

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ



## **The Securities and Exchange Commission of Pakistan**

was established under the Securities and Exchange Commission of Pakistan Act, 1997 for beneficial regulation of the capital market and superintendence and control of corporate entities. Over time, its mandate has been expanded to include supervision and regulation of insurance companies and non-banking finance companies. Consequently, the Commission is now an integrated corporate and non-banking financial sector supervisor/regulator.

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 1 July 2003 to 30 June 2004.

# Abbreviations and Acronyms

ADB	Asian Development Bank
ADR	Alternate Dispute Resolution
AGM	Annual General Meeting
ALICO	American Life Insurance Company (Pakistan) Limited
AML	Anti-money Laundering
APG	Asia/Pacific Group
CA	Chartered Accountant
CBR	Central Board of Revenue
CDC	Central Depository Company of Pakistan Limited
CDS	Central Depository System
CEES	Companies Easy Exit Scheme
CEO	Chief Executive Officer
CFT	Countering the Financing of Terrorism
CLA	Corporate Law Authority
CLD	Company Law Division
CMA	Cost and Management Accountant
CNIC	Computerized National Identity Card
COI	Certificate of Investment
Cost Audit Rules	Companies (Audit of Cost Accounts) Rules, 1998
COT	Carry-over Transactions
CRO	Company Registration Office
CS	Chairman's Secretariat
CSR	Corporate Social Responsibility
Deposit Rules	Companies (Invitation and Acceptance of Deposit) Rules, 1987
DFI	Development Finance Institution
EFU	EFU Life Assurance Limited
EMC	Emerging Markets Committee
FMGP	Financial (non-bank) Markets and Governance Program
FSAP	Financial Sector Assessment Program
FY	Financial Year
GATS	General Agreement on Trade in Services
GNP	Gross National Product
HBFC	House Building Finance Corporation
IAIS	International Association of Insurance Supervisors
IAS	International Accounting Standard
ICAP	Institute of Chartered Accountants of Pakistan
ID	Insurance Department
IFIC Bank Limited	International Finance Investment and Commerce Bank Limited
IMF	International Monetary Fund
INPRS	International Network of Pension Regulators and Supervisors
Insurance Ordinance	Insurance Ordinance, 2000
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offer
ISE	Islamabad Stock Exchange
IT	Information Technology
ITSP	Information Technology Strategy Plan
JEIS	Junior Executives Induction Scheme
KSE	Karachi Stock Exchange
KSE-100 Index	Karachi Stock Exchange 100 Shares Index
KYC	Know-Your-Customer
LAN	Local Area Network
LSE	Lahore Stock Exchange
LUMS	Lahore University of Management Sciences
MAP	Modaraba Association of Pakistan
METRO	Metropolitan Life Assurance Company of Pakistan Limited
MIS	Management Information System
MLM	Multi-level Marketing

Modaraba Ordinance	Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980
Modaraba Rules	Modaraba Companies and Modaraba Rules, 1981
MoU	Memorandum of Understanding
MSF	MetroBank Pakistan Sovereign Fund
NAB	National Accountability Bureau
NAV	Net Asset Value
NBFC	Non-banking Finance Company
NBFCD	Non-banking Finance Companies Department
NBFC Rules	Non-banking Finance Companies (Establishment and Regulation) Rules, 2003
NBFI	Non-banking Financial Institution
NBP	National Bank of Pakistan
NCCPL	National Clearing Company of Pakistan Limited
NCEL	National Commodity Exchange Limited
NDLC	National Development Leasing Corporation
NICL	National Insurance Company Limited
NJLI	New Jubilee Life Insurance Company Limited
NOC	No Objection Certificate
OGDCL	Oil and Gas Development Company Limited
OTC	Over-the-Counter
PD	Policy Department
PIA	Pakistan International Airlines Corporation
PICIC	Pakistan Industrial Credit and Investment Corporation
Policy Board	Securities and Exchange Policy Board
PRCL	Pakistan Reinsurance Company Limited
PSD	Professional Services Department
PSPD	Professional Services and Policy Division
QCR	Quality Control Review
RIA	Regulatory Impact Assessment
SBP	State Bank of Pakistan
SCD	Specialized Companies Division
SLIC	State Life Insurance Corporation of Pakistan
SMC	Single Member Company
SMD	Securities Market Division
SME	Small and Medium Enterprise
SOE	State-owned Enterprise
SPV	Special Purpose Vehicle
SRO	Self-regulatory Organization
SSD	Support Services Division
SSGCL	Sui Southern Gas Company Limited
TA	Technical Assistance
TFC	Term Finance Certificate
The Commission	The Securities and Exchange Commission of Pakistan
The Companies Ordinance	The Companies Ordinance, 1984
The Constitution	The Constitution of the Islamic Republic of Pakistan, 1973
The SECP Act	The Securities and Exchange Commission of Pakistan Act, 1997
ToR	Terms of Reference
UK	United Kingdom
UNDP	United Nations Development Program
UNODC	United Nations Office on Drugs and Crime
USA	United States of America
UTP	Unit Trust of Pakistan
VPS	Voluntary Pension System
WAN	Wide Area Network
WG3	Working Group-3
WTO	World Trade Organization

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## Vision

The development of modern and efficient corporate sector and capital market, based on sound regulatory principles, that provide impetus for high economic growth and foster social harmony in the country.

## Mission

To develop a fair, efficient and transparent regulatory framework, based on international legal standards and best practices, for the protection of investors and mitigation of systemic risk aimed at fostering growth of a robust corporate sector and broad based capital market in Pakistan.

## Strategy

To develop an efficient and dynamic regulatory body that fosters principles of good governance in the corporate sector, ensures proper risk management procedures in the capital market, and protects investors through responsive policy measures and effective enforcement practices.

# Chairman's Report

I am pleased to present the annual report of the Securities and Exchange Commission of Pakistan (the Commission) covering the year 1 July 2003 to 30 June 2004. During the year under review, sustained efforts were made to implement the reform measures identified at the outset of the year. The Commission developed a diagnostic approach towards solving the various issues in the financial sector and intends to develop a medium-term strategy for the regulation and development of corporate and financial (non-banking) sectors.



## Market Development

Regulatory mechanisms of the Commission supplemented the milestones achieved by the capital market during the year as the Karachi Stock Exchange 100 Shares Index touched an all time high of 5,620 on 19 April 2004. Market capitalization of the Karachi Stock Exchange nearly doubled during the year, reaching US\$ 24.3 billion as at the close of the year from US\$ 13.05 billion as at the close of last year.

Activity in the primary market signified the depth added to the capital market. There were eleven equity issues during the year, compared to three in the last year. All, except one, were oversubscribed. The Commission continued to take proactive measures to curtail systemic risk in the capital market and, in this regard, introduced the Margin Trading Rules, 2004. Moreover, a road map for the phase-out of Carry-over Transactions (COT) was also announced in consultation with the stock exchanges; accordingly, COT would be replaced by margin financing and futures trading by June 2005.

To strengthen and develop the financial sector, the Commission continued to encourage mergers for improving the capital base of non-banking finance companies (NBFCs). It also granted licenses to new NBFCs to undertake various forms of business, as laid down in the Companies Ordinance, 1984. New products were also introduced in the insurance sector as the Commission introduced takaful business in the country and constituted a task force to prepare necessary rules in this regard. Pursuant to its recently expanded mandate to regulate private pension schemes in the country, the Commission designed a scheme of voluntary pension system and is presently finalizing the rules for the purpose.

## Governance Measures

The Commission diligently pursued its objective of improving the governance of capital market and corporate sector. During the year, the Commission constituted an Expert Committee, comprising of national and international experts, to formulate a comprehensive plan for demutualization and integration of stock exchanges. For the furtherance of corporate governance, the Commission initiated the process of setting up an Institute of Corporate Governance in Pakistan in collaboration with major stakeholders. The Institute, which is now at the final stages of establishment, shall provide training and development in corporate governance as well as cater for indigenous research. In all, it will provide an enabling environment for effective implementation of the Code of Corporate Governance.

## Institutional Developments

During the year, the Securities and Exchange Policy Board (Policy Board) was reactivated and brought to its full strength of nine members. The Policy Board provides advice to the Federal Government relating to the securities market, insurance industry and corporate sector as well as oversees the performance of the Commission. Meetings of the Policy Board were held every quarter during the year to achieve these purposes.

In order to strengthen the policy making function at the Commission as well as to ensure the independence of professional services provided to the financial sector under its purview, the Commission underwent internal restructuring and established a new Division, namely, Professional Services and Policy Division. The Division recommends policy guidelines for the consideration of the Commission and the Policy Board, based on international best practices and local circumstances. One of the key responsibilities assigned to the Division is to regulate and promote the development of professional bodies and self-regulatory organizations. The Division also provides legal support to the Commission.

Efficient and timely resolution of investor complaints was rigorously pursued so as to achieve the Commission's primary objective of protection of investor interests. An enabling environment within the Commission is being engendered for this purpose and well-defined, transparent procedures have been developed. Capacity building of the Commission also remained a continuous feature of development. A number of skilled professionals were inducted during the year and placed in various Divisions of the Commission. Capacity building in terms of information technology (IT) enhancement was also undertaken during the year.

## Operational Overview

During the year under review, public facilitation was enhanced to ensure growth of the corporate sector. The incorporation fee was reduced and a number of guides were published to educate the public. The Companies Easy Exit Scheme was re-launched to provide another opportunity to dormant companies to get their names struck off the register of companies. On the enforcement side, the Commission undertook targeted actions to discourage unauthorized inter-corporate financing, non-payment of dividends, irregularities relating to employees' provident fund accounts and other contraventions of statutory provisions.

In the securities market area, the Commission initiated on-site inspection of books and records of several brokers. Furthermore, the National Clearing Company of Pakistan Limited has improved efficiency of the settlement process and operationalization of the National Commodity Exchange is in the offing.

In order to strengthen the non-banking finance sector and introduce a uniform set of regulations, prudential regulations were introduced for NBFCs while prudential regulations for modarabas were revised. Accounting regulations and accounting formats for life insurance companies were also reviewed while their illustrative returns were capped at 8 percent.

The Commission maintained a regular review of operational matters of professional bodies of accountants and credit rating agencies. Amendments were proposed in various laws administered by the Commission and guidelines on certain regulatory matters were drafted. The Fourth Schedule to the Companies Ordinance, 1984 was also revised to improve the reporting framework of listed companies.

Within the Commission, the Internal Audit, Human Resource, Finance, Administration and IT functions were strengthened to provide efficient services to the Commission. The Commission also liaised with various multilateral organizations and relevant capital market and non-banking financial sector related projects were initiated/extended during the year with their assistance.

## International Activities

To attain harmonization of policies internationally, the Commission deems it expedient to contribute to the actual standard setting process. This is ensured through active participation in international fora and standard setting bodies. During the year under review, the Commission was honored to be re-elected to chair the Working Group-3 (WG3) of Emerging Markets Committee (EMC) of the International Organization of Securities Commissions (IOSCO). As chair of the WG3, the Commission presented a draft report on 'Cross-border Activities of Financial Intermediaries in Emerging Markets' at IOSCO's Annual Conference in Amman, Jordan this year. The report covers the issue of cross-border trading at three levels – international experience, prevalent regulatory practices in EMC member countries and recommendations for emerging markets.

Subsequent to the close of the year, the Commission obtained membership of the International Organization of Pension Supervisors in consideration of its mandate to regulate voluntary pension schemes in Pakistan. The Commission also joined the International Association of Insurance Supervisors (IAIS) to coordinate with counterpart regulatory authorities in the area of insurance; its membership is subject to approval in the forthcoming annual meeting of IAIS.

During the year under review, joint Mission of the World Bank and the International Monetary Fund visited the Commission in connection with Financial Sector Assessment Program. The Mission carried out detailed assessments of compliance with IOSCO's thirty principles of securities regulation as well as in areas of insurance and NBFCs. While finding the Commission compliant to a large extent with IOSCO's principles, the Mission highlighted that the securities market has gained from the recent reforms introduced by the Commission but may still be vulnerable to risk owing to speculative trading and highly leveraged position. Detailed recommendations were also made in this regard, which are being used in developing a blue print for securities market reforms.

## Bilateral Cooperation

As a step towards bilateral cooperation, the Commission signed a Memorandum of Understanding (MoU) with the Securities and Exchange Commission of Sri Lanka. The three stock exchanges of Pakistan also signed MoUs with the stock exchanges of Colombo and Chittagong. The MoUs set out a framework for mutual cooperation and sharing of information amongst these jurisdictions, which is in line with our objective of integrating Pakistan's capital market with global markets.

In order to ensure holistic regulation, the Commission has initiated coordination with other regulatory bodies within the country. Coordination with the State Bank of Pakistan (SBP) is being strengthened and quarterly coordination meetings are held regularly to discuss areas of mutual concern and to ensure that there are no regulatory gaps or overlaps. A MoU was signed with SBP to institutionalize mutual cooperation. The Commission is also in the process of forming a task force with the Central Board of Revenue (CBR) to study the tax structure for addressing the impediments to corporatization and growth of the corporate sector.

## Regulatory Challenges

The Commission enjoys different roles, ranging from supervisory to regulatory, in the various sectors under its purview. At the time of its establishment, the Commission was assigned the regulation of capital market and corporate sector. Subsequently, insurance and non-banking finance sectors as well as private pensions were also passed on to the Commission. While the idea of consolidated regulation is appreciable, the Commission's mandate – that has enlarged substantially but piece-meal – needs to be realigned and made consistent across all sectors. In terms of the securities market, the corporate sector as well as the NBFC sector, the Commission is the apex regulator; however, in the insurance sector, there is a need to strengthen the powers of the Commission to effectively enforce the rules and regulations and take timely remedial actions to protect the interests of policyholders. Cohesive regulation of the sectors under the Commission's purview cannot be achieved unless uniform regulatory powers are assigned to it for all sectors.

In the area of professional services for corporate and financial sectors, a regulatory gap seems to exist. Although the Federal Government has delegated its powers to the Commission for regulation of certain service providers in the industry, many are functioning without

any proper regulatory framework in place. Service providers have a key role to play in the development of corporate and financial sectors and unless they are given due recognition and regulated under one umbrella, it would be difficult to raise the standards of corporate service delivery and strengthen these sectors.

Despite the focused measures undertaken by the Commission to improve the regulatory framework, regulatory imbalance among various sectors proves to be a major hindrance to the uniform development of the financial (non-banking) sector. Sustained buoyancy in the financial sector cannot be achieved unless its various segments receive adequate attention and uniform regulation is set out for each.

In an attempt to address some of these issues, I have developed a blueprint for the regulation and development of corporate and financial (non-banking) sectors, which is laid out in the first chapter of this report. The blueprint is intended to assist the Commission in developing the proposed medium-term strategy for the purpose.

## Regulatory Policy

In order to overcome the regulatory imbalance, the Commission intends, with the help of the Policy Board, to develop an integrated and uniform regulatory policy focused on removing the gaps in regulation and providing an enabling environment for business growth and development. The regulatory policy will, *inter alia*, include the following:

- i. a framework for proactive and flexible regulation;
- ii. standards defining the structure and quality of information that regulatees should provide; and
- iii. harmonization between local requirements and international best practices.

In order to introduce cost-effective regulation in the country, the Commission also intends to restructure the legal and regulatory framework, including the introduction of regulatory impact assessment (RIA). The Commission takes due cognizance of the fact that the policies it adopts have far reaching effects on various segments of the economy. As the ultimate aim of any legal and regulatory framework is to provide impetus to economic development, it is important to scrutinize its impacts on the various facets of the economy. RIA will provide the Commission with the mechanism to evaluate the impact of its laws, rules and regulations and strengthen the design and implementation of regulatory strategies.

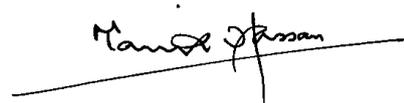
The Commission further intends to develop a corporate tax policy, in collaboration with CBR, to promote corporatization and encourage progressive development of corporates in the country.

## Acknowledgments

Before I conclude, I would like to thank the Policy Board members for their valuable guidance and support. I would also like to take this opportunity to commend the management and staff of the Commission for their hard work and dedication throughout the year. It has been through concerted and focused team effort that the Commission has achieved many more milestones this year. I value the contributions of all my colleagues and am grateful for their efforts to improve institutional services for all stakeholders. In particular, I would like to acknowledge and appreciate the valuable contribution of Mr. Zafar-ul-Haq Hijazi who retired as Commissioner during the year. Mr. Hijazi contributed immensely towards the reform process instituted by the Commission over his five-year tenure as Commissioner.

I would also like to extend my gratitude to Mr. Shamim Ahmad Khan, first Chairman of the Commission and the architect of its institutional reforms, for not only his valuable comments on the blueprint set out in chapter 1 of this report but also his dedicated support for the continuing process of reforms being followed by the Commission.

Last but not least, I would like to thank my staff and, in particular, the editorial team comprising Jaweria Ather, Sarah Parvez and Salman Khan for ensuring the quality of this report.



The background of the cover features the national coat of arms of Malaysia, which includes a crescent moon and a star at the top, a shield with a scale of justice, a sword, and a book, and a banner at the bottom. The entire design is rendered in a dark red color.

**A BLUEPRINT FOR REGULATION AND  
DEVELOPMENT OF CORPORATE AND  
FINANCIAL (NON-BANKING) SECTORS**

**S E C**

# A Blueprint for Regulation and Development of Corporate and Financial (non-banking) Sectors<sup>1</sup>

*Regulation is a means to an end and not an end in itself. The objective of regulation is the progressive development of business, commerce, trade and industry.*

*Dr. Tariq Hassan*

## 1.1 Introduction

The power to regulate business and trade and enact business and trade laws is provided in the Constitution of the Islamic Republic of Pakistan, 1973 (the Constitution). The Constitution, under Article 18, grants every citizen the right to enter into any lawful profession or occupation and to conduct any lawful trade or business. This fundamental right is conditional on such qualifications, if any, as may be prescribed by law for the purpose. Various trade and business laws, falling within the Federal Legislative List of the Constitution, have been enacted to lay down qualifications for the conduct of banking, insurance, and securities businesses. Furthermore, an enactment on companies, including non-banking finance companies (NBFCs), serves as the underlying legislation for all such business and trade activities.

The fundamental right to conduct any trade or business is also subject to the stipulation that any trade or profession may be regulated by a licensing system and that trade, commerce or industry may be regulated in the interest of free competition as well. Based on these stipulations, the Securities and Exchange Commission of Pakistan (the Commission) was established in 1997 for the beneficial regulation of capital market and superintendence and control of corporate entities. Over time, its supervisory and regulatory mandate has been extended to insurance companies, NBFCs, private pensions as well as various professional services.

The rule and regulation making powers of the Commission are derived from the Securities and Exchange Commission of Pakistan Act, 1997 (the SECP Act). Section 43(b) of the SECP Act provides that rules under the Companies Ordinance, 1984 (the Companies Ordinance) or under any law being administered by the Commission shall be made by the Commission with the approval of the Federal Government. Similarly, the power to make regulations have been conferred by Section 40 of the SECP Act on the Securities and Exchange Policy Board (Policy Board) on the recommendation of the Commission and in consultation with the Federal Government and also on the Commission in consultation with the Policy Board.

In addition to its regulatory function, the Commission has been assigned the task of encouraging the organized development of the corporate sector and the capital and insurance markets in Pakistan. In performing its functions and exercising its powers, the Commission is required to maintain facilities and improve the performance of companies and securities markets in the interest of commercial certainty, reducing business costs, and boosting efficiency and development of the economy. It is also required to promote the establishment and development of professional and educational organizations connected with insurance business with a view to improving the quality of insurance services in the country.

Mindful of its expanded role as an integrated regulator of corporate and financial (non-banking) sectors in Pakistan, the Commission is in the process of developing a medium-term strategy for improving the existing regulatory framework and facilitating the development of corporate and financial sectors.

As a step towards the formulation of the medium-term strategy, this chapter provides an overview of the current legal and regulatory framework of sectors falling within the purview of the Commission and identifies issues impeding development of these sectors. It suggests measures to address the challenges that lie ahead and provides a blueprint for the effective regulation and development of corporate and financial (non-banking) sectors in the country. Based on this blueprint, the Commission intends to develop a more comprehensive regulatory framework for development over the course of the year.

<sup>1</sup> Financial (non-banking) sector, for the purpose of this report, includes capital market, insurance sector, NBFC sector, modaraba sector, private pensions as well as professional service providers in these sectors.

## 1.2 Overview of Legal and Regulatory Framework

Over the past few years, the Commission has introduced a plethora of reforms in the legal and regulatory framework with a view to improve and update the same. This section outlines those significant developments in the legal and regulatory framework, which have considerable bearing on the future development of the corporate and financial (non-banking) sectors.

### 1.2.1 Corporate Sector

The Commission, upon succeeding the erstwhile Corporate Law Authority (CLA), was charged with the responsibility of regulating the affairs of companies through administering and enforcing the Companies Ordinance. The Companies Ordinance, which repealed the Companies Act, 1913, was promulgated to, *inter alia*, consolidate and amend the law relating to companies and certain other associations for the purpose of healthy growth of corporate enterprises, protection of investors and creditors, promotion of investment and development of economy. These objectives are met by detailed provisions in the Companies Ordinance pertaining to formation and registration of companies, their management and administration, duties and liabilities of directors and chief executive officers (CEOs), allotment, issue and transfer of shares, and regulation of deposits. There are also provisions for foreign companies to establish their places of business in Pakistan. Additionally, investors and creditors are protected through provisions enabling investigation, prevention of mismanagement, and winding up and liquidation of companies, with detailed sections on legal proceedings and offences.

Since the commencement of its operations in 1999, the Commission has been involved in the process of revamping the existing corporate laws and suggesting new ones to keep up with the changing needs and circumstances in Pakistan and the emerging trends internationally. Two significant developments in the regulatory framework for the corporate sector were the introduction of the concept of a single member company (SMC) and the Code of Corporate Governance.

Following the European Union model, which allows registration of a private limited company as a SMC, the Commission introduced this concept in the Companies Ordinance through the Companies (Amendment) Ordinance, 2002. Subsequently, the Single Member Companies Rules were framed in 2003 to address the practical requirements of this new concept. The introduction of SMCs will facilitate sole proprietorships to obtain corporate status and give them the privilege of limited liability as well as encourage documentation of the economy.

In order to promote good governance practices in the corporate sector, the Commission issued the Code of Corporate Governance in March 2002, which was subsequently included in the listing regulations of stock exchanges. It is presently applicable to all public listed companies while efforts are underway to extend the initiative to public sector entities and not-for-profit associations. The Code emphasizes openness and transparency in corporate affairs and decision-making process of companies and requires directors to discharge their fiduciary responsibilities in the larger interest of all stakeholders in a transparent, informed, diligent and timely manner. It seeks to strengthen corporate working, internal control system and external audit requirements of companies. Moreover, corporate and financial reporting framework has been re-defined to foster better disclosure.

### 1.2.2 Capital Market

The Commission regulates all aspects of the capital market including licensing and coordination, regulation of secondary market and market intermediaries, and public offerings; in addition, the Commission undertakes regular monitoring and surveillance of the market. The Securities and Exchange Ordinance, 1969 is the primary legislation providing for the protection of investors, regulation of markets and dealings in securities. These objectives are met through requirements stipulating that stock exchanges must be registered with and hence regulated by the Commission. There are further stipulations in the Securities and Exchange Ordinance, 1969 prohibiting

insider trading, fraudulent acts, false statements and making fictitious and multiple applications for new shares. The Securities and Exchange Rules, 1971, framed thereunder, provide for the basic qualification for membership of stock exchanges, the parameters for transactions of members' business and the maintenance of accounts.

Major reforms have been introduced in the regulation and working of the capital market to bring it in line with international standards. The Central Depositories Act, which was promulgated in 1997 and provides for the establishment and operation of book entry systems for transfer of securities by central depository companies, and the Central Depository Companies (Establishment and Regulations) Rules, 1996 have been instrumental in achieving the desired results. They have helped replace the manual system of physical handling and settlement of shares with a modern and efficient electronic system.

The Listed Companies (Substantial Acquisition of Voting Shares and Takeovers) Ordinance, 2002 has been promulgated to provide for fair and equal treatment of all investors as well as a transparent and efficient system for substantial acquisition of voting shares and takeovers of listed companies. These objectives are met by the requirement that persons acquiring more than 10 percent of the voting shares in a listed company must disclose this information to the said company and to the concerned stock exchange. Similarly, a person who intends to acquire more than 25 percent voting shares has to make a public announcement of his offer and send an offer letter to all the shareholders of the company.

In order to bring trading practices in stock exchanges in line with international best practices, the Commission has framed the Margin Trading Rules, 2004. These Rules aim to replace Carry-over Transactions (COT) or 'Badla' with margin financing so as to reduce systemic risk and speculative trading associated with COT/Badla. For the purpose, only such brokers, who are registered with the Commission and who meet the minimum net capital and capital adequacy requirements, will be allowed to engage in margin trading and margin financing. Margin trading will be allowed in scrips fixed by the Commission, in consultation with stock exchanges. Furthermore, the Commission, in consultation with stock exchanges, will fix the limit of margin financing facility available to any single client of the broker.

### **1.2.3 Insurance Sector**

The insurance sector was previously under the regulatory purview of the Ministry of Commerce. In the year 2000, regulatory authority was passed on to the Commission upon promulgation of the Insurance Ordinance, 2000 (Insurance Ordinance), which repealed the Insurance Act, 1938.

The Insurance Ordinance provides for improved capitalization and administration of the insurance sector and introduces market conduct policies and procedures for sound and prudent management of insurers and protection of rights of policyholders. These objectives have been met by provisions in the Insurance Ordinance stipulating that only public companies registered with the Commission will be allowed to carry on the business of insurance. The administration of the insurance sector has been further improved by dividing it into life insurance and non-life insurance businesses. Life insurance business has been divided into four classes whilst non-life business has been divided into ten different classes. Moreover, in order to strengthen capital base of insurers, minimum paid-up capital requirements for life insurance and non-life insurance companies have been increased to Rs. 150 million and Rs. 80 million, respectively, while life insurance companies are also required to maintain statutory funds.

The Commission framed the Securities and Exchange Commission (Insurance) Rules, 2002 to give effect to the various provisions of the Insurance Ordinance. The said Rules cover significant matters relating to accounting and reporting, reinsurance arrangements and solvency and capital requirements for insurers, eligibility criteria for insurance agents/intermediaries, and conduct of surveyors.

#### 1.2.4 NBFC and Modaraba Sectors

In order to provide for holistic and consolidated regulation of the sector, regulatory authority over various non-banking financial institutions (NBFIs) was transferred from the State Bank of Pakistan (SBP) to the Commission over a period of time. During 2002, the NBFC regime was introduced through suitable amendments in the Companies Ordinance, as a result of which regulatory authority of the Commission and SBP over financial sector has been clearly segregated. Accordingly, NBFCs have been allowed to function as companies, duly licensed by the Commission and having multi-tiered capital requirements, to carry out any one or more of the following forms of business, namely:

- i. asset management services;
- ii. discounting services;
- iii. housing finance services;
- iv. investment advisory services;
- v. investment finance services;
- vi. leasing; and
- vii. venture capital investment.

The main objective behind implementation of the NBFC concept was to consolidate the non-banking financial sector by allowing multiple business activities under one umbrella, so that a whole variety and range of financial products tailored to the needs of customers could be offered through a one-window operation. Mergers and consolidation in the sector are expected to contribute towards stronger and financially viable institutions.

In order to provide a comprehensive framework for regulation and monitoring of NBFCs, the Non-Banking Finance Companies (Establishment and Regulation) Rules (NBFC Rules) were notified in 2003. The NBFC Rules lay down the minimum equity requirements for each business activity covered under the NBFC regime ranging from Rs. 5 million for venture capital companies to Rs. 300 million for investment finance companies. Detailed conditions and comprehensive legal requirements for undertaking each of the business activities have also been laid down in the NBFC Rules.

The registration of modaraba companies and the floatation, management and regulation of modarabas is done through the application of the Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980 (Modaraba Ordinance) and the Modaraba Companies and Modaraba Rules, 1981 (Modaraba Rules). The Modaraba Ordinance and Modaraba Rules lay down the minimum paid-up capital requirements for floating a modaraba, which may be either multi-purpose or specific-purpose.

#### 1.2.5 Private Pensions

In 2003, while the Ministry of Finance assigned its actuarial office to develop a contributory pension scheme for all new employees of the Government, development of the private pension scheme was entrusted to the Commission. The Commission has designed a scheme for Voluntary Pension System (VPS), which has been approved, in principle, by the Ministry of Finance. Necessary rules in this regard would be formulated to provide a comprehensive legal framework for private pensions in the country, to be administered by the Commission.

#### 1.2.6 Professional Services

In case of professional service providers, the extent of the Commission's supervisory/regulatory authority varies largely.

### **i. Accountants**

The accountancy profession in Pakistan is mainly regulated by two self-regulatory organizations (SROs), namely, the Institute of Chartered Accountants of Pakistan (ICAP) and the Institute of Cost and Management Accountants of Pakistan.

