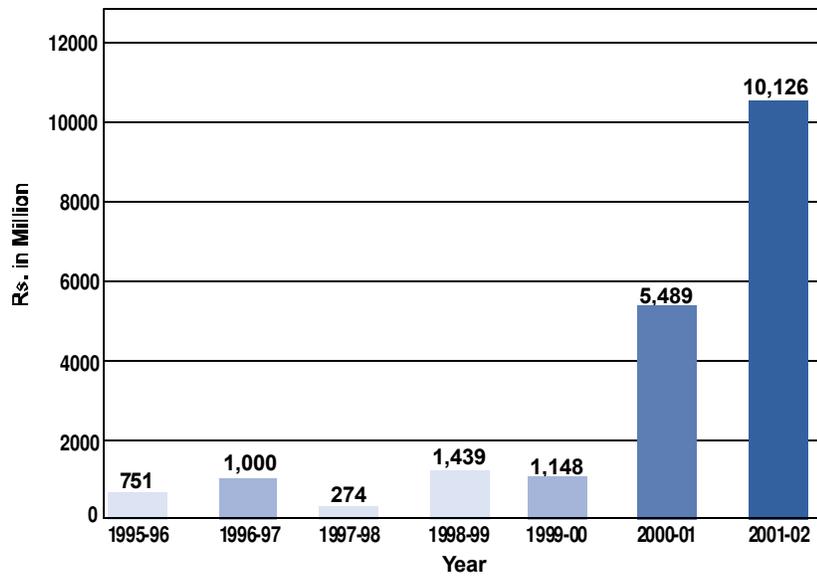


CHART 7 Amount Raised through TFCs During the Years 1995-96 to 2001 - 02



2.8 Review of Prospectuses and Supporting Documents

During the year under review, the Capital Issues Wing initiated a review of prospectuses and supporting documents with a view to improve the quality of disclosure and rationalize the contents of these documents. After due consultation with the stakeholders, the Commission issued guidelines to help the issuers in providing complete disclosure of all material information to investors. The guidelines, *inter alia*, stipulate the following:

- (i) language of the prospectus should be simple, clear and concise;
- (ii) all foreseeable risk factors and management's perception of these factors should be adequately disclosed;
- (iii) the primary purpose of the issue should be explained in appropriate detail and the use of subscription proceeds should be specified;
- (iv) the disclosure of dividend policy should be meaningful;
- (v) all material information, such as changes in key personnel, statement of capital structure before and after the issue and material expenses of the issue, should be disclosed; and
- (vi) the prospectus should not be used as a marketing tool and printing of photographs and fancy formatting should be avoided.

Further, to facilitate investors and broaden the scope and readability of prospectuses, the Commission has, through these guidelines, encouraged the publication of prospectuses in Urdu as well as in English languages. In addition to the guidelines, a complete checklist of the documents required to be submitted along with the application for approval of prospectus has also been issued and posted on the Commission's website.

2.9 Inspection of Books and Records of Members

Rule 5 (2) of the Securities and Exchange Rules, 1971, read with Section 6 (i) of the Securities and Exchange Ordinance, 1969, requires every stock exchange and every director, officer, and member of the stock exchange to prepare and maintain books and accounts, which shall be subject to inspection by any person authorized by the Commission. On April 26, 2001, the Commission issued the Stock Exchange Members (Inspection of Books and Record) Rules, 2001. These Rules provide for maintenance of certain books and records by members of the stock exchanges in addition to the records required to be maintained by them under the Securities and Exchange Rules, 1971. The Commission is currently seeking to build its capacity to effectively and efficiently undertake inspection of books in addition to conducting audit of members.

3. Specialized Companies Division



- 3.1 Overview
- 3.2 Leasing
- 3.3 Modarabas
- 3.4 Mutual Funds
- 3.5 Venture Capital Companies and Venture Capital Funds
- 3.6 Special Purpose Vehicles for Asset Backed Securitization
- 3.7 Credit Rating Companies
- 3.8 Oversight of Accountancy Profession

3. Specialized Companies Division

3.1 Overview

The Specialized Companies Division (SCD) is responsible for regulation and monitoring of leasing companies, modarabas, mutual funds and other specialized companies. A list of all specialized companies licensed by the Commission is presented in Appendix C. In addition, the Division maintains oversight over the accountancy profession and has been actively involved in new initiatives for improving transparency and disclosure in financial reporting of companies. The SCD has played a pivotal role in introduction of the Code of Corporate Governance (the Code), which is the first-ever institutional effort of its kind in Pakistan.

Substantial progress was made during the year in the regulation and monitoring of specialized companies. Besides an internal restructuring of the Division that required recruitment of professionals and streamlining of operating procedures, a two-pronged approach was adopted for enhancing effectiveness of regulatory actions. A thorough review of relevant rules and regulations was undertaken and amendments proposed after due consultation with industry representatives. These amendments are aimed at making the rules more responsive to the needs of the industry and plugging the loopholes identified in the process of applying these laws. At the same time, monitoring and surveillance mechanisms were enhanced to enable the Commission to take proactive measures and impose appropriate punitive or remedial measures to deter further violations. The SCD conducted a number of investigations and special audits during the course of the year and took appropriate follow up action.

On January 11, 2002, the SBP and the Commission jointly announced the transfer of supervisory functions of certain Non-bank Financial Institutions (NBFIs) from the SBP to the Commission effective July 1, 2002. These NBFIs include investment banks, discount houses and housing finance companies. Subsequent to the transfer, all financial institutions – with the exception of commercial banks and Development Finance Institutions (DFIs) – will be regulated by the SCD. The transfer, however, was delayed pending enactment of necessary amendments in relevant laws by the Government.

Following the transfer of regulatory supervision of these institutions, the Commission intends to implement the concept of the Non-bank Finance Company (NBFC). A NBFC, as a company duly licensed by the Commission, would be able to carry out any one or more of the following forms of business, subject to compliance with the prescribed criteria:

- (i) investment finance services;
- (ii) leasing;
- (iii) housing finance services;
- (iv) venture capital investment;
- (v) discounting services;
- (vi) investment advisory services (as management company of closed-end mutual funds); and
- (vii) asset management services (as management company of open-end mutual funds).

The main objective behind the introduction of NBFC is to consolidate the activities of the non-bank financial sector under one umbrella. Consolidation is expected to lead to reduction in operating expenses as well as strengthening of the capital base of these companies, thereby providing a fillip for future development of this sector.

In order to provide a comprehensive framework for the regulation and monitoring of NBFCs, the Non-Bank Finance Companies (Establishment and Regulation) Rules, 2002 were drafted for issuance under appropriate provisions of the Companies Ordinance, 1984. The draft Rules were notified in the official gazette in May 2002 to solicit public opinion. After considering the comments and suggestions of the concerned quarters, the Rules were finalized and forwarded to the Ministry of Finance for approval prior to promulgation.



Ms. Sada Khan, Executive Director, SCD (sitting) with officers of Division

The SCD has also been instrumental in developing a policy framework to encourage mergers and consolidation in the financial sector. The SCD worked closely with the SBP and the Central Board of Revenue (CBR) to recommend certain tax incentives for mergers/ amalgamations of banks and NBFIs. In recognition of the growing economic need for mergers and business reorganizations, the proposed tax incentives were introduced through the Finance Ordinance, 2002. These incentives include carry forward and set-off of losses of merged institutions, tax admissibility of expenses on merger, continued availability of unabsorbed depreciation and admissibility of different tax rates to banking and non-banking operations of a merged institution. It is envisaged that these fiscal incentives would facilitate consolidation of the financial sector, which will lead to enhancement of capital base and economies of scale of financial institutions, thereby improving competitiveness and cost effectiveness within the sector.

A brief review of the activities of the SCD during the financial year 2002 is given below.

3.2 Leasing

3.2.1 Overview

The Leasing Wing of the SCD regulates and monitors activities of leasing companies in accordance with the provisions of the Companies Ordinance, 1984 and the Leasing Companies (Establishment and Regulation) Rules, 2000.

As financial intermediaries providing medium and long term financing, leasing companies have made a significant contribution towards development of the financial sector in the country. Leasing companies have also played an important role in the development of small and medium scale enterprises in Pakistan and remain a significant player in the vehicle financing business. Previously, establishment of various small leasing companies and entry of other financial institutions into the leasing business had resulted in a fragmented sector with limited opportunities for growth. Moreover, leasing of plant and machinery was adversely affected due to increase in the number of sick units in textile and cement sectors. The capital base of a number of leasing companies was, therefore, eroded due to the large amount of provision that was needed against such non-performing assets.

During the year under review, the number of leasing companies decreased from 32 to 30 as a result of consolidation through mergers and amalgamations. Of these 30 companies, one is in liquidation. Consolidation in the sector is expected to continue as a few more mergers are in the pipeline while some are at an advanced stage of negotiations. These include not only intra-sector mergers but also cross-sector mergers involving modarabas and investment banks. It is anticipated that the

encouraging trend of mergers and consolidation in the sector would result in improving resource mobilization potential and operational efficiency of leasing companies due to strengthening of capital base and economies of scale, respectively.

During the year, investment in leases increased by 9 percent to Rs. 37.5 billion, a significant portion of which was invested in vehicle financing. An important factor that contributed towards this growth was the availability of tax concessions in the Finance Ordinance, 2001 through which First Year Allowance for depreciation of leased assets at the rate of 30 percent was accorded to leasing companies and ceiling on cost of vehicles for depreciation allowance was increased to Rs. 750,000 from Rs. 600,000. In the Finance Ordinance 2002, the initial depreciation allowance permissible in respect of leased assets has been enhanced to 50 percent and ceiling on cost of vehicles for depreciation allowance has been revised upwards to Rs. 1,000,000. This is expected to further boost the performance of the leasing sector.

Despite frequent reduction in interest rates and persistent slow down in economic activity, the leasing sector demonstrated reasonable growth during financial year 2002, as evident from increase in aggregate assets by 8.9 percent to Rs. 47.88 billion. The aggregate equity base improved by 4.9 percent to Rs. 8.5 billion during the year. By the end of financial year 2002, around 78 percent of the assets were deployed in the principal line of business. However, the sector continued to remain highly concentrated as six leasing companies accounted for more than 70 percent of total assets of the sector. Certificates of Investment (COIs) remained a significant source of mobilizing short and medium term funding for leasing companies and as at June 30, 2002, the aggregate amount raised through this source was Rs. 13.53 billion, indicating an improvement of 19.5 percent over the previous year. The maturity period of COIs issued by leasing companies ranges from three months to five years.

Key statistics of the leasing sector as on June 30, 2002, based on audited statements, are given in Table 8.

S. No.	NAME OF COMPANY	TOTAL EQUITY	TOTAL ASSETS	NET INVESTMENT IN LEASES	COIs	PROFIT / (LOSS) AFTER TAX	DIVIDEND (%)
1	Asian Leasing Corporation Limited	58,950	116,667	68,897	—	118	—
2	Askari Leasing Limited	755,175	8,426,990	6,385,898	5,991,008	21,115	—
3	Capital Assets Leasing Corporation Limited	104,701	284,163	238,433	19,040	3,905	—
4	Crescent Leasing Corporation Limited	410,089	1,677,774	1,234,232	193,241	52,350	10.00 5.00(B)
5	Dawood Leasing Company Limited	336,367	2,345,409	1,553,061	558,762	22,103	5.00(B)
6	English Leasing Limited *	78,315	289,530	178,436	5,924	N.A.	N.A.
7	First Leasing Corporation Limited *	208,492	798,059	555,012	4,819	N.A.	N.A.

(continued on next page)

S. No.	NAME OF COMPANY	TOTAL EQUITY	TOTAL ASSETS	NET INVESTMENT IN LEASES	COIs	PROFIT / (LOSS) AFTER TAX	DIVIDEND (%)
8	Grays Leasing Limited	232,855	748,158	689,696	–	23,219	10.00
9	Ibrahim Leasing Limited	321,364	455,112	435,751	–	30,269	10.00
10	Inter Asia Leasing Company Limited	16,070	156,536	94,561	65,065	(53,985)	–
11	International Multi Leasing Corporation Limited	81,319	109,286	60,774	–	(5,312)	–
12	Lease Pak Limited *	61,252	364,972	325,216	–	N.A.	N.A.
13	National Asset Leasing Corporation Limited	12,657	150,455	59,982	3,556	(911)	–
14	National Development Leasing Corporation Limited	1,167,537	4,902,288	4,331,183	1,381,708	(82,225)	–
15	Natover Lease and Refinance Limited	196,145	272,038	94,327	5,170	4,849	–
16	Network Leasing Corporation Limited	205,427	985,969	531,115	–	11,482	–
17	Orix Leasing Pak Limited	1,047,794	11,021,913	9,357,117	2,366,804	126,343	45.00
18	Pacific Leasing Company Limited	240,686	731,724	618,137	–	12,851	–
19	Pak Apex Leasing Company Limited	233,988	515,196	487,311	–	22,812	7.50
20	Pakistan Industrial and Commercial Leasing Limited	125,787	907,378	696,994	17,676	N.A.	N.A.
21	Pak Gulf Leasing Company Limited	171,039	264,653	208,478	–	11,767	–
22	Paramount Leasing Limited	305,229	1,850,535	1,579,194	372,000	9,969	–
23	PILCORP*	596,483	3,588,640	2,580,375	641,493	N.A.	N.A.
24	Saudi Pak Leasing Company Limited	292,566	2,807,122	1,775,031	1,225,543	13,696	–
25	Security Leasing Corporation Limited	149,761	913,263	804,731	170,000	15,531	–
26	Sigma Leasing Corporation Limited	230,235	511,676	363,836	81,354	20,233	8.50
27	Trust Leasing Corporation Limited *	383,395	683,942	427,168	95,493	12,239	10.00(B)
28	Union Leasing Company Limited	323,497	1,762,641	1,600,286	329,932	55,051	15.00
29	Universal Leasing Corporation Limited *	159,383	242,685	81,061	–	N.A.	N.A.
TOTAL		8,506,558	47,884,774	37,416,293	13,528,588		

* Un-audited figures as on June 30, 2002
(B) Bonus (Stock dividend)

3.2.2 Regulatory Actions

(i) Requirement for Increase in Paid-up Capital

In 1997, the minimum paid-up capital requirement in respect of leasing companies was raised to Rs.200 million from Rs.100 million through an amendment in Leasing Rules, 1996. The increase in the capital base was expected to improve prospects for resource mobilization and lead to consolidation in the sector through mergers and acquisitions. Leasing companies, whose capital was below the stipulated level, were advised to enhance their paid-up capital to Rs.200 million within a time span of two years, i.e. by end-October 1999. Later, this deadline was extended to June 30, 2001.

During the year under review, the Commission considered a number of cases regarding enhancement of the capital base and an extended time period for compliance was allowed on a case-to-case basis depending on the viability of plans. As a result, the number of companies compliant with the minimum capital requirement of Rs. 200 million increased to 18 from nine at financial year-end 2001. Another eight are expected to become compliant by June 2003 by way of mergers, issuance of right shares at a discount and issuance of preference shares. By the end of 2003, it is expected that almost all the leasing companies would have met the minimum capital requirement. The enhanced capital base is expected to result in greater financial stability, improved resource mobilization capacity and economies of scale to enable leasing companies to compete effectively with larger financial institutions undertaking leasing business.

The status of compliance of leasing companies with the minimum capital requirement, as on June 30, 2002, is presented below:

TABLE 9 Status of Compliance with Minimum Paid-up Capital Requirement

FULLY COMPLIANT COMPANIES		
S. No.	NAME OF COMPANY	PAID-UP CAPITAL (Rs. in thousand)
1	Askari Leasing Limited	324,000
2	Crescent Leasing Corporation Limited	221,381
3	Dawood Leasing Company Limited	250,000
4	First Leasing Corporation Limited	272,782
5	Ibrahim Leasing Limited	228,500
6	National Development Leasing Corporation Limited	377,400
7	Orix Leasing Pakistan Limited	241,664
8	Pak Apex Leasing Company Limited	200,000
9	Paramount Leasing Limited	250,000
10	PILCORP	217,893
11	Saudi Pak Leasing Company Limited	220,000
12	Union Leasing Company Limited	207,000
13	Universal Leasing Corporation Limited	210,000
14	Pacific Leasing Comapny Limited	200,000
15	Trust Leasing Corporation Limited	203,280
16	Natover Lease and Refinance Limited	202,500
DEEMED COMPLIANT COMPANIES		
S. No.	NAME OF COMPANY	PAID-UP CAPITAL AND ADMISSIBLE RESERVES (Rs. in thousand)
17	Grays Leasing Limited	227,500
18	Pakistan Industrial and Commercial Leasing Limited	202,687

(ii) Mergers and Consolidation

During the year under review, leasing companies pursued a number of merger proposals and the Commission accorded in principle 'no objection' to six such

schemes of merger/ amalgamation. Of these, the following three schemes have subsequently been approved by the relevant High Courts:

- (a) Atlas Leasing Limited stands merged into Atlas Investment Bank Limited;
- (b) Ghandhara Leasing Limited stands merged into Al-Zamin Leasing Modaraba; and
- (c) Pakistan Industrial Leasing Corporation Limited (PILCORP) stands merged into Trust Investment Bank Limited.

(iii) Suspension of Permission to Issue COIs

The Commission suspended the permission to issue COIs of two leasing companies during the year under review. This followed the suspension of permission to issue COIs of six leasing companies during 2001. The credit ratings of these companies were below the minimum investment grade and issuance of COIs by such companies was in violation of the Leasing Companies (Establishment and Regulation) Rules, 2000. In case these companies fail to obtain a satisfactory investment grade credit rating within a period of two years, the permission to issue COIs will be cancelled. During the two-year time period, these companies have been advised not to issue any new COIs or rollover the existing COI deposits upon maturity.

(iv) Permission to Investment Banks and DFIs to Undertake Leasing Business

During the year under review, licenses to undertake leasing business were accorded to Small Business Finance Corporation, First International Investment Bank Limited and Pak Oman Investment Company (Private) Limited in terms of Rule 18 of the Leasing Companies (Establishment and Regulation) Rules, 2000.

(v) Budget Proposals for Finance Ordinance

As a result of concerted efforts of the Commission, certain amendments were introduced in the Income Tax Ordinance, 2001 in respect of the leasing sector. Meanwhile, modarabas and other financial institutions undertaking leasing business were allowed, through the Finance Ordinance, 2002, to deduct depreciation from lease rental income derived by such institutions. This amendment is expected to provide a level playing field to all participants in the leasing business.

3.2.3 Monitoring and Enforcement

(i) Appointment of Administrator

During the year under review, special audit of a leasing company revealed gross misappropriation and misapplication of funds by its management.

Further, it was observed that the directors had managed the affairs of the company in a manner oppressive to the members and prejudicial to the public interest.

During the course of the special audit, the management handed over the affairs of the company to a new group in a clandestine manner. The newly inducted directors of the company were required to obtain prior approval of the Commission in terms of Leasing Companies (Establishment and Regulation) Rules, 2000. Although the Commission did not grant approval to the appointment of new directors due to incomplete information about them, the new management, in violation of the legal requirements, went ahead with further changes in the composition of the board of directors without prior approval of the Commission. This attracted the provisions of Sections 185 and 186 of the Companies Ordinance, 1984. As a result of continuing defaults in observing statutory requirements, a show cause notice was issued in terms of the above Sections to the new management of the company. At the conclusion of the hearing granted to them, the new management agreed to provide to the Commission requisite information about legitimate ownership of the company and credibility of the newly inducted individuals. However, the new management failed to furnish such information and the Commission, therefore, initiated proceedings for appointment of administrator under Section 290 of the Companies Ordinance in respect of the said leasing company.

The case for appointment of administrator under Section 290 of the Companies Ordinance has since been filed in the Sindh High Court and proceedings are currently in progress.

In addition to the above, it became evident that the financial statements issued by the previous management of the leasing company did not present a true and fair view of the company's affairs. Therefore, proceedings against the concerned directors of the company for knowingly and willfully making contradictory and untrue statements in accounts were initiated. These proceedings have been filed under Section 230 (7) (a), read with Section 492 of the Companies Ordinance, 1984 in the Court of Session in Karachi South.

(ii) Cancellation of License to Undertake Leasing Business

The statutory time limit allowed to leasing companies to enhance their capital to the minimum stipulated level of Rs. 200 million was June 30, 2001. The Commission decided to exercise regulatory forbearance until September 30, 2001 during which time the companies were expected to submit viable, time-bound plans for enhancing their paid-up capital to the requisite level. A few companies, however, did not make any serious attempt to meet the regulatory

requirement. Consequently, show cause notices were issued and opportunities of being heard were provided to the non-compliant companies. These companies were again encouraged to come up with reasonable plans to meet the requirement. Leasing companies that presented viable plans were given further time to implement their proposals. However, four companies failed to provide any workable plan to meet the minimum paid-up capital requirement and the Commission, in exercise of powers conferred under Rule 20 (2) of the Leasing Companies (Establishment and Regulation) Rules, 2000, cancelled their licenses to undertake leasing business.

(iii) Holding of Annual General Meetings

In terms of Section 158 of the Companies Ordinance, 1984, companies are required to hold their Annual General Meetings (AGMs) within six months of the close of the financial year. During the year, the Commission received applications from five leasing companies for extension in holding of AGMs, out of which two were adjudged to be on inadequate grounds and, therefore, rejected. Appropriate extension was granted to the remaining three companies.