The Commission maintains oversight of the accountancy profession through powers given under the Companies Ordinance in relation to auditors and development of relevant financial reporting framework for companies. Furthermore, the Code of Corporate Governance contains a number of provisions for bringing about greater transparency and independence in the activities of auditors and accounting firms. The Commission is also represented by its Chairman on the ICAP Council, which facilitates participation in efforts to better develop and regulate the profession.

### **ii. Company Secretaries**

Company secretaries play an important role in improving the governance of corporate entities. At present, there are no effective regulatory provisions or institutions for regulation and supervision of these service providers. The profession is fast growing though, particularly due to the legal requirements for appointment of company secretaries by listed companies and SMCs. In this regard, the Commission has prescribed the qualifications of company secretaries to be appointed by listed companies and SMCs, through the Companies (General Provisions and Forms) Rules, 1985 and the Single Member Companies Rules, 2003, respectively.

### **iii. Administrators, Receivers and Liquidators**

Administrators, receivers and liquidators play an important role in not only corporate insolvency but also in prevention of mismanagement of companies. This role is reflected in various sections of the Companies Ordinance including Section 295 whereby the Commission may order appointment of an administrator from a panel maintained by it to manage the affairs of a company that is not being run properly. Similarly, in winding up of companies by the court, an official liquidator is appointed from a panel maintained by the court, on the recommendations of the Commission. Presently, there is no regulatory framework in place for these professional service providers.

### **iv. Stock Brokers and Agents**

The integrity of members of stock exchanges and their brokers and agents is essential to instill confidence of investors in the capital market. In terms of the Securities and Exchange Ordinance, 1969, the Commission has the authority to monitor intermediaries associated with the securities market.

The Commission regulates the affairs of brokers and agents through the Brokers and Agents Registration Rules, 2001. In case of any unscrupulous or unethical activity or contravention of legal provisions, the Commission is empowered to cancel or suspend the registration of brokers and agents and impose fines. The Members' Agents and Traders (Eligibility Standards) Rules, 2001 lay down necessary criteria for registration of agents and traders of members of stock exchanges.

### **v. Financial Analysts**

Financial and investment analysts play a crucial role in the securities market. However, there is presently no direct legal requirement for regulation or supervision of these service providers.

### **vi. Insurance Surveyors and Intermediaries**

Section 20(4)(t) of the SECP Act provides for regulation of professional organizations connected with insurance business. Moreover, Section 20(4)(s) thereof provides that the Commission has to ensure and monitor compliance of insurance surveyors and intermediaries with laws, rules and regulations pertaining to insurance.

The insurance law has put in place strict controls for insurance agents and insurance brokers. Licensing, qualification and power for inspection in relation to insurance agents and insurance brokers are stated in Part XIII of the Insurance Ordinance while licensing and registration of insurance surveyors is to be monitored and maintained by the Commission as provided in Sections 112 to 114 of the Insurance Ordinance.

#### **vii. Actuaries**

The Commission may give assent to or reject, on reasonable grounds, the appointment of an actuary by any insurance company under Section 26 of the Insurance Ordinance. The responsibilities of actuaries and their dismissal are provided in Section 27 of the Insurance Ordinance. Moreover, Section 22(4)(da) of the SECP Act requires the Commission, while exercising its powers, to have regard to the professional competence and capability of persons engaged in the provision of services in the insurance industry.

While the said provisions do provide the Commission with authority in respect of appointment of actuaries, there is no specific provision empowering the Commission to prescribe a code of conduct for actuaries or impose penalties in case of deviation from responsibilities laid down in the Insurance Ordinance.

#### **viii. Credit Rating Companies**

In terms of Section 32-B of the Securities and Exchange Ordinance, 1969, the Commission is vested with powers to regulate credit rating companies. The Credit Rating Companies Rules, 1995 provide the necessary legal framework for registration and certain operational matters of credit rating companies. Under the said Rules, the Commission has powers relating to registration, renewal and cancellation of licenses of these companies. Moreover, the Commission can also give them necessary directions; accordingly, it has been made mandatory on credit rating companies operating in the country to submit their annual rating reports to the Commission.

### **1.3 Market Overview**

Market development forms an integral part of the Commission's role. Since its establishment, the Commission has implemented reforms in the context of broader macroeconomic stabilization and structural agenda, thereby providing impetus to the growth and development of sectors under its purview.

As a result of the developmental efforts of the Commission, the corporate sector has witnessed rapid growth in its size with a larger number of companies registering with the Commission over the past few years. As of 30 June 2004, there were a total of 43,728 companies in the country. Of these, 42,681 companies were limited by shares including 39,769 private companies, 2,768 public companies and 144 SMCs. Foreign companies in Pakistan totaled 555; of these, 39 percent belonged to European countries, 18 percent to Asian countries and 17 percent to the United States of America (USA). New companies registered during the course of the year totaled 2,207.

Effective market development and regulation has contributed towards the positive growth of Pakistan's capital market. The Karachi Stock Exchange (KSE) has been pronounced as one of the best performing markets in the world; aggregate market capitalization of KSE was recorded at Rs. 1,421 billion against last year's figure of Rs. 755.8 billion. The Karachi Stock Exchange 100 Shares Index (KSE-100 Index) reached an all time high of 5,620.7 during the year.

The insurance sector has also exhibited progress during the year. There was increase in gross direct premium in both life and non-life insurance sectors. Gross direct non-life insurance premium showed an increase of 0.05 percent whereas for life insurance companies, the increase was 26.43 percent during the year.

Most activities within the NBFC and modaraba sectors depicted improved performance. The leasing and investment finance sectors showed impressive growth – total assets of leasing companies increased by 19 percent during the year while those of investment banks and modarabas increased by 24.7 percent and 11 percent, respectively. Performance of the capital market paved the way for growth of mutual funds, which nearly doubled their asset holdings during the year. However, growth in the housing finance sector remained stagnant. Moreover, discount houses and venture capital companies, which are still in their infancy, checked the marked growth of the NBFC sector.

## 1.4 Regulatory Issues and Developmental Challenges

### 1.4.1 Regulatory Issues

#### i. Regulatory Policy Vacuum

Formulation of appropriate regulatory policies remains a major challenge for the Organization. The policy making function of the Commission is required to be performed by the Policy Board, appointed by the Federal Government. The Commission is authorized to identify matters requiring policy decisions by the Policy Board; it can also make recommendations for consideration of the Policy Board. The Policy Board is empowered to make policy decisions *suo motu* or adopt policies recommended by the Commission. It can express its opinion in writing on any policy matter referred to it by the Federal Government or the Commission. Moreover, all policy decisions, including any change in a previously established policy, are required to be made only by the Policy Board. The policy-making powers extend to any and all matters within the jurisdiction of the Commission.

Hitherto, no formal mechanism of support was available to the Policy Board for formulation of policies. In order to assist the Policy Board in this regard, the Commission has recently set up the Professional Services and Policy Division. The Division will identify matters requiring policy decisions and make policy recommendations to the Policy Board through the Commission.

A holistic approach to policy formulation for the financial sector requires coordination and cooperation at a number of levels. While the Commission is entrusted with the regulation of capital market, insurance companies, modarabas and NBFCs, SBP has the regulatory authority over commercial banks and Development Finance Institutions (DFIs). Moreover, the Ministry of Finance is the relevant Governmental arm for dealing with financial matters affecting the country as a whole. The Commission recently entered into a Memorandum of Understanding (MoU) with SBP that institutionalizes mutual cooperation between the two regulators. Currently, efforts are underway to establish a structured coordination mechanism between Ministry of Finance, SBP and the Commission. This mechanism is likely to provide the desired framework for regulatory policy coordination for the financial sector.

#### ii. Regulatory Imbalance

The Commission exercises varied functions, ranging from supervisory to regulatory, in the sectors under its purview. In case of the securities market, corporate sector and NBFC sector, the Commission is the apex regulator. However, a regulatory imbalance exists in the case of insurance sector where the Insurance Ordinance needs to be fully implemented, particularly with regard to the setting up of the Insurance Tribunal and appointment of an Insurance Ombudsman. Due to these limitations, remedial actions cannot be taken in a timely and effective manner. This regulatory imbalance has been one of the main reasons for the relative under-development of the sector as it creates a major handicap in effectively regulating the insurance industry and protecting the interests of policyholders.

With respect to the professional service providers operating in the country, a regulatory gap seems to exist. While the Commission has been entrusted with the regulation of certain service providers within the financial (non-banking) sector, many are functioning without any proper regulatory framework in place. In the absence of necessary legal framework to govern their operations, it would be difficult to improve and monitor the conduct of professionals providing a range of services to the corporate and financial sectors in the country.

### **iii. Regulatory Arbitrage**

In Pakistan, commercial banks are increasingly undertaking universal banking. Furthermore, the growing trend of mergers between banks and NBFCs is making it difficult to draw clear boundaries across the various types of financial service providers.

These vague boundaries open up opportunities for financial institutions to by-pass certain regulations and create an overall ambiguity about the regulatory framework in place. Furthermore, regulatory institutions and legal framework in Pakistan are traditionally compartmentalized according to institutions rather than by functions. There is, therefore, an inherent risk under the present set up that certain activities of financial institutions engaged in universal banking may remain unsupervised.

### **iv. Regulatory Costs**

Regulation is seen as an instrument to facilitate development of the economy but this can only be achieved if the regulatory framework is effective and does not impose costs on businesses higher than the imperfections that it seeks to prevent. The objectives of regulatory framework must, therefore, be defined in view of the changing needs of a flexible and dynamic business environment. Moreover, a careful and thought-out choice must be made between which burdens to enforce and which to ease.

The legal framework is comprised of a combination of laws, rules, regulations and directions issued over a period of time. Despite significant progress in harmonization, this framework can still be complicated and expensive for market participants who must comply with it. The challenge is to maintain effective investor protection while making the legal framework more harmonized, less complex and, at the same time, cost-effective.

### **v. Regulatory Efficiency**

While a great deal has been accomplished in updating regulatory standards, competing priorities can often result in significant time passing between the identification of a problem and the adoption of a regulatory solution. The challenge is to respond quickly and effectively to regulatory and market issues without burdening the market participants with a plethora of legal requirements that may stifle market development and innovation.

Regulatory efficiency is hampered by any delays in the law-making process. The Commission has been entrusted with the power to frame rules under the laws it administers, albeit, approval of the Ministry of Finance is required along with vetting by the Ministry of Law and Justice before the Commission can notify rules. Often times, the Ministerial reviews and approvals are time consuming and lead to unnecessary delays. In this regard, it is essential to provide for a clearly defined scheme of making laws, rules and regulations whereby the authority to make these is clearly delineated.

### **vi. Regulatory Compliance**

A culture of non-compliance is found to be prevalent in the country. Despite best efforts, laws are perceived to be hindrances in efficiently conducting business. The problem can perhaps be best related to the socio-cultural elements where defiance to laws stemmed during the colonial rule. Despite the transformation into an independent society, the fear that laws and regulations impose requirements that may not be in the best interest of those who are to follow it appears to linger on. The situation has also been aggravated, to some extent, by rapid changes in governments since Pakistan's independence that have resulted in inconsistent economic policies and hasty law-making over a period of time.

A concerted effort appears to be necessary to improve understanding of market participants on why regulation is desirable for healthy and competitive business as well as to promote the role of stakeholders in protecting their rights. As such, regulatory compliance can be best achieved through education and awareness to address the misperceptions that exist in our economy.

### **vii. Regulatory Enforcement**

Regulatory enforcement and adjudication is the process by which the Commission ensures that the corporate and financial sectors comply with prescribed rules and regulations. The Commission has the power to investigate the actions and records of companies and the power to impose sanctions and penalties for contravention of legal provisions. However, most of the adjudication pertaining to areas affecting investor interest is done by courts with the Commission assisting the courts in enforcement. Effective enforcement is impeded, at times, because of delays in the judicial process due to the sheer volume of litigation in the country.

Enforcement powers of the Commission have a direct impact on development of the sectors under its purview. Effective enforcement caters for the protection of investors and stakeholders, thereby building confidence in our markets.

### **viii. Regulatory Capacity**

Being the apex regulator of the corporate and financial (non-banking) sectors, it is desirable for the Commission to have adequate capacity to formulate relevant laws, rules and regulations, vigilantly monitor their compliance and take necessary actions for contraventions. Given the diversified regulatory challenges that the Commission is faced with in the various sectors under its purview, it is essential that there is a continuous matching of skills with job requirements. While the Commission has initiated necessary steps in this regard to review the remuneration of its employees and assess their skill requirements, there is also a need to formulate and implement a human resource development strategy to ensure that the Commission's employees are adaptable to the changing financial sector landscape.

Realizing the new vistas that advancements in information technology (IT) and communications have opened for organizations, the Commission needs to be well-equipped in terms of IT skills and resources. Over the years, the Commission has laid emphasis on in-house development of software systems that would assist in its functioning as well as efficient regulation and monitoring of entities under its purview.

The underlying philosophy of automation should be to bring about a change in the overall business processes, aimed at improving organizational productivity and responsiveness, reducing costs and improving interaction with stakeholders. The Commission needs to be cognizant of these objectives in pursuing its automation program.

### **ix. Regulatory Assessment**

An effective and efficient regulatory framework requires a regulator to remain abreast with changing dynamics. Due to increasing integration of the global financial markets, cooperation and coordination at the international level has become essential.

The Commission, in recognition of challenges posed by integrated financial systems, maintains regular liaison with counterpart regulatory bodies and is also an active member of a number of international organizations. Notably, the Commission recently underwent an assessment by the joint Mission of the World Bank and the International Monetary Fund (IMF) under the Financial Sector Assessment Program (FSAP). The Mission assessed the Commission against international benchmarks in the areas of securities, NBFC and insurance regulation and made pertinent observations to achieve full compliance with international standards.

The assessment of regulatory procedures and processes should be undertaken on a regular basis. While a start has been made with the FSAP, it is expedient that the Commission continues to monitor its adherence to international best practices.

## 1.4.2 Developmental Challenges

### i. Corporatization

Corporatization entails separation of management from ownership while transforming an association of persons into a legal entity with limited liability having perpetual succession. It allows a number of significant benefits to the entity as well as to the economy as a whole. Primarily, it extends the rights, duties and privileges of a natural person to a legal entity. These rights include, among others, the right to borrow money and invest funds, own property, sue and be sued and enter into contracts.

In consideration of the multiple benefits arising from corporatization, the Government has encouraged a policy of corporatization and privatization of public sector entities, which is expected to have a profound impact on accountability therein. The Commission has also been proactive in encouraging corporatization, particularly among Small and Medium Enterprises (SMEs). While these efforts have led to an increase in incorporation of companies, a large chunk of SMEs and microfinance institutions remain in the informal sector. A major challenge is to attract such entities to come to the corporate fold through fiscal incentives and regulatory ease. Moreover, the progressive development of corporates in terms of their size and growth needs to be ensured.

### ii. Self-regulation and Market Abuse

The growth and buoyancy of Pakistan's securities market will depend highly on the level of good governance and transparency exhibited by market participants. Poor governance, information asymmetry and conflicts of interest result in lack of investor confidence. While the Commission has introduced far-reaching reforms to improve and strengthen these areas in recent years, governance and transparency remain major challenges for Pakistan's capital market.

The basic challenge in this regard is the demutualization of stock exchanges in Pakistan that continue to be owned solely by brokers. The mutualized structure of exchanges carries with it the inherent risk/potential for market abuse. Demutualization is aimed at broad-basing ownership and separating ownership from management in order to, *inter alia*, put in place a non-conflicted self-regulatory system.

### iii. Product Diversification and Outreach to Consumers

The level of penetration of insurance sector is quite low compared to other jurisdictions in the region. Although there are over fifty insurance companies in the country, their services are still limited to the main cities. The low consumer base has also resulted from limited product portfolio of insurance companies. Despite being an agrarian economy, the insurance companies in Pakistan have not offered suitable products to the agriculture sector.

### iv. Market Integration

Over recent years, there have been significant developments in Pakistan's financial sector. The universal banking trend is evident, which is supported by the international trend to remove prohibitions between banking and non-banking financial and insurance services. This trend was enforced when, after more than six decades, the Glass-Steagall Act in the USA was repealed in 1999 and the Gramm-Leach-Bliley Act, adhering to the principles of functional regulation, was introduced. This new Act permitted additional activities to be conducted by subsidiaries of USA banks. The integration of financial markets within European Union provides another international precedent. While the financial sector in Pakistan is fast developing on similar lines, market integration poses a number of challenges to financial institutions in terms of achieving operational capacity, creating market niche and meeting regulatory requirements.

### v. Level Playing Field

The emergence of universal banking poses increasing competition for NBFCs and modarabas from the banking sector. The mobilization base and branch networks of banks are vast as compared to NBFCs. Certain distortions at the policy level remain, which have worked to the advantage of some institutions while discriminating against others.

In such a scenario, it is important to provide a level playing field to all institutions undertaking non-banking financial activities to ensure proper development of the NBFC sector.

#### **vi. Professional Independence and Conduct**

There is no uniform framework for professional service providers in Pakistan. As such, the level of their independence and integrity needs to be improved in order for them to provide efficient and reliable services and to engender consumer confidence. It is essential that the professional service providers maintain and comply with Codes of Ethics to ensure quality and integrity of their services.

#### **vii. International Trend towards Financial Sector Liberalization**

Recent economic reforms around the world, characterized by liberalized financial sectors, have started the process of globalization. The pace of globalization is accelerating as a result of the establishment of an international trade regime under the auspices of the World Trade Organization (WTO). The General Agreement on Trade in Services (GATS) is among the WTO's most important agreements. The accord, which came into force in January 1995, is the first and only set of multilateral rules covering international trade in services.

Among other things, GATS deals with financial services and lays down the right of parties to take prudential measures, *inter alia*, for the protection of investors, deposit holders and policy holders – and to ensure the integrity and stability of the financial system. With respect to market access, the understanding contains more detailed obligations on, among other things, monopoly rights, cross-border trade, right to establish or expand a commercial presence and temporary entry of personnel. The aim is to provide a framework of obligations and a forum for future negotiations aimed at greater market access and liberalization of the financial sector.

While liberalization is most likely to stimulate capital flows, it can also aggravate the problems of financial institutions in a period of confidence loss, as capital flowing in can just as easily flow out. Financial sector liberalization achieved through increased market access does not leave room for the Government to afford any slack in the macroeconomic policy.

Another major challenge posed by financial sector liberalization is the need to mitigate the risk of market abuse due to cross-border transactions. Securities markets, particularly those in emerging countries, are susceptible to the effects of cross-border activities, specially to higher short-term volatilities after economic shocks or during periods of great uncertainty. It is, therefore, necessary that financial sector regulators are in a position to assess the nature of cross-border conduct in order to ensure the existence of fair, efficient and transparent markets.

## **1.5 Blueprint for Effective Regulation and Development**

The Commission perceives its role to be that of a facilitator as well as a regulator. It is committed to encouraging growth and development of the corporate and financial (non-banking) sectors while ensuring necessary compliance with applicable laws. In recognition of this role, the blueprint sets out notable actions that need to be undertaken for a cohesive regulatory framework that propels economic development.

### **1.5.1 Coordination Among Domestic Authorities**

In order to fill in the regulatory policy vacuum for the financial sector, a coordination committee of Ministry of Finance, SBP and the Commission should be set up. This would provide a platform for achieving uniformity in regulatory approach and undertaking policy dialogue in line with the present macroeconomic structure of the economy.

Cooperation with various agencies is also required to achieve the objective of corporatization. In this regard, the Commission is setting up a task force with the Central Board of Revenue (CBR) to study and rationalize the tax structure for corporates. Moreover, it would also collaborate with CBR and other concerned agencies to remove impediments to corporatization of SMEs.

### **1.5.2 Holistic Regulation**

Given the compartmentalized regulatory structures where regulatory ambit is defined by institutions, it is extremely important for the regulatory bodies to develop cohesive policies to ensure smooth and efficient running of the financial sector. To achieve this objective, the Commission and SBP have set up a joint Coordination Committee, which meets every quarter to discuss areas of mutual concern emanating in the banking and financial (non-banking) sectors. However, to address the regulatory arbitrage posed by commencement of universal banking in the country, it appears necessary to undertake regulation by function rather than by institution. For this purpose, the Commission and SBP need to devise appropriate regulatory interventions through which banks undertaking non-banking functions are either supervised jointly by the two authorities or are required to set up subsidiaries to undertake such activities. This would also serve to provide a level playing field to all institutions providing non-banking financial services.

### **1.5.3 Integrated and Uniform Regulatory System**

Given the broad mandate of the Commission to regulate the entire financial sector – with the exception of commercial banks and DFIs – it is crucial that its regulatory authority be consistently and uniformly defined. This may require enabling provisions in the relevant laws to allow the Commission to exercise strong vigilance and take necessary actions against all financial institutions under its purview, including insurance companies, market intermediaries and other professional institutions. In this regard, it is essential that a Corporate Laws Review Commission be set up to undertake an exhaustive review of corporate, NBFCs, securities and insurance laws for the purpose of achieving integrated and uniform legal and regulatory system across all sectors.

### **1.5.4 Re-regulation**

In order to reduce procedural requirements, it is necessary for the Commission to go through a continuous process of re-regulation. The Government may consider delegating the issuance of rules and regulations to the Commission fully to expedite the process. Ensuring the effective administration of laws with minimum procedural requirements is a statutory mandate assigned to the Commission in terms of Section (20)(6)(d) of the SECP Act.

### **1.5.5 Regulatory Impact Assessment**

It is important to understand the impact of regulation and also to improve the design and implementation of regulatory strategies. Virtually every regulatory policy and strategy has some economic impact. Regulatory impact assessment (RIA) is an analysis of the estimated cost and the perceived benefits of a proposed regulation. The purpose of preparing RIA is to help determine the risks, costs and benefits of a regulatory proposal and to identify who will be affected by the proposed regulation. RIA is particularly important whenever regulations are proposed that impose costs on businesses.

RIA is intended to ensure that any proposed regulation is:

- i. necessary;
- ii. aimed at the right target; and
- iii. in proportion to the problem or issue being addressed.

The concept of RIA is relatively new for Pakistan. However, it underpins any attempt to introduce cost-effective regulations. The Commission should, therefore, develop this mechanism to evaluate the impact of its laws, rules and regulations and strengthen the design and implementation of regulatory strategies.

### 1.5.6 Stakeholder Participation

Effective and early consultation with stakeholders helps to build commitment to the regulatory framework. It also ensures that regulations are as widely accepted as possible. In the absence of a consultative process, regulatory non-compliance is bound to increase.

While the Commission consults market participants and other stakeholders in drafting new laws or amending existing ones, there is a lack of awareness among various stakeholder groups about the dynamics of issues affecting them. In this regard, the Commission should launch an awareness program to inform investors and stakeholders about their rights and responsibilities as market participants. The awareness program will instill a spirit of openness between the Commission and stakeholders, which will go a long way in addressing the issue of information asymmetry. This, in turn, will engender trust and help to avoid an adversarial relationship, which gives rise to a culture of non-compliance.

An effective legal and regulatory framework also requires proactive participation of market representatives through recognized forums. Institutional representation helps to give a collective voice to the concerns and needs of market participants and provides a forum for effective dialogue with the Government and the regulator, as necessary. Moreover, such collective forums can be used to propel development of respective sectors. Product diversification and outreach to consumers are likely to be achieved at a rapid pace if addressed at institutional levels rather than by companies individually.

Within the corporate sector, the Federation of Pakistan Chambers of Commerce and Industry and local chambers provide representation to companies to some extent. However, since these bodies also include individuals engaged in trade and industry, they do not provide an exclusive forum for dealing with issues specific to companies. In such a situation, it is imperative that the corporate sector establishes institutional representation for voicing their collective as well as individual requirements and observations – either by establishing a separate association of corporate entities or as a sub-group of chambers of commerce and industry.

In case of the capital market, the stock exchanges in Pakistan act as the SROs for regulating the affairs of their member brokers. With the onset of demutualization of stock exchanges, it appears necessary for brokers to establish an association that represents their institutional interest.

The Insurance Association of Pakistan is the representative body of non-life insurance sector in Pakistan. It was established in 1948 to deal with the collective issues of non-life insurers. However, much improvement is desired in its functioning besides creating an institutional body of life insurers in the country.

The Modaraba Association of Pakistan (MAP) is the representative body of modarabas while the NBFC sector is represented by Leasing Association of Pakistan, Mutual Funds Association of Pakistan, and Investment Banks Association of Pakistan. These associations have been actively working to promote the business interests of relevant sections that they represent. However, given the introduction of NBFC as a consolidated entity to undertake different financial activities, it would be expedient for these associations to also consider forming one representative body for the NBFC sector as a whole.

### **1.5.7 Corporate Rehabilitation**

In order to provide a mechanism that allows for the rehabilitation of viable businesses and thereby encourage economic growth, appropriate laws for corporate rehabilitation and insolvency need to be framed. These laws will require a greater role for administrators, receivers and liquidators with enhanced powers and duties and should also introduce Alternative Dispute Resolution (ADR) methods including mediation. Similarly, the possibility of establishing an office of a Corporate Ombudsman to resolve conflicts and investigate reported complaints also needs to be explored.

In terms of Section 295 of the Companies Ordinance, the Commission may make rules for administrators. However, no such provision exists for receivers and liquidators. In addition to a regulatory framework, these service providers also require adequate training and organization and necessary efforts should be undertaken in this regard. Like various other professional services in the financial sector, these occupations need to be recognized in Pakistan. A representative body/association would be a step in this direction as it would provide a forum for development of these professions.

### **1.5.8 Enhanced Compliance**

In order to encourage companies to comply with the requirements of law, the Commission is seeking to develop a corporate scorecard to assess their level of compliance. Companies would be assessed on various aspects of their compliance with statutory provisions, codes of conduct as well as their corporate governance and corporate social responsibility outlook.

These efforts would be complemented by the establishment of an Institute of Corporate Governance in Pakistan, which would seek to create awareness about corporate governance and strengthen corporate bodies' compliance and conformance to laws, rules and regulations.

### **1.5.9 Enhanced Enforcement**

The objective of market development cannot be achieved without effective and efficient enforcement. Enhancement of enforcement powers of the Commission would lead to better-governed sectors and protection of stakeholders' interests.

In addition to effectively exercising its enforcement powers, the Commission can also play a meaningful role in assisting the courts as an enforcement arm of the judiciary. In this regard, no special treatment of the Commission is advocated but a reduction in corporate litigation is sought through specific mechanisms. This may be done by instituting specialized benches in the High Courts headed by judges specializing in corporate matters. The Commission can provide assistance to judges on specific corporate and financial issues and by instituting strict actions for enforcing their decisions.

Moreover, the Commission should provide ADR methods such as arbitration, conciliation and even mediation to the corporate and financial (non-banking) sectors. ADR can also be provided by the Commission in partnership with external service providers and trade and industry bodies.

### **1.5.10 Regulatory Audit of SROs**

In terms of Section 20(f) of the SECP Act, the Commission is charged with the responsibility of promoting and regulating SROs as well as related securities industry and NBFI associations. Moreover, in terms of Section 20(k) of the SECP Act, the Commission may call for information from and undertake inspections, conduct inquiries and audits of SROs while Section 21(a)(iii) enables the Commission to provide for standards as well as codes of conduct for these associations.

In exercise of these powers, the Commission should undertake regulatory audits of SROs and formulate necessary standards and codes to seek assurance that the self-regulatory role is being exercised in an independent, fair and transparent manner. This would help to augment the capacity of SROs operating in the country in properly exercising their regulatory and enforcement functions. This is particularly desirable in the case of professional services, where lack of effective oversight has been a major reason for lack of confidence in the integrity and independence of their services.

### **1.5.11 Good Governance**

The Commission should further strengthen its reform processes for risk mitigation and improving governance and transparency in the corporate and financial (non-banking) sectors. In this regard, establishment and regulation of SROs, improving the skill base of market intermediaries and participants, and effective monitoring and supervision by the Commission are essential steps to boost good governance. Furthermore, the Code of Corporate Governance should be extended to all entities raising funds from the public to improve their conduct and bring in higher transparency. Good governance in all sectors would ultimately result in protecting the rights and interests of all stakeholders and maximizing returns to shareholders.

### **1.5.12 International Cooperation**

Due to increasing integration of the global financial markets, economies have become more open and responsive to worldwide developments. In this context, it is important for the Commission to develop linkages with counterpart regulatory agencies through bilateral and multilateral agreements. Moreover, it should actively participate in the activities of international bodies to contribute towards the standard setting process, which underlies the development of international benchmarks for the financial sector.

Cooperation at international level is also essential for cross-border regulation. With the offing of WTO regime in 2005 and the consequent liberalization of financial markets, the Commission should institutionalize appropriate coordination mechanisms to ensure that liberalization of financial markets does not result in market abuse across borders. In addition to consultation and cooperation at the international level, this would also involve a thorough and extensive consultative process with industry stakeholders in Pakistan. Signing of the multilateral MoU of the International Organization of Securities Commissions (IOSCO) by the Commission would constitute a significant step in this direction.

### **1.5.13 Market Development**

Development of the various sectors under the Commission's purview remains an ongoing activity; the Commission is continuously making efforts to bring our corporate and financial (non-banking) sectors at par with developed countries around the world.

In line with the Government's endeavors to document the economy, the Commission is promoting corporatization of entities. Efforts are being particularly undertaken to create an enabling environment for corporatization of SMEs. Appropriate steps would be identified to remove impediments to corporatization of SMEs and implemented in consultation with concerned agencies.

In order to reduce conflict of interest situations in the securities market and reduce the risk to investors, two major efforts underway at the Commission are the demutualization of stock exchanges as well as the phase-out of COT/Badla and its replacement with margin financing/futures contracts. Risk mitigation resulting through these measures would channel more investment and add depth to our market.

The Commission is also encouraging integration and mergers in the NBFC sector so as to build sound, viable and competitive institutions. While similar efforts are also underway in the insurance sector, particular attention is being awarded to the improvement of service providers in the industry – this would also involve more formalized regulatory structures for these entities.

In line with its recently expanded mandate to develop and regulate private pensions, the Commission would be launching the VPS through promulgation of necessary rules. These rules are expected to be finalized soon and would lay the foundation for development of private pensions in Pakistan.

Developmental efforts in all these sectors would be coupled with investor education and training of market participants, particularly intermediaries. The Institute of Corporate Governance would play a key role in such efforts and would provide a platform, in conjunction with other institutes/associations, to cater for the training needs of the corporate and financial (non-banking) sectors. The existing training institutions, like the Pakistan Insurance Institute, would also be supported in the execution of their training programs to improve the quality of service providers.

#### **1.5.14 Institutional Capacity**

In order for the Commission to effectively regulate the various sectors under its purview, it is imperative that it has the institutional capacity to perform its regulatory, supervisory, monitoring and enforcement functions. An adequate capacity in this regard involves dynamic systems and procedures; the desired functionality can be best achieved through state-of-the-art technology based systems, which would bring about a change in the entire business processes.

At the core of the institutional capacity is the human resource base of the Commission. The Commission's employees need to be able to adapt to the new products and services being introduced in the corporate and financial sectors and possess hands-on knowledge of their regulatory requirements. This would require regular and sustainable training and development of the employees, particularly with respect to international trends and regulatory best practices.

### **1.6 Conclusion**

In creating the enabling environment that is needed for the development of corporate and financial (non-banking) sectors, the Commission should focus on the legal and regulatory framework and its effects on development of these sectors. An appropriate legal framework can serve as a catalyst for development. In today's modern markets, legal and regulatory reforms should have the flexibility to respond to and encourage business innovation. This flexibility must, however, be supported by an adequate risk management framework.

While providing for a level playing field to all financial market players through an efficient regulatory framework, policy makers must ensure that markets provide an attractive forum for foreign investment. In addition to enforcement of appropriate measures to check market abuse, this requires effective enforcement and redressal systems to be in place. This becomes particularly important given the international trend towards integration and financial sector liberalization.

In this scenario, it is pertinent to note that the Commission is poised to address the regulatory issues and developmental challenges within the sectors it regulates. The blueprint set out above would enable the Commission to achieve this end in an effective, economic, efficient and holistic manner.



The background of the slide is the national coat of arms of Malaysia, featuring a shield with a crescent moon and star at the top, a double-headed eagle in the center, and a banner at the bottom. The shield is divided into four quadrants: the top-left shows a white crescent and star on a red field; the top-right shows a white eagle on a red field; the bottom-left shows a white gear and a white cotton flower on a red field; the bottom-right shows a white bar chart on a red field. The shield is surrounded by a wreath of rice and rubber leaves.

## THE ORGANIZATION

**S E C**

# The Organization

## 2.1 Organizational Structure

The Commission was established in pursuance of the SECP Act and became operational on 1 January 1999. Its establishment represents an important milestone in development of the regulatory framework for the corporate sector and the capital market in Pakistan.

On 18 August 2003, the Government of Pakistan appointed Dr. Tariq Hassan as Chairman of the Commission. In addition to the Chairman, the Commission comprised three Commissioners as on 30 June 2004.



**Dr. Tariq Hassan**

Dr. Tariq Hassan, prior to his appointment as Chairman of the Commission, was the Adviser to the Federal Minister for Finance and Economic Affairs on matters pertaining to law and economics/finance. He has also been an Adviser to the Governor of SBP and has assisted the Government of Pakistan and SBP in implementing financial sector reforms. A lawyer by profession, Dr. Hassan has a Master's and doctoral degree from Harvard Law School. He has been engaged in corporate law practice and specialized in bank finance while working in a leading Wall Street law firm in New York after completing his post graduate studies in USA. Dr. Hassan has extensive experience in development finance as well having worked for international financial institutions in Rome and Washington, D.C. He has taught corporate law and international banking and finance at various Universities in Pakistan and USA. In his career of over thirty years, he has worked in both private and public sectors as an advocate, consultant, adviser and educationist.



**Mr. Abdul Rehman Qureshi**

Mr. Abdul Rehman Qureshi is a lawyer by profession, with expertise in the regulation and administration of corporate laws. He has been associated with the erstwhile CLA since 1976. During the year under review, Mr. Qureshi was overseeing the Company Law Division and the Support Services Division.



**Mr. Shahid Ghaffar**

Mr. Shahid Ghaffar, who was the Managing Director of KSE prior to joining the Commission, oversees the Securities Market Division. He has wide exposure in all aspects of securities market operations and stock exchange regulations.



**Mr. Etrat H. Rizvi**

Mr. Etrat H. Rizvi was the Managing Director of National Development Leasing Corporation (NDLC) prior to his appointment as Commissioner. During the year under review, Mr. Rizvi was the Commissioner in charge of the Specialized Companies Division and the Professional Services and Policy Division.



**Mr. Zafar-ul-Haq Hijazi**

Mr. Zafar-ul-Haq Hijazi completed his tenure as Commissioner during the year under review. He was a practicing chartered accountant (CA) prior to joining the Commission.

## 2.2 Policy Board

While ensuring full autonomy of the Commission, the SECP Act provides that the Federal Government shall appoint the Policy Board consisting of nine members, of which five shall be from the public sector and four from the private sector. The ex-officio members are Secretary, Finance Division; Secretary, Law and Justice Division; Secretary, Commerce Division; Chairman of the Commission; and Deputy Governor of SBP.

During the year under review, the Government notified three members representing the private sector on the Policy Board, thus bringing the Policy Board to its full strength of nine members. Previously, these positions were lying vacant.

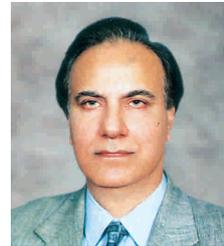
As of 30 June 2004, the Policy Board consisted of:



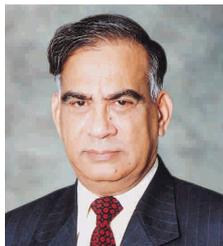
**Dr. Tariq Hassan**  
Chairman of the Commission  
(Chairman of the Policy Board)



**Mr. Nawid Ahsan**  
Secretary,  
Finance Division



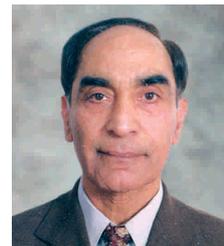
**Mr. Tasneem Noorani**  
Secretary,  
Commerce Division



**Mr. Justice (R) Mansoor Ahmed**  
Secretary,  
Law, Justice, Human Rights  
and Parliamentary Affairs  
Division



**Mr. Tawfiq A. Husain**  
Deputy Governor,  
SBP



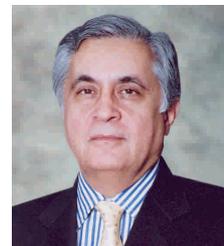
**Mr. Mian Muhammad Anwar**  
Chairman,  
Crescent Textile Mills Limited



**Dr. Mohammad Zubair Khan**  
Managing Director,  
Financial Techniques  
Internationale



**Dr. Shahida Jaffrey**  
Vice Chancellor,  
Sardar Bahadur Khan  
Women University



**Mr. Zubyr I. Soomro**  
Managing Director,  
Citigroup Pakistan

The objective of the Policy Board is to provide guidance to the Commission in matters relating to its functions and to formulate policies in consultation with the Commission. As part of its functions, the Policy Board advises the Government on issues pertaining to the securities industry and regulation of the corporate sector, as well as oversees performance of the Commission. It also provides opinion on policy matters referred to it by the Government or the Commission.

### 2.2.1 Policy Board Meetings

During the year under review, four meetings of the Policy Board were held. In these meetings, the Policy Board was apprised of the Commission's achievements, particularly, relating to demutualization and integration of stock exchanges, signing of MoU between SBP and the Commission, takaful business in Pakistan, Code of Ethics and Conduct for the Commission's employees, signing of bilateral MoU with the Securities and Exchange Commission of Sri Lanka, regulation of financial scams and measures to enhance investor confidence. The major issues discussed and decided in the meetings were as under:

- i. approval for budgetary allocation of Rs. 3 million from the Commission's funds for partly financing the establishment of an Institute of Corporate Governance in Pakistan;
- ii. approval of the proposal to sign MoUs with securities regulators in other jurisdictions, particularly in the South Asian countries;
- iii. approval for establishment of a library at the Commission;
- iv. approval of amendments in the Service Manual of the Commission;
- v. approval of budget of the Commission for the financial year (FY) 2005;
- vi. approval of human resource plan of the Commission; and
- vii. approval for undertaking a study on financial scams and preparation of a draft law, which may give enabling power to the Commission to proceed against fraudulent financial activities of both corporate and non-corporate entities.



Meeting of the Policy Board in progress

## 2.3 Bilateral Cooperation

The Commission engages in cooperative mechanisms with counterpart regulatory authorities within the country as well as abroad. During the period under review, the Commission signed a MoU with the Securities and Exchange Commission of Sri Lanka. The MoU sets forth a statement of intent of the two regulators to establish a framework for mutual assistance and to facilitate the exchange of information between them. This is expected to enforce/ensure compliance with the respective securities and futures laws and regulatory requirements of the two countries. The scope of the MoU includes: assistance in discovery of and taking action against insider dealings, market manipulation and other fraudulent practices in securities dealings; enforcement of laws, rules and regulations relating to dealing in, arranging deals in, managing and advising on securities, futures contracts, options and collective investments; supervising and monitoring securities and futures markets and clearing and settlement activities and their compliance with the relevant laws and

regulations; and promoting and securing the fitness and properness of licensed or registered persons and promoting high standards of fair dealings and integrity in their conduct of business.

The Karachi, Lahore and Islamabad stock exchanges also jointly signed MoUs with the stock exchanges of Colombo and Chittagong to establish a system for mutual assistance and information sharing.

In order to provide for holistic regulation of the financial sector, the Commission has constituted a Coordination Committee with SBP; quarterly meetings of the Committee were held throughout the year. During the year under review, the Commission also entered into a MoU with SBP. The MoU institutionalizes the mutual cooperation between the two regulators and sets out parameters for close coordination in supervision of banks, DFIs, capital market and NBFCs. The Commission is also in the process of constituting a joint task force with the CBR to study the tax structure of the corporate sector and recommend a policy framework aimed at promoting corporatization and progressive development of corporates in the country.

In order to develop a cohesive policy structure for smooth and efficient operation of the financial sector, the Commission has proposed the formation of a Financial Sector Coordination Committee comprising representatives of the Ministry of Finance, SBP and the Commission. The purpose of the proposed Committee would be to ensure an integrated approach towards financial sector planning and development.

## 2.4 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 CEO. He is assisted by Commissioners, particularly in overseeing the working of various operational units, as may be determined by him.

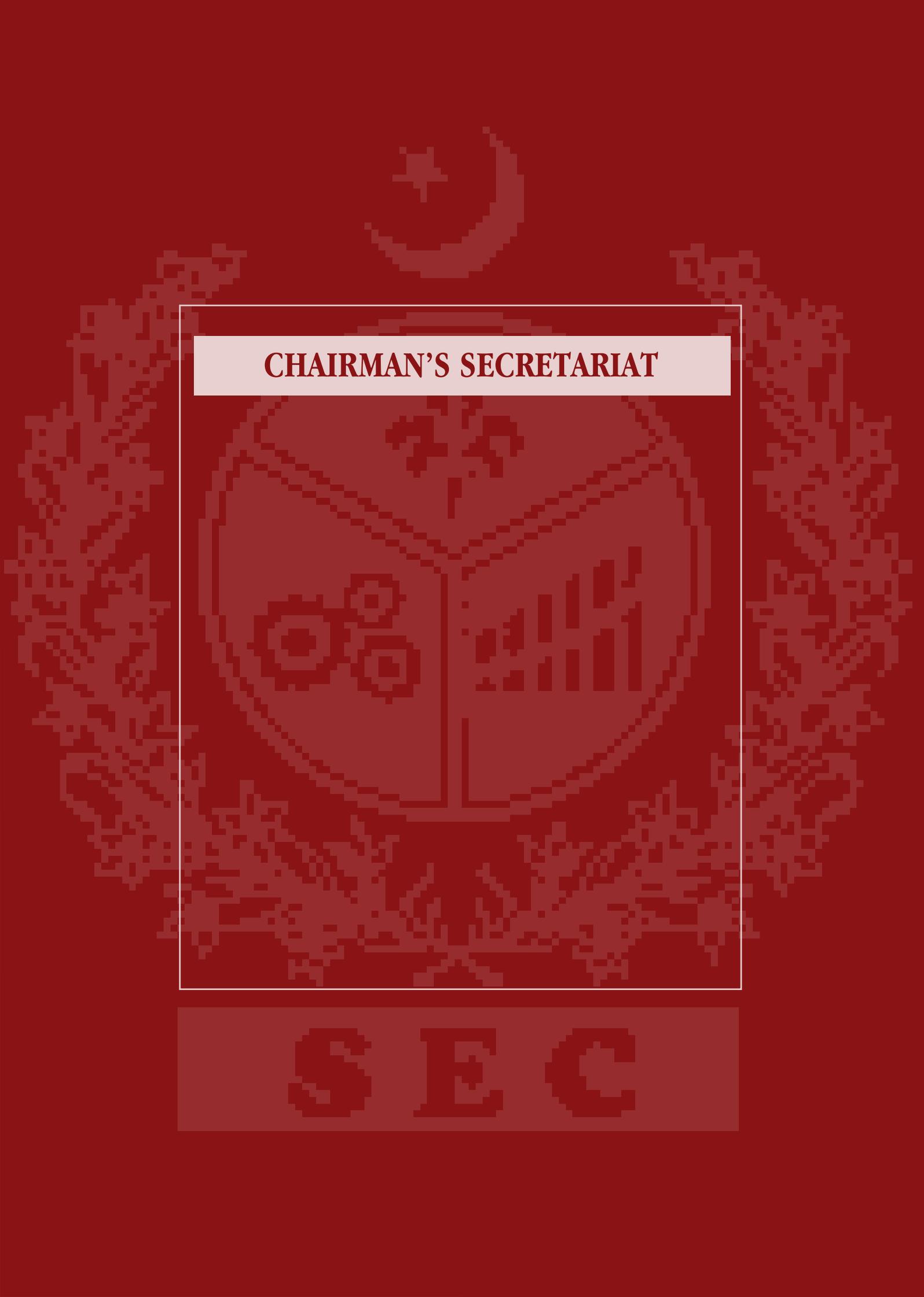


Commission meeting in progress

During the year, a re-organization of the Divisions was undertaken so as to increase their operational efficiency and coordination. Each Division is sub-divided into Departments, which are headed by Executive Directors. As of 30 June 2004, the Commission operationally comprised the following five Divisions apart from the Chairman's Secretariat:

- i. Company Law Division;
- ii. Securities Market Division;
- iii. Specialized Companies Division;
- iv. Professional Services and Policy Division; and
- v. Support Services Division.



The background of the page features the national coat of arms of Malaysia, which includes a crescent moon and a five-pointed star at the top, a shield with a palm tree, a sheaf of rice, and a gear, and a banner at the bottom with the motto 'BERSEKUTULAH BERTAMBAH KEKUATAN'.

**CHAIRMAN'S SECRETARIAT**

**S E C**

## Chairman's Secretariat

### 3.1 Operational Structure

#### 3.1.1 Structure

The Chairman's Secretariat (CS) coordinates the overall functioning of the Commission and liaises with external entities, including Government agencies and multilateral and international organizations. In addition, it supervises the internal audit and monitoring functions within the Commission and is responsible for the management of donor-funded projects. The CS comprises the following Wings:

- Internal
- External

#### 3.1.2 Management Team

During the course of the year, the CS was headed by two Directors, namely, Mr. Abbas Kizilbash and Ms. Jaweria Ather who oversaw, respectively, the Internal and External Wings. Both were CAs by profession. They were assisted by various professionals in the CS for internal audit, monitoring and compliance, external communication and project execution.



Ms. Jaweria Ather (right), Director with officers of the CS

### 3.2 Internal Audit

The Internal Audit Unit is housed in the Internal Wing of the CS and serves as an independent appraisal function to examine and evaluate the functions and activities of the Commission as well as to assure management of the adequacy of controls and adherence thereto. It advises the management on the relationship and balance between risk and control and assists in achieving the following objectives:

- i. resources are being used effectively and efficiently;
- ii. safeguarding of assets;
- iii. assessing the reliability and accuracy of management information; and
- iv. compliance with policies, procedures and regulations of the Commission.

During the year under review, the Internal Audit Unit prepared an Internal Audit Manual and an Internal Audit Charter, which are in the process of being approved. Focused assignments conducted during the year included:

- i. review of payroll processing, petty cash management, revenue collection, travel, procurement and administration functions;
- ii. carrying out the audit of Gratuity Fund and Pension Fund for the Commission's employees;
- iii. conducting the pre-audit of all payment vouchers at the head office;
- iv. analyzing the control environment at Company Registration Offices (CROs) in Karachi, Peshawar, Sukkur, Multan and Islamabad; and
- v. review of the efficacy of monthly Management Information System (MIS) reports and annual accounts of the Commission.

### 3.3 Monitoring and Compliance

The Monitoring and Compliance Unit, within the Internal Wing, continued to ensure expeditious resolution of investors' complaints received at the Commission through regular follow-up. As in the previous year, the complaints received during the year showed a declining trend. This reflects improved discipline in the corporate and financial sectors due to varying reforms implemented by the Commission.

Table 1 below shows that altogether 414 complaints, appeals and petitions were received by the CS during the year. These, combined with the forty-one complaints etc. brought forward from last year, were appropriately processed and as many as 416 complaints, appeals and petitions were disposed off. Only thirty-nine complaints, appeals and petitions remained outstanding at the end of the year.

**Table 1 - Disposal of Complaints, Petitions and Appeals (July 2003 - June 2004)**

S. No.	Receipts	Brought Forward	Received	Total	Disposed Off	Outstanding
1	Complaints	23	349	372	346	26
2	Petitions	11	9	20	19	1
3	Appeals	7	56	63	51	12
	<b>Total</b>	<b>41</b>	<b>414</b>	<b>455</b>	<b>416</b>	<b>39</b>

A synopsis of the complaints lodged and resolved during the year is given in Table 2 below.

**Table 2 - Detail of Complaints**

S. No.	Nature of Complaints	Brought Forward	Received	Total	Disposed Off	Outstanding
1	Issue of duplicate shares under Section 75 of the Companies Ordinance	-	2	2	2	-
2	Transfer of shares under Section 76 of the Companies Ordinance	-	66	66	60	6
3	Verification of transfer deeds	-	6	6	6	-
4	Payment of dividend under Section 251 of the Companies Ordinance	-	44	44	44	-
5	Non-receipt of annual and half-yearly accounts	-	12	12	12	-
6	Complaints against brokers	21	49	70	60	10
7	Miscellaneous	2	170	172	162	10
	<b>Total</b>	<b>23</b>	<b>349</b>	<b>372</b>	<b>346</b>	<b>26</b>

The on-line link established via the Commission's website for electronically lodging complaints was frequently visited by investors as well as the general public. Through this link, the CS received 227 complaints and queries regarding various issues. These were forwarded to and disposed off by the relevant Divisions of the Commission.

### 3.4 Media and Publications

During the year under review, external communication remained a key activity of the CS through the Media and Publications Unit within the External Wing. It proactively liaised with the media on issues of key importance. While the media continued to be supportive of the Commission's initiatives, positive criticism provided feedback on practical difficulties faced by the stakeholders. A key area of focus during the year was the on-going work on demutualization of stock exchanges and the introduction of Margin Financing Rules, 2004 as a step towards the phasing out of Badla financing. A number of articles were written on these topics; the CS played its role in providing regular input so as to deter speculation and maintain a clear perspective of the market in the media. Moreover, handouts of developments in the Divisions and press briefings arranged with the Chairman of the Commission remained a regular feature of its activities.

The Media and Publications Unit prepared and issued a newsletter every quarter, encapsulating the Commission's activities and achievements throughout the year. The various issues of the newsletter can be accessed through the Commission's website. Other publications of the Commission included Manual on Corporate Governance, Directors and Secretaries Guide and Guide on Accounts and Accounting Reference Dates.

### 3.5 International Liaison

The International Liaison Unit in the External Wing is primarily responsible for coordinating with multilateral and international organizations as well as executing the donor-funded projects and assignments of the Commission. During the year under review, the CS liaised with the representative bodies of securities regulators and pension supervisors, namely, IOSCO and the International Network of Pension Regulators and Supervisors (INPRS). Moreover, it successfully extended the project on corporate governance with the assistance of United Nations Development Program (UNDP) and progressed further on the on-going projects of the Asian Development Bank (ADB) and the World Bank to sustain the reform process in the financial sector. A new research-based assignment for corporatization of SMEs was also started during the year with the assistance of the World Bank.

#### 3.5.1 Financial Markets and Governance Program

The Financial (non-bank) Markets and Governance Program (FMGP) is an integrated assistance package of three loans and two political risk guarantee facilities from the ADB to the Government of Pakistan. It primarily seeks to support the development of Pakistan's non-banking financial market through reform, capacity building and international private sector participation.

The main objectives of the FMGP are to:

- i. strengthen market soundness, stability and investor confidence through improved governance, transparency and risk management;
- ii. improve availability of and access to financial instruments for savings and investment and related services; and
- iii. improve market efficiency and attractiveness to issuers and investors, including institutional and foreign investors.

Under the FMGP, the Commission is the executing agency for one of the Technical Assistance (TA) loans to strengthen regulation, enforcement and governance of non-banking financial markets. The TA mainly involves a consultancy assignment focusing on operations

of a wide array of financial intermediaries, i.e. stock exchanges, NBFCs and insurance companies. Specifically, the consultancy assignment will include a detailed review of legal and regulatory framework and address key issues of the capital market, such as insider trading, development of new products, risk management and electronic transaction systems for stock exchanges. Capacity building of the Commission and other market participants will also form a major part of the consultancy assignment. The outputs of the consultancy assignment shall focus on the following four components:

- i. upgrading of the legal and regulatory framework;
- ii. support for development of NBFI and capital market, including restructuring of stock exchanges;
- iii. capacity building of the Commission, with particular attention to its enlarged mandate for regulation and supervision of capital market, NBFI, insurance, and pensions; and
- iv. establishment of sustainable mechanisms for skills development and training.

During the year under review, evaluation of short-listed consulting firms to undertake the assignment under the TA was concluded. A Consultant Selection Committee, comprising of two members of the Commission and one member each from the Ministry of Finance and the Economic Affairs Division of the Government of Pakistan, was formed for the purpose. After detailed examination of technical proposals submitted by the short listed firms, International Securities Consultancy Limited emerged as the first-ranked firm. The firm was advised to submit its financial proposal and contract negotiations were successfully conducted in the presence of ADB representatives from Philippines. The consultancy assignment subsequently commenced in August 2004.

### **3.5.2 Project on Corporate Governance**

The project to develop and implement good corporate governance practices and establish a sound regulatory framework for the corporate sector in Pakistan was started in August 2002 with the technical and financial assistance of UNDP. Upon its conclusion in July 2003, it was considered imperative to extend the same to sustain the efforts undertaken during the one-year period. The primary objectives of the extended project, which commenced in early 2004, are to improve transparency and accountability in the corporate sector and enhance capacity of the Commission. Various activities have been identified to achieve these objectives, ranging from research studies and stakeholder awareness programs to establishing a Corporate Governance Cell at the Commission. Details of these activities are as follows.

#### **i. Institute of Corporate Governance**

A feasibility study to establish an Institute of Corporate Governance in Pakistan was completed during the year. Based on its recommendations, the Commission took the lead in promoting the Institute and invited stakeholders from various sectors to join as founding members of the Institute. In this regard, meetings with the stakeholders were held to discuss and finalize the concept of the Institute and its scope of activities. It was decided that the Institute would be called the Pakistan Institute of Corporate Governance and would be set up as a company limited by guarantee under Section 42 of the Companies Ordinance. Founding members would be drawn from a balanced representation of public and private sectors and subsequent membership would be open to individuals as well as corporates. The Institute is expected to be the primary body involved in awareness and training on corporate governance in the country and will serve to create an enabling environment for effective implementation of the Code of Corporate Governance.

#### **ii. Formulation of Corporate Scorecard**

In realization of the role that institutional investors play in the corporate governance system, the Commission took the initiative to formulate a corporate scorecard which shall assist not only domestic but also foreign investors in evaluating corporate governance practices within companies.

The scorecard proposes to provide a balanced view of the state of a company by including perspectives of key stakeholders, including investors, customers, employees, management, directors and shareholders. An in-house study, focusing on the following main areas, was in progress at the close of the year to devise and implement the scorecard:

- a. identification of variables and benchmarks;
- b. design and analysis;
- c. assessment of potential threats and barriers to implementation; and
- d. development of an implementation strategy.

### iii. Stakeholder Awareness

A seminar titled “Corporate Governance beyond Listed Companies” was held in Islamabad on 6 May 2004. The Federal Minister for Finance and Economic Affairs, Mr. Shaukat Aziz was the chief guest at the occasion. The seminar aimed at encouraging dialogue amongst unlisted and public sector entities for promoting good governance practices. It was attended by representatives of unlisted companies, state-owned enterprises (SOEs), Government agencies and multilateral organizations.

In order to encourage dialogue on corporate governance and corporate social responsibility (CSR), a conference on “Corporate Governance in Pakistan: Regulation, Supervision and Performance” was held in Lahore on 29-30 May 2004 in association with the Lahore University of Management Sciences (LUMS). This was the first-ever conference on corporate governance in Pakistan, which aimed at bringing to the forefront stimulating discussion on and promotion of various aspects related to corporate governance and CSR in the country. Presenting a regional aspect of corporate governance, Dr. Philip Pillai, Director, Monetary Authority of Singapore shared Singapore’s corporate governance experience with the audience.

In order to improve corporate governance practices in the country, the Commission prepared a Manual on Corporate Governance. The Manual explains the responsibilities of management, directors and auditors of listed companies in achieving compliance with good governance practices. Furthermore, the brief series on corporate governance was resumed to deliberate on key issues in the corporate governance regime. Various issues of the brief series, focusing on different aspects of corporate governance, are available on the website of the Commission.

### iv. Capacity Building of the Commission

A Corporate Governance Cell was established at the Commission to augment its capacity. The Cell is responsible for undertaking research and awareness assignments on corporate governance to enable the Commission to gauge emerging trends and developments and refine corporate governance practices in Pakistan.

The project also aims to enhance the Commission’s capacity and improve the understanding of key governance issues by its officials. In this regard, an officer of the Commission participated in the Annual International Conference of the Institute of Internal Auditors, held in Australia from 20 to 23 June 2004.

### 3.5.3 Anti-money Laundering

The Anti-money Laundering (AML) Cell was established at the Commission under the World Bank’s TA for banking sector reforms. The Cell oversees the implementation of AML activities, which include:

- i. creating awareness among stakeholders on the need for an AML framework;
- ii. reviewing and harmonizing existing laws/regulations for ensuring better documentation and reporting of transactions; and
- iii. strengthening the capacity of the Commission to enable it to play a more proactive role in curbing money laundering activities and ensuring authentic capital flows within the financial system.