(iv) Examination of Annual and Interim Accounts

Annual and interim accounts of leasing companies for the year ended June 30, 2001 were reviewed in light of the provisions of the Companies Ordinance, 1984, applicable International Accounting Standards (IASs) and the Leasing Companies (Establishment and Regulation) Rules, 2000. Deficiencies noted were pointed out to the managements of relevant companies for necessary rectification or clarification. Further, as appropriate, these companies were also advised to ensure that such lapses do not recur in future and to give adequate disclosures in their financial statements. A visible improvement in the financial reporting of leasing companies is evident due to enhanced monitoring and surveillance by the Commission.

(v) Inspection of Books of Account

During the year under review, inspection of books of accounts of a leasing company was carried out under Section 231 of the Companies Ordinance, 1984. This inspection was ordered by the Commission in order to verify that proper books were maintained by the company. The inspection also aimed at ascertaining the accuracy of claims of different financial institutions that the directors of the leasing company were involved in fraudulent activities. On the basis of the inspection, it was concluded that the company had maintained incomplete books of account in contravention of Section 230 of the Companies Ordinance. Further, it was observed that the directors and management of the company were exploiting weaknesses in the internal control system and appeared to be involved in fraudulent activities. In order

to delve further into this matter, an investigation by an independent firm of chartered accountants was initiated in terms of Section 265 of the Companies Ordinance, 1984. The inspectors were required to carry out a detailed investigation to determine the amount misappropriated by the management and to fix specific responsibility on the individuals concerned. In the meantime, findings of the inspection carried out under Section 231 have been forwarded to the National Accountability Bureau (NAB) for appropriate action.

(vi) Investigation into the Affairs of a Leasing Company

While reviewing the annual audited accounts of a leasing company, it was observed that the company was in a precarious financial position that could lead to insolvency, thereby raising doubts about the company's ability to continue as a going concern. The main reason for the deteriorating financial position of the company was its excessive investments (around 160 percent of its equity) in associated undertakings, which were under severe financial distress and not in a position to repay the leasing company. The Commission proceeded against the management under Section 208 of the Companies Ordinance, 1984 that restricts investment in associated undertakings to a maximum of 30 percent of paid-up capital and free reserves. The directors were duly penalized and also directed to reimburse the losses suffered by the company. Further, the company was directed under Section 472 of the Companies Ordinance, 1984 to make good the default within 30 days.

In addition to the above, an investigation into the affairs of the leasing company was initiated under Section 265 of the Companies Ordinance, 1984 as there were sufficient grounds to suspect that funds of the company had been misappropriated/ misapplied and the business of the company was being conducted to defraud its creditors and members. The inspectors have submitted their report to the Commission and appropriate penal proceedings are in progress.

(vii) Actions against Auditors

An order under Section 260 of the Companies Ordinance, 1984 was passed against a firm of chartered accountants. The firm, in its capacity as statutory auditors of a leasing company, had failed to discharge its duties in accordance with the provisions of the Companies Ordinance, 1984. Therefore, a fine of Rs. 2,000 was imposed on each partner of the firm for having issued an unqualified audit report to the members of the company despite material misstatements in financial statements on account of certain fake lease transactions.

3.3 Modarabas

3.3.1 Overview

The modaraba is an Islamic corporate form that is essentially akin to a two-tier fund structure. In a modaraba, one party (the modaraba management company) contributes its skills and efforts while the other (the modaraba certificate holders) provides the required funds. The profits earned in the business are shared between the management company and certificate holders on a pre-determined basis. A modaraba may be for a specific purpose or multi-purpose, and may be perpetual or floated for a specified period.

As on June 30, 2002, there were 46 modarabas in existence, of which 41 were operational with aggregate paid-up capital of Rs. 8.34 billion. Total assets of the modaraba sector stood at Rs. 18.49 billion while the aggregate equity amounted to Rs. 8.35 billion. The difficult operating environment prevailing in the recent past has had an adverse impact on the performance of a number of modarabas. However, despite the persistent economic slow-down, the sector, overall, has performed reasonably well. As per the last audited financial results, the dividend payout of the modaraba sector has been quite encouraging – 19 modarabas paid cash dividend, ranging between 1.5 percent to 46 percent as compared to 15 modarabas that paid dividend between 4 percent to 30 percent during the preceding year. The average payout of the modaraba sector compares favorably with any other segment of the corporate sector and Net Asset Value (NAV) of majority of modarabas remained above par during the year.

Fiscal incentives announced in the Finance Ordinance, 2002 for leasing modarabas are expected to give a significant boost to the performance of the sector through tax deferrals and reduced current tax liabilities. Moreover, better monitoring and surveillance methods, recently instituted by the Commission, have resulted in improved compliance by modaraba management companies with the Prudential Regulations and observance of significantly better disclosure standards.

Key statistics of the modaraba sector as on June 30, 2002, based on audited statements, are presented below.

S. No.	NAME OF MODARABA	PAID-UP FUND	RESERVES	EQUITY	ASSETS	PROFIT / (LOSS) AFTER TAX	DIVIDEND (%)
1	Al-Noor Modaraba	210.00	36.82	246.82	282.87	28.78	10
2	Allied Bank Modaraba	350.00	(123.85)	226.15	556.81	(40.46)	–
3	Al-Zamin Leasing Modaraba	177.05	41.66	218.71	813.11	2.86	2.5

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S. No.	NAME OF MODARABA	PAID-UP FUND	RESERVES	EQUITY	ASSETS	PROFIT / (LOSS) AFTER TAX	DIVIDEND (%)
4	B.F. Modaraba	51.41	(6.25)	45.16	50.26	4.70	7
5	B.R.R. International Modaraba	481.93	224.69	706.62	2,447.00	69.51	11
6	Constellation Modaraba	64.63	3.14	67.77	106.86	4.68	5.5
7	Crescent Modaraba *	226.19	80.66	306.85	1,892.00	3.38	–
8	Elite Capital Modaraba	113.40	(17.39)	96.01	111.81	2.38	–
9	Equity Modaraba	262.20	88.12	350.32	410.85	46.41	14
10	Fayzan Manufacturing Modaraba	900.00	7.90	907.90	1,490.00	38.50	3.4
11	Fidelity Leasing Modaraba	206.33	38.57	244.90	395.07	23.51	10
12	Financial Link Modaraba	100.00	(97.59)	2.41	2.60	(0.74)	–
13	General Leasing Modaraba	56.25	(52.16)	4.09	85.30	(11.47)	–
14	Grindlays Modaraba	374.22	321.18	695.40	2,466.00	172.44	40
15	Guardian Modaraba	163.13	19.20	182.33	571.96	10.80	5
16	Habib Bank Modaraba	397.07	126.38	523.45	706.86	83.56	16
17	Habib Modaraba	252.00	171.24	423.24	1,260.00	65.06	20
18	Hajveri Modaraba	205.32	(148.68)	56.64	74.50	(7.31)	–
19	IBL Modaraba	116.88	28.54	145.42	227.91	13.76	8.5
20	Imrooz Modaraba	30.00	28.48	58.48	149.36	19.10	50
21	Industrial Capital Modaraba	94.88	(95.55)	(0.67)	2.97	(19.83)	–
22	Interfund Modaraba	77.56	(65.66)	11.90	16.53	(12.23)	–
23	Islamic Modaraba	100.00	9.54	109.54	118.11	1.09	–
24	LTV Capital Modaraba	395.91	(485.94)	(90.03)	108.66	(13.75)	–
25	Mehran Modaraba	83.16	(48.80)	34.36	41.55	7.07	5
26	Modaraba Al-Tijarah	75.78	(56.94)	18.84	25.77	(9.32)	–
27	Modaraba Al-Mali	182.57	32.60	215.17	324.27	27.76	12.5
28	National Modaraba	51.80	(38.66)	13.14	29.74	0.14	–
29	Pak Modaraba	125.40	(56.56)	68.84	76.05	8.87	–
30	Paramount Modaraba	50.00	6.19	56.19	89.42	5.02	10
31	Professional Modaraba	77.67	15.50	93.17	102.43	2.60	–
32	Prudential Modaraba, 1st *	232.56	(138.77)	93.79	103.17	9.12	–
33	Prudential Modaraba, 2nd*	212.36	(121.67)	90.69	94.67	(33.87)	–
34	Prudential Modaraba, 3rd*	255.99	(109.61)	146.38	157.20	18.17	–
35	Punjab Modaraba	340.20	64.35	404.55	483.28	40.93	12
36	Tri-Star Modaraba, 1st	140.80	(57.54)	83.26	88.47	(0.46)	–
37	Tri-Star Modaraba, 2 nd	128.70	(89.72)	38.98	42.73	(1.68)	–
38	Trust Modaraba *	273.00	149.27	422.27	662.41	1.84	–
39	UDL Modaraba	263.87	65.33	329.20	757.44	9.73	5
40	Unicap Modaraba	136.40	(132.66)	3.74	13.29	(1.67)	–
41	Unity Modaraba *	300.00	(250.45)	49.55	50.87	14.30	–
	TOTAL	8,336.62	(635.09)	7,701.53	17,490.16	583.28	

* Un-audited figures as on June 30, 2002

3.3.2 Regulatory Actions

- (i) Registration of New Modaraba Company**
During the year under review, one modaraba company was registered under the Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980 (Modaraba Ordinance). The company intends to float or acquire a multi-purpose perpetual modaraba.
- (ii) Mergers and Consolidation**
The Commission continued its policy of encouraging mergers within the financial sector as these are expected to result in improved economies of scale and operational synergies. During the year under review, Guardian Leasing Modaraba merged with First Providence Modaraba while Ghandhara Leasing Limited merged with Al-Zamin Leasing Modaraba.
- (iii) Annual Review Meetings of Modarabas**
The Commission has recently introduced the concept of annual review meetings in the modaraba sector as there is no provision for holding of AGMs under the Modaraba Ordinance. Annual review meetings were held by modarabas in December 2001, thus providing a forum for the certificate holders to voice their views about the performance of modarabas and the respective management companies.
- (iv) Submission of Quarterly Accounts**
The Modaraba Wing pursued the Commission's policy of ensuring maximum disclosure of material information through financial statements. In this regard, a circular was issued to all modarabas requiring them to submit quarterly accounts within specified time periods.
- (v) Amendments in Modaraba Ordinance and Rules**
The Modaraba Wing, in consultation with the Modaraba Association of Pakistan (MAP), undertook a detailed review of the Modaraba Ordinance and Modaraba Companies and Modaraba Rules, 1981 to propose necessary amendments therein. The proposed amendments cover *inter alia* the following:

 - (a) increase in paid-up capital requirement for modaraba companies;
 - (b) de-registration of modaraba management company if it fails to float a modaraba within a reasonable time period;
 - (c) enabling provision to allow extension in filing/ circulation of annual accounts under special circumstances;
 - (d) provision to allow voluntary winding up of perpetual modarabas as against winding up through the Modaraba Tribunal;

- (e) rotation of statutory auditors after every five years; and
- (f) rationalization and synchronization of Modaraba Companies and Modaraba Rules, 1981 and regulations with the provisions of Modaraba Ordinance.

Further amendments have been proposed to require financial statements of modarabas to be prepared in accordance with IASs. In addition, format of auditors' report to the modaraba certificate holders is also proposed to be revised in order to delineate the responsibilities of auditors and management and to ensure that financial statements of modarabas conform with IASs. The amendments are being reviewed by the Ministry of Finance and would be notified in the official Gazette after necessary clearance.

(vi) Approval of CEOs and Directors

During the year under review, after due process, approval was granted for the appointment of four CEOs and 18 directors in 16 modaraba management companies.

3.3.3 Monitoring and Enforcement

(i) Amendments in the Prudential Regulations for Modarabas

The Prudential Regulations for modarabas were reviewed with a view to reducing information asymmetry. A time-based provisioning criterion has been proposed in the Prudential Regulations to ensure that a true and fair view of the classified portfolio of modarabas is presented in their financial statements.

(ii) Special Audits of Modarabas

The Modaraba Wing maintained effective off-site monitoring of the sector by reviewing periodic returns/ information submitted by each modaraba. Special audits of four modarabas were conducted during the year and appropriate action under the law was taken against the concerned management companies and their directors.

(iii) Penalties and Warnings

Show cause notices were issued to six modaraba management companies and their CEOs and directors to explain their position with regard to violations of the Modaraba Ordinance, Modaraba Companies and Modaraba Rules, 1981 and regulations. After necessary due process, including the opportunity of hearing, the Registrar Modaraba imposed penalties aggregating Rs. 10.61 million, under Section 32 of the Modaraba Ordinance. In addition to the imposition of penalties, warnings were issued to certain modaraba companies for procedural lapses observed in conducting the affairs of modarabas.

(iv) Directives for Repayment of Misappropriated Funds of Modarabas

During the year, the Modaraba Wing issued directives and obtained undertakings from the management of two modaraba companies to deposit specified amounts misappropriated from the funds of the modarabas.

- (a) The directors of a modaraba company were directed to deposit Rs. 10.8 million in the modaraba fund in respect of amounts drawn from the modaraba on account of salary and remuneration of CEO, in violation of Section 17 (2) of the Modaraba Ordinance. The management company has paid back the entire amount to the modaraba.
- (b) The directors of another modaraba company were directed to deposit Rs. 8.08 million in the modaraba fund to repay loan granted to the management company by the modaraba in violation of Section 17 (2) of the Modaraba Ordinance. Consequently, the modaraba company paid back Rs. 4.01 million (almost 50 percent of the loan amount) to the modaraba while the balance would be repaid shortly.

(v) Change of Management of Modarabas

On account of mismanagement and embezzlement of funds of modarabas, registration of two modaraba companies was cancelled under the provisions of Section 19 of the Modaraba Ordinance. New management companies were appointed under Section 20 of the Modaraba Ordinance to manage and revive these modarabas.

The CEO and directors of another modaraba company were issued a show cause notice for mismanaging the affairs of the modaraba and embezzling its funds. After the charges were established, penalties were imposed and a directive was issued to transfer the management of the modaraba voluntarily to a party that could revive the modaraba. The change of management has taken place with the approval of the Commission.

(vi) Criminal Complaints

Criminal complaints under the Modaraba Ordinance have been lodged in the Modaraba Tribunal against certain modaraba companies and their directors for embezzlement of funds and non-filing of audited accounts of the modarabas.

3.4 Mutual Funds

3.4.1 Overview

The mutual funds industry in Pakistan dates back to 1962 when National Investment Trust Limited (NIT) was set up in the public sector to float the first open-end fund. The aim of this mutual fund was to encourage and mobilize savings that could be channeled into productive sectors of the economy. In 1966, the Government promulgated an Ordinance to set up the Investment Corporation of Pakistan (ICP) and enabled it to float closed-end mutual funds. Subsequently, ICP floated 26 closed-end funds over a period of about 30 years.

In 1971, the Investment Companies and Investment Advisors Rules were framed to facilitate entry of the private sector in the mutual funds industry. These Rules provide the framework and necessary monitoring mechanism for closed-end funds. Until 1996, 13 private sector closed-end mutual funds were floated, three of which have merged during the past two years. For regulation of open-end mutual funds, the Asset Management Companies Rules were issued in 1995. So far, four open-end schemes under the Asset Management Companies Rules, 1995 have been authorized by the Commission.

The total market capitalization of the mutual funds sector was Rs. 26 billion as on June 30, 2002 representing around 6 percent of the total market capitalization of the stock market. Dividend payout by mutual funds showed slight improvement during the year under review, which was largely owing to better equity investment opportunities to mutual funds as a result of favorable stock market conditions.

Key statistics of public sector closed-end mutual funds as on June 30, 2002, based on audited financial statements, are given below.

TABLE 11 Key Statistics of Public Sector Closed-end Funds								
S. No.	NAME OF FUND	LISTED CAPITAL	PAR VALUE	NAV	MARKET VALUE	D I V I D E N D (%)		
		Rs. in Million	Rs.	Rs.	Rs.	2000	2001	2002
1	1st ICP	50.00	10.00	12.86	9.95	12.00	13.00	17.00
2	2nd ICP	50.00	10.00	10.93	6.95	–	12.00	18.00
3	3rd ICP	50.00	10.00	15.56	11.60	10.00	16.00	29.00
4	4th ICP	50.00	10.00	31.66	20.40	30.00	37.00	45.00
5	5th ICP	50.00	10.00	12.58	8.00	–	11.00	17.00
6	6th ICP	50.00	10.00	22.99	14.50	10.00	25.00	30.00
7	7th ICP	50.00	10.00	13.94	6.45	–	9.00	15.00
8	8th ICP	50.00	10.00	20.07	16.00	20.00	32.00	48.00
9	9th ICP	50.00	10.00	17.45	33.50	50.00	60.00	165.00
10	10th ICP	50.00	10.00	12.93	13.00	15.00	18.00	60.00
11	11th ICP	50.00	10.00	16.45	12.90	15.00	17.00	28.00
12	12th ICP	50.00	10.00	15.69	9.50	–	19.00	23.00
13	13th ICP	50.00	10.00	34.11	17.25	20.00	28.00	35.00
14	14th ICP	50.00	10.00	13.18	7.75	10.00	18.00	13.00
15	15th ICP	50.00	10.00	13.80	6.75	–	10.00	17.00
16	16th ICP	50.00	10.00	10.33	4.20	7.00	7.50	10.00
17	17th ICP	50.00	10.00	14.08	7.20	12.00	10.00	16.00
18	18th ICP	50.00	10.00	10.46	4.60	–	9.00	12.00
19	19th ICP	50.00	10.00	16.76	9.90	–	17.00	23.00
20	20th ICP	50.00	10.00	16.66	9.50	–	16.00	21.00
21	21st ICP	100.00	10.00	4.82	2.40	–	5.00	9.00
22	22nd ICP	200.00	10.00	8.92	3.75	–	6.00	11.00
23	23rd ICP	200.00	10.00	4.64	1.95	3.50	–	–
24	24th ICP	400.00	10.00	5.15	1.80	4.50	–	–
25	25th ICP	400.00	10.00	8.59	3.70	–	6.00	7.50
26	SEMF	840.00	10.00	26.95	18.85	12.00	22.00	26.00
TOTAL		3,140.00						

Key statistics of private sector closed-end mutual funds as on June 30, 2002, based on audited financial statements, are as follows:

TABLE 12 Key Statistics of Private Sector Closed-end Funds

S. No.	NAME OF FUND	LISTED CAPITAL	PAR VALUE	NAV	MARKET VALUE	DIVIDEND (%)		
		Rs. in Million	Rs.	Rs.	Rs.	2000	2001	2002
1	Security Stock Fund Limited*	-	-	-	-	32.50	4.00	-
2	Dominion Stock Fund Limited	50.00	10.00	3.17	1.60	-	-	-
3	Tri-Star Mutual Fund Limited	50.00	10.00	3.21	0.35	-	-	-
4	Safeway Mutual Fund Limited **	30.00	10.00	3.18	2.90	-	-	-
5	First Capital Mutual Fund Limited	150.00	10.00	5.71	2.60	5.00	-	-
6	BSJS Balanced Fund Limited	340.00	10.00	12.35	9.00	31.00	11.00	15.00
7	Golden Arrow Fund Limited	81.05	5.00	5.44	2.65	-	-	-
8	Al-Meezan Mutual Fund Limited	250.00	10.00	10.68	7.05	21.00	6.60	16.00
9	KASB Premier Fund Limited	400.00	10.00	8.95	6.00	-	3.50	5.00
10	Prudential Stock Fund Limited	60.00	10.00	3.10	0.85	-	-	2.50
11	Asian Stock Fund Limited **	100.00	10.00	3.71	1.50	10.00	-	-
12	Growth Mutual Fund Limited	100.00	10.00	(0.13)	1.90	-	-	-
TOTAL		1,611.05						

* Acquired by BSJS Balanced Fund Limited during the year
** NAV – unaudited as on June 30, 2002

Key statistics of open-end mutual funds as on June 30, 2002, based on audited financial statements, are presented below.

TABLE 13 Statistics of Open-end Funds

S. No.	NAME OF FUND	NET ASSETS	PAR VALUE	NAV	MARKET VALUE		DIVIDEND (%)		
		Rs. in Million	Rs.	Rs.	Offer Price	Re-Purchase Price	2000	2001	2002
1	Public Sector								
	NIT	17,414.00	10.00	10.89	12.70	12.10	5.50	12.00	12.00
2	Private Sector								
	Unit Trust of Pakistan	897.00	5,000.00	5,397.00	6,255.00	6,132.00	22.50	12.00	15.00
	Pakistan Stock Market Fund	323.00	50.00	50.31	52.58	50.21	-	-	-
	Pakistan Income Fund	310.00	50.00	51.94	54.26	51.82	-	-	-

The Commission has been actively involved in promoting the mutual funds sector and creating an environment conducive to investments through collective investment schemes. Some of these developmental efforts are listed below:

(i) Provident Funds Allowed to Invest in Unit Trust Schemes

In order to promote investment through mutual funds, the Commission issued a notification whereby provident funds were allowed to invest up to 50 percent of their funds in unit trust schemes authorized by the Commission and, further, to expose up to 20 percent of their funds to a single scheme.