A draft AML legislation, which will provide the legal framework for concerted AML efforts in Pakistan, is under consideration by the Parliament and is yet to be promulgated. Till such time that the AML law is promulgated, it is imperative that necessary efforts are undertaken at all levels to preempt and prevent money laundering and financial fraud. The Commission is at the forefront of such efforts and carries out a number of essential measures in order to adhere to international standards on AML. Notable achievements during the year under review were as follows:

- i. In line with the Commission's strategy for strengthening the AML regime, necessary directions were issued in January 2004 to NBFCs and modarabas as part of the Prudential Regulations for prevention/detection of money laundering and financial fraud activities. In this regard, recommendations formulated by the AML Cell regarding use of a proper account opening form and restriction on payments or receipts exceeding Rs. 50,000 in cash were included in the Prudential Regulations for NBFCs and modarabas.
- ii. To provide a forum for policy guidance on the proposed AML initiatives and facilitate a participative approach in developing an effective AML regulatory framework, the Commission led the way in establishing a Consultative Group on Money Laundering. The Group includes representatives of SBP, NBFCs, stock exchanges, banking sector and private sector. It is chaired by the Chairman of the Commission. The first meeting of the Group was held in October 2003, in which the recent achievements of SBP and the Commission in minimizing money laundering activities were discussed. Moreover, various international obligations imposed by the United Nations' resolutions, Asia/Pacific Group (APG) on Money Laundering and IOSCO were highlighted. It was agreed that an assessment of compliance with international obligations and best practices should be carried out to ascertain the gaps in regulatory and legal framework.
- iii. A standardized account opening form for purchase of certificates of musharaka was introduced during the year by MAP at the behest of the Commission to follow the recommendations on know-your-customer (KYC).
- iv. The AML Cell arranged two seminars on "Countering Money Laundering" and "Developing AML Measures" in Lahore and Karachi, respectively. The participants consisted of senior representatives of the capital and financial markets. The seminars successfully highlighted the need for countering money laundering and initiated dialogue on the imminent tools to do so.
- v. The United Kingdom (UK) Charity Commission, responsible for overseeing the operation of non-profit organizations in the UK, visited the Commission and discussed various issues regarding the regulation of non-government organizations. They also held detailed discussions on AML and Countering the Financing of Terrorism (CFT).
- vi. The AML Cell continued to issue brief series on current and critical issues in money laundering with the aim to create awareness on the subject matter. So far, three issues of the brief series have been circulated and are also available on the website of the Commission.
- vii. A lecture on financial crimes and money laundering by a representative of the United Nations Office on Drugs and Crime (UNODC) was arranged by the AML Cell for officers of the Commission. Furthermore, certain officers of the Commission attended a one-day seminar on "The International Response to Corruption and Money Laundering" organized by UNODC. The seminar highlighted national and international concerns on money laundering by various enforcement agencies in Pakistan.
- viii. Officers of the Commission attended a number of seminars and conferences in the realm of AML/CFT. This interaction at the international level provided an opportunity to the officers to share their views and ideas with their counterparts and learn from their experiences in improving AML/CFT framework in Pakistan. Significant events are noted below:
  - a. Sixth Annual Conference of APG held in Macau, China in September 2003. The focus of the Conference was primarily on implementation of AML legislation and training needs of countries.
  - b. Training on AML at the USA Office of the Controller of the Currency in September 2003.
  - c. Conference on financial fraud and crime organized by the Commercial Crime Bureau in the UK in October 2003. The event focused on various issues, including financial fraud, international trade and money laundering, cyber crime, fraudsters' perspective to fraud, bankers' perspective to money laundering and methods on conducting investigation.

### 3.5.4 Corporatization of SMEs

The SMEs play an effective role in alleviating poverty and expanding the economic base in any country. The promotion of SMEs is of paramount importance to the Commission in line with its vision for development of the corporate sector in Pakistan.

In this context, a short-term research study on evaluation and simplification of company registration laws and procedures for corporatization of SMEs commenced during the year. The study, which is being administered by the Commission, is funded by the World Bank under its Institutional Development Fund grant to the Ministry of Industries and Production. The Terms of Reference (ToR) of the assignment were prepared by the Commission and duly approved by the Ministry and the World Bank.



Officers of the CS engaged in a meeting

The objective of the study is to evaluate laws and procedures governing corporatization of SMEs and develop a comprehensive policy framework to encourage SMEs to enter into the corporate arena. Once the research work is completed, the consultant will design and implement a promotional workshop, primarily to create awareness amongst SMEs regarding the benefits of corporatization. The assignment focuses on the following deliverables:

- i. designing a comprehensive and proactive strategy to collect pertinent information on SMEs;
- ii. review of legal and regulatory framework for corporatization of SMEs by studying the impact of existing laws, rules, regulations and procedures governing company registration, post registration formalities as well as de-corporatization;
- iii. development of a policy framework for corporatization of SMEs, which includes defining a system for improving the outreach and dissemination of services by the Commission to encourage corporatization of SMEs; and
- iv. designing and initiating a promotional strategy for corporatization of SMEs.

The research portion of the project is expected to be completed shortly and workshop for SMEs and other stakeholders will be held soon thereafter.

### 3.5.5 Financial Sector Assessment Program

The FSAP is a joint program run by the IMF and the World Bank since 1999. It helps to identify financial system strengths and vulnerabilities in a jurisdiction and to reduce the potential for crisis.

During the year under review, joint Mission of IMF and the World Bank visited the Commission. The focus of the Mission was to assist the Government of Pakistan in identifying strengths and systemic vulnerabilities of the financial sector and to identify priority measures for improving the operation and oversight of the system. In carrying out its assessment, the Mission met relevant authorities, including officials of the Commission and representatives of the private sector. It drew upon the self-assessments conducted by the authorities

and analyzed relevant statutes and regulations as well as responses to the FSAP questionnaires that had been filled in and submitted prior to the Mission's arrival.

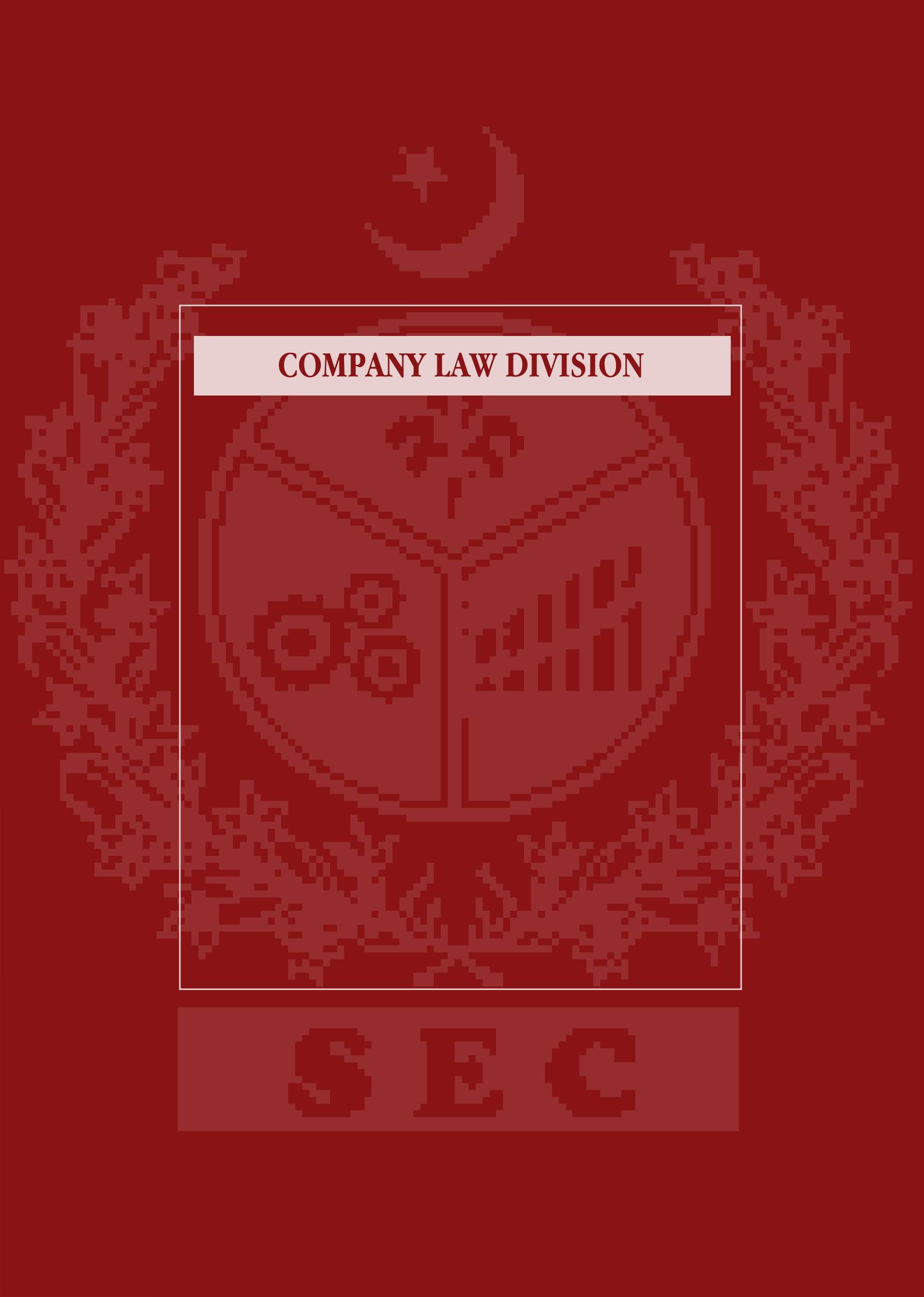
The assessment report of the Mission was under compilation at the close of the year. The Mission did, however, submit a draft report wherein it had carried out detailed assessments of the Commission's compliance with IOSCO's thirty principles of securities regulation as well as the operations and oversight of NBFC and insurance sectors. Of the thirty principles, the Mission observed that Pakistan has implemented eleven principles and partially implemented seventeen principles. Only two of IOSCO's thirty principles of securities regulation have not been implemented. The Mission also made pertinent observations in the regulation of NBFCs and insurance companies and gave detailed recommendations in this regard. The Commission reviewed the recommendations and has initiated reforms to remove deficiencies in the regulation of the financial sector.

### **3.6 Annual Plan**

The CS plans to undertake the following activities during the coming year:

- i. to develop and implement a risk-based internal audit approach;
- ii. to identify common areas of concern in complaints received at the Commission and develop standardized procedures for their effective and timely disposal;
- iii. to launch an investor education and protection program;
- iv. to enter into MoUs, bilaterally as well as multilaterally, with counterpart regulatory authorities;
- v. to launch support programs in collaboration with international and multilateral organizations targeted at priority reform measures; and
- vi. to promote socially responsible practices and investments in the corporate sector in Pakistan.



The background of the page features the national coat of arms of Malaysia, which includes a crescent moon and a star at the top, a shield with a book and a scale, and a banner at the bottom. The shield is divided into four quadrants: the top-left shows a crescent and star, the top-right shows a book, the bottom-left shows a scale, and the bottom-right shows a hand holding a sword. The shield is flanked by two mythical creatures, a lion and a unicorn, and a banner at the bottom contains the Malay motto "BERSEKUTUAN BERTAMBAH KEKUATAN".

**COMPANY LAW DIVISION**

**S E C**

# Company Law Division

**Objective:** *Healthy growth of corporate enterprises, protection of investors and creditors, promotion of investment and development of economy.*

## 4.1 Operational Structure

### 4.1.1 Structure

The Company Law Division (CLD) is entrusted with a wide array of responsibilities that encompass regulation, monitoring and enforcement of laws pertinent to the corporate sector. In recent years, it has brought about necessary amendments in existing laws as well as enacted new laws to cater to the changing business needs and scenario. The CLD also undertakes strict monitoring and vigilance of the corporate sector with a view to promoting transparency, accountability and good corporate governance practices, thereby protecting the interests of investors.

The CLD operates with the following Departments.

#### i. Registration Department

The Registration Department is responsible for registration of new companies and ensuring compliance with statutory requirements. Its operational ambit includes examination of various statutory returns and accounts filed by companies. It also supervises and coordinates the working of CROs.

The Registration Department consists of the following Wings:

- Registration and Licensing
- Investigation and Compliance
- MIS

#### ii. Enforcement Department

The Enforcement Department is responsible for monitoring companies listed on stock exchanges, except NBFCs, modarabas and insurance companies. It examines published accounts of such companies, monitors their compliance with applicable laws, rules and regulations and prosecutes the companies in default.

The Enforcement Department consists of the following Wings:

- Accounts
- Enforcement and Capital Issues
- Compliance and Prosecution

### 4.1.2 Management Team

Mr. Abdul Rehman Qureshi, Commissioner heads the CLD. In managing the Registration Department, he is assisted by a Director, a Registrar of Companies and an Additional Registrar. Three Additional Registrars oversee the CROs at Karachi, Lahore and Islamabad while the remaining five CROs are supervised either by Joint, Deputy or Assistant Registrars.

In managing the Enforcement Department, Mr. Qureshi is assisted by three Directors and a team of professionals comprising CAs, cost and management accountants (CMAs), lawyers and business graduates.

### 4.1.3 Laws Administered

- i. Companies Ordinance, 1984
- ii. Securities and Exchange Commission of Pakistan Act, 1997
- iii. Companies (Appointment of Legal Advisers) Act, 1974
- iv. Companies (Appointment of Legal Advisers) Rules, 1975
- v. Companies (General Provisions and Forms) Rules, 1985
- vi. Companies (Invitation and Acceptance of Deposit) Rules, 1987
- vii. Companies (Issue of Capital) Rules, 1996
- viii. Companies (Audit of Cost Accounts) Rules, 1998
- ix. Companies (Buy-back of Shares) Rules, 1999
- x. Companies Share Capital (Variation in Rights and Privileges) Rules, 2001
- xi. Companies (Registration Offices) Regulations, 2003

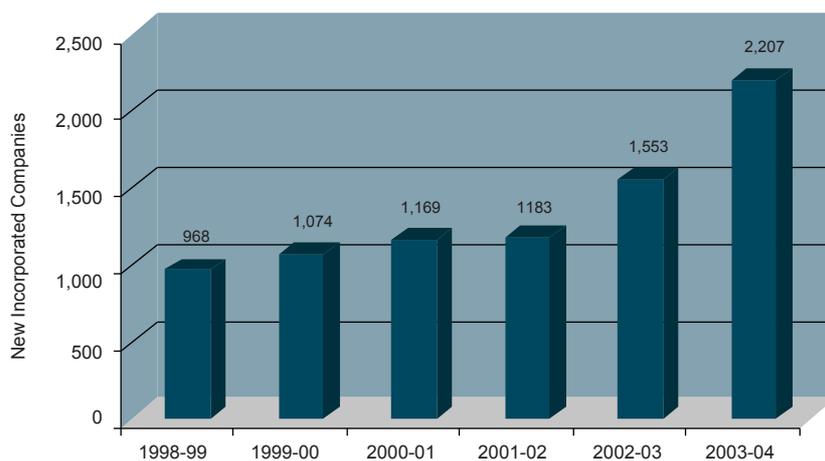
The Registration Department administers the laws pertinent to private companies, unlisted public companies and foreign companies while the Enforcement Department administers the laws relevant to listed companies.

## 4.2 Sector Overview

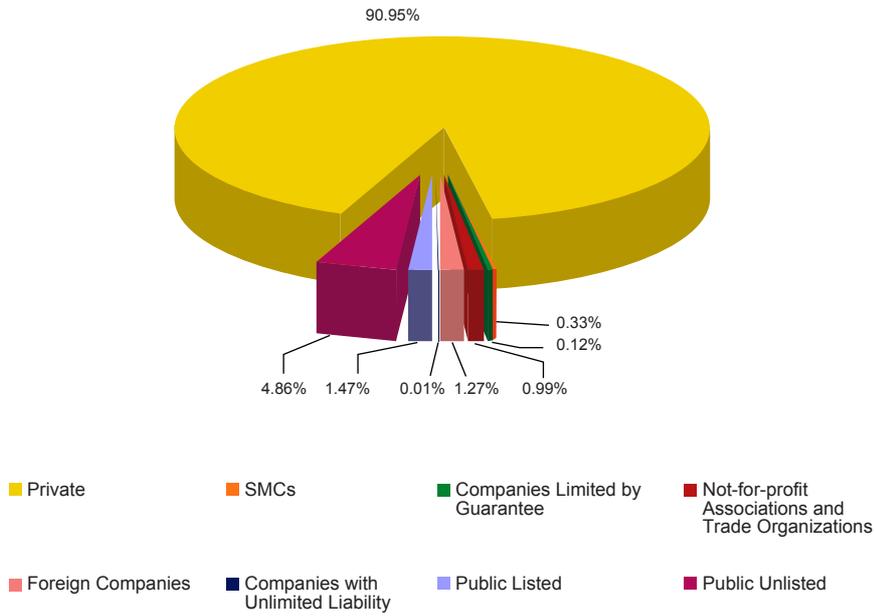
As on 30 June 2004, there were a total of 43,728 companies in the country. Of these, 42,681 companies were limited by shares including 2,768 public companies, 144 SMCs and 39,769 private companies. During the year, 2,207 new companies were registered, of which 2,152 companies were limited by shares.

Registration of companies over the period 1999 to 2004 is displayed in Chart 1 while the growth in companies according to their type is figured in Chart 2.

**Chart 1 - Registration of Companies During the FYs 1999 - 2004**

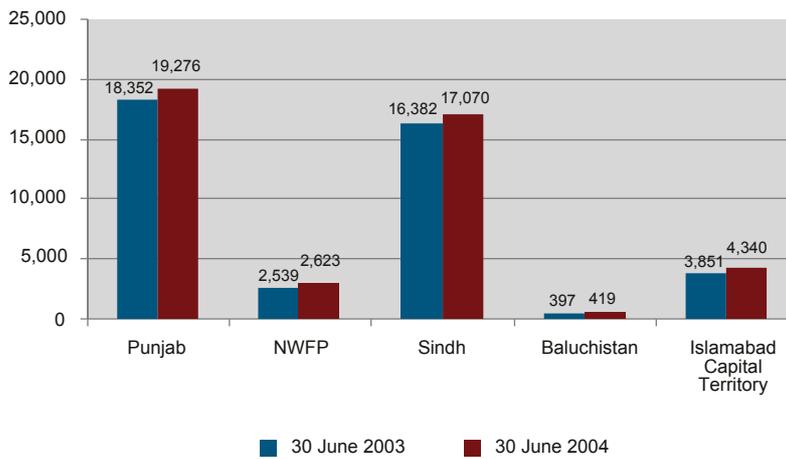


**Chart 2 - Growth in Various Types of Companies During the Year**



Geographical spread of registered companies as of the close of the year under review and the preceding year is given below.

**Chart 3 - Geographical Spread of Companies**



Sector-wise distribution of companies limited by shares is shown in Table 3.

**Table 3 - Sector-wise Distribution of Companies Limited by Shares**

S. No.	Sector	Number of Companies as at 30 June 2004
1	Commercial Banks	21
2	Investment Banks	79
3	Leasing Companies	41
4	Mutual Funds and Management Companies	13
5	Modaraba Management Companies	40
6	Brokerage Houses	129
7	Investment Advisers	71
8	Insurance	104
9	Textile Spinning	242
10	Textile Weaving	249
11	Textile Composite and Others	2,877
12	Synthetic Rayon	63
13	Woolen	109
14	Jute	18
15	Sugar and Allied	152
16	Tobacco	108
17	Cement	64
18	Fuel and Energy	459
19	Power Generation	214
20	Engineering	1,333
21	Auto and Allied	220
22	Electrical and Electronics	322
23	Transport	483
24	Communication	1,355
25	Chemical and Pharmaceuticals	1,283
26	Paper and Board	311
27	Ghee and Cooking Oil	284
28	Construction	944
29	Housing and Real Estate	292
30	Food and Allied	952
31	Leather and Tanneries	246
32	Glass and Ceramics	347
33	IT	1,124
34	Security Services	353
35	Corporate Agriculture Farming	26
36	Miscellaneous	27,753
	<b>Total</b>	<b>42,681</b>

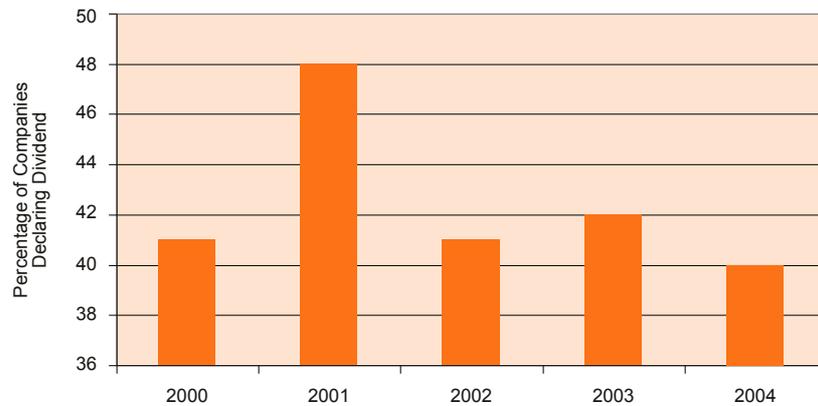
The pattern of paid-up capital of companies limited by shares is given in the table below.

**Table 4 - Pattern of Paid-up Capital of Companies Limited by Shares**

Paid-up Capital	Listed Companies	Unlisted Public Companies	Private Companies	SMCs
Below Rs. 0.5 million	3	839	26,849	123
Rs. 0.5 million to Rs. 1 million	-	91	3,321	9
Rs. 1 million to Rs. 10 million	47	342	7,535	9
Rs. 10 million to Rs. 100 million	288	645	1,915	3
Rs. 100 million to Rs. 500 million	226	164	132	-
Rs. 500 million to Rs. 1,000 million	34	17	12	-
Rs. 1,000 million and above	46	26	5	-

During the year under review, 214 out of 536 listed companies – under the purview of the CLD – paid dividends to their shareholders. The pattern of dividend payment by listed companies during the last five years is presented as follows.

**Chart 4 - Dividend Paying Companies During the FYs 2000 - 2004**



A slight decrease in dividend payment was experienced during the year, which was primarily because some dividend paying companies were merged while some were de-listed from stock exchanges. Moreover, the financial results of nine companies, which were listed on stock exchanges during the year, were not due as on 30 June 2004.

Table 5 - Sector-wise Pattern of Dividend Declared

S. No.	Sector	2002		2003		2004	
		No. of Companies	No. of Companies Declaring Dividend	No. of Companies	No. of Companies Declaring Dividend	No. of Companies	No. of Companies Declaring Dividend
1	Investment Companies/Securities Companies/Banks*	40	17	24	15	25	16
2	Insurance*	39	18	38	15	-	-
3	Textile Spinning	133	57	126	45	121	37
4	Textile Weaving	21	6	20	4	20	4
5	Textile Composite	57	23	56	23	55	22
6	Woolen	6	2	6	2	5	2
7	Synthetic	24	10	23	9	22	10
8	Jute	7	1	7	2	6	2
9	Sugar and Allied	38	13	38	14	38	10
10	Cement	21	5	22	9	21	7
11	Tobacco	6	2	5	2	5	2
12	Refinery	3	3	4	3	4	3
13	Power Generation and Distribution	14	5	13	6	12	7
14	Oil and Gas Marketing	6	6	6	5	6	6
15	Oil and Gas Exploration	2	2	2	2	3	2
16	Engineering	14	4	13	5	14	5
17	Automobile Assembler	13	6	13	7	13	8
18	Automobile Parts and Accessories	12	5	12	6	12	6
19	Cable and Electric Goods	13	4	12	4	10	4
20	Transport	4	-	4	-	5	1
21	Technology and Communication	5	4	5	3	8	3
22	Fertilizer	4	3	4	3	4	3
23	Pharmaceutical	11	9	11	9	11	9
24	Chemical	23	10	23	12	23	11
25	Paper and Board	14	7	13	7	13	7
26	Vanaspati and Allied	19	-	18	4	18	-
27	Leather and Tanneries	7	6	5	3	5	3
28	Food and Personal Care Products	24	16	22	15	21	15
29	Glass and Ceramics	10	5	10	5	10	4
30	Miscellaneous	27	6	27	5	26	5
	<b>Total</b>	<b>617</b>	<b>255</b>	<b>582</b>	<b>245</b>	<b>536</b>	<b>214</b>

\*The regulation of insurance companies and investment banks has been taken out from the ambit of the CLD.

### 4.3 Performance Review

In order to encourage growth of corporate enterprises and to ensure public facilitation through prompt information dissemination, the Registration Department took a number of appropriate measures. Notable steps included revision and updating of the Promoters' Guide for incorporation of a company, reduction in initial incorporation fees and reduction in the rates of late filing fee of documents by companies. A booklet titled "Directors and Secretaries Guide" was also published to guide and educate the public regarding corporate laws and their compliance. Efforts were made to further develop the legal framework in order to promote and achieve the overall objective of effective regulatory compliance by registered entities. The Registration Department also undertook effective monitoring and enforcement in the case of unauthorized and illegal international brokerage houses, forex companies and multi-level marketing (MLM) companies/pyramid schemes. Further, the Companies Easy Exit Scheme (CEES) was re-launched during the year to provide another chance to dormant companies to get their names struck off the register of companies.



Officers of the Registration Department in a meeting

During the year, the Enforcement Department focused its efforts on ensuring transparency in the affairs of companies and, for the purpose, took a number of actions targeted at discouraging unauthorized and unlawful inter-corporate financing, non-payment of dividends, irregularities relating to employees' provident fund accounts, non-compliance with statutory provisions, negligence by auditors and inadequate or misleading disclosures in accounts. It ordered investigations into the affairs of various listed companies during the year. Based on the findings in inspectors' reports, appropriate penal actions were initiated against directors of those companies and their statutory auditors. Compliance with corporate laws and International Accounting Standards (IASs) by listed companies has notably improved as a result of stringent corporate discipline enforced by the CLD.

### 4.4 Development of Laws

#### 4.4.1 Amendments in Companies (General Provisions and Forms) Rules, 1985

Appropriate amendments in the Companies (General Provisions and Forms) Rules, 1985 were notified on 7 July 2003. The draft amendments were finalized last year in consultation with stakeholders. Major amendments related to the following:

- i. mode of serving notices and documents;
- ii. reformatting of forms and returns;
- iii. application for alteration in memorandum of association;
- iv. company representatives in proceedings before the Commission; and
- v. authorized signatories on returns submitted to the Commission.

Consequent upon promulgation of the Companies (Amendment) Ordinance, 2002, further amendments were deemed necessary in the Companies (General Provisions and Forms) Rules, 1985. Accordingly, the following notable amendments in the Rules were notified on 29 October 2003 so as to bring their requirements in line with those of the Companies Ordinance as amended:

- i. particulars to be provided by a subscriber;
- ii. disqualification from appointment as a director;
- iii. approval of capital and other expenditure by directors;
- iv. qualifications of company secretary; and
- v. auditors' report on consolidated financial statements.

#### **4.4.2 Amendments in Companies (Invitation and Acceptance of Deposit) Rules, 1987**

The Commission, on 1 October 2003, amended the Companies (Invitation and Acceptance of Deposit) Rules, 1987 (Deposit Rules) to bring within their ambit the advance money collected by real estate, automobile or other companies against the promise to supply a property or commodity at some future date. The amendments were introduced after considering the complaints received against certain companies engaged in the real estate and automobile businesses, which had launched schemes for inviting and collecting advance money from the public. These companies had promised to supply properties or commodities at some future date but did not honor their commitments.

While implementing Deposit Rules, specially on real estate business, it was observed that managements of such businesses started registration of cooperative societies for launching different housing schemes in order to avoid application of the said Rules. Furthermore, registration of new real estate companies was also curtailed, which hampered the Commission's aim of formalizing the unorganized business sector through corporatization. This shift in the legal status of real estate business from corporate entities to cooperative societies - registered by district governments/development authorities - made the implementation of Deposits Rules nearly impracticable and made this sector more vulnerable to irregularities and financial scams.

In view of these concerns, the Commission has proposed to withdraw amendments made in Deposit Rules that applied to real estate and automobile companies. It has instead been proposed that companies seeking deposits from the public would be required to obtain credit rating from registered credit rating companies. This would protect the interests of investors and facilitate them in making informed investment decisions. The enhancement of penalty in case of non-compliance with the provisions of Deposit Rules was also proposed. Moreover, the Commission has suggested to the Government that provincial/district governments, development authorities or another agency may be required to formulate a legislation to safeguard the interests of the general public, particularly in case of real estate business, where advance money is collected from the public.

#### **4.4.3 Single Member Companies Rules, 2003**

Subsequent to inclusion of the concept of SMC in the Companies Ordinance, the Single Member Companies Rules, 2003 were framed and notified by the Commission to provide impetus to the formation of SMCs. The Rules provide necessary legal framework for such companies and clarify matters concerning their formation.

The Single Member Companies Rules apply to a company incorporated as a SMC and any private company limited by shares and having more than one member that becomes a SMC after complying with the requirements of the said Rules. Its notable requirements include the following.

##### **i. Formation of a SMC**

A single person may form a SMC and nominate at least two individuals to act as nominee director and alternate nominee director.

**ii. Change in Status of a SMC**

A SMC may be converted into a private company upon increase in the number of its members to more than one due to transfer of shares, further allotment of shares, death of the single member or operation of law. In this regard, the SMC will pass a special resolution for change of status and alter its articles of association accordingly, transfer the shares and appoint and elect additional directors.

**iii. Director's Meeting**

Any provision of the Companies Ordinance, rules made thereunder, or articles of association of the company which requires any action or decision to be taken by directors or members, or by a resolution of directors or members of a company will be deemed to be satisfied if taken by the sole director or single member and drawn up in writing and recorded in the minutes book.

**iv. Company Secretary**

A SMC will appoint a company secretary who will attend general meetings and meetings of directors and record a fair and accurate summary of the minutes of proceedings of such meetings.