(ii) Credit Rating of Unit Trust Schemes Made Obligatory

The Commission made it obligatory upon asset management companies to get the unit trust schemes managed by them rated by a rating agency registered with the Commission. Management companies were also required to widely disseminate ratings of their funds so that institutional as well as individual investors could make informed decisions.

(iii) Tax Relief Sought for Mutual Funds and their Investors

During the year under review, the following changes in the tax laws were secured through the Finance Ordinance, 2002:

- (a) Clause 103 of Part I of the Second Schedule to the Income Tax Ordinance, 2001 has been amended. Through this amendment, exemption from tax on the capital gains portion of dividend has been extended to unit holders/ shareholders of a unit trust scheme or mutual fund in line with the exemption previously available to unit/ certificate holders of public sector mutual funds only.
- (b) A new clause 47B has been added in Part IV of the Second Schedule to the Income Tax Ordinance, 2001. Under the new clause, unit trust schemes and mutual funds have been exempted from levy of withholding tax on receipt of income from dividends, etc.
- (c) Recognized provident funds established by employers, not being companies, can invest in mutual funds up to the limits specified in sub-Rule (1) of Rule 102 of the Income Tax Rules, 2002.
- (d) Approved institutions, trusts, societies or organizations can also invest in mutual funds up to the limits specified in clause (i) of sub-Rule (1) of Rule 213 of the Income Tax Rules, 2002.

The Commission is pursuing further amendments in the Income Tax Ordinance, 2001, the Zakat and Ushr Ordinance, the Companies Ordinance, 1984 and the Employees Old Age Benefits (Investment) Rules to encourage investments in mutual funds.

(iv) Fund Managers to Demonstrate Relevant Expertise

In an effort to maintain minimum standards within the mutual funds sector, the Commission has ensured adherence to strict eligibility criteria for entry into the sector. The credentials of the sponsors of schemes are scrutinized in detail and the professional background, qualifications and expertise of personnel are assessed to ensure that only qualified professionals are entrusted with the task of managing the pooled savings of individual investors. Foreign technical partnership with an international asset management company is emphasized for those wishing to float an equity market fund. On-going technical collaboration with established international fund managers is considered important to enable the transfer of technical knowledge and know-how from experienced professionals from around the world as well as to ensure that local funds adopt the international best practices for management and governance of mutual funds. All the open-end mutual funds operating in the private sector, namely, Unit Trust of Pakistan (UTP), Pakistan Income Fund and Pakistan Stock Market Fund have been set up with international technical collaboration. It is expected that with greater expertise at their disposal, these funds will be able to perform better with a demonstration effect for the rest of the sector.

(v) Study of Mutual Funds Industry

During the year under review, the Commission hired the services of a UK based consultancy firm, Cadogan Financial, to study the state of the mutual funds industry in Pakistan and suggest measures for its development. The consultants made a number of recommendations, which were examined by the Commission for improving the effectiveness of its regulatory and monitoring measures. A number of these recommendations have been adopted either as part of proposed amendments in the relevant rules or in terms of ongoing monitoring and surveillance activities of the SCD. The consultants also conducted a training program for officers of the SCD.

(vi) Registration of Mutual Funds Association of Pakistan

Several fund managers had proposed to the Commission the establishment of a representative body for the industry. During the year, the Ministry of Commerce issued a license to the Mutual Funds Association of Pakistan (MUFAP) as an association under the Trade Organizations Ordinance, 1961, subsequent to its incorporation under the Companies Ordinance, 1984 and clearance of its memorandum of association by the Commission. MUFAP's main objective is to encourage investments through closed-end and open-end mutual funds.

3.4.2 Regulatory Initiatives

(i) Investment Companies and Investment Advisors Rules, 2002

A draft notification has been submitted to the Ministry of Finance seeking to replace the Investment Companies and Investment Advisors Rules, 1971 with the Investment Companies and Investment Advisors Rules, 2002. Salient features of the new rules are as follows:

- (a) Floatation of closed-end funds has been allowed in corporate as well as trust form. This structural flexibility will, in particular, facilitate privatization of ICP mutual funds.
- (b) Conversion of a closed-end fund into an open-end fund with prior approval of the Commission has been allowed. The Commission may permit such a conversion by evaluating the proposal of fund managers and the performance of the fund.
- (c) The responsibility for safe custody of all assets of a fund has been entrusted to a separate custodian.
- (d) Auditors of investment advisors have been restricted from being appointed as auditors of relevant mutual funds. Moreover, rotation of auditors of funds after every three years has been made mandatory. The Commission may also order special audit of a fund if the circumstances so warrant.
- (e) Penal provisions have been included for intentional and willful defaults by fund managers.
- (f) Floatation of money market and other special purpose funds has been made possible.
- (g) A revised remuneration structure of fund managers, in line with the current industry practice, has been prescribed.
- (h) The component of capital gains has been excluded in calculating mandatory distribution of income of a mutual fund. The amendment is expected to provide liquidity to fund managers and enhance NAV of funds.
- (i) More than 50 per cent of directors on the boards of investment companies are required to be independent of the investment advisors.
- (j) Annual renewal of investment advisors' license has been stipulated.

(ii) Amendments in the Asset Management Companies Rules, 1995

Amendments have been proposed in the Asset Management Companies Rules, 1995 that aim at introducing effective monitoring and surveillance mechanisms to gauge performance of open-end funds. Necessary provisions have been included for special audit and eligibility criteria for statutory auditors of a scheme. The amendments also require management companies to submit periodic statements on various activities of the schemes. The borrowing limit available to a scheme has been revised downward from 25 per cent of

assets of a scheme to 15 per cent and a repayment schedule of 90 days has been prescribed to reduce the risk of excessive leverage.

(iii) Permission Granted for Launch of Two Schemes with Nine Administrative Plans

Upon its registration by the Commission, Arif Habib Investment Management Limited presented constitutive documents and offer documents of two open-end schemes and nine subordinate schemes, which it intended to offer to the public for investment. The Commission authorized the launch of the schemes and administrative plans after an extensive scrutiny of relevant documents. A total of 22 corporate entities, banks, financial institutions and brokers contributed in the initial capital of these schemes; the initial capital shall remain invested in the schemes for a period of two years in accordance with the rules.

The constitutive documents of the schemes contain certain key features, like continuous compliance audit, monthly reporting to the trustee, daily announcement of NAV-based prices, rotation of auditors after three years and appointment of auditors with the consent of the trustee. One of the schemes is equity-based while the other is focused on investments in short-term debt instruments and securities, including COT transactions. The subordinate plans of both the schemes offer a range of products tailored to the needs of a wide range of clientele with varying investment and risk profiles, particularly retail investors.

(iv) Registration of Asset Management Companies and Investment Advisors

During the year, an asset management company, namely, United Asset Management Company Limited, a subsidiary of United Bank Limited, was registered under the Asset Management Companies Rules, 1995. Also, two investment advisors, namely, ANZ Capital Pakistan (Private) Limited and United Asset Management Company Limited were registered under the Investment Companies and Investment Advisors Rules, 1971. With the registration of these companies, the number of investment advisors and asset management companies, registered with the Commission, has risen to 57 and four, respectively.

The Commission also allowed change of management of two investment advisors in view of inability of their managements to prudently manage the relevant funds and to meet the minimum capital requirement. The newly approved fund managers have submitted proposals to the Commission for reviving the funds and increasing the capital.

(v) Launch of First Money Market Fund

The Commission authorized United Asset Management Company to launch a fund that aims at investing exclusively in money market instruments. The promoters have been allowed four months from the date of authorization to submit the offer document of the scheme for scrutiny by the Commission and to commence operations.

(vi) Permission Granted to ABAMCO Limited for Launch of Second Fund with Reduced Seed Capital

During the year, ABAMCO Limited proposed floatation of a second income fund. The company is already managing an open-end fund, i.e. UTP. In view of the overall satisfactory financial performance of the existing open-end fund under the company's management, the Commission has conveyed its approval, in principle, to the launch of the proposed fund under Rule 10 of the Asset Management Companies Rules, 1995 with reduced seed capital of Rs. 50 million.

(vii) Merger of Security Stock Fund with BSJS Balanced Fund

BSJS Balanced Fund, which had acquired Confidence Mutual Fund last year, presented a proposal for merger with Security Stock Fund. The Commission cleared the scheme of merger in view of potential synergies in operations and similarities in investment objectives of the funds. The merged entity is to be managed by ABAMCO Limited, which is also managing UTP.

3.4.3 Monitoring and Enforcement

(i) Introduction of Periodic Returns

To enhance monitoring and surveillance, the Mutual Funds Wing prescribed certain periodic returns to be filed by mutual funds during the year under review. These periodic returns consist of four statements, namely, statement of assets and liabilities, statement of investments, statement of transactions with associated undertakings and statement of brokerage charges. The off-site monitoring of mutual funds has enhanced substantially through review of these periodic returns.

(ii) Investigations into the Affairs of an Investment Advisor

During the last half of 2001, the Commission had ordered an investigation into the affairs of an investment advisor on observing deterioration in its financial position and gross negligence in the management of the mutual fund. The investigation report noted the following violations:

- (a) non-maintenance of register of transfer of shares;
- (b) non-maintenance of proper books of account; and
- (c) false and misleading financial statements prepared by the management.

On the basis of findings of this investigation report, penalties were imposed during the year under review on the management of the fund for violation of statutory requirements. Subsequently, the management of the fund was also changed. The new management is trying to revive the fund.

(iii) Investigations into the Affairs of a Closed-end Mutual Fund

The Commission ordered an investigation into the affairs of a closed-end mutual fund on observing deterioration in its financial position and non-payment of dividends to its shareholders since inception. Upon receiving the investigation report, appropriate penal actions were taken against the management for violation of statutory requirements. The violations are summarized below:

- (a) non-maintenance of register of transfer of shares;
- (b) non-maintenance of proper books of account;
- (c) non-maintenance of securities with the custodian; and
- (d) loan to investment adviser in violation of Rule 8 (c) of the Investment Companies and Investment Advisors Rules, 1971.

(iv) Examination of Annual and Quarterly Accounts

All mutual funds are required to submit annual as well as quarterly accounts to shareholders, stock exchanges and the Commission. A standardized checklist was devised to examine these accounts, keeping in view the disclosure requirements laid down in the laws governing mutual funds. During the year under review, published accounts were thoroughly examined and the managements of several funds were asked to explain their position with regard to deficiencies noted in the financial statements. As a result of strict monitoring by the Commission, the quality as well as presentation of financial statements of mutual funds has improved considerably.

(v) Actions against Auditors

During the year under review, it was observed that certain auditors had failed to act in conformity with the statutory requirements and material facts had not been brought to the notice of members. Action was initiated against such auditors for misconduct and negligence. These cases were also referred to the Institute of Chartered Accountants of Pakistan (ICAP) for appropriate action.

(vi) Implementation of IAS 39

During the year, on the recommendation of ICAP, the Commission notified IAS 39 entitled "Financial instruments: recognition and measurement" for adoption by listed companies in preparation of their financial statements. This accounting standard will have a significant impact on the presentation of

financial statements of mutual funds. Under IAS 39, four categories of financial assets have been established, with the accounting treatment being different for each category. Most investments of mutual funds in securities are likely to be categorized as 'financial assets held for trading' as these securities are primarily acquired and held by mutual funds for the purpose of generating profit from short-term fluctuations in prices to enhance their underlying NAVs.

3.5 Venture Capital Companies and Venture Capital Funds

During the year, TMT Venture Limited was registered as the first venture capital company under the Venture Capital Companies and Venture Capital Funds Rules, 2001 (VCC & VCF Rules). The company has a paid-up capital of Rs. 5 million and has invested in Information Technology (IT) related projects.

The Commission also notified characteristics of venture projects in terms of Rule 2 (f) of the VCC & VCF Rules. Investments in such projects will be allowed tax exemptions notified by the CBR.

The Commission had proposed that venture capital companies and venture capital funds be exempted from application of tax for a period of ten years from the date of their registration. However, the tax exemption actually allowed is for a specific, limited period of seven years only, i.e. from July 1, 2000 to June 30, 2007.

3.6 Special Purpose Vehicles for Asset Backed Securitization

Securitization is an effective tool used by companies in developed as well as developing countries for improving balance sheet liquidity and reducing overall financial costs. This technique was not, however, being used in Pakistan. Certain tax anomalies and lack of guidelines for banks/ NBFIs for participating in securitization transactions had been major impediments in the growth of this structured finance instrument. Although the Commission notified the Companies (Asset Backed Securitization) Rules in December 1999, necessary guidelines for banks/ NBFIs, desirous of participating in asset securitization transactions in various capacities (i.e. as originator, arranger, investor, etc.) through Special Purpose Vehicles (SPVs), have just recently been finalized by SBP.

During the year, the Commission granted the first certificate of registration to First Securitization Trust to operate as an SPV under the Companies (Asset Backed Securitization) Rules, 1999. The Trust envisages raising funds amounting to Rs. 100 million for PILCORP through issuance of debt securities against PILCORP's specific

vehicle lease receivables. In addition, another application for registration of an SPV is under active consideration of the Commission. With successful implementation of these two ground-breaking transactions that could serve as models for others to follow, it is expected that securitization would develop as a useful structured finance instrument that would help companies to improve liquidity and raise funds at lower all-in cost.

3.7 Credit Rating Companies

3.7.1 Notification of Ratings by Rating Agencies

Credit rating reports serve as useful tools for investors to make informed investment decisions in respect of various listed and non-listed debt instruments. Credit ratings are also one of the factors considered by the regulator in approving issues of corporate debt for public subscription. The Commission has made it obligatory upon credit rating agencies to notify ratings in newspapers within two working days of issuance of ratings and provide copies of rating reports to the relevant stock exchanges and the Commission within 10 working days of the notification of such ratings. Any change in the rating also needs to be intimated immediately.

3.7.2 Amendments in Credit Rating Companies Rules, 1995

The Credit Rating Companies Rules, 1995 were amended during the year. The significant amendments are as follows:

- (i) Prior approval of the Commission is required for replacing the chairman and the CEO of a rating agency.
- (ii) The CEO of a rating agency has been prohibited to hold similar position in any other entity.
- (iii) The Commission may exempt rating agencies from the requirement of technical collaboration or joint venture arrangements, envisaged in Rule 3 of the Credit Rating Companies Rules, 1995, after a period of five years. This exemption may be granted by the Commission upon being satisfied with the capabilities and performance of the rating agency.
- (iv) Rating agencies are required to inform the Commission before undertaking the rating assignment of an entity in which any of its directors is holding a directorship by virtue of nomination by the Federal or Provincial Government. Such a director would also be required to submit an undertaking that he would not take part in the rating process of that entity.

3.8 Oversight of Accountancy Profession

The SCD maintains oversight of the accounting profession through processing the recommendations of ICAP for adoption of IASs, suggesting improvements in financial reporting framework of companies and proposing measures to enhance the quality

of disclosures in financial statements of companies. During the year under review, the SCD was actively involved in introducing the first Code of Corporate Governance for Pakistan. To facilitate smooth implementation of the Code, the Accountancy Cell of the SCD remains the focal point within the Commission; promptly resolving queries from companies pertinent to the Code.

The role of professional accountants has gained immense importance in the wake of the Enron debacle. Efficient working of the capital market demands the highest standards of accounting, disclosure and transparency. Accounting and auditing firms have immense public responsibility; hence it is necessary to strengthen the existing system for guarding against audit failures and preventing investor losses. Recognizing the need for improving the quality of financial reporting, the Commission has taken a number of steps during the year in this respect, including rotation of auditors, restriction on auditors to provide non-audit services to their listed audit clients and enhancement of penalties on auditors in case of professional misconduct.

3.8.1 Chartered Accountants (Amendment) Ordinance, 2002

A draft Chartered Accountants (Amendment) Ordinance submitted by ICAP was reviewed by the Commission and, after suitable amendments, forwarded to the Ministry of Finance in June 2001. This Ordinance envisages a number of amendments in the Chartered Accountants Ordinance, 1961. It primarily seeks to provide a more effective regulatory framework for the profession of chartered accountants. The proposed amendments are essentially designed to convert the Chartered Accountants Ordinance into an 'enabling law' that lays down the basic framework, leaving all operative matters to be covered in the bye-laws.

During the year under review, the draft Ordinance was vetted by the Ministry of Law, Justice and Human Rights pursuant to extensive discussion between the Commission and the Ministry of Finance.

3.8.2 Amendments in Chartered Accountants Bye-laws, 1983

The Council of ICAP is empowered under the Chartered Accountants Ordinance, 1961 to make bye-laws for the purpose of carrying out the objects of the said Ordinance. The existing Chartered Accountants Bye-laws were notified by ICAP on November 1, 1983. These bye-laws have since been amended from time to time.

During the year, ICAP proposed amendments in certain bye-laws to give effect to the recently introduced modular examination structure. These amendments were reviewed by the Commission and notified in the official Gazette after obtaining approval of the Ministry of Finance.

3.8.3 Adoption of IASs

The Commission has so far adopted all IASs issued by the International Accounting Standards Board, except two that are not considered relevant to the economic circumstances in Pakistan and another one that is yet to be recommended by ICAP. These accounting standards govern the financial reporting framework of listed companies in terms of Section 234 of the Companies Ordinance, 1984.

During financial year 2002, the Commission notified for adoption IAS 22 'Business combinations', IAS 36 'Impairment of assets', IAS 39 'Financial instruments: recognition and measurement' and IAS 40 'Investment property' pursuant to the recommendations of ICAP. Moreover, IAS 35 'Discontinuing operations', IAS 37 'Provisions, contingent liabilities and contingent assets' and IAS 38 'Intangible assets' were re-notified with full text. The Commission also extended the scope of IAS 30 'Disclosures in the financial statements of banks and similar financial institutions' to investment banks, modarabas (other than trading modarabas) and leasing companies.

3.8.4 Code of Corporate Governance

The Code was issued by the Commission in March 2002 and made a part of the listing regulations of the three stock exchanges. The Code has been discussed in detail in Chapter 8 "Other Developments".

The Commission has identified a number of measures to facilitate effective implementation of the Code. While the queries of companies regarding the various provisions of the Code are being addressed on a day-to-day basis, workshops of directors and executives of listed companies were also arranged during the year under the auspices of major academic institutions to familiarize them with their responsibilities under the Code.

3.8.5 Measures to Improve the Quality of Statutory Audit of Listed Companies

The Commission has taken numerous steps to ensure that statutory auditors of listed companies conduct audits with independence, due care and competence. These steps are aimed at restoring public confidence in the financial information disseminated by companies.

During the year under review, directives were issued to the three stock exchanges to appropriately amend their listing regulations in order to enforce the following requirements on listed companies:

(i) Facilitating the Quality Control Review Program of ICAP

The Quality Control Review (QCR) program is being carried out by ICAP to ensure that audits are conducted by its members in accordance with the applicable auditing standards and relevant laws and regulations. It involves

a review of the working papers of audit firms by chartered accountants employed by ICAP. The QCR program is expected to substantially enhance the quality of audits. The Commission, therefore, considered it expedient to require listed companies to facilitate this program by giving their consent to statutory auditors to release their audit working papers to the ICAP reviewers.

(ii) Restriction on Providing Non-audit Services to Audit Clients

Over the years, auditing firms have transformed themselves into 'professional services' entities that derive an increasing portion of revenues and profits from non-audit services, like consultancy and advisory services. Where the auditors provide such non-audit services to their audit clients, conflicts of interest may arise. As such, auditors may become beholden to management for additional remunerative work, like consultancy assignments, at a time when they are required to be reporting on the financial statements prepared by the same management. Often, fees from consultancy and advisory assignments are large enough to lure auditors to compromise on their independence.

Through a directive to the stock exchanges, the Commission has prohibited listed companies to appoint statutory auditors or their associates for providing non-audit services. It is expected that this restriction would largely curtail situations causing conflict of interest. Certain services that are synergistic to the audit and are not likely to infringe on the independence of auditors have been exempted from this restriction. The exempted services are as follows:

- (a) attestation, certifications, special purpose audits/ reviews and agreed-upon procedures as defined in the International Standards on Auditing;
- (b) taxation services;
- (c) opinion on accounting standards;
- (d) Information Risk Management Assurance and Risk Management Reviews;
- (e) corporate law compliance services including representation before authorities; and
- (f) financial due diligence exercise in relation to acquisitions and mergers.

(iii) Debarment of Auditors

Given the growing evidence of auditors' negligence in corporate failures and the resultant investor losses, the Commission decided to restrict listed companies from appointing auditors who have been found guilty of professional misconduct, for a period of up to three years. This measure would help to ensure that an auditor, grossly negligent in his duties, is adequately penalized.

(iv) Further Measures Prescribed in the Code

The Commission has also spelled out a number of requirements regarding external auditors in the Code. The significant requirements are summarized below.

- (a) In order to qualify for appointment, the auditor should possess a satisfactory rating under the QCR program of ICAP.
- (b) Auditors should comply with the International Federation of Accountants' (IFAC) Guidelines on Code of Ethics, as adopted by ICAP.
- (c) Auditors should be rotated after every five years. Although this requirement was initially applicable from the forthcoming AGM of companies, it has now been phased-in by the Commission. Accordingly, no regulatory action will be taken by the stock exchanges, up to December 31, 2003, against listed companies that fail to rotate their auditors. However, non-compliance with this condition after December 31, 2003 would render companies liable to penal action under the listing regulations.
- (d) A 'cooling down' period of two years has been prescribed before partners and employees in the firm of auditors can be appointed as directors or CEO or CFO or internal auditor in listed audit clients.

3.8.6 Corporate Secretaries Ordinance, 2002

The Commission has proposed promulgation of Corporate Secretaries Ordinance to the Ministry of Finance. The Ordinance has been vetted by the Ministry of Law, Justice and Human Rights and is presently with the Ministry of Finance. Through this Ordinance, the Institute of Corporate Secretaries of Pakistan (ICSP) will be granted the status of a statutory body. ICSP 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 660 qualified professionals.

4. Enforcement and Monitoring Division



- 4.1 Overview
- 4.2 Regulatory Actions
- 4.3 Monitoring and Enforcement
- 4.4 Cost Audits

4. Enforcement and Monitoring Division

4.1 Overview

The Enforcement and Monitoring Division (EMD) is responsible for regulation and monitoring of all listed companies, other than insurance companies and specialized companies, which at present number more than 600. The EMD seeks to ensure transparency in financial reporting of listed companies and compliance with relevant laws and IASs with the aim of protecting the interests of minority shareholders, creditors and other stakeholders.

During the year under review, the EMD took appropriate measures to ensure timely holding of AGMs by listed companies and circulation of their annual and interim accounts within the prescribed period. The EMD's regulatory and enforcement actions were also focused towards discouraging unauthorized and unlawful inter-corporate financing, non-payment of dividends, irregularities and mismanagement, oppression, poor financial performance, non-compliance with statutory requirements and inadequate or misleading disclosures in accounts of companies under its purview. The EMD ordered investigations into the affairs of various listed companies during the year. Based on the findings in inspectors' reports, appropriate penal actions were taken against directors of these companies and their statutory auditors for negligence and professional misconduct.

There has been a visible improvement in the corporate governance structure of listed companies as a result of stricter corporate discipline and higher standards of transparency prescribed by the EMD. Proactive monitoring by the EMD considerably improved compliance with corporate laws and IASs by listed companies that helped to engender confidence among investors and the general public. The auditors of listed companies have also become more vigilant in performing their statutory duties.

4.2 Regulatory Actions

4.2.1 Mergers and Amalgamations

The Commission has been proactive in facilitating mergers and amalgamations among companies in order to strengthen their capital base and achieve economies of scale. Consolidation within the corporate sector will enhance its capacity to deal with systemic risk and to withstand exogenous shocks. During the year under review, the EMD received 20 merger applications, of which seven schemes of arrangement were approved by the concerned High Courts and the SBP, two were rejected while 11 schemes of arrangement were pending at the end of the year.

The Commission carefully examines schemes of arrangement proposed by companies to ensure that they are not prejudicial to the interests of minority shareholders. In

case a scheme of arrangement appears to be detrimental to the interests of minority shareholders, the concerned registrar makes a representation before the Court under Section 288 of the Companies Ordinance, 1984 after obtaining comments of the EMD in this respect. During the year, the proposed merger of Kohinoor Raiwind Mills Limited and Kohinoor Gujar Khan Mills Limited with Kohinoor Textile Mills Limited was rejected by the Honorable Lahore High Court on the representation of the Commission and small shareholders. In another case, the merger of Parke Davis and Company Limited with Pfizer Laboratories Limited was rejected by the Honorable Sindh High Court.



Mr. Rashid Sadiq, Executive Director, EMD (centre) with officers of the Division

4.2.2 Directive to Listed Companies for Circulation of Quarterly Accounts

In November 2001, the Commission issued a notification to require listed companies to circulate quarterly accounts to their shareholders, the Commission, registrar and stock exchanges within one month of the close of every quarter in an accounting year. This requirement was in line with international best practice and the Commission's policy to ensure maximum disclosure to shareholders at regular intervals. The EMD ensured early disposal of queries of listed companies with regard to circulation of quarterly accounts and issued necessary clarifications to address practical difficulties. As a result, it was clarified that quarterly accounts would not be required to be circulated for the second quarter of the accounting year, at the end of which half-yearly accounts become due under Section 245 of the Companies Ordinance, 1984. In addition, the requirement for circulation of fourth quarter's accounts was relaxed for companies that undertook to circulate their annual audited accounts within three months from the close of financial year, instead of the stipulated four months. Further, companies were allowed to publish their quarterly accounts in two daily newspapers in lieu of circulation to their shareholders. However, the requirement to furnish quarterly accounts to the Commission, registrar and stock exchanges remained unchanged.

4.3 Monitoring and Enforcement

4.3.1 Holding of AGMs

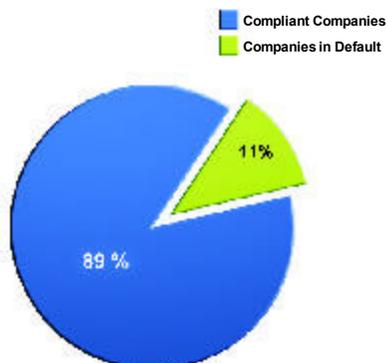
The AGMs provide a forum for shareholders to consider and approve significant matters relating to management and performance of companies, including approval of annual accounts, declaration of dividends, appointment of auditors and election of directors. Under the Companies Ordinance, 1984 listed companies are required to hold AGMs at least once in every calendar year within a period of six months following the close of their financial year.

The EMD undertook strict monitoring to ensure that listed companies held AGMs within the prescribed period and in an orderly manner. As a result of timely actions by the EMD, compliance with this mandatory requirement of the Companies Ordinance, 1984 improved by 5 percent as compared to the preceding year. Of the total 617 companies being monitored by the EMD, 548 companies held their meetings within the specified time period whereas 69 companies failed to hold their meetings in accordance with the statutory requirements.

TABLE 14 Extent of Compliance with the Requirement for Timely Holding of AGM: A Comparison with Last Year

YEAR	TOTAL LISTED COMPANIES	NUMBER OF COMPLIANT COMPANIES	PERCENTAGE OF COMPLIANCE
2002	617	548	89
2001	635	534	84

CHART 8 Status of Compliance with the Requirement to Hold AGM within the Stipulated Time Period



The table below shows, for the year under review, the sector-wise status of compliance with the requirement to hold AGM on the basis of the financial year-end.

TABLE 15 Sector-wise Status of Holding of AGM within the Prescribed Time Period

S. No.	SECTOR	AGMs OF COMPANIES WITH FINANCIAL YEAR END IN								TOTAL		
		June		September		December		Others		Due	Held	Default
		Due	Held	Due	Held	Due	Held	Due	Held			
1	Investment and Commercial Banks	22	19	-	-	18	18	-	-	40	37	3
2	Insurance	-	-	-	-	39	32	-	-	39	32	7
3	Textile Spinning	1	1	132	121	-	-	-	-	133	122	11
4	Textile Weaving	1	1	20	15	-	-	-	-	21	16	5
5	Textile Composite	13	9	44	42	-	-	-	-	57	51	6
6	Woolen	5	2	1	1	-	-	-	-	6	3	3
7	Synthetics and Rayon	22	19	1	1	1	-	-	-	24	20	4
8	Jute	7	6	-	-	-	-	-	-	7	6	1
9	Sugar and Allied	1	1	37	36	-	-	-	-	38	37	1
10	Cement	21	21	-	-	-	-	-	-	21	21	-
11	Tobacco	5	5	-	-	1	1	-	-	6	6	-
12	Fuel and Energy	25	24	-	-	-	-	-	-	25	24	1
13	Engineering	12	11	-	-	2	1	-	-	14	12	2
14	Auto and Allied	19	16	-	-	4	4	2	2	25	22	3
15	Cables and Electric Goods	10	7	1	1	2	2	-	-	13	10	3
16	Transport and Communication	8	6	-	-	1	1	-	-	9	7	2
17	Chemical and Pharmaceutical	21	19	1	1	15	15	1	1	38	36	2
18	Paper and Board	12	11	1	1	1	1	-	-	14	13	1
19	Vanaspati and Allied	15	14	1	-	1	-	2	2	19	16	3
20	Construction	4	4	-	-	-	-	-	-	4	4	-
21	Leather and Tanneries	5	5	-	-	2	2	-	-	7	7	-
22	Food and Allied	13	10	2	2	3	3	2	2	20	17	3
23	Glass and Ceramics	10	7	-	-	-	-	-	-	10	7	3
24	Miscellaneous	23	20	-	-	3	2	1	-	27	22	5
	TOTAL	275	238	241	221	93	82	8	7	617	548	69

During the financial year 2002, the EMD initiated proceedings against companies that had defaulted in holding AGMs within the prescribed period. As a consequence of these proceedings, penalties were imposed on 17 companies and their directors while appropriate actions against other defaulter companies are underway.

4.3.2 Extension in Period for Holding of AGMs

During the year, the EMD received applications from 36 listed companies to extend the minimum period for holding of AGMs. These applications were examined in light

of the provisions of sub-Section (1) of Section 158 of the Companies Ordinance, 1984 and Rule 14 of the Companies (General Provisions and Forms) Rules, 1985. The Commission allowed extensions of varying periods, up to a maximum of 90 days, to 33 companies. The remaining three applications were rejected as either the grounds for seeking extension in the minimum period were found inadequate or the applications were not in accordance with the requirements of Rule 14 of the aforesaid Rules.

During the preceding year, i.e. 2000-2001, the Commission had received applications from 76 companies for seeking extension in the period for holding of AGMs, of which 56 applications were approved by the Commission. It is evident that there was a drastic reduction from the preceding year in the number of companies that sought relaxation in the minimum period for holding of AGMs. This declining trend is in line with the Commission's objective to achieve timely holding of AGMs by companies.

The number of applications received, approved and rejected during the year is given in the following table.

TABLE 16 Sector-wise Information of Applications for Extension in Minimum Period to Hold AGM

S. No.	SECTOR	APPLICATIONS RECEIVED	EXTENSIONS GRANTED	APPLICATIONS REJECTED
1	Textile Spinning	5	4	1
2	Textile Weaving	1	1	–
3	Textile Composite	4	4	–
4	Sugar and Allied	3	3	–
5	Chemical and Pharmaceutical	4	4	–
6	Investment and Commercial Banks	6	5	1
7	Brokerage	1	1	–
8	Tobacco	2	2	–
9	Cable and Electric	1	1	–
10	Insurance	1	1	–
11	Synthetic and Rayon	1	1	–
12	Cement	3	2	1
13	Glass and Ceramics	1	1	–
14	Food and Allied	1	1	–
15	Jute	1	1	–
16	Miscellaneous	1	1	–
	TOTAL	36	33	3

4.3.3 Presentation of Annual Accounts in AGMs

The directors of listed companies are required under the Companies Ordinance, 1984 to present the annual financial statements of their companies to shareholders in their AGMs. A delay in presentation of annual accounts or a failure to present them altogether in AGM is a default that is punishable with imprisonment for a term, which may extend to one year and with a fine of not less than Rs. 10,000.

During the year, the EMD enhanced its surveillance activities to identify companies that failed to prepare, circulate and present their accounts in accordance with the provisions of law. On the basis of vigilant monitoring, the EMD identified 27 companies, which had not prepared and presented their accounts to the shareholders in AGMs within the specified time frame. References were made in the courts of law for prosecution of directors of the companies in default. The list of companies against whose directors prosecutions were in progress as of June 30, 2002 is given in Table 17. The list includes the 27 cases of prosecution initiated during the year as well as two cases that were started in previous years and were pending adjudication by the close of the year 2002.

TABLE 17 Cases of Prosecution for Default in Presenting Annual Accounts in AGMs

S. No.	NAME OF COMPANY	FILLING OF REFERENCE WITH CROs
1	Prudential Investment Bank Limited	May 2001
2	Mediglass Limited	June 2001
3	Tri-Star Shipping Lines Limited	January 2002
4	Quality Steel Works Limited	February 2002
5	Quice Foods Industries Limited	March 2002
6	Kohinoor Looms Limited	March 2002
7	Sarhad Ghee Industries Limited	March 2002
8	Dadabhoj Insurance Company Limited	April 2002
9	Sadoon Textile Mills Limited	April 2002
10	Mehran Jute Mills Limited	May 2002
11	Orient Straw Board Limited	May 2002
12	Sterling Insurance Company Limited	May 2002
13	Pakistan Northern Insurance Company Limited	May 2002
14	Syed Match Company Limited	May 2002
15	Lasbela Cement Limited	May 2002
16	Karim Cotton Mills Limited	May 2002
17	Tri-Star Power Limited	May 2002
18	Sindh Alkalies Limited	May 2002
19	Noori Textile Mills Limited	May 2002
20	Regal Ceramics Limited	May 2002

(continued on next page)

S. No.	NAME OF COMPANY	FILLING OF REFERENCE WITH CROs
21	Bela Automotives Limited	June 2002
22	Apex Fabrics Limited	June 2002
23	Bahawalpur Textile Mills Limited	June 2002
24	Azmat Textile Mills Limited	June 2002
25	Tri-Star Polyester Limited	June 2002
26	Awan Textile Mills Limited	June 2002
27	Alif Textile Mills Limited	June 2002
28	Haji Doosa Limited	June 2002
29	Schon Textile Limited	June 2002

4.3.4 Publication and Circulation of Notices of AGMs

The Companies Ordinance, 1984 requires that notices of AGMs should be sent to shareholders at least 21 days before the date of meetings. Moreover, listed companies are required to publish these notices in two daily morning newspapers in English and Urdu languages. To ensure timely issuance and publication of notices of meetings, the Commission has directed the listed companies to send it copies of notices through facsimile on the same day on which they are issued to shareholders as well as to submit to it clipping of newspapers in which the notices are published.

On the basis of information received pursuant to this directive, the Commission was able to take corrective measures in cases where resolutions were proposed to be passed by companies in violation of the statutory requirements or full disclosure of material facts was not provided to shareholders. During the year, the EMD identified all such instances and issued timely instructions to the concerned companies to either refrain from passing such resolutions or proceed only after removing the deficiencies observed in the notices of meetings.

4.3.5 Holding of AGMs at Places of Registered Offices

Listed companies are required to hold their AGMs in the city where their registered offices are situated, except where the Commission allows a company to hold its AGM at any other place. During the year under review, the EMD received applications from five companies to allow holding of their AGMs at places other than their registered offices. After careful examination of explanations provided by such companies, the Commission accorded its approval to allow holding the respective AGMs at places other than the registered offices.

The EMD identified two cases where companies had held their AGMs at places other than their registered offices without seeking the approval of the Commission. Necessary proceedings were initiated during the year against those companies for violation of mandatory provisions of the Companies Ordinance, 1984.

4.3.6 Disclosure of Information in Case of Special Business

The Companies Ordinance, 1984 requires that where any special business (a business other than approval of annual audited accounts, declaration of dividends, appointment and fixation of remuneration of auditors and election of directors) is to be transacted at a general meeting, a statement setting out material facts concerning the business should be circulated to the shareholders along with the notice of the meeting. The intention is to apprise shareholders sufficiently in advance about relevant details of significant matters to be decided in general meetings. The Companies Ordinance further requires that the nature of interest of a director, whether directly or indirectly, in such special business should be disclosed.

During the financial year 2002, the EMD focused its monitoring efforts on requiring listed companies to provide all material information to shareholders in respect of any special business to be transacted at a general meeting. The EMD examined the statements of material facts pertaining to special businesses transacted by 130 listed companies during the year under review. Strict monitoring by the EMD resulted in an enhanced disclosure of information by companies. However, certain deficiencies were noted in a few cases and nine companies were directed to circulate additional information to their shareholders. Broadly, these actions were taken in respect of deficiencies in the following matters:

- (i) remuneration of directors;
- (ii) investment in associated companies;
- (iii) sale of assets by companies;
- (iv) merger of companies;
- (v) alteration in memorandum and articles of association; and
- (vi) increase in authorized share capital.

4.3.7 Commission's Representation at AGMs

During the year under review, the Commission also sent its representatives as observers to attend AGMs of selected companies. The presence of these observers resulted not only in orderly holding of meetings but also helped to enhance shareholder confidence. A large number of shareholders were motivated to attend AGMs and to discuss the affairs of their companies openly with the management.

4.3.8 Circulation of Half-yearly Accounts

Listed companies are required to circulate their half-yearly accounts to shareholders within two months from the close of first half of their accounting years, in terms of Section 245 of the Companies Ordinance, 1984. In addition, half-yearly accounts have to be furnished to the Commission and the stock exchanges on which shares of the companies are listed. During the year under review, 361 companies circulated

their half-yearly accounts within the prescribed period whereas 170 companies circulated them late. Another 86 companies failed altogether to prepare and circulate half-yearly accounts to the shareholders, stock exchanges and the Commission. In view of these defaults, show cause notices were issued to directors of 38 companies while EMD is scrutinizing the remaining 48 cases for initiating appropriate proceedings. Of the 38 companies that were issued show caused notices during the year, penalties were imposed on directors of 24 companies while the remaining cases were pending at the year end.

The status of compliance with the statutory requirement to prepare and circulate half-yearly accounts within the prescribed time period is given in the following table.

TABLE 18 Circulation of Half-Yearly Accounts

SUBMISSION OF HALF-YEARLY ACCOUNTS	ACCOUNTS FOR HALF-YEAR ENDED				TOTAL
	June	September	December	Others	
In time	142	157	57	5	361
Late	98	50	20	2	170
Not submitted	36	35	14	1	86
TOTAL	276	242	91	8	617

4.3.9 Circulation of Quarterly Accounts

During financial year 2002, listed companies were directed to circulate quarterly accounts to their shareholders, stock exchanges, registrar and the Commission. A total of 712 quarterly accounts of listed companies were due to be filed during the year. Although it was the first year of its application, this requirement was substantially complied with. As many as 605 accounts were circulated by listed companies at a compliance rate of 85 percent. Since circulation of quarterly accounts was a new requirement, only warnings were issued for defaults pertaining to the quarter ended December 31, 2001. However, for the quarter ended March 31, 2002 – the second quarter after introduction of this requirement – show cause notices were issued to the companies in default. The status of compliance for the year under review is tabulated below.

TABLE 19 Circulation of Quarterly Accounts

SUBMISSION OF QUARTERLY ACCOUNTS	ACCOUNTS FOR QUARTER ENDED				TOTAL
	December	February	March	May	
In time	300	1	301	3	605
Not submitted	36	–	69	2	107
TOTAL	336	1	370	5	712

4.3.10 Examination of Annual and Interim Accounts

During the year under review, the EMD undertook careful examination of published accounts of listed companies to identify deficiencies in disclosures and other irregularities. As a result of strict monitoring by the EMD, the quality of financial reporting by companies improved significantly, which was apparent from more comprehensive and transparent presentation of financial statements.

(i) Disclosures in Financial Statements

The Fourth Schedule to the Companies Ordinance, 1984 together with IASs forms the framework for preparation and presentation of financial statements of listed companies. The directors of every company are responsible for complying with the requirements set out in the Fourth Schedule and IASs to give adequate and meaningful disclosures in financial statements that are essential for a true and fair view. During the year, the financial statements of companies were thoroughly examined and directors of several listed companies were asked to furnish explanations with regard to deficiencies noted in the financial statements of their companies. Accordingly, warnings were issued to nine companies to ensure due compliance in future while show cause notices were issued to eight companies where serious violations were noted.

(ii) Disclosure in Directors' Report

The Companies Ordinance, 1984 lays down the minimum parameters for information to be provided in the directors' report, annexed with the financial statements of listed companies in terms of Section 236. The EMD noted that vital information was missing from directors' reports in several cases with the result that shareholders were deprived of meaningful information about the affairs of these companies. During the year, directors of 32 companies were asked to furnish reasons for deficiencies in their respective directors' reports. While most of the companies were issued warnings to comply with the disclosure requirements in future, proceedings were initiated against directors of six companies for grossly inadequate disclosures in directors' reports.

(iii) Proper Maintenance of Books of Account

The directors of listed companies are required to maintain proper books of account that give a true and fair view of the state of affairs of companies. Failure to maintain proper books of account is an offence in terms of the Companies Ordinance, 1984, which is punishable with imprisonment and fine. During the year, it was observed that the auditors of two listed companies had qualified their audit reports on account of inadequate books of account maintained by the management. The case of Adil Polypropylene Products Limited was referred to the Court of Session for prosecution of directors while the other case was pending adjudication as of June 30, 2002.

During the year under review, the EMD noted seven cases where statutory auditors had qualified their audit reports on financial statements of the companies for non-maintenance of Fixed Assets Register. The Commission has directed the management of the respective companies to undertake necessary steps for preparation of Fixed Assets Register within a period of one year, failing which appropriate penal proceedings would be initiated.

(iv) Treatment of Surplus on Revaluation of Fixed Assets

Section 235 of the Companies Ordinance, 1984 deals with the treatment of surplus arising out of revaluation of fixed assets of a company. During the year, there were three cases where depreciation had been charged to revaluation surplus, in contravention of the requirements of the aforesaid provisions of law. Show cause notices were issued to the directors of these companies and after providing reasonable opportunity of hearing, fine was imposed in one case while the other two cases were pending finalization at the end of June 2002.