**v. Transfer of Management to Nominee Director**

The nominee director will manage the affairs of a SMC in case of death of single member till the transfer of shares to his legal heirs. In case of any impediment, the nominee director is required to report the circumstances to the Registrar and seek necessary directions within seven days of the death of the single member.

**vi. Contracts with Single Member**

Where a SMC enters into a contract with the single member of the company, the SMC must, unless the contract is in writing, ensure that the terms of the contract are forthwith set out in a written memorandum or recorded in the minutes of the first meeting of the directors of the company following the making of the contract.

**vii. Company becoming a SMC**

A private limited company having two or more members can become a SMC by passing a special resolution for change of its status, making necessary alteration in its articles of association and on obtaining prior approval of the Commission.

**viii. Pattern and Style of the Name of a SMC**

The pattern and style of the name of a SMC shall be "XYZ (SMC-Private) Limited".

**4.4.4 Companies (Registration Offices) Regulations, 2003**

On 5 September 2003, the Companies (Registration Offices) Regulations, 2003 were issued to replace the Companies (Registration Offices) Regulations, 1986. The Regulations were formulated with a view to improve document management, boost internal efficiency and eradicate redundant manual work at CROs, specially with respect to maintenance of various registers. Some of the major reforms introduced through the new Regulations are as under.

**i. Time Period for Examination of Documents, Applications, etc.**

In order to facilitate the corporate sector, the Regulations define the maximum possible time period in which documents or applications filed at CROs would be examined and in case of delay, reasons and circumstances causing the delay would be recorded. Most of the applications and statutory returns would be disposed, registered or recorded within one day. Certificates of commencement of business, registration of a foreign company and incorporation of a company would be issued within a period of two and three days, respectively, while inspection of documents would be carried out within an hour.

**ii. Payment of Additional Fee for Late Filing of Documents**

In order to encourage compliance with statutory requirements, additional filing fee slabs for companies have been reduced.

## 4.5 Regulatory Actions

### 4.5.1 Mergers and Amalgamations

The Commission ensures that schemes of arrangement proposed by listed companies are not prejudicial to the interests of minority shareholders. In the event of a scheme of arrangement appearing to be detrimental to the interests of minority shareholders, the concerned Registrar, under Section 288 of the Companies Ordinance, makes a representation before the court on the basis of comments of the CLD. During the year under review, the CLD filed oral and written representations in the courts in respect of eleven cases of mergers regarding listed and unlisted companies. Of these, nine related to schemes of arrangement involving listed companies. The following schemes were approved by the courts/SBP during the year:

- i. merger of Dilon Limited, Lawrencepur Woolen Mills, Burewala Textile with Dawood Cotton Mills;
- ii. merger of Kohinoor Genertech with Kohinoor Weaving;
- iii. merger of Hattar Fruit Products with Shezan International;
- iv. merger of Ka'as ul Mustafa (Private) Limited with Ghani Glass Limited;
- v. merger of Crescent Investment Bank Limited with Mashreq Bank Limited;
- vi. merger of Pak Elektron Limited with PEL Appliances Limited;
- vii. merger of Worldcall Phonocards with Worldcall Communications; and
- viii. merger of KASB Leasing Limited with KASB Bank Limited.

Only one scheme of arrangement of listed companies was under consideration as of the close of the year.

### 4.5.2 Re-launching of CEES

During the year under review, the Commission re-launched the CEES, which allows dormant and inactive public unlisted companies, private companies, associations not-for-profit, companies limited by guarantee and foreign companies to get their names struck off the register of companies under Section 439 of the Companies Ordinance. The Scheme was re-introduced after considering the continuous demand and representations received from the corporate entities to provide another chance to these companies to exit from the corporate sector.

The Scheme remained operative from 1 March 2004 to 30 June 2004. The procedural requirements under the Scheme included:

- i. payment of fee for private limited companies, unlisted public companies and companies limited by guarantee;
- ii. a resolution by the Board of directors or of the shareholders of the company;
- iii. a duly verified affidavit from one of the directors, preferably CEO, stating that the company has no assets or liabilities, it is not carrying on any business or operation and does not owe any amount to any authority; and
- iv. a certificate from the company's auditor and in case the auditor is not a practicing CA or a CMA, then a certificate from a practicing CA or a CMA verifying that the company is not doing any business, has no assets or liabilities and does not owe any amount to any authority.

A total of 1,143 companies applied under the Scheme. As many as 154 applications were accepted by CROs while the remaining 989 cases were under consideration as at the close of the year.

### 4.5.3 Approvals and Permission

The Companies Ordinance contains a number of provisions in which approval of the Commission or the Registrar is mandated for effecting the requirements of such provisions. A large number of applications were received during the year and, after due process, necessary approvals were accorded. Relevant details are given in Table 6.

Table 6 - Cases Approved under the Companies Ordinance

Section	Nature of Approval/Permission Sought	Number of Cases Disposed Off
Section 21	Amendment in memorandum and articles of association	79
Sections 21,131,25	Issue of certified copies of documents	391
Section 25	Extension in time period for filing the order confirming alteration in memorandum of association with the Registrar	1
Section 37	Availability of name	6,781
Section 39	Change of name	168
Section 42	Grant of license to associations	23
Section 44	Conversion of public companies into private companies	8
Section 57	Registration of prospectus	10
Section 90	Issue of shares under the Companies Share Capital (Variation in Rights and Privileges) Rules, 2000	2
Section 121,129,132	Registration, modification and satisfaction of charge	6,068
Section 131	Condition of delay in submission of particulars of charge	14
Section 146	Commencement of business certificate	38
Section 158, 233	Extension in period for holding of Annual General Meetings (AGMs) by unlisted public and private companies	112
Section 170	Calling of overdue meetings	29
Section 195	Grant of loans to directors of unlisted public companies	2
	Miscellaneous	6,833
<b>Total</b>		<b>20,559</b>

Moreover, conversion of a private company into SMC under Rule 9 of the Single Member Companies, Rules, 2003 was approved during the year. In addition, CROs allowed inspection of records in 8,996 cases in terms of Regulation 18 of the Companies (Registration Offices) Regulations, 2003.

#### **4.5.4 Attendance of Directors in Board Meetings through Video Conferencing**

In recognition of the convenience provided by modern technology and to facilitate compliance with legal requirements, the Commission, vide circular no. 30 of 2003, allowed listed companies to hold meetings of their Boards of directors through videoconferencing. This decision is expected to facilitate companies whose directors are based abroad, particularly given the requirement to hold Board meetings at least once in each quarter.

#### **4.5.5 Transmission of Quarterly Accounts by Listed Companies**

During the year, listed companies were advised, vide circular no. 13 of 2003, to set up their websites and place their financial information thereon in order to reap the advantages provided by modern technology. The Commission also received concerns from various listed companies that circulation of periodic accounts to all shareholders by mail was a costly and cumbersome exercise. In this regard, suggestions were made to the Commission to allow listed companies to place quarterly accounts on their websites instead of transmitting the same to shareholders by post. After suitable consideration of this proposal, listed companies were allowed, subject to certain requirements, vide circular no. 19 of 2004, to place their quarterly accounts on their websites. This would be treated as compliance with the provisions of Section 245 of the Companies Ordinance and would also ensure timely availability of information to shareholders.

#### **4.5.6 Capital Issues**

During the year under review, the CLD received twelve applications from nine companies related to issue of capital by way of right issue and/or otherwise than right issue. After necessary examination, four companies were allowed to issue preference shares/different class of shares to existing shareholders by way of right, amounting to Rs. 3,233.65 million while two companies were allowed to issue shares to foreign investors amounting to Rs. 335 million. Another company was allowed to issue shares at a discount of 20 percent to existing shareholders. However, one case for issuance of 100 percent right preference shares was rejected due to non-compliance with the requisite legal formalities. Two cases, where companies intended to issue shares other than by way of right issue, were also rejected, being unjust and unfavorable to the interests of minority shareholders. As of the close of the year, only two applications were pending on account of deficiencies to be resolved by the companies concerned.

### **4.6 Monitoring and Enforcement**

#### **4.6.1 Action against Forex Companies/International Brokerage Houses**

During the year under review, it was found out that thirty-eight illegal and unauthorized registered forex companies/international brokerage houses were operating in the country in violation of the provisions of law. Moreover, twenty-two individuals/firms conducting illegal forex/international brokerage business were identified.

In this regard, the Commission and SBP set up a joint task force to devise a cohesive strategy to deal with errant companies. Petitions for winding up of fifteen companies were filed with the courts while twenty-two cases were referred to the National Accountability Bureau (NAB) for action against companies and calling/settlement of claims of investors. Prohibitive notices and directives were issued to the companies concerned and names of their directors/CEOs were placed on the Exit Control List.

#### **4.6.2 Action against MLM and Pyramid Schemes**

The Commission noted that certain companies, firms and individuals were engaged in unauthorized, unlawful and unethical business practices, deceiving general public by inducing them to earn sky-high returns in a short span of time through schemes that sought referrals and recruitment of new participants. Although participants at the very first levels may benefit from such a scheme, a vast majority lose their original investment without generating any profit.

Companies engaged in this business were identified and necessary action was initiated. Petitions for winding up of two companies were filed while three cases were referred to NAB for further action.

In addition, a media campaign was launched to warn the public against unlawful activities of such companies and to educate them on MLM concepts and pyramid schemes. Notices were published in the newspapers and warnings were placed on the Commission's website to further alert the public against companies involved in such activities.

#### 4.6.3 Investigations into the Affairs of Companies

During the year under review, the CLD ordered investigations into the affairs of two listed companies under Section 265 of the Companies Ordinance in view of the following concerns:

- i. non-compliance with statutory requirements;
- ii. complaints of shareholders about poor performance and mismanagement;
- iii. inconsistencies in operating results;
- iv. considerable deterioration in performance; and
- v. oppression of minority shareholders.

Prosecution was initiated in case of the company whose management did not cooperate with the inspector appointed by the Commission.

In addition, the Commission ordered investigation into the affairs of a private limited company on an application received from its shareholders. The shareholders had conveyed that the affairs of the company were not being managed in accordance with prudent commercial practices. The inspector, appointed by the Commission under Section 263 of the Companies Ordinance submitted his report during the year. Necessary action on the report was in process at the close of the year.

#### 4.6.4 Holding of AGMs

The CLD carries out strict monitoring to ensure that listed companies hold AGMs within the prescribed period of time and in an orderly manner. Of the 536 listed companies under the purview of the CLD, 472 companies were found to be compliant whereas sixty-four companies failed to hold their meetings within the specified time period. The position in comparison to previous years is illustrated in the table below.

**Table 7 - Extent of Compliance with the Requirement for Timely Holding of AGM: A Comparison with Last Three Years**

Year	No. of Companies	No. of Compliant Companies	Compliance %
2004	536	472	88.1
2003	582	498	85.6
2002	617	548	88.8
2001	635	534	84.1

Chart 5 - Detail of Companies in Default

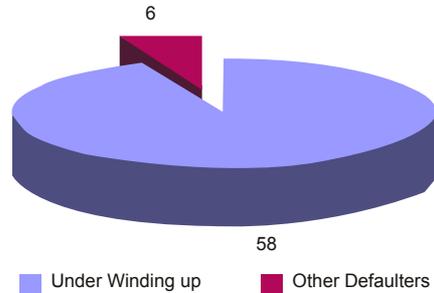


Table 8 - Sector-wise Status of Holding of AGM within the Prescribed Time Period

S. No.	Sector	AGMs of Companies with FY End								Total		Default
		June		September		December		Others		Due	Held	
		Due	Held	Due	Held	Due	Held	Due	Held			
1	Investment Companies/ Securities Companies	7	7	-	-	-	-	-	-	7	7	-
2	Commercial Banks	-	-	-	-	18	18	-	-	18	18	-
3	Textile Spinning	1	1	120	112	-	-	-	-	121	113	8
4	Textile Weaving	1	1	19	10	-	-	-	-	20	11	9
5	Textile Composite	13	9	42	39	-	-	-	-	55	48	7
6	Woolen	4	2	1	1	-	-	-	-	5	3	2
7	Synthetic	21	17	1	1	-	-	-	-	22	18	4
8	Jute	6	5	-	-	-	-	-	-	6	5	1
9	Sugar and Allied	1	1	37	35	-	-	-	-	38	36	2
10	Cement	21	21	-	-	-	-	-	-	21	21	-
11	Tobacco	4	4	-	-	1	1	-	-	5	5	-
12	Refinery	4	4	-	-	-	-	-	-	4	4	-
13	Power Generation and Distribution	12	11	-	-	-	-	-	-	12	11	1
14	Oil and Gas Marketing	6	6	-	-	-	-	-	-	6	6	-
15	Oil and Gas Exploration	3	3	-	-	-	-	-	-	3	3	-
16	Engineering	12	10	-	-	2	1	-	-	14	11	3
17	Automobile Assembler	8	7	-	-	4	4	1	1	13	12	1
18	Automobile Parts and Accessories	10	9	-	-	-	-	2	2	12	11	1
19	Cable and Electric Goods	7	4	1	1	2	1	-	-	10	6	4
20	Transport	4	2	-	-	1	1	-	-	5	3	2
21	Technology and Communication	8	8	-	-	-	-	-	-	8	8	-
22	Fertilizer	-	-	-	-	4	4	-	-	4	4	-
23	Pharmaceutical	4	4	-	-	6	6	1	1	11	11	-
24	Chemical	18	17	1	1	4	4	-	-	23	22	1
25	Paper and Board	11	9	1	1	1	1	-	-	13	11	2
26	Vanaspati and Allied	14	9	1	-	-	-	3	2	18	11	7
27	Leather and Tanneries	3	3	-	-	2	2	-	-	5	5	-
28	Food and Personal Care Products	15	13	1	1	5	5	-	-	21	19	2
29	Glass and Ceramics	10	7	-	-	-	-	-	-	10	7	3
30	Miscellaneous	23	20	-	-	2	1	1	1	26	22	4
	<b>Total</b>	<b>251</b>	<b>214</b>	<b>225</b>	<b>202</b>	<b>52</b>	<b>49</b>	<b>8</b>	<b>7</b>	<b>536</b>	<b>472</b>	<b>64</b>

In addition to sixteen show cause notices brought forward from the previous year, the CLD issued twenty show cause notices during the year under review for defaults in holding of AGMs. As a consequence of these proceedings, penalties amounting to Rs. 1.06 million were imposed in twenty-seven cases while seven cases were closed due to satisfactory explanations received from companies. As at the end of the year, only two cases were pending adjudication.

#### 4.6.5 Circulation of Quarterly Accounts

A total of 1,279 quarterly accounts of listed companies were due to be filed during the year. As many as 1,092 accounts were circulated by listed companies, exhibiting 85.4 percent compliance. The status of compliance for the year under review is tabulated below.

**Table 9 - Circulation of Quarterly Accounts**

	1st Quarter	2nd Quarter	3rd Quarter	Total
Accounts Due	537	484	258	1,279
Accounts Submitted	461	410	219	1,092
Compliance (%)	85.8	84.7	84.9	85.4

During the year, sixty-two companies did not submit a total of 187 accounts for various quarters. In view of the failure to comply with the requirements of the Companies Ordinance, fifty-three show cause notices were issued to forty-two companies while fifty-six show cause notices were brought forward from the previous year. After completion of due process, penalties amounting to Rs. 1.383 million were imposed in forty-two cases while fifty-one cases of default were either condoned due to minor defaults and satisfactory explanations received or winding up proceedings were initiated. There were sixteen cases pending adjudication as of 30 June 2004.

#### 4.6.6 Examination of Annual and Interim Accounts

During the year under review, the Enforcement Department undertook examination of published accounts of listed companies with the aim to identify deficiencies in disclosures and other irregularities. As a result of strict monitoring, there has been more comprehensive and transparent presentation of financial statements by listed companies.

##### i. Disclosures in Financial Statements

During the year, 135 listed companies were asked to furnish explanation regarding deficiencies in their financial statements. Upon a review of explanations submitted to the Commission, proceedings were initiated against eight companies for not presenting true and fair view in the financial statements and not maintaining proper records. The cases of two companies were closed whereas remaining cases were at various levels of adjudication as at the end of the year.

##### ii. Disclosures in Directors' Reports

The CLD observed that disclosures required under Section 236 of the Companies Ordinance were missing from directors' reports in certain cases, with the result that shareholders were deprived of meaningful information about the affairs of these companies. Consequently, clarifications were sought and show cause notices were issued to directors of four companies for grossly inadequate disclosures in the directors' reports annexed to the financial statements.

##### iii. Irregularities in Provident Funds

During the year under review, the CLD initiated actions against directors of companies and trustees of provident fund trusts for committing irregularities in employees' provident funds under the Companies Ordinance. In this regard, five show cause notices were issued and necessary penalties were imposed. Moreover, these companies were asked to repay the contributions and loans due to the respective funds along with accrued mark-up. In addition, directions under Section 472 of the Companies Ordinance were issued to two companies to repay the liability due to the provident fund accounts within the stipulated time.

Besides the above, examination of annual accounts of 511 unlisted companies and associations not-for-profit was carried out by the Registration Department. Show cause notices and warnings were issued to 309 and 109 companies, respectively, for non-compliance with the statutory requirements. Explanation from auditors of thirty companies was also sought.

#### **4.6.7 Actions against Auditors**

During the year under review, the CLD identified certain cases of negligence of statutory auditors where they had failed to act in conformity with the statutory requirements. The reports issued by such auditors either failed to bring out material facts about the affairs of companies or contained untrue statements. As a result, proceedings in the case of one firm of CAs were initiated during the year. Moreover, penalty was imposed in another case, which was brought forward from the previous year.

#### **4.6.8 Inter-corporate Financing**

During the year under review, efforts were made to deter unlawful inter-corporate financing in order to curb the misuse of funds. Timely intervention by the CLD caused two companies to withdraw the proposed resolutions for making investments, aggregating Rs. 111.06 million, in their associated companies. Cases were also identified where investments made in associated companies were either free of return or without approval of shareholders. In this regard, proceedings were initiated against two companies for violation of mandatory provisions of the Companies Ordinance. A penalty of Rs. 100,000 was imposed in one case besides issuance of directions to recover the amount from the associated undertaking. As a result of actions taken, it is expected that investment of more than Rs. 97 million would be returned to the concerned company.

#### **4.6.9 Disclosure of Information in Case of Special Business**

The CLD continued its efforts to require listed companies to provide material information to shareholders. In this regard, it examined the statements of material facts pertaining to special businesses to be transacted by ninety-three listed companies. Strict monitoring by the CLD resulted in enhanced disclosure of information by companies. Where material deficiencies were identified in the notices of meetings, the CLD took appropriate actions. Accordingly, thirty-four companies were advised to circulate addendums whereas three companies were stopped from passing resolutions that were considered to be against the interests of shareholders or contrary to the provisions of the Companies Ordinance.

During the year under review, proceedings under Section 160 of the Companies Ordinance were initiated against five companies for failure to annex the statement of material facts with the notice of AGM and failure to include special business in the agenda of the notice. Consequently, penalties were imposed on three companies. Generally, actions were taken in respect of deficiencies in the following matters:

- i. remuneration of CEO and directors;
- ii. investment in associated companies;
- iii. alteration in memorandum and articles of association;
- iv. increase in authorized share capital;
- v. issuance of bonus shares;
- vi. sale or lease of whole undertaking or sizeable part thereof; and
- vii. election of directors/increase or decrease in the number of directors.

#### **4.6.10 Irregularities in Holding Election of Directors**

During the year under review, thirty-four companies did not hold elections of their Boards after expiry of the term of office of directors and also did not report impediments to the Registrar within fifteen days of the date of elections, as required by law. As a consequence

of violation of Section 177 of the Companies Ordinance, necessary proceedings were initiated and penalties amounting to Rs. 227,000 were imposed on the directors of seven companies. Prosecution proceedings were initiated in rest of the cases except one, which was pending adjudication at the close of the year.

#### **4.6.11 Delay in Transfer of Shares**

In cognizance of complaints received from investors regarding delay in transfer of shares, the CLD issued show cause notice to one company. Another case, which was pending from previous year, was decided and penalty was imposed on the directors of the company, including CEO.

During the year under review, the CLD received five appeals under Section 78A of the Companies Ordinance for refusal for registration of transfer of shares. After providing considerable opportunity to appear in person and to clarify the position, the concerned companies were directed to transfer shares in the names of the applicants.

#### **4.6.12 Investors' Grievances**

The CLD has been active in addressing and resolving complaints received from small shareholders. On the basis of these complaints, the CLD was able to identify companies' violations of various provisions of the Companies Ordinance and take timely actions in the following areas:

- 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;
- v. wrongful deduction of Zakat;
- vi. disputes in shareholdings; and
- vii. removal of directors.

During the year under review, the Registration Department received seventy-six complaints from shareholders and the general public. Of these, seventy complaints were disposed off. A total of 891 applications were received and complainant's grievances satisfied by the Enforcement Department during the year as compared to 919 complaints resolved during last year.

#### **4.6.13 Striking off the Names of Defunct Companies**

Section 439 of the Companies Ordinance provides that where the Registrar has reasonable cause to believe that a company is not carrying on business or is not in operation, he may, by following the prescribed procedure, strike off the name of such company. During the year under review, names of forty-eight companies were struck off the register of companies under Section 439. The CLD also initiated actions against inactive companies, which had not filed their statutory returns for the last fifteen years. In this regard, notices were issued to all defaulter companies.

#### **4.6.14 Liquidation of Companies**

The Registrar of Companies sought approval of the Commission to present winding up petitions against fifty-three listed companies, under Section 305 of the Companies Ordinance, that had either failed to hold two consecutive AGMs or suspended their business for more than a year. The Commission, after giving an opportunity to the companies concerned, accorded its approval for presentation of winding up petitions against twenty-six listed companies. In case of twelve companies, the courts appointed official liquidators to initiate formal proceedings.

#### 4.6.15 Adjudication of Cases under the Companies Ordinance

During the year under review, a total of 6,397 cases were adjudicated by the CROs, Registrar of Companies, Executive Director and Commissioner (CLD) for violations of various provisions of the Companies Ordinance. Appropriate actions were taken against companies and their managements where violations were proven.

#### 4.6.16 Developments in the Case of Taj Company Limited

The petition for winding up of Taj Company Limited was filed before the Lahore High Court and was accepted on 18 May 1998. The Supreme Court suspended the liquidation order but it was vacated on 13 June 2003.

During the year, the Lahore High Court appointed joint official liquidators to proceed with the winding up of Taj Company Limited by taking over all moveable and immoveable assets of the company including its bank accounts. Of the twelve properties of the company, four were sold, generating an amount of Rs. 420 million. On 12 March 2004, the Honorable Prime Minister of Pakistan distributed cheques, amounting to Rs. 224 million, among 8,911 depositors and claimants. Subsequently, the official liquidators of the company, under direct supervision of the Lahore High Court, reported in May 2004 that funds amounting to Rs. 434 million were available for disbursement to the depositors. As of 1 April 2004, an amount of Rs. 448.67 million had been distributed among 23,075 people affected by the Taj Company scam.

The official liquidators of the company, with approval of the company judge, have proposed to make 100 percent payment to claimants, having claims up to Rs. 50,000, whereas the remaining claimants, with claims exceeding Rs. 50,000, would be paid another instalment of 20 percent thus reaching a payment of 40 percent of their deposited amount. The pace of liquidation process is satisfactory and as per the order of the Court, it is expected to be completed within the stipulated period.



Officers of the Enforcement Department engaged in a meeting

#### 4.6.17 Cost Audits

Section 258 of the Companies Ordinance empowers the Commission to direct such class of companies as has been required to maintain cost accounting records under Section 230 (1) (e) of the Companies Ordinance to have the cost accounts audited in accordance with specified stipulations by an auditor who is a CA or a CMA. In this regard, the Commission framed the Companies (Audit of Cost Accounts) Rules, 1998 (Cost Audit Rules) that were notified on 25 July 1998. This requirement has been prescribed for vegetable ghee and cooking oil, cement and sugar industries.

During the year under review, show cause notices were issued to thirteen companies for non-compliance with the Cost Audit Rules. The violations related mainly to non-appointment of cost auditors within the prescribed period of time. After completing necessary proceedings, penalties were imposed in four cases.

## 4.7 Administrative Appeals

The CLD passed a number of orders regarding appointment of inspectors, imposition of penalties for violations of different provisions of law and issuance of directions to make good the defaults committed by listed companies. Of twenty-one appeals against the CLD's orders, the Appellate Bench upheld twenty orders whereas one was set aside.

## 4.8 Judicial Cases

During the period under review, prosecution was initiated in seventeen cases while eighteen were pending from the previous year. Of these, only one case was disposed off whereas thirty-four were pending adjudication by the courts. Moreover, three companies challenged orders/show cause notices of the CLD in High Courts. These were also pending adjudication as at the close of the year.

## 4.9 Developmental Activities

### 4.9.1 Reduction in Incorporation Fee

In order to encourage corporatization and to boost the growth of the corporate sector, the Commission rationalized and reduced the initial fees to be paid by promoters at the time of incorporation of companies. In this regard, the Sixth Schedule to the Companies Ordinance was amended, with the approval of the Federal Government, on 9 December 2003. This step would reduce the cost of forming a company and serve to encourage SMEs to be a part of the corporate arena.

### 4.9.2 Abolition of Stamp Duty on Memorandum and Articles of Association of Companies

Stamp duty on memorandum and articles of association of new companies has been an impediment to the growth of the corporate sector, as affixing of adhesive stamps on these documents is a cumbersome process. To encourage corporatization, the Commission recommended to the provincial governments to abolish stamp duty on these documents. The provinces of Punjab and NWFP accepted the proposal and abolished the duty through their respective Finance Acts. This is expected to result in increased incorporation of companies and greater business activities in these two provinces. The Commission would continue to pursue the matter with the provinces of Sindh and Baluchistan so that stamp duty on memorandum and articles of association is abolished throughout the country.

### 4.9.3 Delegation of Powers

With a view to facilitate corporate entities and streamline the functioning of the Registration Department and CROs, the Commission delegated the powers of the Registrar, conferred by Section 476 of the Companies Ordinance, to the Additional Registrar, CRO Karachi and the Additional Registrar, CRO Lahore as specified below:

- i. powers to be exercised by Additional Registrar, CRO Karachi in the matters of companies registered with CRO Karachi, CRO Quetta and CRO Sukkur;
- ii. powers to be exercised by Additional Registrar, CRO Lahore in the matters of companies registered with CRO Lahore, CRO Faisalabad and CRO Multan; and
- iii. powers of the Additional Registrar, CRO Karachi and the Additional Registrar, CRO Lahore under Section 476 of the Companies Ordinance, in the matters of companies falling in their jurisdiction, further delegated to the concerned Joint Registrars of the respective CROs.

#### **4.9.4 ITCN Asia 2003 Exhibition**

The Commission participated in the ITCN Asia 2003 Exhibition held in Karachi from 10 to 12 August 2003. During the course of the Exhibition, incorporation and regulatory functions of the Commission were explained and 'on-the-spot' incorporation of companies was provided. The services of the Commission were highly appreciated by local and foreign delegates attending the Exhibition.

#### **4.9.5 Directors and Secretaries Guide**

The Commission, as a part of its endeavors to create public awareness on key legal and regulatory issues and to develop a modern, efficient and dynamic corporate sector, launched another guidance booklet titled "Directors and Secretaries Guide" during the year. The guide highlights the responsibilities and duties of directors and secretaries. It is envisioned that such efforts will improve the functions of both directors and secretaries and also help to strengthen corporate compliance and secretarial practices. The booklet is also available on the Commission's website.

#### **4.9.6 Guide on Accounts and Accounting Reference Dates**

In order to facilitate the corporate sector and to improve their understanding of various issues relating to preparation and circulation of accounts, the CLD prepared a comprehensive and detailed guide on accounts and accounting reference dates. The guide provides, in simple and easy to understand form, an insight into the laws and rules governing public disclosure of accounts. It serves as a reference handbook for companies and explains the concept of accounting reference dates, requirements regarding filing of annual and quarterly accounts and their contents.

### **4.10 Annual Plan**

#### **4.10.1 Work in Progress**

##### **i. Draft Law to Prohibit Undesirable Business Activities**

In order to prohibit illegal and fraudulent business activities and to curb financial crimes in the country, the need was felt to develop a legislation that would provide the regulatory framework to deal with such matters. For this purpose, the Commission is drafting a separate law, namely, "Undesirable Companies Bill, 2004". The law is being drafted with a view to safeguard the interests of the public and to provide enabling power to the Commission to proceed against companies involved in unscrupulous business activities.

##### **ii. Proposal to Amend the First Schedule to the Companies Ordinance**

The First Schedule to the Companies Ordinance contains sets of memorandum and articles of association for different kinds of companies. The amendments made in the Companies Ordinance regarding various issues, over a period of time, made it necessary to review the aforesaid Schedule. During the year under review, certain amendments were proposed, which were considered imperative for bringing the First Schedule in conformity with the relevant provisions of the Companies Ordinance as well as for incorporating other suitable provisions. The amendments were at draft stage as of 30 June 2004.