(v) Accounts of Subsidiaries

Under Section 237 of the Companies Ordinance, 1984, every holding company should attach with its financial statements the financial statements of its subsidiaries. However, the Commission, on application of a company or with the consent of its directors, is empowered to grant exemption from this requirement. During the year under review, the Commission received three applications for seeking this exemption. The EMD expeditiously disposed of all the three applications during the year. Further, it initiated action against a company that had failed to comply with the requirements of Section 237 without obtaining approval of the Commission in this regard. Consequently, the violation was rectified by circulation of accounts of the subsidiary to the shareholders of the holding company.

4.3.11 Inter-corporate Financing

While inter-corporate financing constitutes a major source of funding for productive investment and capital formation, this avenue has been greatly abused by managements and sponsors for transfer of funds to their own companies. In order to curb this misuse of funds, the Companies Ordinance, 1984 has placed certain restrictions on investments in associated companies. During the year under review, efforts were made by the EMD to deter unlawful inter-corporate financing. As a result of its proactive monitoring, the EMD was able to detect material deficiencies in the information provided by certain companies in the proposed resolutions and statements of material facts annexed to notices of general meetings. Timely interference by the EMD caused four companies to withdraw the proposed resolutions for making investments aggregating Rs. 120 million in their associated companies. In another case, a company was prevented from selling its investment in a subsidiary at a “throw away” price. Another

company was restricted to pass a resolution for making advances to associated undertakings without any return thereon.

A number of cases were also identified where investments were either made in associated companies without approval of shareholders or in excess of the prescribed limit or free of any return. Proceedings were initiated against 15 companies for violation of the mandatory provisions of the Companies Ordinance. Of these, five cases were disposed of during the year while others were pending adjudication as of June 30, 2002. As a result of actions taken by the EMD, more than Rs. 1.1 million, along with return thereon at not less than the borrowing cost of the investing companies, would be returned to these companies. The details of cases disposed of during the year are given in the table below.

TABLE 20 Cases of Unlawful Inter-corporate Financing Disposed of During the Year			
S. No.	COMPANY	AMOUNT INVESTED (Rs. in Million)	ACTION TAKEN
1	Spencer and Company (Pakistan) Limited	504.697	Penalty of Rs. 1 million imposed on the CEO and direction given to recover the investment along with return.
2	Gharibwal Cement Limited	510.841	Penalty of Rs. 1.5 million imposed on the CEO and directors and direction given to recover the investments.
3	Mandviwalla Mauser	18.000	Penalty of Rs. 200,000 imposed on the CEO and direction given to recover the investment and return thereon.
4	Yousaf Textile Mills Limited	5.626	Penalty of Rs. 10,000 imposed on the CEO.
5	Ghani Glass Limited	49.935	Penalty of Rs. 135,000 imposed on the CEO and directors and direction given to recover the return on investments.
TOTAL		1,089.099	

Further to the orders made by the Executive Director, EMD, appeals were filed before the Appellate Bench of the Commission in the matter of Spencer and Company (Pakistan) Limited and Gharibwal Cement Limited. While the decision of the Executive Director was upheld by the Appellate Bench in the case of Spencer and Company (Pakistan) Limited, the penalty, in the case of Gharibwal Cement Limited, was reduced from Rs. 1.5 million to Rs. 600,000. The case of Spencer and Company (Pakistan) Limited is now pending before the Honorable Sindh High Court. In another case, the Honorable Sindh High Court has stayed the show cause proceedings initiated by the

EMD against a listed company for making unlawful investments in its associated companies.

4.3.12 Sale of Substantial Assets at a Loss to Minority Shareholders

During the year under review, the EMD also took note of situations where sale proceeds of assets of companies were used to settle their outstanding debts, including the amounts borrowed from sponsors. Effectively, this practice results in a loss in the value of investment of minority shareholders. The EMD took a number of remedial measures to discourage this practice. Based on a review of notices published in newspapers regarding sale of assets by companies, appropriate directions were issued to concerned companies to ensure that minority shareholders were adequately compensated. This policy was adopted in the case of companies in which either there was no chance of revival of operations or the future returns to shareholders were considered negligible. During the year, two companies were directed not to sell a sizable part of their assets without the approval of the Commission. Accordingly, these companies were unable to undertake business that was prejudicial to the interest of minority shareholders.

4.3.13 Proper Exercise of Powers by Directors

Provisions of the Companies Ordinance, 1984 place certain restrictions on exercise of powers by directors. During the year under review, two cases were identified where directors had exceeded their powers in violation of statutory provisions and had, in each case, disposed of a sizeable part of the undertaking without seeking the consent of shareholders in general meetings. Taking cognizance of these violations, the EMD issued show cause notices to the directors of these companies. While one of the cases was pending adjudication at the end of financial year 2002, the directors of the other company have obtained the stay order of the Court in respect of proceedings initiated by the EMD.

4.3.14 Loans to Directors

Section 195 of the Companies Ordinance, 1984 prohibits public companies and private companies, which are subsidiaries of public companies, to provide loans, or give guarantees in connection with loans, to their directors. These restrictions equally apply to loans or guarantees to relatives of directors and private companies or firms in which such directors have substantial interest. During the year under review, the EMD issued directives to the following companies whose funds had been transferred in contravention of the statutory requirements.

- (i) The CEO and directors of Associated Industries Limited were directed to recover an amount of Rs. 18.3 million, along with mark-up, from its associated company,

- Quality Food Products (Private) Limited. This amount was unlawfully advanced to the associated company and no interest was being charged under the pretext of non-trading transactions. The company, on the directions of the Commission, recovered an amount of Rs. 46.1 million on account of principal and mark-up.
- (ii) The CEO and directors of United Distributors Pakistan Limited were directed to recover the amount of interest-free loan of Rs. 34.7 million from its associated company, International Brands (Private) Limited. The full amount of the loan has been recovered by the company on the directions of the Commission.
 - (iii) The directors of Brothers Textile Mills Limited were directed to cancel the guarantee provided to a bank in connection with a loan given by the said bank to one of its associated undertakings. The company has complied with the direction of the Commission and consequential proceedings have been dropped accordingly.

Section 195 allows that a company, subject to the approval of the Commission, can extend a loan to a whole time working director for the purpose of construction or acquisition of a house or other purposes enumerated in the said Section. During the year, only one application was received from a company to seek approval for giving a house-building loan to its director. The application was suitably processed and disposed of.

4.3.15 Irregularities in Holding of Election of Directors

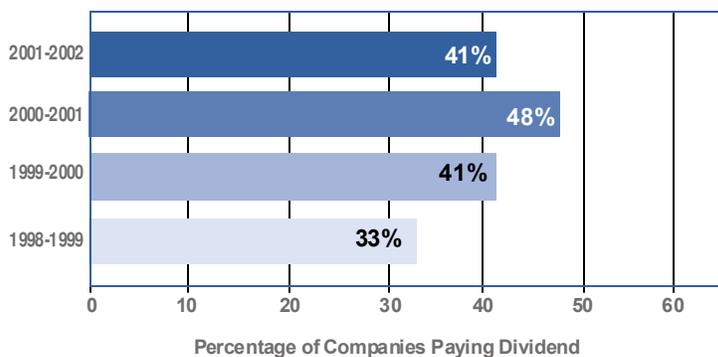
In case of 22 listed companies, the EMD took cognizance of lack of disclosure in notices of general meetings regarding proposed resolutions for election of directors. Explanations were called and remedial actions were taken by the EMD. However, on a complaint by NIT that election of directors in a company was held through show of hands and not in compliance with the procedure prescribed in Section 178 of the Companies Ordinance, 1984, necessary proceedings were initiated against the company. As a result, the CEO of the company was fined for violating mandatory provisions of the Companies Ordinance, 1984.

4.3.16 Payment of Dividends by Listed Companies

During the year under review, 255 listed companies paid dividends to their shareholders. In addition, five listed companies came out of the Defaulters Counter of KSE due to resumption of dividend payments. The pattern of dividend payment by listed companies during the last four years is presented below.

TABLE 21 Sector-wise Pattern of Dividend Declared During Financial Years 1999-2002

SECTOR	1998-1999		1999-2000		2000-2001		2001-2002	
	Number of Companies	Dividend Declared						
Investment Companies/ Securities Companies/ Banks	39	15	39	20	38	25	40	17
Insurance	39	16	39	17	39	14	39	18
Textile Spinning	149	34	146	51	138	78	133	57
Textile Weaving	27	7	26	9	25	7	21	6
Textile Composite	53	16	54	17	54	30	57	23
Woolen	8	1	8	2	7	2	6	2
Synthetics and Rayon	27	9	26	12	26	8	24	10
Jute	8	3	8	3	7	2	7	1
Sugar and Allied	38	8	38	21	38	21	38	13
Cement	20	1	20	4	20	6	21	5
Tobacco	6	2	6	2	6	2	6	2
Fuel and Energy	28	20	28	20	27	19	25	17
Engineering	16	5	16	4	16	4	14	4
Auto and Allied Engineering	25	10	25	11	25	9	25	10
Cables and Electric Goods	15	5	15	4	15	5	13	4
Transport and Communication	7	2	7	2	8	3	9	4
Chemical and Pharmaceuticals	41	23	39	23	39	23	38	22
Paper and Board	15	8	15	8	15	7	14	7
Vanaspati and Allied	19	1	19	–	19	1	19	–
Construction	4	–	4	–	4	2	4	–
Leather and Tanneries	8	4	8	6	8	6	7	6
Food and Allied	22	12	22	13	22	13	20	12
Glass and Ceramics	11	2	10	4	10	5	10	5
Miscellaneous	29	9	29	12	29	12	27	10
TOTAL	654	213	647	265	635	304	617	255

CHART 9 Dividend Declared by Listed Companies During Financial Years 1999-2002

4.3.17 Delayed Payment of Declared Dividend

Section 251 requires that payment of dividend, after it has been declared, should not be withheld or deferred and that the CEO of a listed company is responsible for payment of dividend within 45 days of declaration. Considerable importance is attached to timely payment of dividend under the law and severe penalties, i.e. imprisonment for a term of up to two years and fine of up to Rs. 1 million, have been prescribed to protect the right of shareholders to receive dividend on a timely basis. During the year under review, the EMD filed prosecution applications against CEOs of two listed companies, namely, Quality Steel Works Limited and Fateh Textile Mills Limited, on account of their failure to pay dividend to some of the shareholders within the prescribed time period. In addition, the EMD received applications from three companies during the year for deferment of payment of declared dividend. The EMD, after suitably reviewing the cases and affording appropriate opportunity to shareholders entitled to receive dividend for making a representation against the proposed action, allowed one of the companies to withhold payment of declared dividend. The applications of the other two companies to defer payment of dividend to all the shareholders were rejected since the law does not envisage deferment of declared dividend to all the shareholders of a company.

4.3.18 Delay in Transfer of Shares

The EMD took a serious note of complaints received from investors regarding delay in transfer of shares. As a result, show cause notices were issued to two companies for not returning the transferred shares within the prescribed period of 45 days. Both the cases were disposed of during the year and fines were imposed on the companies and their CEOs.

4.3.19 Misstatement in Prospectus

During the year under review, the EMD filed a case for prosecution of directors of Pak Fibre Industries Limited under Sections 60, 66 and 492 of the Companies Ordinance, 1984. The prosecution was initiated on account of misstatements in prospectus issued by the company for raising funds from the general public.

4.3.20 Actions against Auditors

The auditors have a significant responsibility towards shareholders of companies. In issuing an audit report on financial statements, the auditors are guided by the requirements of relevant laws, particularly the Companies Ordinance, 1984, IASs and International Standards on Auditing. It is essential that auditors discharge their responsibilities with due care, integrity and professionalism to give an independent and objective opinion on financial statements.

During the year under review, the EMD identified several cases of negligence of statutory auditors where they had failed to act in conformity with the statutory requirements. The audit reports issued by such auditors failed to bring out material facts about the affairs of companies or otherwise contained untrue statements. Previously, the Commission used to refer such cases to ICAP for taking necessary disciplinary action against the concerned auditors. In view of delays noted in disposal of these cases, the Commission decided to invoke the provisions of the Companies Ordinance, 1984 to proceed against auditors for negligence and professional misconduct in conducting statutory audit of listed companies. Accordingly, the EMD initiated proceedings in 25 cases against 20 firms of chartered accountants during the financial year 2002. Penalties were imposed in 21 cases while four cases were pending as of June 30, 2002.

The perseverance of the EMD to take strict actions against erring auditors has not been without its results. The statutory auditors have now become more vigilant and conscious of their duties in carrying out audits of listed companies. This is evident from the large number of qualified audit reports, which totaled 162, issued on the financial statements of listed companies for the year 2001.

4.3.21 Investigations into the Affairs of Companies

The EMD also initiates investigations into the affairs of companies to identify reasons for mismanagement, continuous deprivation of a reasonable return to shareholders, violation of statutory provisions or business conducted to defraud creditors or members. During the year under review, the EMD ordered investigations into affairs of certain companies. On the basis of three investigation reports, appropriate action was initiated by the EMD against the management of the relevant companies. The EMD also took suitable action against statutory auditors of the companies who had failed to bring material facts to the notice of shareholders of the companies. At the end of the financial year 2002, five cases of investigations were pending due to stay orders issued by the Courts.

4.3.22 Liquidation of Companies

During the year under review, the Commission filed petitions for winding up of three companies, namely, Asset Investment Bank Limited, Prudential Investment Bank Limited and Prudential Discount and Guarantee House Limited, on the recommendation of SBP. The Commission is also conscious of the need to take suitable action in respect of non-performing companies, which do not hold AGMs, prepare and present their annual accounts or maintain their registered offices in violation of the relevant legal provisions. Liquidation proceedings in respect of such companies may be initiated after consultation with the relevant stock exchanges to protect the interests of minority shareholders.

4.3.23 Investors' Grievances

Immediate and appropriate action was taken on all complaints received by the EMD during the year. Most of the complaints were received from small shareholders. The complaints received and disposed of during the year pertained mainly to the following issues:

- (i) non-receipt of dividend warrants;
- (ii) non-encashment of dividend warrants;
- (iii) delay/ non-transfer of shares and issue of duplicate shares;
- (iv) non-receipt of annual and interim accounts; and
- (v) wrongful deduction of Zakat.

During the year under review, 402 complaints were received from investors, as compared to 159 complaints received in the financial year 2001. The EMD ensured that all complaints received during the year were promptly resolved. There has been a significant improvement in investor confidence as a result of proactive and prompt actions of the Commission.

4.4 Cost Audits

4.4.1 Companies (Audit of Cost Accounts) Rules, 1998

Under the provisions of Section 230 (1) (e) of the Companies Ordinance, 1984, the Commission is empowered to prescribe maintenance of cost accounting records by certain classes of companies engaged in production, processing, manufacturing or mining activities. The Commission has framed the Companies (Audit of Cost Accounts) Rules, 1998 (Cost Audit Rules) to require cost audit of accounts maintained under Section 230 (1) (e) of the Companies Ordinance, 1984. The requirement for cost audits is in addition to statutory audits conducted by auditors appointed under Section 252 of the Companies Ordinance. Audit of cost accounts can be executed by a chartered accountant or a cost and management accountant in terms of Section 258 of the Companies Ordinance.

Cost audits were enforced on vegetable ghee and cooking oil industry in 1990, cement industry in 1994 and sugar industry in 2001. It is expected that cost audits will help the companies identify inefficiencies in their costing mechanisms and pave the way for rationalization of costs that will lead to higher profitability and enhancement in shareholders' value. The table below gives relevant information about the enforcement of cost audit requirements in different industries.

TABLE 22 Enforcement of Cost Audits

S. No.	INDUSTRY	NOTIFICATION	DATE OF ENFORCEMENT	NUMBER OF COMPANIES
1	Vegetable Ghee and Cooking Oil	SRO 1131(I)/90 dated November 1, 1990	January 1991	21
2	Cement	SRO 386(I)/94 dated May 14, 1994	July 1994	22
3	Sugar	SRO 97(I)/2001 dated February 13, 2001	October 2001	38

4.4.2 Cost Audit Reports

In compliance with the Cost Audit Rules, 24 cost audit reports were furnished to the Commission during the year under review as compared to 19 reports received last year. These include reports furnished by companies in vegetable ghee and cooking oil industry and cement industry. Cost audit reports for sugar industry will be submitted for the first time in respect of year ending September 30, 2002.

4.4.3 Appointment of Cost Auditors

During the year, the Commission received 24 applications to approve appointment of cost auditors of companies. Necessary approvals were accorded as required under law.

4.4.4 Actions against Companies

The monitoring and enforcement of the Cost Audit Rules, in respect of listed companies, were transferred to the EMD during the year. On the basis of cost audit reports, matters relating to deficiencies in maintenance of cost accounting records and non-compliance with statutory requirements insofar as applicable to cost audits were rigorously perused. During the financial year 2002, show cause notices were issued to seven listed companies for non-compliance with the Cost Audit Rules. The violations related mainly to non-appointment of cost auditors within 60 days from the end of financial year, late appointment of cost auditors, failure to arrange audit of cost accounting records and failure to furnish necessary explanations on qualifications or reservations noted by cost auditors. After conclusion of due process, appropriate actions were taken against companies in default, their directors and the CEOs.

4.4.5 Actions against Auditors

During the year, 15 show cause notices were issued to auditors for non-submission of cost audit reports within 60 days of their appointment. Proceedings were completed and appropriate actions were taken against nine auditors.

5. Company Law Administration Division



- 5.1 Overview
- 5.2 Improvements in Operational Efficiency
- 5.3 Introduction of New Schemes and Systems
- 5.4 Developmental Activities
- 5.5 Regulatory Actions
- 5.6 Monitoring and Enforcement
- 5.7 Approvals and Permissions

5. Company Law Administration Division

5.1 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. The CLAD grants licenses and accords approval to matters stipulated in the Companies Ordinance, 1984. It also supervises and coordinates the working of its regional offices, the CROs, which are located in Karachi, Sukkur, Multan, Faisalabad, Islamabad, Lahore, Peshawar and Quetta.

The CLAD is responsible for regulation and supervision of non-listed public and private companies that involves:

- (i) ensuring compliance with statutory requirements;
- (ii) developing regulatory mechanisms for effective enforcement, including the conduct of inspections and investigations;
- (iii) implementation of Cost Audit Rules;
- (iv) protecting rights of investors and creditors;
- (v) encouraging best corporate practices; and
- (vi) speedy disposal of complaints from investors and the public.

During the year under review, the CLAD suggested several amendments in the Companies Ordinance, 1984 and the Companies (Appointment of Legal Advisors) Act, 1974. It was also involved in updating various rules and regulations, including the Companies (General Provisions and Forms) Rules, 1985, the Companies (Registration Offices) Regulations, 1986 and the Companies (Invitation and Acceptance of Deposits) Rules, 1987. Two important schemes, namely, the Companies Regularization Scheme and the Companies Easy Exit Scheme were introduced by the CLAD during the year under review. These schemes were widely acclaimed by the business community and the general public.

5.2 Improvements in Operational Efficiency

Substantial progress was made during the year to ensure timely and prompt incorporation of companies, registration of mortgages and charges, and issuance of availability of name certificates to new companies. The CROs were automated to enable them to serve the corporate sector more efficiently and effectively. The general public was facilitated in its inspection of companies' records and was provided certified copies on demand expeditiously.

A number of additional features have been added on the Commission's website to provide better and easily accessible information to the general public.

5.2.1 Availability of Company Name

A facility for “Name Search” is available on the website of the Commission. Through this facility, sponsors can easily confirm whether or not a particular name is available for incorporation of a company.

5.2.2 Statutory Forms and Returns

The forms prescribed under the Companies (General Provisions and Forms) Rules, 1985 have been placed on the Commission’s website. These forms can be downloaded and used for the purpose of incorporation of a company as well as filing of various statutory returns. The fee structure for services, such as availability and approval of name, incorporation of a company, grant of license, alteration in the memorandum of association, registration, modification and satisfaction of charge and filing of statutory returns, is also available on the website.

5.2.3 Guide for Promoters for Incorporation of Companies

A complete guide for promoters of companies has been made available on the website to give useful information about incorporation of local and foreign companies along with contact details of respective CROs.



Officers of the CLAD at work

5.3 Introduction of New Schemes and Systems

5.3.1 Companies Regularization Scheme

It is mandatory for companies to file annual returns and other periodic documents with the registrar under the Companies Ordinance, 1984. Companies that fail to file these returns/ documents are liable to penal action. The extent of non-compliance

with the statutory requirements was such that by December 2001, as many as 27,288 companies, out of a total of 43,317 companies, were in default with respect to filing of their statutory returns. The reluctance of companies to rectify their default was largely owing to fear of penalties and levy of additional fee.

In order to ensure compliance, encourage filing of overdue returns and create an environment of confidence and partnership with the business community, the CLAD introduced a scheme called the Companies Regularization Scheme during the year. An announcement was made in the local press on December 31, 2001 to explain the salient features of the scheme. The Companies Regularization Scheme was effective from January 1, 2002 to June 30, 2002 and was applicable to non-listed public and private companies. It provided an opportunity to defaulting companies to file overdue returns on payment of filing fee and one-time additional fee instead of three-times additional fee, otherwise required under the law. However, the companies were obliged to pay two-times additional fee during the last months of the scheme, i.e. May and June 2002. The companies regularizing their default were assured that no penalty would be imposed on them if the overdue documents were filed during the period of the scheme.

Under the Companies Regularization Scheme, 4,909 companies were regularized over a six-month period and an amount of Rs. 17.19 million was collected as filing/ additional filing fee. The outcome of the scheme, in terms of the number of companies regularized and aggregate fee collected by each CRO is presented in Table 23.

TABLE 23 Outcome of Companies Regularization Scheme

CRO	NUMBER OF DEFAULTER COMPANIES	NUMBER OF COMPANIES REGULARIZED	FEE COLLECTED (Rs.)
Karachi	10,705	2,214	8,175,520
Lahore	10,452	1,619	5,522,800
Islamabad	2,538	496	1,470,800
Peshawar	1,385	187	589,690
Faisalabad	1,008	202	749,200
Multan	929	147	478,750
Quetta	261	34	173,000
Sukkur	10	10	32,700
TOTAL	27,288	4,909	17,192,460

5.3.2 Companies Easy Exit Scheme

After introduction of the Companies Regularization Scheme, it was observed that there were a large number of companies that were not in operation. Representations made by professional bodies and individuals also revealed that a large number of registered companies had, due to various reasons, failed to commence or continue business. In order to facilitate promoters of such companies get the names of the companies struck off without undergoing a cumbersome process, the Commission launched the Companies Easy Exist Scheme. The business community all over the country welcomed the scheme and appreciated the efforts of the Commission in this regard.

The Companies Easy Exist Scheme remained operative from April 1, 2002 to May 31, 2002. An announcement to this effect was made on March 31, 2002 in the local press to explain the salient features and procedural details of the scheme, which included:

- (i) payment of fee of Rs. 3,500 in case of a private company and a fee of Rs. 7,500 in case of a public company;
- (ii) resolution of the Board of Directors that approved submission of application for striking off the name of the company from the register of companies;
- (iii) a duly verified affidavit from the directors or the CEO stating that the company has no assets and liabilities and is not in operation or doing any business; and
- (iv) a certificate from the auditors of the company, and if the auditor was not a chartered accountant or a cost and management accountant then a certificate from a practicing chartered accountant or a cost and management accountant, that the company is not doing any business, has no assets and liabilities and does not owe any amount to any authority.

After proper scrutiny by the concerned registrars, notices were published in the official Gazette to invite objections against striking off the names of specified companies from the register of companies after a period of three months.

The number of companies, which responded to the scheme and the collections made by each CRO up to June 30, 2002 is given in Table 24.

TABLE 24 Companies Easy Exit Scheme

CRO	NUMBER OF COMPANIES WHICH FILED APPLICATION UNDER THE SCHEME	NUMBER OF COMPANIES WHOSE CASES WERE ACCEPTED	NUMBER OF COMPANIES WHOSE CASES ARE UNDER CONSIDERATION	APPLICATION FEE (Rs.)
Karachi	1,221	1,046	175	4,599,500
Lahore	911	763	148	3,474,500
Islamabad	265	160	105	963,500
Peshawar	160	153	7	588,000
Faisalabad	174	150	24	648,000
Multan	97	65	32	371,000
Quetta	29	28	1	109,500
Sukkur	3	3	–	10,500
TOTAL	2,860	2,368	1,129	10,764,500

5.3.3 Corporate Registration System

The Corporate Registration System (CRS) has been launched to computerize the data of 43,788 incorporated companies. The system is accessible to all the CROs for incorporation of companies and for updating the existing companies' database in the central server. The CRS also provides information on name reservation, pre-incorporation activities, cessation of companies, change of a company's name as well as merger of companies. The system can generate user-defined reports, covering various fields in the database.

The CRS will, in particular, facilitate automation of information flow at the CROs. This will not only lead to time saving in compilation of records but will also expedite follow-up by the Commission, in case of any default by a company.

5.4 Developmental Activities

5.4.1 Reduction in Rates of Stamp Duty

It was noted that the exorbitant and substantially different rates of stamp duty prevailing in certain provinces hindered incorporation of companies. In some provinces, the rates of stamp duty had increased manifold a few years back, which had caused reluctance among promoters to get their entities registered under the Companies Ordinance, 1984. As a result, the matter was taken up with the Provincial Governments of Punjab, Sindh and Balochistan and, consequently, the rate of stamp duty was considerably decreased during financial year 2002. A comparison of existing and previous rates is given in Table 25.

TABLE 25 Comparison of Rates of Stamp Duty

PROVINCE/ TERRITORY	PREVIOUS RATES OF STAMP DUTY			EXISTING RATES OF STAMP DUTY		
	Maximum Rate Levied (Rs.)			Maximum Rate Levied (Rs.)		
	Memorandum of Association	Articles of Association	Total	Memorandum of Association	Articles of Association	Total
Islamabad	60	200	260	60	200	260
N.W.F.P.	75	500	575	75	500	575
Balochistan	2,000	5,000	7,000	200	500	700
Sindh	5,000	5,000	10,000	2,000	2,000	4,000
Punjab	5,000	5,000	10,000	4,000	4,000	8,000

Further efforts are underway to bring the rates of stamp duty in Punjab, Sindh and Balochistan at par with those prevalent in Islamabad Capital Territory and N.W.F.P.

5.4.2 Interaction of Mobile Teams of Officials with Professional and Trade Bodies

After the successful experience at the Information Technology Commerce Network (ITCN) Conference in Karachi in March 2001 when 15 companies were incorporated on-the-spot, the idea of mobile teams to provide on-the-spot registration services was conceived. During the year, mobile teams of officers were constituted to meet several professional and trade bodies, such as Hyderabad Chamber of Commerce and Industry, Lahore Chamber of Commerce and Industry, Export Promotion Bureau, Lahore Tax Bar Association, Institute of Cost and Management Accountants of Pakistan (ICMAP), various firms of chartered accountants, Sialkot Chamber of Commerce and Industry, Sialkot District Bar Association and Jhang Chamber of Commerce and Industry. The mobile teams had useful interaction with members of these professional and trade bodies, which gave considerable impetus to corporate registration.

5.4.3 Change of Territorial Jurisdiction of CROs

To streamline the working of CROs, their territorial jurisdiction was redefined in certain cases. As a result, the district of Bhakkar was excluded from the jurisdiction of CRO Faisalabad and included in that of CRO Multan while tehsil Chechawatni of district Pakpattan was excluded from the jurisdiction of CRO Lahore and included in the jurisdiction of CRO Multan.

5.4.4 Establishment of CRO Sukkur

The Commission had received representations from professional and trade bodies for establishment of a separate CRO for civil divisions of Larkana and Sukkur. In response to these representations and to address the difficulties of business community,

a CRO was set up in Sukkur in October 2001. It is expected that establishment of this CRO will promote incorporation of companies in interior Sindh.

5.4.5 Decentralization of Powers

The powers of the registrar, under the Companies Ordinance, 1984, were delegated during the course of the year to Additional Registrars in Karachi and Lahore in respect of companies registered with these CROs to allow for expeditious disposal of cases. These powers are in relation to change of name of a company, extension in period of holding of AGM by a non-listed company, authorization for convening an extraordinary general meeting with a shorter notice, power to call or direct the convening of an overdue general meeting and permission for preparation of accounts for a period of more than 12 months. The decentralization of powers has considerably enhanced the efficiency and responsiveness of the CROs at Karachi and Lahore.

5.5 Regulatory Actions

5.5.1 Amendments in the Companies Ordinance, 1984

The Commission has recommended a number of amendments in the Companies Ordinance, 1984 to remove certain practical difficulties experienced by companies in complying with its provisions. These amendments have been proposed in consultation with professional and trade bodies, chambers of commerce, stock exchanges, associations of investors and individual experts and after taking into account the recommendations of the Justice Shafi-ur-Rehman Commission, constituted in 1997 to review all corporate laws. The salient aspects of the draft amendments are as follows.

(i) Single Member Company

At present, at least two members are required for the formation of a private company. A new concept of a single member company (SMC) has been proposed in Pakistan, whereby one member alone can form a company under the Companies Ordinance. The main rationale behind the establishment of SMC is to encourage the use of corporate structure by small businesses and sole proprietors.

(ii) Reduction in Minimum Number of Members and Directors of Non-listed Public Companies

The minimum number of seven persons to form a public company is proposed to be reduced to three, in view of practical difficulties being faced by promoters to induct a large number of persons at the stage of formation of a company. However, listed companies will continue to have at least seven directors.

- (iii) Appeal against Refusal of Transfer of Shares by Directors**
The existing provisions of the Companies Ordinance do not provide any relief to shareholders if directors refuse transfer of shares without valid grounds. Therefore, right of appeal to the Commission against such refusal is proposed to be included in the Companies Ordinance.
- (iv) Rectification of Register of Mortgages and Charges**
Under the existing provisions of law, the High Court has the power to grant extension in the time period for submitting of documents relating to registration of mortgages and charges. It has been proposed that these powers be entrusted to the Commission in consideration of practical difficulties in getting extension from the High Court.
- (v) Reduction in Period to Present Annual Audited Accounts in AGMs**
In order to provide relevant and timely information to shareholders about the affairs of companies, amendments have been proposed to hold AGMs for consideration and approval of audited accounts within a period of four months instead of six months from the close of accounting period. Moreover, extension period is proposed to be curtailed from three to two months.
- (vi) Quorum of Listed Companies**
To provide for larger representation, the quorum of a general meeting of a public listed company is being increased from three members to 10 members present in person, representing not less than 25 percent of total voting power either on their own account or as proxies.
- (vii) Procedure for Election of Directors of Companies not Having Share Capital**
Amendment has been proposed to lay down the procedure for election of directors of companies, which are limited by guarantee, in the manner provided in the articles of association of such companies.
- (viii) Appointment of Company Secretary**
To formalize secretarial responsibilities within listed companies, appointment of qualified company secretaries is proposed. SMCs will also be required to have company secretaries.
- (ix) Investment in Associated Companies**
It is proposed that the existing provisions restricting investment in associated companies be liberalized and the statutory requirements simplified.

(x) Consolidation of Accounts

An amendment has been suggested to remove the inconsistency between IAS 27 “Consolidated financial statements and accounting for investments in subsidiaries” and Section 237 of the Companies Ordinance, 1984.

(xi) Removal of Auditors

Since the law does not provide for removal of an auditor of a company, a suitable amendment has been proposed to remove this ambiguity.

(xii) Winding up of Companies

The proposed amendments aim to remove certain causes of delay in winding up of companies by official liquidators.

These amendments will go a long way in ensuring healthy growth of the corporate sector, protection of investors and creditors and promotion of investment. The draft amendments have recently been approved by the Cabinet and are expected to be promulgated shortly.

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

The Companies (Appointment of Legal Advisors) Act was promulgated in 1974 to require companies, having paid-up capital of Rs. 500,000 and above, to appoint at least one legal advisor to counsel such companies in the performance of their functions and duties. Under present circumstances, the limit of minimum capital is clearly too low. The Commission, has, therefore, proposed that this limit be raised to Rs. 2.5 million. Further, cognizance of default by a Court not inferior to that of a magistrate of First Class has proven to be cumbersome and expensive. For proper enforcement of the Companies (Appointment of Legal Advisors) Act, the default is proposed to be made cognizable by the registrar of companies with a right of appeal to the Commission. The draft amendments, duly vetted by the Ministry of Law, Justice and Human Rights, have been sent to the Ministry of Finance for promulgation.

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

The rules and forms, which were introduced in 1985, have been revised and reformatted in view of automation of corporate database so that both data entry and retrieval can be made quickly and easily. The new forms have also been simplified so that returns may be filled in easily by companies and promptly filed with the registrar. The proposed changes in rules and forms have been notified in the official Gazette for eliciting public opinion.

5.5.4 Amendments in the Companies (Invitation and Acceptance of Deposits) Rules, 1987

The Companies (Invitation and Acceptance of Deposits) Rules, 1987 were prescribed under Section 88 of the Companies Ordinance, 1984 to regulate deposits collected by companies. It was observed that the rules, in their present shape, do not apply to security deposits, earnest money and advances, including advances against supply of goods or property. After careful consideration of complaints received in this regard, amendments have been proposed to bring the said activities within the ambit of the Companies (Invitation and Acceptance of Deposits) Rules.

The proposed amendments are aimed at protecting the public from fraudulent and unscrupulous elements and are, therefore, expected to safeguard their interests. A number of complaints have been received from aggrieved members of the public who have allegedly lost their money to companies that did not fulfill their commitments to provide developed plots, constructed houses, motor vehicles, etc., as advertised by them. In order to make the amendments meaningful and effective, the Commission has sought public opinion on the draft amendments.

5.5.5 Amendments in the Companies(Registration Offices) Regulations, 1986

The Companies (Registration Offices) Regulations were notified in December 1986, which repealed the Companies (Registration Offices) Regulations, 1978. The existing Regulations were at variance with current advances in technology. Extensive amendments have been made for switching over from the present manual system for record maintenance to a computerized document management system. Salient features of amendments in these Regulations are as under:

- (i) returns filed by companies under various provisions of law will be handled in terms of the CRS;
- (ii) returns have been specified in order to monitor the activities of CROs;
- (iii) the annexures specified in the Regulations have been updated to meet the requirements of automation;
- (iv) a document management system has been included in the Regulations; and
- (v) certificates for conversion of status of companies have been provided in the Regulations to fulfill the requirements of Sections 44 and 45 of the Companies Ordinance, 1984 and address practical difficulties being faced.

The amended Regulations will come into force shortly and will improve the internal working of the CROs.

5.6 Monitoring and Enforcement

5.6.1 Orders and Circulars

To streamline the working of CROs, several orders, circulars and press releases relating to administrative, legal and other matters were issued during the course of the year. A complete list is provided in Appendix D.

5.6.2 Enforcement of the Cost Audit Rules

The enforcement and monitoring of the Cost Audit Rules, in relation to non-listed public and private companies in the vegetable ghee and cooking oil, cement and sugar sectors have been assigned to the CLAD. Companies within these sectors are required to maintain cost data in the manner prescribed under the Orders notified in terms of Section 230 (1) (e) of the Companies Ordinance, 1984. Of a total of 34 non-listed public and private companies to which the Cost Audit Rules applied, 17 companies were in compliance with its requirements, 10 companies were not in operation while another seven companies were found to be non-compliant during the year under review.

5.6.3 Appeal for Enhancement of Sentence in the Matter of Taj Company Limited

On the complaint of the Commission, the Court of Session sentenced the directors of Taj Company Limited (in liquidation) under Section 190 of Cr. P.C and Sections 88 (4), 195 (5), 230 (7) (b), 234 (b), 236 (b), 237 (12) and 492 of the Companies Ordinance 1984. Considering that the sentences awarded to the directors were minimal compared to the gravity of the offence committed, the Commission filed an application in the Lahore High Court for enhancing the sentence of the convicted directors as well as sentencing of the acquitted directors.

5.6.4 Investigations

In response to applications filed by shareholders and on the report of the concerned registrar, the Commission ordered investigations into the affairs of two companies. The affairs of these companies, namely, Daru-Tasnif (Private) Limited and Alliance Textile Mills Limited were not being managed in accordance with prudent commercial practices.

Relevant particulars of other investigation cases are as under:

- (i) Applications were received from shareholders of Effef Industries Limited and Farms Powers (Private) Limited for appointment of inspectors to investigate the affairs of these companies. These applications were pending at the end

of financial year 2002 for want of compliance with certain observations of the Commission.

- (ii) An inspector was appointed on the application of aggrieved shareholders in the matter of Fazal Din and Sons (Private) Limited. The Lahore High Court, Rawalpindi Bench granted a stay and appointment of the inspector is now pending the decision of the Court in the matter.

5.6.5 Adjudication of Cases

During the year, 224 cases were adjudicated by CROs, registrar and the Executive Director, CLAD under Section 476 of the Companies Ordinance, 1984. Penalties amounting to Rs. 1.19 million were imposed on parties in default.

5.6.6 Liquidation of Companies

During the year under review, 118 cases of liquidation were disposed of. The break-up of these cases is as under:

Voluntary winding up	110
Creditors voluntarily winding up	2
Winding up subject to supervision of Court	6
Total	<u>118</u>

5.6.7 Mergers and Amalgamations

During the year under review, oral and written representations were filed in the Court in 17 cases of mergers and amalgamations. Of these, 11 cases have been decided while six cases were pending as of June 30, 2002.

5.6.8 Striking off the Names of Companies

Section 439 of the Companies Ordinance, 1984 provides that where the registrar has reasonable grounds to believe that a company is not in operation, he may strike off the name of such company 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 names of 51 companies from the register of companies.

5.7 Approvals and Permissions

The Companies Ordinance, 1984 provides for approval to be accorded by the Commission and the registrar in various matters. A large number of applications submitted by companies were processed and approved during the year under review as presented in Table 26.

TABLE 26 List of Cases Approved Under the Companies Ordinance, 1984

S. No.	NATURE OF APPROVAL/ PERMISSION SOUGHT	NUMBER OF CASES DISPOSED OF
1	Amendment in memorandum and articles of association under Section 21	127
2	Extension in time for filing the order confirming alteration in memorandum of association with the registrar	2
3	Incorporation of new companies	1,183
4	Availability of name under Section 37	3,124
5	Change of name under Section 39	130
6	Registration of prospectus	5
7	Commencement of business certificate	19
8	Grant of license to associations under Section 42	25
9	Approval for conversion of public companies into private companies under Section 44	7
10	Approval for grant of loans to directors of non-listed public companies under Section 195	1
11	Approval for appointment of sole purchase and sale agents under Section 206	1
12	Application for approval of alteration in articles of association under Rule 6(4) (iii) of the Companies (General Provisions and Forms) Rules, 1985	3
13	Registration, modification and satisfaction of charge	3,110
14	Extension in period for holding of AGMs by non-listed public and private companies	36
15	Extension in period for payment of dividend under Section 251	3
16	Issue of certified copies of documents	17,488
17	Calling of overdue meetings under Section 170	6
18	Inspection of records maintained with CROs	10,677
19	Preparation of accounts for more than 12 months under Section 233	8

6. Insurance Division



- 6.1 Overview
- 6.2 Regulatory Actions
- 6.3 Monitoring and Enforcement
- 6.4 Other Developments

6. Insurance Division

6.1 Overview

Substantive changes have been brought about in the regulation of insurance business since the promulgation of the new insurance law – the Insurance Ordinance, 2000 – and the repeal of the Insurance Act, 1938. The new law transferred administrative and compliance mandate for the insurance industry from the Ministry of Commerce to the Commission. Consequently, the Insurance Division (ID) was set up within the Commission on January 1, 2001 to regulate and monitor the activities of insurance companies. The main functions of the ID are:

- (i) protection of policy holders' rights and interests in matters concerning settlement of insurance claims and other terms and conditions of insurance contracts;
- (ii) issuance of certificate of registration as well as renewal, modification, withdrawal, suspension or revocation of such registration;
- (iii) specification of requisite qualifications and code of conduct for insurance intermediaries, agents and surveyors;
- (iv) specification of market conduct parameters for insurers to promote efficiency in the insurance business;
- (v) collection of Federal Insurance Fees and Annual Supervision Fees from insurers;
- (vi) calling for information and undertaking inspections, enquiries and investigations, including special audits of insurers and intermediaries;
- (vii) specification of the form and manner in which books of account are to be maintained and statement of accounts to be rendered by insurers;
- (viii) specification of the form of actuarial report and conduct of appointed actuaries;
- (ix) regulation of investment of funds by insurance companies;
- (x) regulation of solvency margins to be maintained by insurers;
- (xi) specification of reinsurance base for insurers;
- (xii) specification of acquisition costs for insurers; and
- (xiii) administration of the Insurance Ordinance, 2000.

At present, there are 55 privately owned insurance companies operating in Pakistan, of which 51 are general insurance companies while four operate in the life insurance business. Amongst the general insurance companies, 47 are local while four are foreign. In addition, there are three state-owned enterprises operating in the insurance sector, namely, State Life Insurance Corporation (SLIC), National Insurance Company Limited (NICL) and Pakistan Reinsurance Company Limited (PRCL).

6.1.1 Performance of Life Insurance Companies

The total premium collected by the five life insurance companies during the year ended December 31, 2001 stood at Rs.8.06 billion, indicating a 7.6 percent increase

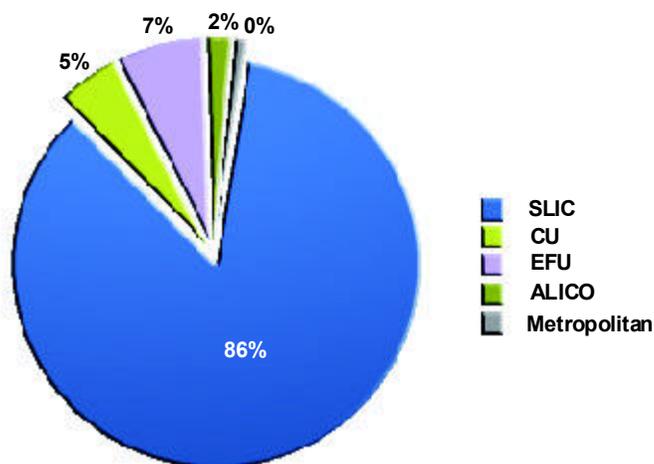
over the previous year. Of this, Rs.1.39 billion represented first year premium collection by life insurance companies, indicating an increase of 9.35 percent from last year. Group premium also registered a significant growth of 19.27 percent to Rs.1.599 billion during the year. On the whole, the state-owned SLIC remained the dominant player in the life insurance market with a share of 86.2 percent in terms of premium collection. The market share of the five life insurance companies, in terms of premium collected during the calendar year 2001, is presented in Table 27.