##### **iii. Company Charges and Mortgage Guide**

Companies sometimes create a mortgage or charge on their assets that must be registered under the Companies Ordinance. The particulars of mortgage or charge, together with any instruments creating or giving evidence of it, are to be filed with the Registrar. In this regard, the CLD is in the process of finalizing a guidance booklet, titled "Company Charges and Mortgage Guide" to help companies or interested parties file the particulars of mortgage or charge properly and in time.

#### 4.10.2 Future Plans

The CLD plans to undertake the following activities during the coming year:

- i. in collaboration with CBR, the corporate tax policy would be rationalized;
- ii. to facilitate the corporate sector, on-line filing of statutory returns and documents would be introduced;
- iii. the provincial governments of Sindh and Baluchistan would be pursued to abolish stamp duty on memorandum and articles of association;
- iv. research studies on the financial and business fundamentals of key sectors within the corporate sector would be undertaken to introduce sector-specific reform strategies;
- v. the feasibility and road map for the establishment of a Company Law Tribunal in Pakistan would be determined;
- vi. in order to streamline and expedite the process for liquidation of companies, a review of insolvency laws would be undertaken to identify powers that can conveniently be transferred from the High Courts to the Commission and an education and awareness campaign would be launched for developing a wider understanding of voluntary corporate winding up and restructuring under the prevalent laws;
- vii. membership of the Asia Pacific Corporate Registers Forum would be acquired to gauge international developments in corporate registration;
- viii. necessary guidelines and criteria would be developed for grant of exemptions; and
- ix. guidelines and booklets would be prepared in areas pertaining to liquidation and dissolution, conversion of status of a company, investigations, mergers and amalgamations, preparation of quarterly accounts, capital issues and reconstruction of distressed companies.

The background of the page features the national coat of arms of Malaysia, which includes a crescent moon and a five-pointed star at the top, a shield with a book and a sheaf of rice, and a banner at the bottom. The shield is divided into four quadrants: the top-left contains a crescent and star, the top-right contains a sheaf of rice, the bottom-left contains a book, and the bottom-right contains a sheaf of rice. The shield is flanked by two mythical creatures, a lion and a unicorn, and is topped by a crown.

**SECURITIES MARKET DIVISION**

**S E C**

# Securities Market Division

**Objective:** To provide for the protection of investors, regulation of markets and dealings in securities.

## 5.1 Operational Structure

### 5.1.1 Structure

The Securities Market Division (SMD) is responsible for monitoring, regulating and developing the securities market. It regulates the primary and secondary market activities as well as market intermediaries through registration, surveillance, investigation, enforcement and rule making, with the objective of protecting investor interest. The SMD also processes and grants approvals to prospectuses for public offering of both debt and equity securities. In addition, it is entrusted with instituting appropriate regulatory reforms to develop and promote the market, engender investor confidence and instill transparency, effective risk management and good governance at stock exchanges, commodity exchange, central depository company and national clearing company.

The SMD is divided into the Self-regulatory Organizations Department and the Securities Department which are further divided into the following Wings:

- Stock Exchanges, Depository and Clearing, Policy and Regulation
- Monitoring and Surveillance and Beneficial Ownership
- Capital Issues
- Brokers' Registration and Inspection
- Investor Complaints
- Commodity Exchange

### 5.1.2 Management Team

Mr. Shahid Ghaffar, Commissioner heads the SMD. There are three Directors who along with various professionals, including lawyers, CAs, management accountants, business graduates and financial analysts, run the Division.



Mr. Shahid Ghaffar (center), Commissioner with officers of the SMD

### 5.1.3 Laws Administered

- i. Securities and Exchange Ordinance, 1969
- ii. Securities and Exchange Commission of Pakistan Act, 1997
- iii. Companies Ordinance, 1984
- iv. Listed Companies (Substantial Acquisition of Voting Shares and Takeovers) Ordinance, 2002
- v. Central Depositories Act, 1997

- vi. Central Depositories (Amendment) Act, 1997
- vii. Securities and Exchange Rules, 1971
- viii. Companies (General Provisions and Forms) Rules, 1985
- ix. Companies (Issue of Capital) Rules, 1996
- x. Central Depository Companies (Establishment and Regulation) Rules, 1996
- xi. Companies (Buy-back of Shares) Rules, 1999
- xii. Companies (Asset Backed Securitization) Rules, 1999
- xiii. Share Capital (Variation in Rights and Privileges) Rules, 2000
- xiv. Brokers and Agents Registration Rules, 2001
- xv. Stock Exchange Members (Inspection of Books and Records) Rules, 2001
- xvi. Members' Agents and Traders (Eligibility Standards) Rules, 2001
- xvii. Public Companies (Employees Stock Option Scheme) Rules, 2001
- xviii. Margin Trading Rules, 2004

## 5.2 Sector Overview

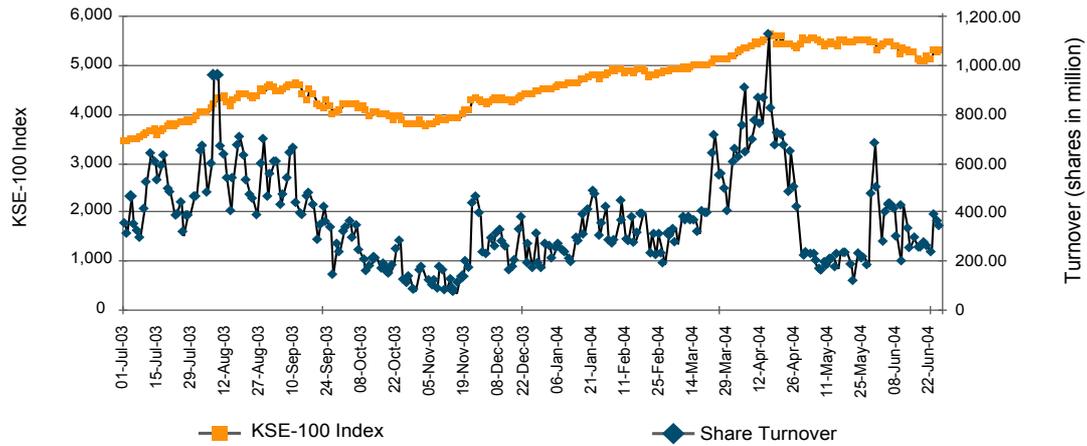
The unprecedented boom in the stock market, witnessed during last year, continued during the year under review as well. The stock market remained buoyant during this period and the KSE-100 Index witnessed a phenomenal growth as it reached a level of 5,279.18 on 30 June 2004 from 3,402.48 at the close of last year. The KSE-100 Index touched an all time high at 5,620.7 on 19 April 2004. A record turnover of over a billion shares was also witnessed on 16 April 2004.

**Table 10 - KSE Performance at a Glance**

	FY 2003	FY 2004	High FY 2004	Low FY 2004
KSE-100 Index (At closing level)	3,402.48 (End June 2003)	5,279.18 (End June 2004)	5,620.66 (19 April 2004)	3,432.55 (1 July 2003)
Turnover (Shares in million)	215 (Daily average for the year)	389 (Daily average for the year)	1,122 (16 April 2004)	63.07 (19 November 2003)
Market Capitalization (Rupees in billion; at closing level)	755.8 (End June 2003)	1,421.58 (End June 2004)	1,511.9 (19 April 2004)	763.8 (1 July 2003)

During the year under review, aggregate market capitalization of KSE surged by 88 percent to Rs. 1,421 billion. In terms of USA dollars, market capitalization of KSE was approximately US\$ 24.30 billion at the close of the year, increasing from US\$ 13.05 billion as on 30 June 2003. Another indicator of the impressive performance of KSE was the upsurge in average daily turnover of shares to 389 million during the year as compared to 215 million shares during last year. In all, the FY 2004 has been exemplary for the stock market in Pakistan, with unprecedented growth in market activity.

Chart 6 - KSE-100 Index and Turnover at KSE (July 2003 - June 2004)

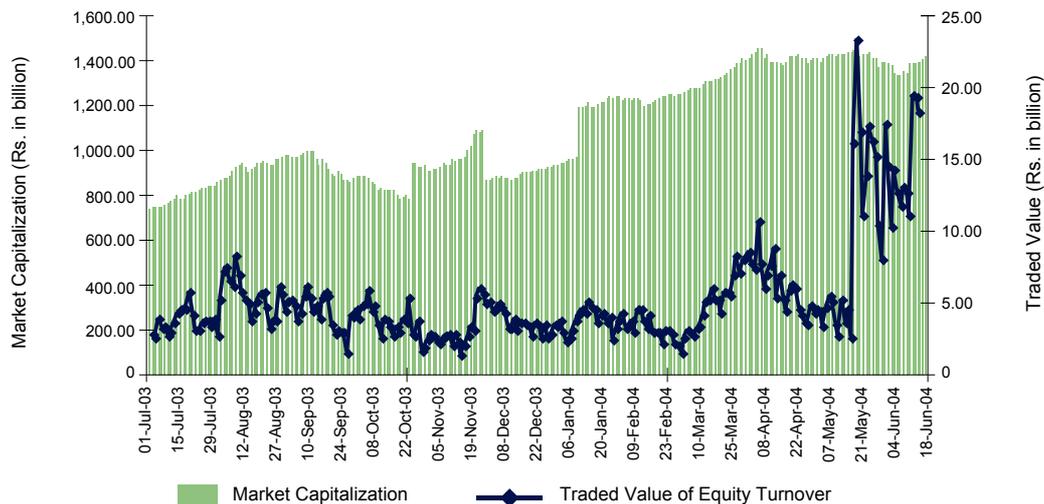


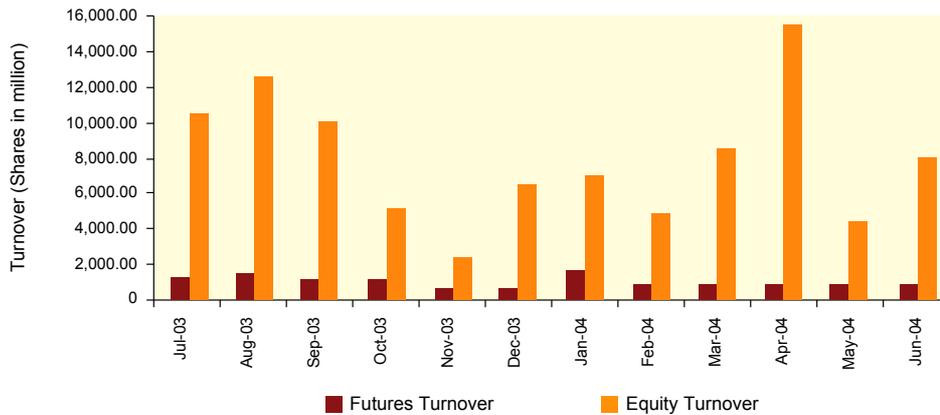
During the year, KSE sustained its position as one of the best performing markets in the world. The landmark performance of the capital market has largely been the result of effective implementation of reforms by the Commission as well as a number of positive factors, namely:

- i. continuation of sound macro-economic and investment friendly policies by the Government;
- ii. strong economic growth and substantial improvements in economic fundamentals;
- iii. successful privatization of SOEs through the capital market; and
- iv. huge build-up of rupee liquidity driven, in large, by continuing foreign exchange flows into Pakistan, thereby making available cheap credit to the private sector.

It is noteworthy that despite an unprecedented growth in market activity during the year, risk management system at stock exchanges worked effectively and no threat to market integrity was observed.

Chart 7 - KSE Market Capitalization and Traded Value (July 2003 - June 2004)



**Chart 8 - Futures Turnover and Equity Turnover at KSE (July 2003 - June 2004)**

### 5.3 Performance Review

The Commission has been actively pursuing a capital market reform program geared towards the development of a modern and efficient corporate sector and capital market. The reforms introduced over recent years in the fields of risk management, governance, transparency and investor protection have contributed significantly towards the growth and development of our capital market and the upsurge in investor confidence.

The far-reaching reforms in the field of risk management, introduced by the Commission in coordination with stock exchanges, have resulted in reducing systemic risk and enhancing investor confidence. More recently, in order to avoid systemic risk associated with COT/Badla financing, the Commission introduced the Margin Trading Rules, 2004 in consultation with the Central Depository Company of Pakistan Limited (CDC) and stock exchanges. It is expected that COT/Badla financing will be abolished and replaced with margin financing and futures during the coming year. Furthermore, as a measure to gradually phase-out COT, the Commission restricted COT to the shares of only thirty eligible companies with effect from 15 December 2003. In May 2004, the eligibility criteria for COT was revised and the number of eligible shares was reduced to twenty-nine.

On 17 February 2004, the Commission constituted an Expert Committee comprising national and international market experts with the objective of formulating a comprehensive plan for demutualization and integration of stock exchanges. Detailed ToR of the Expert Committee involved examining the feasibility of demutualization, integration and transformation of stock exchanges; providing specific recommendations on demutualization of exchanges along with an appropriate model/structure for the demutualized exchange; and recommending a plan of action. The Expert Committee submitted an interim report to the Commission during the year under review, which would be followed by a final report.

As a result of concerted efforts of the Commission, the National Clearing Company of Pakistan Limited (NCCPL) has been fully operational since 19 January 2004; currently, there are 456 securities on the system. NCCPL has improved the efficiency of settlement process, leading to greater confidence in the operations of securities market. It provides for an integrated system for settlement of trades, executed in respect of companies within the Central Depository System (CDS) on all three exchanges, as opposed to the previous set up involving separate clearing houses of each exchange. Furthermore, NCCPL and stock exchanges are exploring the possibility of executing a MoU to ensure coordination in cases of settlement defaults.

The National Commodity Exchange Limited (NCEL) would also start operations shortly. It would provide a secondary market for trading in futures contracts in commodities. The emergence of trading in futures contracts in commodities will add depth to the capital market by providing investors and stakeholders with basic hedging instruments as well as enabling economic players to lock in costs.

In accordance with the Stock Exchange Members (Inspection of Books and Records) Rules, 2001, the SMD, during the period under review, conducted on-site inspection of books and records of several brokers of the three stock exchanges. It is intended that inspection of books and records of brokers would be undertaken on a periodic basis.

The Commission continued to play an active role in the activities of IOSCO. During the year, the Commission was honored to be re-elected as the chair of the Emerging Markets Committee's (EMC's) Working Group-3 (WG3) on financial intermediaries. The mandate adopted for WG3 was "cross-border activities of financial intermediaries in emerging markets". The Commission prepared and circulated a questionnaire to gather information pertaining to key issues in this area from other members of EMC. Based on the views and comments gathered from the respondents of the survey questionnaire and information obtained from desk research, a draft report was prepared and discussed at length at WG3's meeting during the IOSCO Annual Conference in Jordan in May 2004. The report would be finalized shortly and submitted to the EMC Advisory Board for its approval.

## 5.4 Development of Laws

### 5.4.1 Margin Trading Rules, 2004

In Pakistan, financing against shares is not easily available to small investors through banks and financial institutions, which has led to the development of COT/Badla market. While the system of COT/Badla financing has, to some extent, played a positive role in adding liquidity to the market, it has more so been viewed as being the root cause of market crises experienced during the last few years.

In order to minimize market distortions, volatility and systemic risk associated with COT/Badla financing, the Commission notified the Margin Trading Rules, 2004 on 30 June 2004 for the gradual phasing out of COT/Badla financing within the coming year. The introduction of Margin Trading Rules would help to minimize market abuse, reduce systemic risk and strengthen market integrity as well as promote a genuine T+3 cash and futures market.

Margin accounts allow investors to buy shares with a relatively small amount of cash or margin up-front by using the assets currently held in their accounts as collateral. The basic difference between the two systems of share financing is that COT/Badla facility is provided to investors after the purchase of shares (post-trade share financing) while margin financing facility would be available to clients in advance (pre-trade share financing).

Presently, clearing houses of stock exchanges guarantee settlement of COT/Badla transactions in shares of twenty-nine companies, thus bearing the risk in case of defaults. With the onset of margin financing in place of COT/Badla transactions, this risk will shift to banks and DFIs providing margin financing to brokers and/or investors directly on counter part basis. Margin financing will effectively lead to monitoring of risk at three levels: exchanges will monitor risk at broker level; brokers will carry out due diligence of their customers; and banks and DFIs will monitor the risk of providing margin financing to brokers and/or investors directly.

Salient features of the Margin Trading Rules, 2004 are as follows:

- i. Margin financing and trading can only be conducted by brokers registered with the Commission, having minimum net capital balance and meeting capital adequacy requirements as fixed by the Commission in consultation with stock exchanges.
- ii. A broker will enter into a margin agreement with every client. The agreement shall contain terms and conditions regarding mortgage, pledge or hypothecation of securities deposited or bought on behalf of the client as well as authorize the broker to dispose off the collateral in a lawful manner to meet the prescribed margin requirements.
- iii. Brokers have been prohibited from extending margin financing facilities to any of their partners, directors, agents, employees, etc. as well as to any firm where any of their partners is a director, partner or holds any interest.

- iv. Clients shall maintain the prescribed margin with the broker at all times. The broker shall give a margin call to the client whenever, due to market fluctuation, the amount of deposited margin falls below the prescribed minimum level. The limit of margin financing shall be fixed by the Commission in consultation with stock exchanges.
- v. On behalf of clients, brokers are required to keep the credit amount of margin accounts in separate bank accounts and securities deposited/purchased in separate central depository accounts.
- vi. Securities kept as collateral will be valued at last quoted price on the preceding day. For government securities, the value shall be at the closing price on the preceding day.
- vii. The aggregate outstanding balances in margin accounts of all the clients of a broker shall not exceed the level fixed by the Commission in consultation with stock exchanges.
- viii. Stock exchanges shall frame detailed regulations for brokers, subject to prior approval of the Commission, relating to grant of margin financing and margin trading facilities in relation to any margin account.

#### **5.4.2 Regulations for System Audit of Brokers of the Exchanges, 2004**

During the year under review, the Commission approved Regulations for System Audit of Brokers of the Exchanges, 2004. The Regulations were framed by the Commission in consultation with stock exchanges to facilitate outsourcing of system audit of brokers for monitoring and enforcing brokers' compliance with the requirements of securities laws, rules and regulations. The said Regulations provide for a minimum of 30 percent of brokers of exchanges to be audited on a bi-annual basis.

It is expected that introduction of Regulations for System Audit of Brokers of the Exchanges will help to ensure fair dealings at stock exchanges, thereby promoting greater market transparency and investor confidence.

#### **5.4.3 National Clearing and Settlement System Regulations, 2004**

To effectively govern and regulate the affairs of NCCPL, the existing regulations were revised. The revision was largely brought about in view of the change in the main functionality of the National Clearing and Settlement System from Balance Order System to Continuous Net Settlement System. In this regard, the National Clearing and Settlement System Regulations, 2004 were approved by the Commission on 15 January 2004.

#### **5.4.4 Amendments in the Regulations of Stock Exchanges and CDC**

During the year, a review of the regulations of stock exchanges and CDC was carried out to further improve the same. In this regard, amendments were carried out in, *inter alia*, the following:

- i. Regulations for Futures Trading in Provisionally Listed Companies, 2002;
- ii. Regulations Governing the Over-the-Counter (OTC) Market;
- iii. Automated Trading Regulations of Online Trading System of Lahore Stock Exchange (LSE);
- iv. COT Regulations of LSE;
- v. General Regulations of KSE and LSE;
- vi. CDC Regulations;
- vii. Investor Protection Fund Regulations of LSE; and
- viii. Regulations Governing Futures Contracts of KSE.

### **5.5 Regulatory Actions**

#### **5.5.1 Risk Management Measures**

The Commission has, over recent years, introduced a number of significant reforms to strengthen the risk management framework at stock exchanges. During the year under review, the Commission upgraded the eligibility criteria for selection of scrips for COT and futures trading so as to make the selection process more objective as well as to minimize systemic risk and market abuse. On the basis

of the said criteria, twenty-nine companies would be selected for COT/badla financing on a six monthly basis, of which the top fifteen would qualify for trading under futures contract based on a number of key factors such as liquidity/turnover, market capitalization, operational track record, shares entered into CDS and earnings per share of the company.

### 5.5.2 Improvements in Governance

#### i. Introduction of Standardized Account Opening Form

The Commission observed that account opening forms of brokers varied significantly in their terms and conditions and did not adequately safeguard the interests of investors. Furthermore, there was a discernible lack of familiarity of investors with regard to the relevant securities laws as well as their own rights and obligations. In this regard, the Commission prepared a standardized account opening form in consultation with stock exchanges, which was adopted with effect from 15 January 2004 as part of the regulations of exchanges. The standardized form lays down minimum disclosure requirements on part of brokers for the benefit of investors and includes standard terms and conditions that govern the broker-investor relationship. The form strikes a balance between the rights and obligations of both investors and brokers.

The introduction of the standardized account opening form will foster greater market transparency and investor confidence as well as ensure adequate documentation of information. It would also facilitate stock exchanges and the Commission in efficient handling of investors' complaints.



Officers of the SMD at work

#### ii. Enforcement of the Code of Corporate Governance

The Code of Corporate Governance was issued in March 2002 and subsequently incorporated in the listing regulations of stock exchanges. It seeks to infuse transparency and accountability in the corporate sector while protecting the interests of stakeholders. In order to ensure effective enforcement of the Code, the Commission advised stock exchanges to establish separate wings for monitoring compliance of listed companies with the Code. Higher standards of corporate governance will foster an improved corporate culture, better internal controls and greater transparency in management of listed companies in line with international best practices.

### 5.5.3 Issue of Capital

The SMD deals with the approval of prospectuses and offer for sale documents for public offer of securities. The prospectus/offer for sale document of any company inviting public subscription for its securities under the Companies Ordinance is required to be approved by the Commission prior to its issue, circulation and publication. The SMD also processes applications for registration of Special Purpose Vehicles (SPVs) under the Companies (Asset Backed Securitization) Rules, 1999 as well as relaxation from the requirements of the Companies (Issue of Capital) Rules, 1996.

During the year under review, eleven companies made equity offerings to the public as compared to three in the preceding year. Similarly, six companies issued debt instruments, i.e. Term Finance Certificates (TFCs) to the public as compared to twenty-one in the preceding year.

Table 11 below provides a comparison of share capital and TFC offerings during the year under review with the previous year.

**Table 11 - Share Capital and TFC Offerings**

(Rs. in million)

Year	Equity Issues		Debt Issues			
	No. of Issues	New Capital Listed	No. of Issues	Amount Allowed	Amount Offered	Amount Retained
2004	11	48,883.418*	6	4,820.000	3,320.000	3,400.000
2003	3	970.000	21	10,139.000	10,399.000	10,630.835

\* The amount of capital does not include that of National Bank of Pakistan (NBP), Sui Southern Gas Company Limited (SSGCL) and Pakistan International Airlines Corporation (PIA), which were already listed.

#### i. Share Capital

The amount of new listing at KSE, during the year under review, was Rs. 48.88 billion (excluding the capital of NBP, SSGCL and PIA, which were already listed). Moreover, the shares of Oil and Gas Development Company Limited (OGDCL) were offered to the general public for the first time. The offer was oversubscribed by almost eight times. The listing of OGDCL on stock exchanges has substantially increased market capitalization.

Of the eleven equity issues during the year, there were six offerings of fresh equity capital to the general public through which 96 million ordinary shares amounting to Rs. 1,010 million (inclusive of premium amount of Rs. 50 million) were offered. Of these six public issues, all were oversubscribed except one. The total amount listed on the exchange was Rs. 3,874.13 million while initial public offer (IPO) amounted to Rs. 960 million. The details are given as under.

**Table 12 - Offerings of Fresh Equity Capital**

(Rs. in million)

S. No.	Name of Company	Sector	Subscription Date	Formal Listing Date	Total Paid-up Capital	Already Paid-up Capital	Offered Capital	Premium per share (Rs.)	Premium Amount	Subscription Received
1	Pakistan International Container Limited	Transport	28-29 August 2003	13 October 2003	638.008	478.008	160.000	-	-	1,340.679
2	First National Bank Modaraba	Modaraba	23-24 October 2003	22 December 2003	250.000	150.000	100.000	-	-	121.135
3	World Call Broad Band Limited	Technology and Communication	7-8 January 2004	23 February 2004	1,500.000	1,200.00	300.000	-	-	1,976.055
4	Mac Pac Films Limited	Miscellaneous	24-26 February 2004	2 April 2004	389.000	289.000	100.000	5	50.000	473.613
5	Callmate Telips Telecom Limited	Technology and Communication	28-29 April 2004	7 June 2004	502.528	352.528	150.000	-	-	557.930
6	Southern Network Limited	Technology and Communication	12-13 May 2004	21 June 2004	594.598	444.598	150.000	-	-	130.425
	<b>Total</b>				<b>3,874.134</b>	<b>2,914.134</b>	<b>960.000</b>		<b>50.000</b>	<b>4,599.837</b>

The remaining five equity issues during the year were offers for sale (disinvestments), through which 392.831 million ordinary shares amounting to Rs. 11,581.28 million (inclusive of premium amount of Rs. 7,652.97 million) were offered to the general public. All the five offers were oversubscribed.

Details of these secondary offerings are as follows.

**Table 13 - Secondary Offerings of Equity Capital**

(Rs. in million)

S. No.	Name of Company	Sector	Subscription Date	Formal Listing Date	Total Paid-up Capital	Offered Capital	Premium per share (Rs.)	Premium Amount	Subscription Received
1	NBP (3rd Offer for Sale)	Commercial Banks	13-15 October 2003	18 February 2002	4,103.422	131.310	36	472.710	1,222.302
2	OGDCL	Oil and Gas Exploration Companies	10-14 November 2003	19 January 2004	43,009.284	2,150.464	22	4,731.020	27,500.000
3	SSGCL	Oil and Gas Marketing Companies	9-11 February 2004	1956	6,711.744	671.174	16	1,073.870	13,000.993
4	Bank Alfalah Limited	Commercial Banks	17-18 May 2004	5 July 2004	2,000.000	400.000	20	800.000	11,610.942
5	PIA	Transport	7-9 June 2004	1957	11,507.326	575.365	10	575.365	1,329.326
	<b>Total</b>				<b>45,009.284*</b>	<b>3,928.313</b>		<b>7,652.965</b>	<b>54,663.563</b>

\* Excludes paid-up capital of NBP, SSGCL and PIA, which were already listed.

**Chart 9 - Number of Equity Issues During the FYs 1998 - 2004**

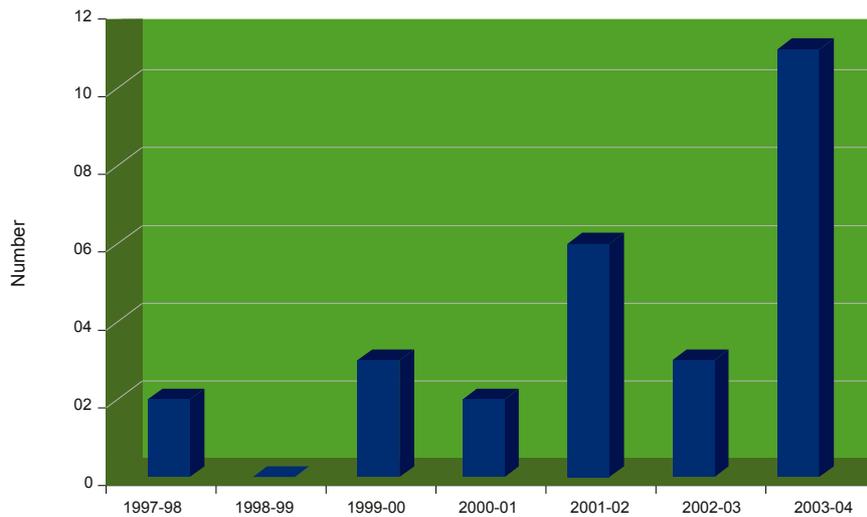
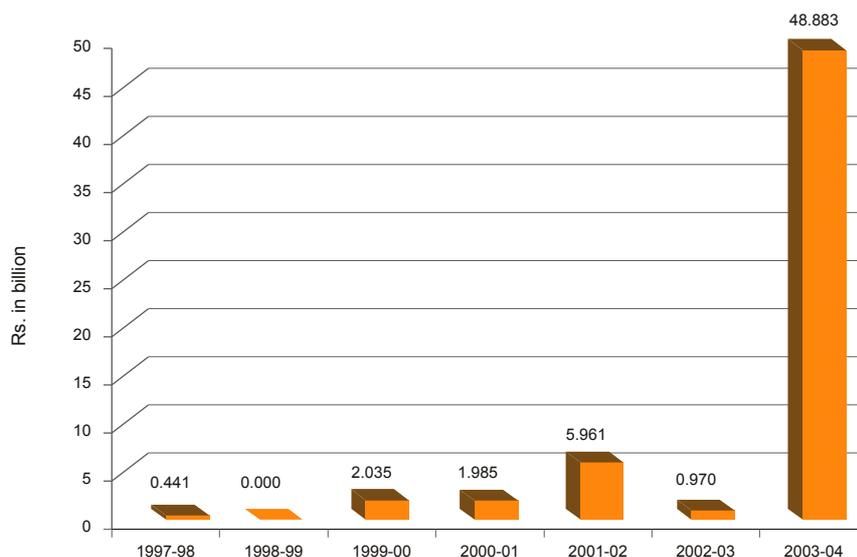


Chart 10 - Amount Listed through Equity Issues During the FYs 1998 - 2004



## ii. Redeemable Capital

During the year under review, six companies made public offer of TFCs (including one company which offered TFCs under securitization arrangement), involving an aggregate amount of Rs. 3.32 billion. An amount of Rs. 3.4 billion (inclusive of green-shoe option) was raised: Rs. 2.575 billion through private placement and Rs. 0.825 billion from the general public.