TABLE 27 Premium of Life Insurance Companies (January 1, 2001 – December 31, 2001)

(Rs. in Million)

	FIRST YEAR PREMIUM	RENEWAL PREMIUM	SINGLE PREMIUM	GROUP PREMIUM	ANNUITY	TOTAL PREMIUM
SLIC	1,121.14	4,564.56	0.04	1,256.48	2.51	6,944.73
Commercial Union (CU)	71.74	113.48	–	178.09	–	363.31
EFU Life Assurance Limited	151.73	270.85	34.95	105.15	–	562.68
American Life Insurance Company (ALICO)	39.83	61.71	0.72	47.21	–	149.47
Metropolitan Life Assurance Company	7.80	20.19	–	11.97	–	39.96
TOTAL	1,392.24	5,030.79	35.71	1,598.90	2.51	8,060.15

CHART 10 Share of Life Insurance Companies in Premium Collection (January 1, 2001 – December 31, 2001)



6.1.2 Performance of General Insurance Companies

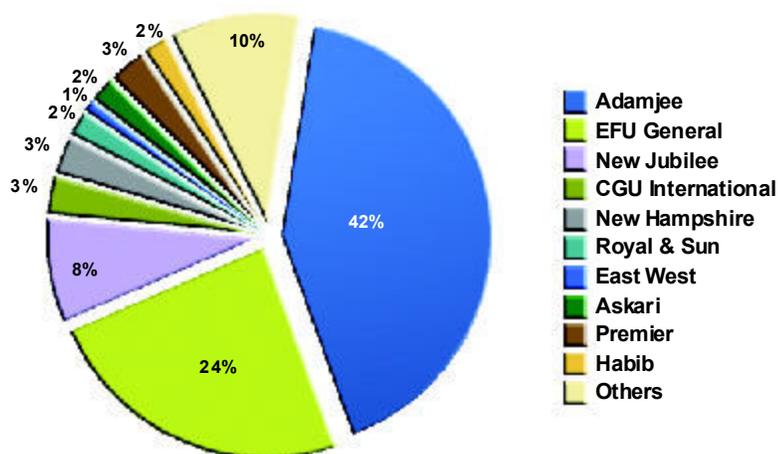
General insurance business in Pakistan depicts an oligopolistic composition with 10 companies accounting for almost 83 percent of the total private sector general insurance business. The total gross direct premium underwritten by general insurance

companies, excluding the state-owned NICL, during the calendar year 2001 was Rs. 10.9 billion. Of this amount, Rs. 9.1 billion was attributable to the 10 largest companies while the balance gross direct premium of Rs. 1.8 billion was underwritten by the remaining 41 companies. Premium underwritten by NICL during the year ended December 31, 2001 amounted to Rs. 2.3 billion. In Pakistan, general insurance companies underwrite four main classes of business, i.e. fire, marine, motor and miscellaneous. The premium earned by general insurance companies in each class of business during the year ended December 31, 2001 is presented in Table 28.

TABLE 28 Paid-up Capital and Gross Premium of General Insurance Companies (January 1, 2001 – December 31, 2001)

S. No.	COMPANY	PAID-UP CAPITAL	PREMIUM				TOTAL
			FIRE	MARINE	MOTOR	MISCELLANEOUS	
(Rs. in million)							
1	Adamjee Insurance	543.20	1,292.70	796.94	1,461.15	682.50	4,233.28
2	EFU General Insurance Limited	170.00	628.92	350.85	881.59	513.07	2,374.43
3	New Jubilee Insurance	209.37	148.94	119.29	175.30	331.63	775.16
4	Premier Insurance Company	115.44	178.46	51.83	69.47	26.84	326.60
5	CGU International	–	77.07	83.61	121.63	33.59	315.90
6	New Hampshire Company	240.71	46.17	30.11	202.26	18.42	296.96
7	Habib Insurance Company Limited	75.00	105.62	51.89	59.23	25.36	242.11
8	Askari General Insurance	76.04	22.05	37.45	98.97	54.17	212.64
9	Royal & Sun Alliance	-	83.34	26.37	49.80	17.01	176.52
10	East West Insurance Company Limited	101.63	62.56	14.96	43.98	20.17	141.67
11	Remaining 41 Companies	–	634.50	414.27	460.18	316.12	1,825.07
TOTAL			3,280.33	1,977.57	3,623.56	2,038.88	10,920.34

CHART 11 Share of General Insurance Companies in Gross Premium (January 1, 2001 – December 31, 2001)



Under the Insurance Ordinance, 2000, general insurance companies are required to raise their paid-up capital to Rs. 50 million by December 31, 2002 and, subsequently, to Rs. 80 million by December 31, 2004, failing which the companies would not be permitted to continue their operations. The minimum paid-up capital requirement under the repealed Insurance Act was Rs. 1.5 million. The enhanced capital requirement is likely to usher in consolidation in the insurance sector, as under-capitalized companies would either have to merge to meet the regulatory requirement or opt for an orderly exit. At present, a few cases of mergers and acquisition are in process. Consolidation through mergers and acquisition is expected to result in fewer but financially stronger insurance companies, which will have better Claims Paying Ability (CPA) and higher solvency margins.



Mr. Shafaat Ahmad, Executive Director, ID (second from right) with officers of the Division

6.2 Regulatory Actions

6.2.1 Settlement of Dispute between Insurance Companies and Banks

Lately, commercial banks had laid down certain eligibility/ selection criteria for enlisting general insurance companies on their panel. In view of grievances of general insurance companies regarding certain aspects of the eligibility criteria, a joint meeting of banks and insurance companies was held on October 16, 2001 under the aegis of the Commission. The meeting was chaired by the Chairman of the Commission. Various aspects relating to the eligibility criteria and the ensuing difficulties faced by insurance companies in enlisting on the panel were discussed in the meeting. The major areas of contention included the following:

- (i) requirement to place deposits with banks under lien in order to procure insurance business; and
- (ii) payment of commission by insurance companies to banks on the business procured by them.

On representation of banks that the condition for placing compulsory deposits under lien had been imposed with a view to protect their interest in case any insurance company did not pay the claim, they were instructed to bring cases of non-payment of insurance claims to the notice of the Commission so that the delinquent companies could be taken to task. As a result of detailed deliberations, the Commission issued the following directive to insurance companies:

- (i) insurance companies should not place deposits in order to secure enlistment or acquire business from banks;
- (ii) any deposit already made and placed under lien for the aforesaid purpose with banks should be withdrawn; and
- (iii) banks should waive the condition of compulsory deposits as a prerequisite for enlistment of insurance companies on their panel.

Subsequently, the SBP also endorsed the decision made by the Commission and directed banks not to take deposits from general insurance companies as a prerequisite for enlistment.

6.2.2 Reinsurance Treaty Arrangements

An essential principle of general insurance business is the spread of risk. The insurers reduce their own risk through reinsurance agreements made with reliable and reputable international reinsurers. In the domestic market, reinsurance services are provided by the state-owned PRCL.

The ID is involved in examining and approving reinsurance programs drawn up by insurance companies prior to execution of reinsurance treaties and reinsurance arrangements abroad. The examination focuses on ensuring that reinsurance arrangements are made with sound reinsurers. In this regard, the Commission has directed all insurance companies to make reinsurance arrangements with international reinsurers, which have minimum 'A' rating from recognized international credit rating agencies.

During the year under review, all insurance companies were advised to furnish their reinsurance plans in respect of risks to be accepted by them for the year 2002, both inside and outside Pakistan. Show cause notices under Section 41, read with Section 63, of the Insurance Ordinance, 2000 were issued to 19 companies, which had failed to secure reinsurance arrangements with 'A' rated reinsurers as stipulated by the Commission. After providing these companies an opportunity of being heard, it was

decided that, as an alternative to reinsurance arrangements with 'A' rated reinsurers, these companies should get their CPA or Financial Strength rated by local credit rating agencies. Necessary directives to this effect were issued by the Commission. The decision was taken mainly to facilitate small insurance companies that were unable to secure 'A' rated reinsurance in the post September 11, 2001 scenario.

6.2.3 Rules for Insurance Companies, Insurance Intermediaries and Surveyors

To ensure a well-performing insurance sector in Pakistan, it is necessary that other components of the insurance market, i.e. intermediaries, professional bodies and surveyors, develop alongside the insurance companies. For this purpose, the ID has drafted rules in consultation with various stakeholders, including the Insurance Association of Pakistan, Pakistan Society of Actuaries and the managements of leading insurance companies. The final draft of these rules has been sent to the Ministry of Finance for its clearance prior to promulgation.

The draft rules relate to registration of insurers, their market conduct, solvency margins, reinsurance, licensing as well as the code of conduct for intermediaries. The rules also lay down the eligibility criteria for insurance agents/ intermediaries. The criteria include minimum educational qualifications at the point of entry, practical on-the-job training, adherence to the code of conduct and capital requirements for insurance brokers. It is essential that the role of agents be streamlined since agents form the key distribution channel for any insurer, being the bridge between the insurer and the insured. They also play a vital role in increasing the breadth and depth of the insurance market. Under the Insurance Ordinance, 2000, the entire procedure for selection of insurance agents and issuance of agency license to selected candidates has been delegated to registered insurers.

Further, the rules drafted by the ID seek to ensure that surveyors conduct their business independently and in a professional manner. Apart from adherence to the code of conduct, individual surveyors have to conform to requirements pertaining to minimum paid-up capital and corporate structure, as prescribed in the draft rules. It has also been proposed that surveying firms should have professional indemnity policy to safeguard the interests of policyholders. These efforts are expected to improve the quality and timeliness of survey reports issued by surveyors. This will not only ensure that policyholders get the reports on time but will also enable the insurers to settle the claims expeditiously.

6.2.4 No Objection Certificate Granted for Conversion into Public Limited Company

During the year, ACE Insurance Limited – a branch of a USA based insurance company – was granted a No Objection Certificate (NOC) for conversion into a public limited company under Section 5 (3) of the Insurance Ordinance, 2000. The newly

incorporated company is expected to bring advanced technical expertise in the domestic insurance industry, in addition to foreign investment.

6.3 Monitoring and Enforcement

6.3.1 Insurance Companies Forbidden to Underwrite Insurance Business

During the year under review, three insurance companies were forbidden from underwriting insurance business in the country with effect from April 2002 due to lack of adequate and sound reinsurance arrangements. The action was taken under Section 63 of the Insurance Ordinance, 2002, which empowers the Commission to restrict a company from entering into new contracts of insurance if it has failed to comply with conditions of registration stipulated in the Ordinance.

6.3.2 Off-site Inspections

To ensure compliance with the Insurance Ordinance, 2000, the ID maintains effective off-site surveillance of insurance companies under its purview. During the year, the ID carefully reviewed and examined the various periodic returns submitted by the insurers. Explanations were obtained in respect of its observations and companies were advised to ensure proper compliance. In order to monitor their performance effectively, the ID plans to hold periodic review meetings with the management of insurance companies and their appointed actuaries.

6.3.3 Public Complaints

Customer complaints against insurance companies are lodged with the Commission regarding settlement of their claims and other grievances. The ID continuously follows up on resolution of these complaints with the relevant companies. Prompt attention is given to disposal of complaints and insurers are advised to settle claims and grievances in an orderly manner. For this purpose, the ID established a system to redress grievances of policy holders during the year. The system has proved useful in not only ensuring timely redressal of complaints but also in providing insight into the operations of insurers, specifically into the areas which require further improvement and streamlining.

6.4 Other Developments

6.4.1 Creation of Reinsurance Pool

The events of September 11, 2001 in the USA that played havoc with the global financial markets, in general, and the insurance industry, in particular, also had repercussions on the insurance sector in Pakistan. The domestic insurance industry received a major setback as international reinsurers refused to provide cover against terrorism risk and increased the rates of premium for future reinsurance

arrangements. To address this problem, the Commission constituted a Task Force, headed by the Chairman PRCL, for formulation of a strategy to mitigate the impact of post September 11 developments. The Task Force submitted its report on November 21, 2001. It recommended that alternate arrangements covering the risk of terrorism be developed as the likely exclusion of cover for terrorism and riot strike damage by international reinsurers could create serious problems for the local insurance industry. Further, it was proposed that a 'Reinsurance Pool' should be created with the following salient features:

- (i) An amount of Rs. 500 million to be initially contributed as "seed" money to the Pool by the Government of Pakistan. This amount may be increased if the ADB or any other international agency shows willingness to participate in creation of the Pool.
- (ii) The maximum amount of loss payable through the Pool should be 25 percent of the sum insured or Rs.100 million, whichever is less.
- (iii) The Reinsurance Pool may be attached with PRCL or NICL and should be supervised by a technical committee comprising insurance experts from the public and private sectors.

However, the scheme could not be implemented because a few leading insurance companies were not willing to participate in the pooling requirements envisaged. The ADB has since expressed its willingness to provide a Political Risk Guarantee of US\$ 175 million. This Guarantee will cover certain defined terrorism and sabotage related political risks for which primary insurers are unable to access the international reinsurance market – a surrogate for reinsurance for terrorism-related risks that is generally unobtainable. Effectively, this would serve to increase the retention capacity of the local insurance industry.

6.4.2 Revenues

During the financial year 2002, the ID collected Rs. 116 million as Federal Insurance Fee from insurance companies on behalf of the Federal Government. In addition, an amount of Rs. 11 million was collected under the head of supervision fee.

6.4.3 Capacity Building

In order to strengthen its capacity to achieve regulatory objectives envisaged in the Insurance Ordinance, 2002, the ID took necessary steps for training of its staff. In this connection, services of a consultant from the ADB were obtained under the agreed technical assistance arrangements. More training programs along similar lines are planned in order to develop the expertise and skills of the Division's staff and augment its regulatory capacity.

7. Support Services Division



- 7.1 Human Resource
- 7.2 Administration
- 7.3 Finance and Accounts

7. Support Services Division

The Support Services Division (SSD) is concerned with facilitating the overall operations of the Commission. It provides necessary support services that assist in efficient and smooth functioning of the organization. The core activities include staff recruitment and development, maintenance and refurbishment of office premises, procurement, disbursements and preparation of financial records and accounts. The SSD has been organized into the following wings:

- (i) Human Resource
- (ii) Administration
- (iii) Finance and Accounts



Mr. Javed Panni, Executive Director, SSD (sitting in the centre) with officers of the Division

7.1 Human Resource

The main functions of the Human Resource Wing are formulation of personnel policies and procedures; recruitment of suitably qualified personnel and processing of employees' transfers, retirements, resignations, inquiries and dismissals; coordination with other Divisions on matters of staff development; organization of local and foreign training programs; and maintenance of employee service records including performance evaluation reports. In performing its functions, the Human Resource Wing is guided by the need to maintain employee morale and motivation.

7.1.1 Recruitment

The recruitment process has been formalized to ensure transparency and objectivity. Candidates are selected purely on merit after considering the particular needs and work requirements of each Division. Pay packages offered to successful candidates are largely commensurate with the market. An increase of up to 25 percent in salaries of the Commission's employees is under consideration in order to make the remuneration structure more competitive.

In recruiting staff, emphasis is placed on induction of qualified professionals in accordance with the corporate plan. Since the establishment of the Commission on January 1, 1999, as many as 100 professionally qualified individuals have been inducted and appointed at varying levels of authority and responsibility. During the year under review, 32 new employees were recruited, of whom three were chartered accountants, two cost and management accountants, three law graduates while 21 held post-graduate degrees.

The Commission is an equal opportunity employer. In continuing with its policy to ensure equal opportunities to female candidates, 22 female officers were inducted during the year under review. This represents almost 70 percent of the total induction during the year and has significantly improved the state of gender balance among the Commission's employees.

7.1.2 Junior Executives Induction Scheme

During the year under review, the Commission introduced a Junior Executives Induction Scheme (JEIS) to attract highly motivated, young individuals who have post-graduate degrees from reputable institutions. The JEIS provides these freshly qualified individuals a starting point for their careers. The scheme is expected to contribute to their professional growth through on-the-job-training and exposure to the Commission's functioning and policies. During the financial year 2002, the first batch of five Junior Executives was hired under the JEIS. The scheme was publicized through advertisements in newspapers and generated considerable interest among post-graduate degree holders. This was evident from the massive number of applications received for placement in the scheme – more than 900 applications were received for five positions. After careful scrutiny of applications, a competitive examination for 255 short listed candidates was arranged. The examination papers were developed and marked by the Institute of Business Administration, Karachi to ensure a high standard as well as impartiality in the selection process.

The Junior Executives selected under the scheme underwent a one-week orientation on the structure and functions of the Commission. They were then assigned work in different Divisions of the Commission based on academic background, personal preference and the Commission's internal staffing requirements. During the initial

period of one year, each Junior Executive would be rotated in two Divisions. They would also be sent on field trips to stock exchanges, CROs and other relevant institutions. It is expected that the hands-on training thus imparted would enable Junior Executives to obtain a broad overview of the Commission's working. At the conclusion of the first year, these Junior Executives would be offered permanent positions in the Commission based on their performance evaluation.

The second batch of Junior Executives under the JEIS will be inducted during 2002-2003. Applications have been invited from interested candidates for the purpose.

7.1.3 Training Programs and Seminars

The Human Resource Wing arranged a number of training programs throughout the year under review. The training programs were conducted in-house as well as in collaboration with other institutions to update professional knowledge and enhance technical expertise of employees. These programs were designed to supplement on-the-job training of employees so that they are able to accomplish their tasks more diligently and efficiently.

The training sessions arranged during the year were as follows:

- (i) A two-week workshop on "Financial Reporting Framework and Practices in Pakistan" was conducted by SKANS School of Accountancy in November 2001 in which 25 officers participated. The Human Resource Wing is contemplating holding a similar program in the coming year.
- (ii) Mr. James Smith, consultant to the ADB, was invited to deliver lectures on "Insurance Reforms/ Regulations" in March 2002. The lectures were attended by 15 officers of the Commission.
- (iii) A workshop on "Corporate Governance" was organized by Lahore University of Management Sciences (LUMS) in April 2002, which was attended by 20 officers of the Commission.
- (iv) A workshop on "Art of Judgment Writing" was organized at LUMS in April 2002 with the objective of improving the skills of participants in judgment and order writing. Several Commissioners and Executive Directors, along with 20 other officers, attended the workshop.
- (v) A workshop on "Job Analysis" was organized by National Institute of Public Administration in August 2001, which was attended by officers of the Human Resource Wing of the Commission.
- (vi) In order to strengthen the institutional capacity of the Commission, a training program is organized every year in collaboration with LUMS to provide all-round education and instruction on subjects relevant to the Commission's working. During the year under review, a rigorous curriculum was devised for the program in consultation with LUMS. The program on "Strengthening

Institutional Capacity” aimed at familiarizing the 30 officers participating in it with key aspects of economics, law, finance, accounting and regulatory requirements.

The Human Resource Wing also arranged participation of officers of the Commission in seminars and conferences organized by different institutions. The Commission was represented by nominated officers on these occasions to present the view point of the regulator. Significant seminars and conferences in which officers of the Commission participated actively during the course of the year are as follows:

- (i) Seminar on Demutualization of Stock Exchanges held in Manila, Philippines in August 2001;
- (ii) Public Pension Funds Management Conference in Washington D.C., USA in September 2001;
- (iii) Seminar on Code of Corporate Governance organized by Overseas Investors’ Chambers of Commerce and Industry in Islamabad in November 2001;
- (iv) Seminar on Income Tax Ordinance, 2001 held in April 2002 at ICMAP in Islamabad;
- (v) First Conference on Corporate Governance in Asia held in Kuala Lumpur, Malaysia in April 2002;
- (vi) Annual Conference of International Organization of Securities Commissions (IOSCO) held in Istanbul, Turkey in May 2002;
- (vii) Seminar on Trade Remedy Laws of the World Trade Organization conducted by ICMAP in June 2002 in Islamabad; and
- (viii) Seminar on Anti Money Laundering and Debt Recovery held in Male, Maldives in June 2002.

The Commission also arranged overseas training for its officers whose participation in international forums, such as the ones mentioned above, served to strengthen its regulatory capacity. These opportunities enable participants to remain abreast with major international developments and engage in dialogue with key players in other jurisdictions. The officers of the Commission who attended the international seminars and conferences were encouraged to share the information and experience so gained with their colleagues through in-house presentations.

7.1.4 Staff Welfare and Development

The Commission has developed and implemented a Service Manual to provide guidelines for appointment of staff, their pay scales and allowances, training, career planning, retirement, terminal benefits, medical facilities as well as their conduct, efficiency and discipline. During the year, the Service Manual was reviewed and appropriately amended to address practical difficulties in implementing some of its guidelines. The revised Manual now contains a number of provisions that are aimed at staff welfare.

During the year under review, the Human Resource Wing developed formats for the following documents, which are required to be maintained under the Service Manual.

(i) Pension Papers

The Pension Papers for employees of the Commission were prepared pursuant to registration of the Employees Pension Fund Trust and framing of the Pension Fund Rules with the approval of the Commission. The Pension Papers designed by the Human Resource Wing have been approved by the trustees of the Fund.

(ii) Service Record Form

The Human Resource Wing drafted a form for maintaining complete service record of the Commission's employees. It is clearly stipulated in the Service Manual that complete record of service of each employee should be kept in such form as the Commission may determine and should be attested by an officer authorized by the Commission in this behalf. The Human Resource Wing developed a form for this purpose after a comparative study of the service book formats prescribed by several other institutions and agencies. It is expected that in due course the complete service record of each employee of the Commission would be transferred on to this form.

7.1.5 Medical Check-up of Employees

The Commission has obtained the services of a qualified medical specialist to ascertain medical fitness of new employees as well as to perform an annual medical check-up of existing employees. The first round of these check-ups was performed during the year under review and will be continued in subsequent years.

7.2 Administration

The Administration Wing within the SSD is responsible for providing various support services relating to purchase and lease of vehicles, equipment, furniture and fixtures; hiring and maintenance of office premises; mail receipts and deliveries; transportation; and printing of reports. The Administration Wing is actively involved in maintaining necessary administrative support to the Divisions and CROs. During the year under review, the focus of administrative services remained on improvement of office décor and establishment of funds for providing staff retirement benefits.

7.2.1 Refurbishment of Commission's Offices

During the year, the Administration Wing undertook refurbishment and modernization of CROs in Lahore, Islamabad and Peshawar. The offices at these stations have been renovated and now provide a conducive and modern work environment.

Necessary refurbishment was also carried out at the Commission's Headquarters in Islamabad.

During the year, essential equipments, like photocopiers and fax machines, were also provided to each Division in Headquarters and to CROs for their capacity building.

7.2.2 Manual of Policies and Procedures

The administrative policies and procedures of the Commission are being formalized. For this purpose, a manual has been drafted by consultants engaged under a technical assistance project of the ADB. The manual provides a framework for efficient administrative support and chalks out specific policies and procedures, as approved from time to time. In particular, the manual contains policies and procedures relevant to procurement, maintenance and outsourcing.

During the year under review, the Commission reviewed its procurement policy to streamline it and make it more transparent and exhaustive. The revised policy was introduced in June 2002 and lays down detailed criteria for procurement of necessary items by the Commission.

7.2.3 Health Care Facilities

The Commission places great emphasis on providing better health care facilities to its employees and their dependents. In this regard, hospitalization coverage was extended during the year to include dependent parents of employees. In addition, health care facilities have now been provided for continued treatment of illnesses after discharge from hospital and for prolonged illnesses that do not require hospitalization.

7.2.4 Establishment of Provident, Gratuity and Pension Funds

The Commission has established a provident fund, a gratuity fund and a pension scheme for the benefit of its employees according to their terms of service. During financial year 2002, following trusts were set up for administration of these funds:

- (i) SEC Employees Provident Fund Trust;
- (ii) SEC Employees Gratuity Fund Trust; and
- (iii) SEC Employees Pension Fund Trust.

The Trusts have been duly registered with the Joint Sub-Registrar, Islamabad. In addition, the Provident Fund Trust has been given recognition by the Commissioner of Income Tax/ Wealth Tax, Islamabad for the purpose of tax exemption. Recognition of Gratuity Fund Trust and Pension Fund Trust by tax authorities is in process. The funds of the Provident Fund Trust have been invested in Pakistan Investment Bonds for five years in compliance with the requirements of the Trust Act, 1882.

Table 29 below shows the total number of employees, as of June 30, 2002, who will benefit from the establishment of Trusts by the Commission.

TABLE 29 Number of Employees with Retirement Benefits	
NATURE OF RETIREMENT BENEFIT	NUMBER OF EMPLOYEES CLAIMING THE BENEFIT
Provident Fund	200
Gratuity	226
Pension	423*
	*Note: includes all regular employees along with the Chairman and Commissioners

The financial statements of Provident Fund Trust and Gratuity Fund Trust, for the year ended June 30, 2001, were finalized during the year under review. These financial statements were audited by Taseer Hadi Khalid and Co., Chartered Accountants as required under Rule 47 of Provident Fund Trust Deed.

7.3 Finance and Accounts

The Finance and Accounts Wing is responsible for treasury functions within the Commission as well as preparation and maintenance of its books of account and related records. In discharging these functions, the Wing is required to comply with the policies and procedures established by the Commission.

7.3.1 Accounting and Internal Control Systems

The Finance and Accounts Wing is responsible for preparation of periodic financial statements of the Commission on the basis of underlying records and books of account. An effective accounting system has been established for the purpose, which involves use of a multi-user accounting software. A system of internal control has also been developed and effectively implemented. As a result, there is adequate segregation of duties coupled with effective checks and controls, appropriate approval and authorization and consistent application of properly documented policies and procedures.

7.3.2 Financial Statements and Budgetary Reports

The audited financial statements of the Commission for the financial year 2001 were submitted to the Federal Government within the stipulated time frame. These financial statements were audited by Taseer Hadi Khalid and Co., Chartered Accountants. The financial statements for the financial year 2002 will be furnished to the Federal Government after the conclusion of statutory audit, which is in progress.

During the year under review, the Finance and Accounts Wing prepared the budget for the year 2002-03, keeping in view the expected revenues and expenses of the Commission for the following year. The budget has been approved by the Commission and the Policy Board under Section 24 of the Act.

During the year, the Finance and Accounts Wing commenced preparation of monthly reports under the Management Information System (MIS). The following reports are included in the MIS:

- (i) Balance Sheet;
- (ii) Income and Expenditure Account;
- (iii) Cash flow Statement;
- (iv) Capital Budget Variance Report;
- (v) Revenue Budget Variance Report; and
- (vi) Division-wise Income and Expenditure Statement.

The MIS reports are placed before the Commission on a monthly basis. These reports provide useful information about the revenue generated and expenditure incurred at each Division in the Headquarters as well as at each CRO. In addition, a consolidated position of assets, liabilities, revenues and expenses of the Commission for each month is determined and a comparative analysis of actual results with the budget is carried out. The introduction of monthly MIS reports has strengthened and improved the ability of the Commission to evaluate its financial performance on a regular basis.

8. Other Developments



- 8.1 Corporate Governance
- 8.2 Legal Wing
- 8.3 Information Technology Wing
- 8.4 Vigilance Cell
- 8.5 External Communication

8. Other Developments

8.1 Corporate Governance

Corporate governance was a key area of reform during the year under review. In March 2002, the first Code of Corporate Governance for Pakistan was finalized by the Commission, which was subsequently included in the listing regulations of the stock exchanges. The Code has been issued by the Commission after an extensive consultative process and is the result of joint efforts of the Commission and ICAP. The initiative to develop a framework of good governance, which addresses the objective circumstances in Pakistan, was taken in December 1998 at the Fifth All Pakistan Chartered Accountants' Conference. The draft Code was developed by a Committee comprising representatives of ICAP, ICMAP, stock exchanges and the Commission. Seminars were held in Karachi, Lahore and Islamabad to elicit opinion on the provisions of the Code. In addition, the draft Code was placed on the websites of ICAP and the Commission. Based on the recommendations received from various quarters, the Code was finalized and made a part of the listing regulations of the three stock exchanges. It is now applicable to all public listed companies.

The Code primarily aims to establish a system whereby a company is directed and controlled by its directors in compliance with best practices so as to safeguard the interests of a diverse range of stakeholders. It proposes to restructure the composition of board of directors to introduce representation by minority shareholders. The Code emphasizes openness and transparency in corporate affairs and decision-making process. It also requires directors to discharge their fiduciary responsibilities in the larger interest of all stakeholders in a transparent, informed, diligent, and timely manner. The salient features of the Code are as follows:

- (i) The Code encourages representation of independent non-executive directors and those representing minority interests on the boards of directors of listed companies.
- (ii) It lays down the qualification and eligibility criteria for directors of listed companies.
- (iii) While reinforcing the powers, responsibilities and functions of the board of directors, the Code formalizes the corporate decision making process and requires adequate documentation of policies and decisions of directors.
- (iv) It seeks to strengthen corporate working, internal control system and external audit requirements of listed companies.
- (v) Corporate and financial reporting framework has been re-defined to foster better disclosure.
- (vi) Audit Committees and internal audit functions are required to be established by all listed companies.
- (vii) A statement of compliance with the Code is required to be published by

companies to set out the extent of compliance with the Code. The statutory auditors of listed companies have been made responsible for reviewing and certifying this statement.

Pursuant to implementation of the Code, the Commission has designed a program to promote good governance practices in the corporate sector in collaboration with the United Nations Development Program (UNDP). Under this program, the Commission will focus on seeking participation of various stakeholders and professionals in the effective enforcement of the Code and broadening the understanding of stakeholders on different aspects of corporate governance. The program will also be instrumental in building the regulatory capacity of the Commission for efficient enforcement of good corporate governance practices. It will also help in keeping pace with international developments on the topic as well as participating in interchange of views on prioritized issues.

8.2 Legal Wing

In an effort to sustain the impetus for achieving a fair, transparent and efficient regulatory environment, the Commission has been actively engaged in the development of its in-house legal expertise. In this regard, a Legal Wing, headed by an Executive Director designated General Counsel, has been set up under the direct supervision and guidance of the Chairman. Drawing upon the successful experience in other Divisions where induction of professionals from the private sector has contributed to improving the quality of work and level of services provided, the Commission has engaged the services of qualified lawyers from the private sector in the Legal Wing as well.



The Commission's team of legal experts

The Legal Wing is primarily involved in assisting various Divisions on legal issues. It works in close association with the Appellate Bench of the Commission, providing extensive research assistance, analyzing and interpreting provisions of law and resolving issues of procedural as well as technical nature. The Wing is currently in the process of finalizing the Appellate Bench Rules, which aim at providing guidelines to contesting parties for expeditious disposal of cases. The Wing also recommends appointment of counsel to represent the Commission in court cases and lends technical as well as substantive support to enable the legal counsel to better represent the interests of the Commission.

The Legal Wing has been entrusted with the role of updating the Commission with respect to contemporary corporate and securities legislation as well as similar new initiatives in other jurisdictions, including the USA and the United Kingdom. At present, the Wing is carrying out a comparative study of securities legislation in certain developing jurisdictions for the purpose of recommending amendments to the Securities and Exchange Ordinance, 1969. This study focuses on the probable effects of legislative amendments and steps to be taken to protect the interests of investors, companies and the securities market. Often, the Legal Wing is called upon to provide assistance to relevant Ministries in reviewing other laws impacting the securities market or the corporate sector and, in the process, facilitates integration of views amongst relevant Governmental agencies.

8.3 Information Technology Wing

The IT revolution has had a profound impact on organizations in developing countries and continues to have significant implications on business development. Realizing the immense possibilities and challenges presented by the rapid spread of IT, the Commission restructured its IT Wing. The IT Wing is engaged in providing efficient services and solutions for boosting the overall efficiency of the various Divisions. Gradual exposure to state-of-the-art technology at the Commission along with step-by-step training has paved the way for general acceptance of IT, which is essential for effective implementation of IT-related action plans.

The IT Wing provides a range of services for various management support functions, including specialized applications, MIS applications and managed workstation services. There is a conscious effort on the part of IT Wing to work in close collaboration with the Divisions of the Commission and CROs to meet the needs of a variety of users.

8.3.1 Software Applications and Database Development

The IT Wing is conscious of the growth of Internet-enabled applications, which have brought about a new challenge to Information System (IS) designs that must accept input and tacit knowledge from a broad range of users. In addition, it is also understood

that IS must now accept and manage dynamic and often unstructured information. The IT Wing is working on appropriate procedures to address these issues.

The following software systems have been, or are being, developed to automate various functions at the Commission.

- (i) **CRS**
The CRS is pivotal to all other software systems at the Commission. It facilitates registration of companies and development of their database. A database of over 43,000 companies has been compiled and put on the central database server in Islamabad with online access to CROs. The system is in place since November 2001.
- (ii) **Corporate Compliance and Facilitation System**
This system is designed to facilitate management of information contained in statutory returns, i.e. Forms A, 3, 10, 16, 17 and 29. It is now being integrated with CRS.
- (iii) **Diary System**
This system is meant to automate the diary register and to track handling of documents within the Commission so as to ensure timely communication and correspondence.
- (iv) **Complaints Monitoring System**
The system is used to keep track of investor complaints and to identify actions taken in respect of each complaint.
- (v) **Specialized Companies Monitoring System**
This system is being developed to monitor submission of various returns filed by specialized companies, i.e. leasing companies, modarabas and mutual funds.
- (vi) **MSS**
The MSS would provide support to MSW for monitoring of trading at the stock exchanges. At present, this system is under development.
- (vii) **Beneficial Ownership Module**
This system is intended to keep a record of beneficial owners of public companies to monitor corporate compliance and insider trading.
- (viii) **General Ledger**
It forms the MIS component to maintain accounts of the Commission in an efficient manner.

(ix) Payroll System

The Payroll System is used to process salaries of employees of the Commission and to provide other facilities, like automatic tax computation and deduction, loans, generation of statements relating to salary payments, etc.

(x) Human Resource System

This system helps to maintain relevant employee records by the Human Resource Wing. It is also an important MIS component with facilities for generation of various management reports.

(xi) Fixed Assets System

This system is designed to keep a record of fixed assets of the Commission and assist in automatic calculation of periodic depreciation.

8.3.2 Website Re-engineering and Maintenance

The website of the Commission is regularly updated to ensure access to accurate and useful information to all concerned. Efforts are also underway to re-engineer the site in order to give it a better appearance and to reorganize the available information in a user-friendly manner. At present, information available on the website includes important corporate and security market regulations; corporate laws; notifications and directives issued by the Commission; orders of the Commission and Appellate Benches; annual reports; and job vacancies within the Commission. An interface of the CRS has been provided on the website for company name search facility, company registration guidelines and prescribed forms. There is also a provision for online registration of investor complaints.

8.3.3 Local Area Network and Wide Area Network Connectivity and Central Services

The IT Wing's technical and developmental role includes: designing the Local Area Network (LAN), Wide Area Network (WAN) and external connections such as Internet, Intranet, e-mail and website development; ensuring appropriate and carefully designed changes to the IT operating environment; investigating system failures requiring software modification; and analyzing cost effective uses of IT. The Commission deployed an extensive LAN at its Headquarters, spanning 10 floors of the building, in November 2001. WAN connectivity is being set up using DXX between the Headquarters, major CROs and the stock exchanges. The IT Wing maintains a variety of servers in order to support the wide-ranging sets of applications. A number of central services have back-up support, including central e-mail system through Microsoft Exchange Server, backup of user data on File Server and Internet surfing facility through a proxy server. The IT Wing contemplates increasing the bandwidth for increasing the speed of external connectivity.

8.3.4 Managed Workstation Services

The IT Wing offers an array of support services to users located in the Headquarters in Islamabad as well as in all CROs. The support staff of the IT Wing creates computing accounts for new staff, offers informal training services, troubleshoots problems and keeps the Commission's computing infrastructure on the cutting edge. Individual personal computers have been linked to a centrally managed files store and software base. Each registered user has a unique User Identity for logging on to the system and has been provided a personal quota space on the network drive. A daily back-up of drive is maintained. All preferences and Windows settings are stored on a per user basis which allows users to move to any other managed machine while retaining the personalized setup. The managed service setup makes it possible to recover from a range of common problems quickly and also helps to avoid the problem of data loss.

The Helpdesk is the primary point of contact within the IS for users and ensures person-to-person advice or help. It channels queries of users to relevant staff within the IT Wing, as required. The Helpdesk also acts as the fault-report point for the CROs throughout the country.

8.3.5 Training in IT Products and Services

The IT Wing seeks to improve the quality of work being done by the various Divisions of the Commission and the CROs through enhancing their ability to maneuver and use IT to the fullest extent possible. Capacity building is being accomplished through informal and formal training programs. During the year, the IT Wing conducted an in-house training program in Microsoft Office and Microsoft Outlook. The IT Wing also plans to organize a comprehensive training program for officers and staff of the Commission in collaboration with a reputed training institute.

8.4 Vigilance Cell

During the year under review, the Commission, through its Vigilance Cell, continued to give top priority to issues pertaining to investors' complaints. The number of complaints registered with the Vigilance Cell exhibited a decline during the year owing to the enhanced institutional capacity and effectiveness of the Commission as a whole. One of the main factors contributing to reduced grievances and disputes between investors, brokers and companies was the introduction and enforcement of new laws and regulations that created a more transparent and efficient market.

As is evident in the table below, a total of 604 complaints, appeals and petitions were lodged with the Commission during the financial year 2002 as against 974 complaints, appeals and petitions received during the preceding year. In all, 585 complaints, appeals and petitions were disposed of during the year under review. Of these, only

64 were pending as of June 30, 2002. The average time taken for disposal of complains, petitions and appeals was considerably reduced due to strict vigilance of the Commission and the emphasis on resolving investor disputes.

TABLE 30 Performance of Vigilance Cell (July 1, 2001 - June 30, 2002)

S No.	RECEIPTS	BROUGHT FORWARD	RECEIVED DURING THE YEAR	TOTAL	DISPOSED OF DURING THE YEAR	PENDING
1	Complaints	40	479	519	470	49
2	Petitions	1	55	56	52	4
3	Appeals	4	70	55	63	11
	TOTAL	45	604	649	585	64

8.5 External Communication

The Commission is conscious of the need to maintain a participative approach for effective implementation of reforms in the financial market and the corporate sector. In this regard, it is essential to engage in regular dialogue with all stakeholders about the positive impact of the various reforms carried out or contemplated. As such, the Commission has always ensured that new rules and regulations are introduced after extensive discussion and consultation with the concerned industry representatives.

During the past two years, the supervisory role of the Commission has expanded manifold. Therefore, the role of external communication in opinion formation, education and minimizing information asymmetry has become the basis for all its initiatives. To focus on this area, a Wing dedicated to external communication was established within the Commission in March 2001. While the immediate task assigned to the Wing was to counter unfounded criticism that the Commission was facing as a result of its deep-rooted reforms, during the year under review, the Wing was also involved in various other activities, including stakeholder awareness and dissemination of timely and accurate information to media and the general public.

8.5.1 Media Coordination

The media act as the eyes and ears of the general public and play a key role in disseminating information to a wide range of audiences. The Commission has ensured that a continuous liaison is maintained with the media so that a true and fair picture of measures taken by the Commission reaches the public and stakeholders. This has resulted in removing various misconceptions about the Commission as well highlighting the impact of reforms introduced in the capital market and the corporate sector.

Constructive criticism from the media continues to be a source of guidance for appropriate adjustments in regulations and policies of the Commission. During the course of the year, regular interaction with media professionals helped in enhancing overall understanding of critical issues. It also resulted in the media becoming generally supportive of the regulatory measures taken by the Commission.

During the year under review, significant activities of the Media Wing were as follows:

(i) Press Briefings

Press conferences of the Chairman of the Commission with media representatives were arranged in Islamabad, Karachi and Lahore. These interactive sessions helped to clear many ambiguities and unfounded criticism of the steps taken by the Commission, particularly with regard to the rationale behind these steps. Dissemination of correct information has also helped in bringing about in-depth understanding of the reforms.

(ii) Articles

The Wing provided assistance to eminent economic writers in preparing articles and facilitated them in gathering relevant and correct information from the industry.

During the year under review, there was extensive media coverage of financial sector regulations around the world, in general, and in Pakistan, in particular. While eminent journalists wrote articles on almost all aspects of the financial sector, a large number of articles were published on the performance of the capital market, regulatory changes, mergers and consolidation, corporate governance and the role of auditors. After the events of September 11, 2001, the insurance industry around the world was brought to center stage and Pakistan was no exception. In this regard, there was considerable debate in the media on the performance of the insurance industry and steps taken by the Commission to revive this sector.

Although improvement in every section of economic activity is a continuing process, yet the up-gradation in the management of the stock exchanges is a distinctive achievement of the SEC.

Business Recorder

With effective reforms introduced in the capital market, country's stock market has depicted ample improvement during the last two and a half years.

Nation

(iii) Press Releases

As a matter of policy, the Media Wing keeps track of developments in the various Divisions within the Commission and regularly sends handouts to the media to keep them updated with the latest regulatory measures. Over the course of the year, the handouts have become a regular aspect of the Wing's activities and are greatly appreciated by the media.

The upgrading of the corporate practices is, indeed, a macro-level national priority. It is no less important at micro level either. Global investors will not look twice at us unless the existing corporate practices are improved.

Dawn

(iv) Liaison with Organizations in Other Jurisdictions

Financial market developments cannot be analyzed in isolation and require a review of contemporary issues in global financial markets. For providing policy support to the Commission and to develop an insight into international regulatory developments, the Wing maintained continuous liaison with regulatory bodies, research institutes and international media on contemporary developments in financial markets.

8.5.2 Publications

The Commission has been involved in developing a series of publications for the assistance and guidance of investors. A quarterly newsletter was started in September 2001 that focuses on the activities of the Commission, related developments in the capital market as well as future trends. Three issues of the newsletter have so far been published.

In continuance of its investor awareness program, the Commission plans to bring out a series of guides relating to corporate governance and insurance.