Table 14 summarizes the TFC offerings (other than that issued under securitization arrangement) during the year under review.

Table 14 - Debt Issues

(Rs. in million)

S. No.	Name of Company	Subscription Date	Formal Listing Date	Amount of Capital Allowed	Total Amount Offered			Subscription Received			Green Shoe Option	Amount Retained
					Pre-IPO	IPO	Total	Pre-IPO	IPO	Total		
1	Pacific Leasing Company Limited	7-8 July 2003	25 August 2003	320.000	250.000	70.000	320.000	250.000	118.355	368.355	up to Rs.30 million	350.000
2	Pharmagen Limited	16-17 October 2003	24 November 2003	300.000	225.000	75.000	300.000	225.000	21.850	246.850	N.A.	300.000*
3	Pakistan Services Limited	11-12 November 2003	24 December 2003	700.000	500.000	200.000	700.000	500.000	1,356.065	1,856.065	N.A.	700.000
4	Al-Zamin Leasing Modaraba	23-24 December 2003	26 January 2004	1,000.000	200.000	50.000	250.000	200.000	193.740	393.740	up to Rs.50 million	300.000
5	Union Bank Limited (2nd Issue) First tranche of total authorized Rs. 1,500 million	19-20 January 2004	27 February 2004	1,500.000	600.000	150.000	750.000	600.000	106.010	706.010	N.A.	750.000*
	<b>Total</b>			<b>3,820.000</b>	<b>1,775.000</b>	<b>545.000</b>	<b>2,320.000</b>	<b>1,775.000</b>	<b>1,796.020</b>	<b>3,571.020</b>		<b>2,400.000</b>

\* Unsubscribed certificates taken up by underwriters.

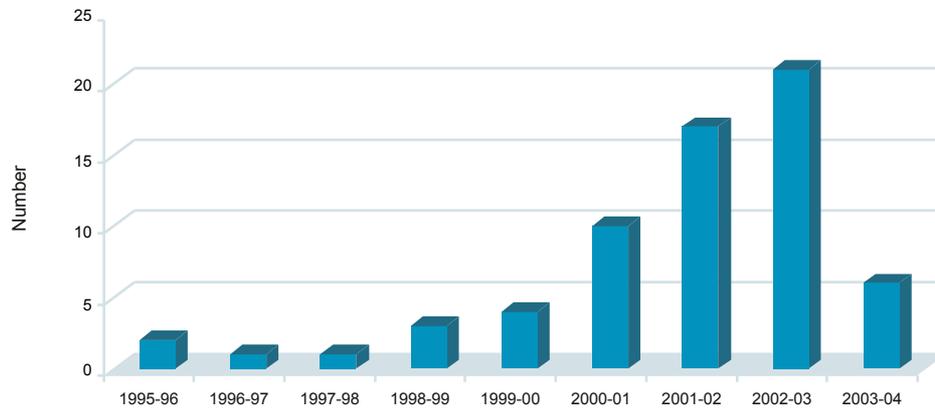
The detail of TFCs issued to the general public under the asset backed securitization arrangement is given as under.

**Table 15 - TFC Issue under Securitization Arrangement**

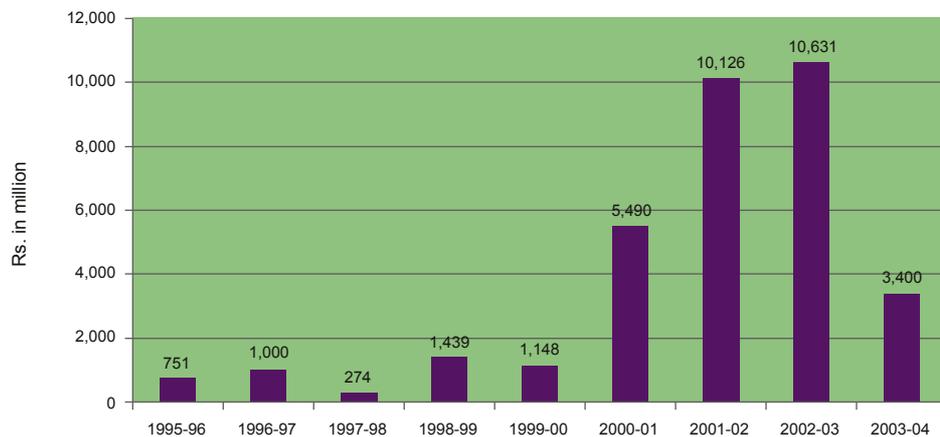
(Rs. in million)

S. No.	Name of Company	Subscription Date	Formal Listing Date	Amount of Capital Allowed	Total Amount Offered			Subscription Received			Green Shoe Option	Amount Retained
					Pre-IPO	IPO	Total	Pre-IPO	IPO	Total		
1	First Oil and Gas Securitization Limited	3-4 September 2003	20 October 2003	1,000.000	800.000	200.000	1,000.000	800.000	740.315	1,540.315	N.A.	1,000.000
	<b>Total</b>			<b>1,000.000</b>	<b>800.000</b>	<b>200.000</b>	<b>1,000.000</b>	<b>800.000</b>	<b>740.315</b>	<b>1,540.315</b>		<b>1,000.000</b>

**Chart 11 - TFC Issues Floated During the FYs 1996 - 2004**



**Chart 12 - Amount Raised through TFCs During the FYs 1996 - 2004**



During the year under review, the Commission registered one company, namely, Chanda Oil and Gas Securitization Company Limited as a SPV under the Companies (Asset Backed Securitization) Rules, 1999. The detail is given in the table below.

**Table 16 - Registration of SPV**

(Rs. in million)

S. No.	Name of Originator	Name of SPV	Size of Issue	Tenure	Pre-IPO	IPO	Private Placement
					Listed		Non-Listed
1	Zaver Petroleum Corporation Limited	Chanda Oil and Gas Securitization Company Limited	1,000	7 Years	750	250	-

#### 5.5.4 Registration of Brokers and Agents

Brokers and agents are required to be registered with the Commission under the Brokers and Agents Registration Rules, 2001.

##### i. Brokers

During the year under review, the Commission granted certificates of registration to thirty-one brokers while twenty-three were de-registered due to cancellation or surrender of licenses. As a result, total number of brokers registered with the Commission increased to 286 as on 30 June 2004.

The distribution of brokers in each stock exchange is given as under.

**Table 17 - Details of Registered Brokers**

Stock Exchange	Corporate Brokers	Individuals	Total
KSE	86	73	159
LSE	40	44	84
Islamabad Stock Exchange (ISE)	19	24	43
<b>Total</b>	<b>145</b>	<b>141</b>	<b>286</b>

The KSE accounted for 56 percent of the total brokers registered with the Commission as compared to 29 percent at LSE followed by 15 percent at ISE.

During the year under review, a number of brokers adopted the corporate status. This is a sign of healthy development in stock market of Pakistan. The corporatization and institutionalization of brokers would help to raise the standard of brokerage business in the country.

## ii. Agents

The statistics with respect to registration of agents during the year under review are presented in the table below.

**Table 18 - Registration of Agents**

Stock Exchange	Total Number of Registered Agents as on 30 June 2003	Registration During the Year	Cancellation/ Surrender of Certificate of Registration	Total Number of Registered Agents as on 30 June 2004
KSE	43	20	9	54
LSE	25	29	1	53
ISE	15	7	5	17
<b>Total</b>	<b>83</b>	<b>56</b>	<b>15</b>	<b>124</b>

## 5.6 Monitoring and Enforcement

### 5.6.1 Market Monitoring and Surveillance

The Monitoring and Surveillance Wing of the SMD is at the forefront for detecting matters relating to systemic risk and unfair market practices. Apart from continuous monitoring of markets through live, online resources, it vigorously analyzes the data for systemic risk indicators.

During the year under review, the SMD's emphasis was largely on risk management and market fairness. On many occasions, it not only pointed out sporadic trading activities to the concerned stock exchange for action, but also conducted necessary investigations. Continuous communication and exchange of views with stock exchanges enabled the Commission to identify various risk management issues and to positively contribute towards rooting out market ills.

In order to promote transparent practices and safeguard investor interest, the SMD insisted on maximum disclosure of information by stock exchanges and other market institutions. As a result of its initiatives, KSE started displaying COT session live on its website. The CDC also posted information pertaining to dematerialized volume of all CDS securities on its website. Moreover, Surveillance Wings have been established at two stock exchanges and the customized Market Surveillance Software is expected to be functional shortly.

In October 2003, the COT rate in illiquid securities soared abnormally, elevating the COT rate in general. The COT rates were capped by KSE as per categorization of securities. To further enhance risk management, the Commission, vide a directive, restricted COT to twenty-nine companies. This step was taken to abate the highly leveraged level of the market and to stop speculators from taking positions in illiquid securities.

In line with its resolve to pursue fair market practices, risk management and transparency, the SMD is also developing the concept of unique client identity for trading in Pakistan's stock market.

### 5.6.2 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 exchange to prepare and maintain books and accounts, which are subject to inspection by the Commission.

In order to infuse discipline within stock exchanges and their members, the Commission promulgated the Stock Exchange Members (Inspection of Books and Record) Rules, 2001. With the introduction of these Rules, clear guidance has been provided for maintenance of books and records by members. Furthermore, the Rules empower the Commission to order inspection of books and records of a member of a stock exchange. During the year, the Commission exercised its power under the said Rules and ordered inspection of books and records of members. To start with, inspection of one member from each exchange was undertaken by officials of the Commission. This exercise is expected to help the Commission in its endeavors to bring about greater transparency in the business activities of members, monitor their compliance with applicable rules and regulations and safeguard investor interest.

In order to enhance the Commission's in-house capacity to carry out inspections, the SMD is actively pursuing capacity building to efficiently discharge the functions assigned to it under the securities laws.

### 5.6.3 Investor Complaints

In an effort to ensure investor protection and provide relief to aggrieved investors, the SMD works in close coordination with stock exchanges to investigate illegal practices of market intermediaries and enforce the Commission's orders. It also exercises vigilance over stock exchanges for expeditious and efficient dispute resolution. In this regard, new and far more stringent reporting requirements have been imposed on stock exchanges. Furthermore, uniform regulations across all stock exchanges have been implemented so as to resolve contentious issues in a quick and impartial manner. In cases of defaulting members, the Investor Complaints Wing of the SMD works diligently in monitoring the default procedures and practices of stock exchanges so as to provide relief to investors aggrieved by such defaults.

In order to increase efficiency and cut down on unnecessary correspondence with both complainants and respondents, the SMD devised and implemented an Investor Complaints Registration Form. The same was widely publicized through newspapers, the Commission's website, CROs and stock exchanges. The Registration Form, which is available in English and Urdu, is comprehensive and exhaustive in nature and covers areas that previously used to surface very late during investigations. By requiring full disclosure of all facts of a case while lodging a complaint, it is expected that the complaint handling procedure would become effective and efficacious.

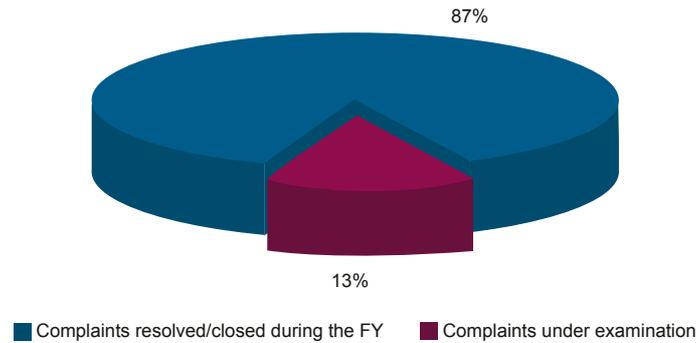
During the year under review, the rate of resolution of complaints was 87 percent. This is consistent with the trend witnessed in previous years and exhibits a strong commitment on part of the Commission to pursue all cases rigorously and with undeterred focus. The statistics of complaints received and handled by the Investor Complaint Wing are tabulated below.

**Table 19 - Statistics of Investor Complaints (July 2003 - June 2004)**

	KSE	LSE	ISE	Total
Complaints under examination at the Commission as on 1 July 2003	99	131	12	242
Complaints/claims received (July 2003 - June 2004)	50	59	16	125
Total complaints dealt with (July 2003 - June 2004)	149	190	28	367
Complaints pending with stock exchanges as on 30 June 2004	22	23	6	51
Complaints/claims with stock exchanges against defaulted members as on 30 June 2004	9	42	9	60*
Break-up of complaints handled by the SMD (July 2003 - June 2004)				
Complaints resolved/closed (July 2003 - June 2004)	102	109	12	223
Complaints under examination as on 30 June 2004	16	16	1	33

\*Out of sixty, forty-two claims against S.H. Bukhari Securities, defaulted member of LSE have been disposed off by LSE on 5 July 2004 and pro-rata payments have been made to the approved claimants.

**Chart 13 - Investor Complaints Handled by the SMD**



#### 5.6.4 Beneficial Ownership

For protecting the interests of small shareholders, Section 224 of the Companies Ordinance stipulates that every director, CEO, chief accountant, company secretary and auditor of a listed company as well as a person who is a beneficial owner of more than 10 percent of a listed equity security shall tender the amount of gain to the issuer or the Commission, as the case may be, if the said gain has been made within a period of six months on account of sale and purchase (or purchase and sale) transactions. For the purpose of identifying cases where tenderable gain may have accrued, the returns of beneficial ownership are examined. The said returns are filed with the Commission and the Registrar in terms of Section 222 of the Companies Ordinance. In addition, every listed company is required to file with the Commission an annual return on Form-A, the prescribed additional information and a soft copy of list of its members, in accordance with SRO No. 1014/(I)86 dated 12 November 1986 and circular number 6 of 2001.

During the year under review, eight cases of tenderable gain were finalized. As of 30 June 2004, the position of cases of tenderable gain was as under.

**Table 20 - Details of Tenderable Gain**

Status	Number of Cases
Amount of gain tendered in favor of the Commission	6
Amount of gain tendered in favor of companies	2
In process	2
Pending with Lahore High Court, Lahore	2

#### 5.6.5 Transfer of Securities on CDS

CDC has become an integral part of the capital market in Pakistan. During the year under review, the number of investor account holders with CDC crossed 13,000. Presently, there are 472 companies on CDS, having a market value of Rs. 415 billion and representing 44.8 percent of issued (floated) capital. Similarly, debt instruments with market value of Rs. 46.6 billion and representing 61.37 percent of the total listed TFCs have been inducted into CDS. Approximately 98 percent of the securities traded on stock exchanges are being settled through CDS.

During the year, it was observed that some companies had failed to join CDS even after their securities had been declared eligible by CDC. Consequently, notices were sent to the management of forty-four companies to explain their position. A hearing was held, which was attended by representatives of twenty-eight companies. Pursuant to the hearing, the Commission passed an order under sub-

Section (4) of Section 9 of the Securities and Exchange Ordinance, 1969 to direct listed companies, whose securities had been declared eligible by CDC but which had not entered CDS, to join CDC by 30 September 2004 or otherwise be de-listed from the relevant exchange, as provided in the listing regulations.

## 5.7 Administrative Appeals

An appeal against the order of the Commissioner (SMD), in the matter of delisting of Pakistan National Shipping Corporation from LSE and ISE, was lodged before the Appellate Bench by LSE under Section 33 of the SECP Act. Subsequent to the close of the year, the Appellate Bench dismissed the appeal.

Of the twelve orders passed by the SMD pertaining to the Investor Complaints Wing, appeals against six were filed before the Appellate Bench. In two cases, orders of the Executive Director (SMD) were upheld by the Appellate Bench while in another case, the Appellate Bench partially decided in favor of appellant. Three appeals were pending adjudication as of 30 June 2004.

## 5.8 Judicial Cases

On 14 June 2003, LSE filed an appeal before the Lahore High Court, Lahore against the order of the Appellate Bench dated 24 April 2003 in the case of delisting of B.R.R. International Modaraba from LSE. The dispute was subsequently settled out of court between the parties.

In another case, Ghazi Fabrics International Limited filed a writ petition in the Lahore High Court, Lahore against CDC, the Commission and others challenging the order passed by the Commissioner (SMD) wherein all listed companies were directed to join CDS by 31 July 2003. The subject petition is pending before the High Court.

In addition to the above, forty cases are presently pending before various courts of Pakistan. Of these, two cases were filed by the Commission whereas the remaining thirty-eight cases include writ petitions, commercial appeals from orders of the Appellate Bench of the Commission under Section 34 of the Act and civil suits where the Commission has been made a pro forma party or party from whom relief is being sought.

## 5.9 Developmental Activities

### 5.9.1 OTC Market

The OTC market will provide investors an efficient and transparent source of investment besides encouraging enterprising promoters to set up new projects by raising cost-effective finance. Further, it will serve as a second tier market for illiquid scrips currently listed on stock exchanges.

The required systems and procedures relating to trading, clearing and settlement for the OTC market have been developed. Presently, exchanges are seeking assistance of leading corporate brokerage houses and professional firms, which have expertise in consulting and advisory work on IPO, for successful market making activity of scrips to be listed on the OTC market. The market will become functional once securities are listed on the OTC Board.

It has been agreed between stock exchanges and the Commission that a unified quote driven trading system and a separate board for trading of debt securities on the OTC market would be developed. The listing and trading of debt instruments on the OTC market

is expected to make the corporate debt market more vibrant, efficient and liquid. The Commission, in the Coordination Committee meeting with SBP, also discussed the possibility of listing and trading of government debt securities on the OTC market.

### 5.9.2 NCEL

During the year under review, significant steps were taken to complete the groundwork for making NCEL operational. These include appointment of its Managing Director and installation of a state-of-the-art automated trading, monitoring and surveillance system. NCEL also set up its own clearing and settlement system, which possesses a number of key features including pre-trade checks, exposure limits, initial and maintenance margins, surveillance and monitoring at client level, etc. During the year, a number of training programs were conducted to familiarize brokers with the working of the new trading system.

### 5.9.3 NCCPL

NCCPL has made steady progress towards full implementation of an integrated, national clearing system through which settlement of trades executed in respect of companies within CDS on all the three exchanges would be done. During the year, new functionalities were added to the existing system, namely, COT and COT Reversal, Undisclosed Market, and Balance Order Netting to cater for double clearing, broker to broker and institutional delivery system.

## 5.10 Annual Plan

### 5.10.1 Work in Progress

#### i. Demutualization of Stock Exchanges

Considering the numerous benefits that demutualization of stock exchanges has to offer, the Commission has set up an Expert Committee comprising of national and international securities market experts to formulate a comprehensive plan for demutualization and assess the desirability of integration of stock exchanges in Pakistan. The detailed ToR of the Expert Committee involve examining the feasibility of integration/transformation of stock exchanges and providing specific recommendations on demutualization of exchanges, including an appropriate structure for the demutualized exchange and a plan of action for its implementation.

During the year under review, the Expert Committee held a number of meetings with the stakeholders and submitted its interim report to the Commission. The final report would be furnished subsequent to the close of the year. The future course of action by the Commission, including the manner in which demutualization and/or integration of stock exchanges will take place, will largely depend on the recommendations of the Expert Committee.

#### ii. Futures Market

In order to effectively regulate and monitor NCEL, the draft Commodity Exchange and Futures Contracts Rules, 2004 were prepared in consultation with stakeholders. The Rules will be finalized shortly and forwarded to the Government for approval.

The introduction of futures contracts in commodities will offer investors with basic hedging instruments, enabling them to lock-in costs. The regulations governing futures contracts are currently under review and will be finalized shortly. These regulations will comprise of operational, administrative and disciplinary matters relating to trading, listing, dispute settlement, risk management and membership at NCEL.

**iii. Web Based Trading**

The growth and advancement of internet technology and its wider accessibility has created both opportunities and regulatory challenges. The value and volume of financial transactions taking place on the internet has grown rapidly, leading to highly sophisticated challenges relating to risk management.

At present, KSE has 116, LSE has 236 and ISE has fourteen remote trading terminals. In order to address the regulatory concerns arising from the growth in internet trading, the Commission is currently reviewing this area so that regulations for internet-based trading and services may be introduced in the near future. The implementation of such regulatory standards will facilitate further growth of the capital market in the country. These regulations are expected to be finalized shortly.

**iv. Proprietary Trading**

Keeping in view the conflicts of interest that arise as a result of proprietary trading, the Commission prepared draft Regulations for Proprietary Trading by Brokers. The regulations, which are expected to be implemented by December 2004, will ensure improved supervision and regulation of proprietary trading so as to safeguard investor interest.

**v. Regulations for Stock Lending and Borrowing**

The Commission and CDC are working towards the development of a legal framework for stock lending and borrowing. In this regard, CDC has initiated a study for exploring possibilities of facilitating stock lending and borrowing arrangement for the benefit of market participants.

**5.10.2 Future Plans**

The SMD plans to undertake the following activities over the course of the coming year:

- i. guidelines/regulations would be introduced in coordination with exchanges, particularly with respect to underwriters' registration, bankers to an issue and issue of commercial paper;
- ii. regulations for Clearing House Protection Fund/Member Protection Fund would be finalized in consultation with NCCPL;
- iii. necessary rules would be introduced to provide for effective monitoring of the affairs of NCCPL;
- iv. amendments would be made in the National Clearing and Settlement System Regulations for settlement of futures contracts;
- v. in order to ensure that NCCPL is managed independently from CDC, independent CEO as well as senior executives would be appointed in NCCPL;
- vi. guidelines for registration of brokers and agents would be introduced; and
- vii. to ensure market fairness, regulations governing investigations would be introduced in consultation with stock exchanges.



The background of the page features the national coat of arms of Malaysia, which is a shield with a crescent moon and a five-pointed star at the top. The shield is divided into four quadrants: the top-left contains a sheaf of rice, the top-right contains a sheaf of wheat, the bottom-left contains three interlocking gears, and the bottom-right contains a bar chart with three bars of increasing height. The shield is flanked by two palm trees and a banner at the bottom with the Malay motto 'BERSEKUTU-LAHU BERTAMBAH KEMAKMURAN'.

**SPECIALIZED COMPANIES DIVISION**

**S E C**

# Specialized Companies Division

**Objective:** *To ensure protection of the interests of insurance policyholders and to promote sound development of the insurance industry.*

*To develop and strengthen NBFCs by ensuring a comprehensive regulatory framework and its proactive enforcement through sustained monitoring in order to protect the interests of all stakeholders.*

## 6.1 Operational Structure

### 6.1.1 Structure

The Specialized Companies Division (SCD) is primarily responsible for regulating and monitoring insurance companies, NBFCs and modarabas. Its core objective is to provide a conducive regulatory environment to foster growth in the non-banking financial sector, safeguard the financial system and protect the interests of shareholders, depositors and policyholders under the relevant laws. The SCD has been organized into the following Departments.

#### i. Insurance Department

The Insurance Department (ID) regulates and monitors the insurance sector and administers the relevant insurance laws. It consists of the following Wings:

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



Mr. Shafaat Ahmad (left), Executive Director with officers of the ID

## ii. Non-banking Finance Companies Department

The Non-banking Finance Companies Department (NBFC) is responsible for licensing and regulation of entities under its purview and their enforcement and compliance with applicable laws, rules and regulations. These include NBFCs (companies engaged in the business of leasing, investment finance services, discounting services, housing finance services, venture capital investment, asset management services or investment advisory services), mutual funds, venture capital funds, modaraba management companies and modarabas. The NBFCD consists of the following Wings:

- NBFC-I
- NBFC-II
- Modaraba
- Monitoring and Inspection



Mr. Rashid Sadiq (right), Executive Director with officers of the NBFCD

### 6.1.2 Management Team

The ID is headed by Mr. Shafaat Ahmad, Executive Director. He has over thirty years of experience in various Government organizations and has dealt with Pakistan's insurance sector for more than thirteen years. He is assisted by a team of professionals overseeing the functions of the Wings.

Mr. Rashid Sadiq, Executive Director heads the NBFCD. He is a CA and has several years of executive experience with leading business groups. He is assisted by a team of professionals led by three Directors and Registrar Modaraba.

### 6.1.3 Laws Administered

- i. Companies Ordinance, 1984
- ii. Insurance Ordinance, 2000
- iii. Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980
- iv. Modaraba Companies and Modaraba Rules, 1981
- v. Securities and Exchange Commission (Insurance) Rules, 2002
- vi. Ministry of Commerce, Insurance Rules, 2002
- vii. Non-banking Finance Companies (Establishment and Regulation) Rules, 2003
- viii. Prudential Regulations for NBFCs and Modarabas

## 6.2 Sector Overview

### 6.2.1 Insurance

The insurance industry plays a crucial role in channeling contractual savings and long-term funds to the capital market as well as in social security and risk diversification. Sound and orderly development of insurance sector is necessary for rapid economic growth of the country. Over the years, a number of significant reforms have been undertaken to improve the institutional framework within which this sector operates, particularly through promulgation of the Insurance Ordinance to replace the Insurance Act, 1938 and vesting of regulatory authority with the Commission.

As of 30 June 2004, there were fifty-three private sector insurance companies operating in the country, of which five were foreign while forty-eight were local enterprises. Of the forty-eight local companies, forty-six were engaged in non-life insurance business and two in life insurance business. In case of foreign insurers, three companies operated in non-life and two in life insurance sectors. As of the close of the year, twenty-eight insurance companies were listed, having aggregate paid-up capital of Rs. 4,706.8 million.

The public sector in insurance industry comprised of four SOEs, namely, State Life Insurance Corporation of Pakistan (SLIC), National Insurance Company Limited (NICL), Pakistan Reinsurance Company Limited (PRCL) and Alpha Insurance Company Limited. The latter is the fully owned subsidiary of SLIC. While SLIC is engaged in life insurance business, NICL provides insurance coverage to public sector entities. PRCL remains the only local enterprise in the business of reinsurance and every non-life insurer operating in Pakistan is required to cede 10 percent of its premium to PRCL as compulsory cession.

With the strengthening of the domestic economy, the insurance sector has also witnessed growth. However, much remains to be desired as the contribution of premium income to Gross National Product (GNP) is very low – premium income of insurance industry accounted for only 0.70 percent of GNP in 2003 – as compared to other developing countries.

During the year ended 31 December 2003, the industry recorded growth of 24.79 percent in combined life and non-life insurance premium income, which increased to Rs. 32.35 billion by the close of the year from Rs. 25.92 billion in the previous year. Similarly, total benefits and gross claims paid by the insurance industry during the year increased by 11.3 percent to Rs. 20.60 billion. Insurance fund assets also exhibited improvement, increasing by 14.65 percent to Rs. 144.99 billion in 2003 from Rs. 126.46 billion during the previous year. Investment of insurance funds in government securities and listed equities, etc. accounted for the largest share of 70.06 percent (i.e. Rs. 101.52 billion) in total fund assets of the industry.

#### i. Life Insurance

The life insurance sector was spurred by substantial increase in unit-linked and endowment business. It recorded a first year premium growth of 37 percent during the year ended 31 December 2003. The collection increased to Rs. 2.415 billion in 2003 from Rs. 1.763 billion during the preceding year. Combined market share of the three local life insurance companies in first year premium remained 89 percent, of which 74 percent was collected by SLIC.

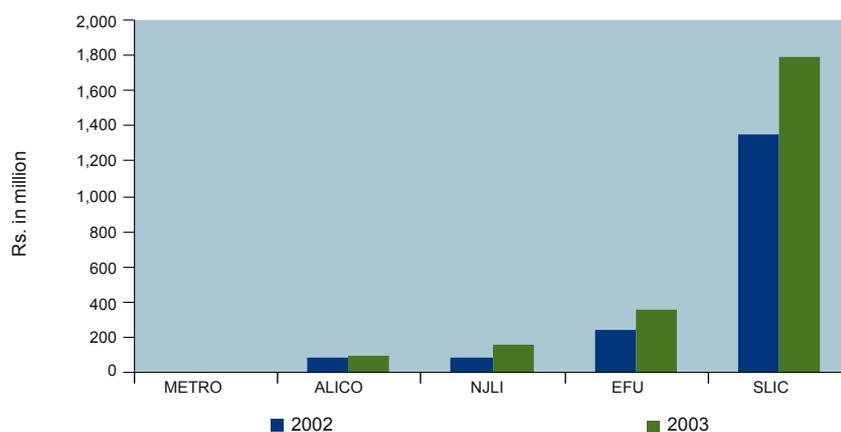
The premium written by life insurance companies during the year ended 31 December 2003 is given in the table below.

**Table 21 - Premium Written by Life Insurance Companies (January 2003 - December 2003)**

(Rs. in million)

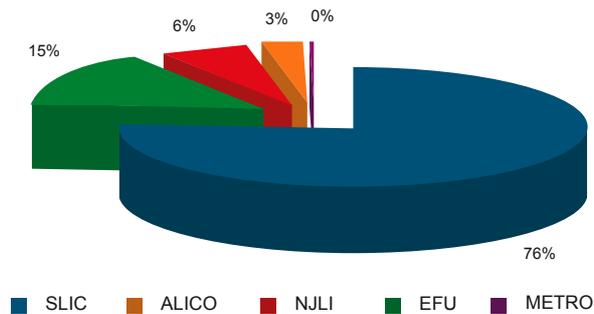
	American Life Insurance Company (Pakistan) Limited (ALICO)	EFU Life Assurance Limited (EFU)	Metropolitan Life Assurance Company of Pakistan Limited (METRO)	New Jubilee Life Insurance Company Limited (NJLI)	SLIC	Total
<b>Gross Premium</b>						
First year	99	358	3	161	1,795	2,415
Second year renewal	57	206	4	70	1,059	1,395
Subsequent year renewal	79	370	18	140	4,770	5,376
<b>Total Individual Life Premium</b>	<b>234</b>	<b>933</b>	<b>25</b>	<b>370</b>	<b>7,623</b>	<b>9,186</b>
Single Premium Individual Policies	-	617	-	96	-	713
Group Policies	112	384	26	314	2,288	3,123
Annuities	-	-	-	-	7	7
<b>Total Gross Premium</b>	<b>346</b>	<b>1,933</b>	<b>51</b>	<b>780</b>	<b>9,918</b>	<b>13,029</b>
Less: Reinsurance Premium Ceded						
On individual policies	20	40	-	16	30	114
On group policies	13	142	14	83	7	252
<b>Total Reinsurance Premium Ceded</b>	<b>33</b>	<b>182</b>	<b>14</b>	<b>99</b>	<b>37</b>	<b>367</b>
<b>Net Premium</b>	<b>313</b>	<b>1,751</b>	<b>37</b>	<b>681</b>	<b>9,881</b>	<b>12,662</b>

**Chart 14 - First Year Premium Written by Life Insurance Companies**



During the year ended 31 December 2003, gross premium increased to Rs. 13.03 billion from Rs. 10.31 billion in the previous year. While SLIC remained the dominant player, its share in gross premium decreased from 82 percent in 2002 to 76 percent in 2003. The chart below presents the market share of life insurance companies in terms of gross premium written during the year.

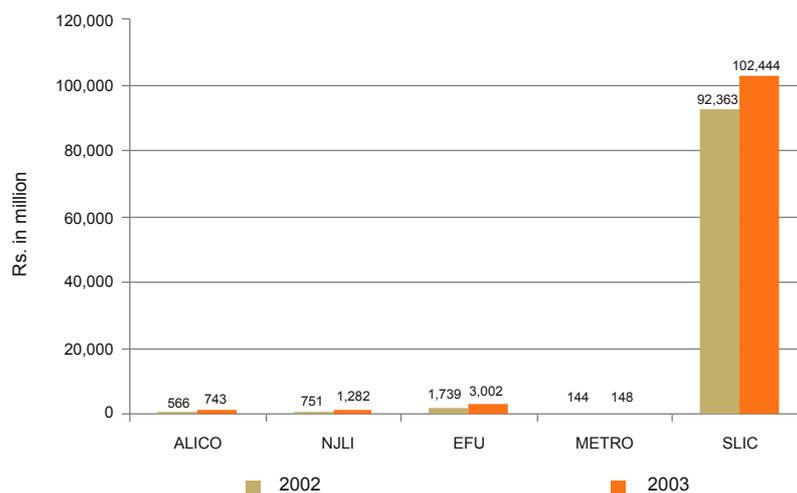
**Chart 15 - Gross Premium Written by Life Insurance Companies**



Total claims paid by life insurance companies also increased during the year ended 31 December 2003 to Rs. 6.93 billion. Individual life claims accounted for 66 percent of this amount as compared to group claims of 34 percent. Reinsurance recoveries were Rs. 240 million, which represent 3 percent of gross claims.

Total assets of life insurance companies increased by 13 percent to Rs. 107.62 billion in 2003. As much as 81 percent of the assets remained invested in government securities and listed equities. Growth in assets of two life insurers offering unit-linked policies was impressive as their assets grew by more than 70 percent over the previous year. The asset size of life insurance companies during the years 2002 and 2003 is presented below.

**Chart 16 - Assets of Life Insurance Companies as on 31 December 2002 and 2003**



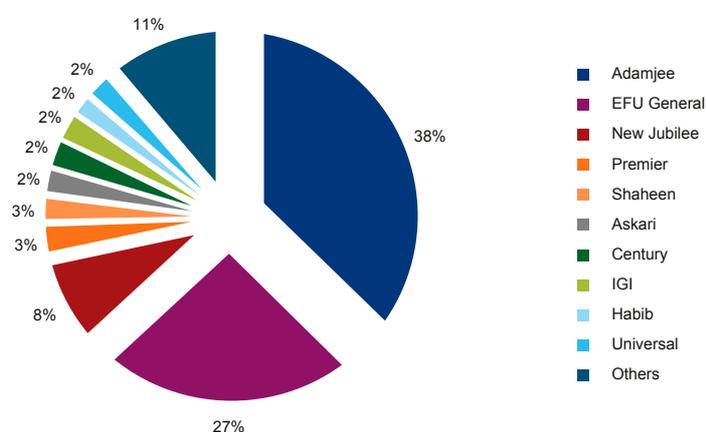
## ii. Non-life Insurance

The private sector, non-life insurance business was largely dominated by top ten insurance companies, which accounted for almost 85 percent of the total premium written by the sector. The total gross direct premium written by non-life insurance companies, excluding that by the state owned NICL, increased by 19 percent to Rs. 15.62 billion during the year ended 31 December 2003. Of this amount, Rs. 13.30 billion was written by the ten largest insurance companies while the remaining thirty-nine companies underwrote the balance of Rs. 2.32 billion. The premium underwritten by NICL during the year amounted to Rs. 3.699 billion.

Fire and property damage insurance portfolio of non-life insurance sector increased to Rs. 6.74 billion while marine, aviation and transport insurance and motor (including miscellaneous) insurance increased to Rs. 4.50 billion and Rs. 7.87 billion, respectively, during the year ended 31 December 2003.

The market share of non-life insurance companies, in terms of gross premium written during the year, is presented below.

**Chart 17 - Share of Private Sector Non-life Insurance Companies in Gross Premium**



The industry incurred claim expenses amounting to Rs. 13.68 billion during the year. Of this, Rs. 5.44 billion represented net claim expenses after deducting all reinsurance recoveries. The details are given in Table 22.

**Table 22 - Claim and Net Claim Expenses of Non-life Insurance Companies (January 2003 - December 2003)**

Rs. in million

S. No.	Classes	Claim Expenses	Net Claim Expenses
1	Fire	5,262	1,026
2	Marine	2,562	759
3	Miscellaneous	5,206	3,248
4	Treaty	647	411
	<b>Total</b>	<b>13,677</b>	<b>5,444</b>

During the year ended 31 December 2003, total assets of non-life insurance sector increased by 21 percent to Rs. 37.377 billion. Investments in shares and debentures, including government securities, constituted the largest component. As compared to the previous year, investments showed an increase of 36 percent, rising to Rs. 14.886 billion during the year.

During the year, management control of the largest non-life insurance company in Pakistan, namely, Adamjee Insurance Company Limited was taken over by Mansha Group from Adamjee Group. Earlier Adamjee Group filed a case against the takeover, which was dismissed by the Supreme Court of Pakistan. The AGM of the company was held on 29 May 2004 in which six out of nine directors were elected from Mansha Group. Election of new directors was duly approved by the Commission after fulfillment of requirements of Section 12 of Insurance Ordinance.

### 6.2.2 Leasing

In Pakistan, leasing has rapidly gained prominence because of ease in obtaining the facility as compared to conventional forms of financing, inherent tax benefits and flexibility to cater to the needs of customers. Despite severe competition, the sector in general has experienced impressive growth over the years. It has proven to be an important source of financing by filling in gaps in the range of financial services being provided. The presence of commercial banks and DFIs in the lease market has affected margins of NBFCs engaged in the business of leasing albeit their capability of offering large ticket leasing has enhanced the leasing options.

During the year under review, the number of NBFCs exclusively undertaking the business of leasing decreased from twenty-nine to twenty-three because of mergers and acquisitions. Three companies, namely, Paramount Leasing Limited, First Leasing Corporation Limited and Pacific Leasing Company Limited merged into First Standard Investment Bank Limited. The new entity was named Crescent Standard Investment Bank Limited. Another leasing company, namely, NDLC merged with International Finance Investment and Commerce Bank Limited (IFIC Bank Limited) of Bangladesh and became NDLC-IFIC Bank Limited. Moreover, Dawood Leasing Company Limited changed to First Dawood Investment Bank Limited while KASB Leasing Company Limited merged with KASB Bank Limited.

The leasing sector exhibited significant growth in its operations during the year. The total assets of the sector increased by 19 percent to Rs. 44.65 billion. Similarly, net investment in leases increased by almost 15 percent to Rs. 33.09 billion. However, borrowing from general public through Certificates of Investment (COIs) decreased by 4 percent over the year, indicating that investment in leasing was financed from sources other than public deposits.

Key statistics of the leasing sector as on 30 June 2004, based on un-audited statements, are given in the following table.

**Table 23 - Key Statistics of Leasing Sector**

(Rs. in thousand)

S. No.	Name of Company	Total Equity	Total Assets	Net Investment in Leases	COIs
1	Asian Leasing Corporation Limited	93,020	119,710	11,097	-
2	Askari Leasing Limited	885,434	7,390,179	5,294,148	4,607,895
3	Capital Assets Leasing Corporation Limited	131,041	370,980	275,575	17,000
4	Crescent Leasing Corporation Limited	492,362	3,479,150	2,164,144	548,282
5	English Leasing Limited	76,942	212,470	60,298	3,866
6	Grays Leasing Limited	263,911	1,079,632	1,024,640	45,200
7	Ibrahim Leasing Limited	389,184	784,491	704,322	-
8	Inter Asia Leasing Company Limited	6,418	139,447	38,053	60,500
9	International Multi Leasing Corporation Limited	82,284	91,846	59,145	-
10	Lease Pak Limited	(4,346)	177,347	71,843	-
11	National Asset Leasing Corporation Limited	24,968	137,555	49,365	2,805
12	Natover Lease and Refinance Limited	202,945	548,509	164,562	25
13	Network Leasing Corporation Limited	224,868	1,565,068	714,222	10,000
14	Orix Leasing Pak Limited	1,781,809	13,170,911	11,325,338	746,148
15	Pak Gulf Leasing Company Limited	221,273	545,206	492,747	16,560
16	Pakistan Industrial and Commercial Leasing Limited	(3,784)	542,884	315,523	4,890
17	Saudi Pak Leasing Company Limited	350,530	3,755,312	2,501,559	1,335,469
18	Security Leasing Corporation Limited	355,250	2,329,067	1,535,757	260,250
19	Sigma Leasing Corporation Limited	260,624	1,123,027	744,468	204,056
20	SME Leasing Limited	237,472	869,106	782,192	-
21	Trust Leasing Corporation Limited	637,998	2,104,314	1,412,473	134,873
22	Union Leasing Company Limited	464,271	3,886,588	3,320,593	1,425,017
23	Universal Leasing Corporation Limited	199,001	224,766	31,326	-
	<b>Total</b>	<b>7,373,475</b>	<b>44,647,565</b>	<b>33,093,390</b>	<b>9,422,836</b>

### 6.2.3 Mutual Funds

The mutual funds industry in Pakistan continued to exhibit a growing trend. This growth is attributable to an effective regulatory regime, presence of qualified and experienced fund managers, continued higher corporate earnings, reduction in interest rates and a buoyant capital market. Total net assets of the mutual funds sector approximately doubled over the year and amounted to Rs. 100 billion as on 30 June 2004. The rate of dividends given out by mutual funds also improved considerably during the year and as a result, investors and promoters were attracted to the mutual funds industry, particularly towards open-end funds.

To date, thirteen open-end schemes have been authorized by the Commission in the private sector, of which eleven have been floated since March 2002. Recently, the closed-end mutual funds sector also witnessed renewed activity with the authorization and public offering of two new funds in trust structure.

Key statistics of closed-end funds as on 30 June 2004, based on un-audited monthly statements, are given in Table 24.

**Table 24 - Key Statistics of Closed-end Funds**

S. No.	Name of Fund	Listed Capital (Rs. in million)	Par Value (Rs.)	Net Asset Value (NAV) (Rs.)		Market Value (Rs.)		Dividend %		
				2004	2003	2004	2003	2004	2003	2002
1	ABAMCO Capital Fund (A)	1,193.78	10.00	20.06	N.A.	16.10	N.A.	-	N.A.	N.A.
	1st ICP				24.66		16.75	-	16.00-15.00B	17.00
	3rd ICP				30.14		20.00	-	20.00-10.00B	29.00
	8th ICP				33.16		25.25	-	24.00-12.50B	48.00
	11th ICP				33.04		19.20	-	18.00-12.50B	28.00
	12th ICP				26.86		15.50	-	17.50-7.50B	23.00
	15th ICP				27.36		15.60	-	21.00-10.00B	17.00
	19th ICP				19.92		18.50	-	21.00-10.00B	23.00
	20th ICP				29.58		18.10	-	16.00-15.00B	21.00
2	ABAMCO Composite Fund	3,000.00	10.00	10.07	N.A.	9.40	N.A.	-	N.A.	N.A.
3	ABAMCO Stock Market Fund (B)	500.00	10.00	23.87	N.A.	20.90	N.A.	-	N.A.	N.A.
	21st ICP				7.80		7.25	-	20.00-10.00B	9.00
	23rd ICP				7.89		6.70	-	32.50-17.50B	-
	25th ICP				15.78		14.05	-	24.00-12.50B	7.50
4	Al-Meezan Mutual Fund Limited	775.00	10.00	15.91	19.08	15.45	18.40	-	20.00-10.00B	16.00
5	Asian Stock Fund Limited	100.00	10.00	6.51	5.91	8.20	4.00	-	-	-
6	BSJS Balanced Fund Limited	1,054.00	10.00	15.44	19.38	12.95	20.30	-	15.00-10.00B	15.00
7	Dominion Stock Fund Limited	50.00	10.00	1.97	3.43	3.40	8.50	-	2.00	-
8	First Capital Mutual Fund Limited	150.00	10.00	7.90	8.85	6.85	5.60	-	25.00	-
9	Fourth ICP Mutual Fund	122.50	10.00	46.36	59.01	35.10	40.90	-	32.50-17.50B	45.00
10	Golden Arrow Selected Stocks Fund Limited	100.50	5.00	9.46	7.39	10.40	6.00	-	22.00-24.00B	-
11	ICP State Enterprises Mutual Fund	1,260.00	10.00	53.90	52.08	47.25	45.55	10.00(i)	35.00	26.00
12	Investec Mutual Fund Limited	100.00	10.00	2.27	2.50	2.80	8.25	-	2.00	-
13	Pakistan Capital Market Fund	1,500.00	10.00	10.79	N.A.	10.25	N.A.	-	N.A.	N.A.
14	Pakistan Premier Fund Limited	675.00	10.00	18.10	16.33	19.20	14.20	12.5(j)	12.50B	5.00
15	PICIC Investment Fund (C)	284.08	10.00	19.96	N.A.	18.00	N.A.	-	N.A.	N.A.
	2nd ICP				21.38		19.15	-	10.00-15.00B	18.00
	5th ICP				25.10		18.40	-	10.00-15.00B	17.00
	6th ICP				43.83		32.40	-	25.00-15.00B	30.00
	7th ICP				26.29		18.75	-	10.00-15.00B	15.00
	9th ICP				34.91		33.00	-	40.00-15.00B	165.00
	10th ICP				34.35		24.00	-	15.00-15.00B	60.00
	13th ICP				65.86		48.70	-	33.00-15.00B	35.00
	14th ICP				24.28		17.50	-	10.00-15.00B	13.00
	16th ICP				19.92		14.60	-	10.00-15.00B	10.00
	17th ICP				26.08		18.25	-	10.00-15.00B	16.00
	18th ICP				19.67		13.45	-	10.00-15.00B	12.00
	22nd ICP				17.01		12.95	-	10.00-15.00B	11.00
	24th ICP				9.81		7.55	-	12.00	-
16	Prudential Stocks Fund Limited	60.00	10.00	4.08	3.85	8.05	3.45	-	-	2.50
17	Safeway Mutual Fund Limited	165.00	10.00	26.36	17.09	16.00	10.00	-	10.00B	-
18	Tri-Star Mutual Fund Limited	50.00	10.00	6.47	5.10	3.10	1.65	-	1.00	-
	<b>Total</b>	<b>11,139.86</b>								

(A) 1<sup>st</sup>, 3<sup>rd</sup>, 8<sup>th</sup>, 11<sup>th</sup>, 12<sup>th</sup>, 15<sup>th</sup>, 19<sup>th</sup> and 20<sup>th</sup> ICP Mutual Funds have merged into ABAMCO Capital Fund.

(B) 21<sup>st</sup>, 23<sup>rd</sup> and 25<sup>th</sup> ICP Mutual Funds have merged into ABAMCO Stock Market Fund.

(C) 2<sup>nd</sup>, 5<sup>th</sup>, 6<sup>th</sup>, 7<sup>th</sup>, 9<sup>th</sup>, 10<sup>th</sup>, 13<sup>th</sup>, 14<sup>th</sup>, 16<sup>th</sup>, 17<sup>th</sup>, 18<sup>th</sup>, 22<sup>nd</sup> and 24<sup>th</sup> ICP Mutual Funds have merged into PICIC Investment Fund.

Key statistics of open-end funds as on 30 June 2004, based on un-audited monthly statements, are presented in the table below.

**Table 25 - Key Statistics of Open-end Funds**

S. No.	Name of Fund	Net Assets (Rs. in million)	Par Value (Rs.)	NAV (Rs.)	Market Value		Dividend (%)		
					Offer Price (Rs.)	Re- purchase Price (Rs.)	2004	2003	2002
	<b>Public Sector</b>								
1	National Investment (Unit) Trust	54,218.00	10.00	34.34	34.60	33.05	25.50	17.50	12.00
	<b>Private Sector</b>								
2	Atlas Income Fund	371.32	500.00	500.21	529.24	518.86	-	N.A.	N.A.
3	Crosby Dragon Fund	369.36	100.00	102.20	N.A.	N.A.	-	N.A.	N.A.
4	Dawood Money Market Fund	1,313.82	100.00	107.12	109.94	106.90	7.00B	-	N.A.
5	Faysal Balanced Growth Fund	2,073.62	100.00	99.50	100.77	98.70	-	N.A.	N.A.
6	Meezan Islamic Fund	1,258.17	50.00	63.49	62.50	61.25	15.00B	N.A.	N.A.
7	MetroBank Pakistan Sovereign Fund (MSF)								
	MSF -12/05	10.85	50.00	50.21	N.A.	N.A.	-	-	N.A.
	MSF -12/07	11.70	50.00	48.83	N.A.	N.A.	-	-	N.A.
	MSF -12/12	444.88	50.00	44.97	N.A.	N.A.	-	-	N.A.
	MSF- Perpetual	462.23	50.00	44.46	N.A.	N.A.	-	-	N.A.
8	Pakistan Income Fund	3,400.53	50.00	54.53	55.26	54.51	9.00B	40.00B	11.66B
9	Pakistan Stock Market Fund	1,051.64	50.00	111.99	115.24	112.36	60.00B	12.00B	8.94B
10	Unit Trust of Pakistan (UTP)	3,300.30	5,000.00	7,101.00	8,782.00	8,608.00	-	25.00	15.00
11	UTP – Income Fund	1,285.95	500.00	540.00	549.25	538.25	-	9.50	N.A.
12	UTP – Islamic Fund	641.91	500.00	692.57	701.50	687.50	-	8.00	N.A.
13	United Money Market Fund	2,067.78	100.00	104.72	UMF-A 104.98	UMF-A 104.98	-	-	N.A.
					UMF-C 104.98	UMF-C 103.93	-	-	N.A.

#### 6.2.4 Modarabas

In pursuance to Islamization of economy, the Modaraba Ordinance was promulgated in 1980 followed by the issuance of Modaraba Rules. The modaraba sector has an established legal framework that allows flexibility to undertake any business activity, which is not against the injunctions of Islam.

During the last two decades, modarabas have provided attractive investment opportunities to investors based on dividend yield. As on 30 June 2004, there were thirty-seven modarabas in existence with an aggregate paid-up fund of Rs. 8.41 billion. Total assets of the modaraba sector stood at Rs. 18.75 billion while total equity amounted to Rs. 9.03 billion as on the close of the year.

Key statistics of the modaraba sector as on 30 June 2004, based on un-audited statements, are given in Table 26.

**Table 26 - Key Statistics of Modaraba Sector**

(Rs. in million)

S. No.	Name of Modaraba	Paid-up Fund	Reserves	Equity	Total Assets
1	Al-Noor Modaraba	210.00	72.24	282.24	342.86
2	Al-Zamin Leasing Modaraba	254.72	89.44	344.16	1,737.84
3	B.F. Modaraba	51.41	11.21	62.62	64.32
4	B.R.R. International Modaraba	481.94	361.71	843.65	1,659.74
5	First Allied Bank Modaraba	350.00	(96.12)	253.88	449.63
6	First Constellation Modaraba	64.63	8.82	73.45	108.67
7	First Elite Capital Modaraba	113.40	(1.70)	111.70	130.05
8	First Equity Modaraba	262.00	263.00	525.00	583.00
9	Fayzan Manufacturing Modaraba	900.00	21.10	921.10	1,367.00
10	First Fidelity Leasing Modaraba	206.33	72.73	279.06	463.81
11	Financial Link Modaraba	100.00	(52.87)	47.13	509.61
12	First Grindlays Modaraba	374.00	473.00	847.00	2,339.00
13	Guardian Modaraba	163.13	151.43	314.56	1,019.12
14	Habib Bank Modaraba, 1st	397.07	247.84	644.91	815.11
15	First Habib Modaraba	252.00	218.00	470.00	1,987.00
16	First Hajveri Modaraba	205.00	(144.00)	61.00	68.00
17	First IBL Modaraba	116.88	32.98	149.86	252.39
18	First Imrooz Modaraba	30.00	44.86	74.86	134.21
19	First Interfund Modaraba	77.56	(52.72)	24.84	30.28
20	Investec Modaraba, 1st	30.00	(71.35)	(41.35)	18.29
21	First Islamic Modaraba	100.00	10.87	110.87	139.69
22	Long Term Venture Capital Modaraba	395.92	(409.05)	(13.13)	115.84
23	First Mehran Modaraba	83.16	(36.29)	46.87	48.74
24	Modaraba Al-Mali	182.57	75.27	257.84	319.27
25	Modaraba Al-Tijarah	75.78	(71.81)	3.97	13.51
26	First National Modaraba	51.80	(42.49)	9.31	24.19
27	First National Bank Modaraba	250.00	4.88	254.88	394.26
28	First Pak Modaraba	125.40	(33.56)	91.84	99.47
29	First Paramount Modaraba	50.00	17.91	67.91	121.92
30	Prudential Modaraba, 1st	872.18	(368.18)	504.00	556.79
31	First Punjab Modaraba	340.20	130.96	471.16	1,041.78
32	Tri-Star Modaraba, 1st	140.80	(23.25)	117.55	118.97
33	Tri-Star Modaraba, 2nd	128.70	(70.02)	58.68	63.03
34	Trust Modaraba	273.00	163.69	436.69	554.92
35	First UDL Modaraba	263.87	62.05	325.92	794.26
36	Unicap Modaraba	136.40	(138.35)	(1.95)	12.66
37	Unity Modaraba *	300.00	(300.49)	(0.49)	247.00
	<b>Total</b>	<b>8,409.85</b>	<b>621.74</b>	<b>9,031.59</b>	<b>18,746.23</b>

\* Based on un-audited statements as on 31 December 2003.

### 6.2.5 Investment Finance

The concept of investment banking as a separate functional entity began to take shape in Pakistan in 1987 when the private sector was allowed to set up investment banks. The first investment bank commenced operations in 1989. At present, there are twelve NBFCs undertaking investment finance services in the country. The scope of activities of investment banks includes money market operations, capital market activities, project financing and corporate financial services along with other multifarious activities.

As on 30 June 2004, the aggregate equity base of the sector was Rs. 4.88 billion against aggregate asset base of Rs. 36.18 billion, indicating a marginal increase over last year. Certificates of deposits constituted a major source of funding and amounted to Rs. 11.9 billion. During the year under review, NBFCs engaged in investment finance services focused their operations on capital and money market activities as evident from aggregate investments of Rs. 16.13 billion that represented 45 percent of total assets.

During the year, winding up petitions were filed against two investment banks due to their precarious financial condition. Moreover, First Standard Investment Bank renamed itself as Crescent Standard Investment Bank after its merger with three leasing companies while Dawood Leasing Company Limited transformed into First Dawood Investment Bank Limited.

Key statistics of NBFCs undertaking investment finance services as on 30 June 2004, based on un-audited statements, are given in the following table.

**Table 27 - Key Statistics of NBFCs undertaking Investment Finance Services**

(Rs. in thousand)

S. No.	Name of Investment Bank	Investments	Advances	Total Assets	Deposits	Total Equity
1	Asset Investment Bank Limited	25,279	47,936	93,442	115,345	(197,945)
2	Atlas Investment Bank Limited	2,340,805	21,076	5,877,240	1,236,907	743,261
3	Crescent Standard Investment Bank Limited	1,253,766	3,385,027	6,452,953	2,296,752	903,088
4	Escort Investment Bank Limited	1,132,748	503,028	2,765,687	1,129,757	451,766
5	First Credit and Discount Corporation Limited	1,201,624	-	1,354,434	-	440,043
6	First Dawood Investment Bank Limited	2,580,495	7,414	5,112,445	1,737,974	704,687
7	First International Investment Bank Limited	904,224	442,674	3,434,493	945,398	562,017
8	Islamic Investment Bank Limited*	2,188,026	158,850	2,550,497	2,048,445	(427,191)
9	Jehangir Siddiqui Investment Bank	1,660,437	116,198	3,501,739	996,064	1,090,905
10	Orix Investment Bank Limited	1,325,038	813,220	2,771,653	745,713	476,528
11	Prudential Investment Bank Limited	42,595	67,938	183,624	188,182	(402,834)
12	Security Investment Bank Limited	1,475,225	356,465	2,088,968	481,367	541,969
	<b>Total</b>	<b>16,130,262</b>	<b>7,062,219</b>	<b>36,187,175</b>	<b>11,921,904</b>	<b>4,886,294</b>

\* Based on un-audited statements as on 29 May 2004.

### 6.2.6 Housing Finance

Housing finance is essentially available through three major sources, i.e. state-owned House Building Finance Corporation (HBFC), NBFCs in the private sector and some commercial banks. Recent regulatory reforms have brought private housing lenders, operating under the umbrella of NBFC, to the regulatory purview of the Commission.

Over the past years, growth in the housing finance sector has remained stagnant due to complex operational and legal framework, insufficient tenancy laws, weak enforcement of contracts and inadequate recovery of mortgage finances. However, given the recent focus of the Government on developing this sector, it is expected that the housing finance sector will gain requisite strength in the coming years.

The housing finance sector is dominated by HBFC, which holds more than 90 percent of total assets, advances, investments and equity in the sector. Other than HBFC, three companies were exclusively engaged in providing housing finance services during the year under review. One of these companies – previously in voluntary liquidation – applied to the Commission, towards the close of the year, for relaxation in equity requirement to obtain license under the NBFC Rules.

Key statistics of the housing finance sector as on 30 June 2004, based on un-audited statements, are given as follows.

**Table 28 - Key Statistics of Housing Finance Sector**

(Rs. in thousand)

S. No.	Name of Company	Investments	Advances	Total Assets	Deposits	Total Equity
1	Asian Housing Finance Limited	-	-	154,000	19,588	103,872
2	Citibank Housing Finance Company Limited	-	14,676	135,428	-	133,813
3	HBFC	4,223,426	11,562,867	19,752,370	-	4,759,408
4	International Housing Finance Limited	29,184	332,280	440,042	2,230	276,468
	<b>Total</b>	<b>4,252,610</b>	<b>11,909,823</b>	<b>20,481,840</b>	<b>21,818</b>	<b>5,273,561</b>

### 6.2.7 Discounting

The discounting business in Pakistan is still under-developed. Furthermore, there are no well-defined rules for undertaking discounting services. The Commission is presently working, in consultation with the industry representatives, to develop necessary legal framework for the purpose. Of the three discount houses in the country, only one was operational during the year under review whereas the remaining two were in liquidation.

### 6.2.8 Venture Capital

During the year under review, the venture capital sector continued its trend of slow but steady growth as the third venture capital company, namely, AMZ Ventures Limited was registered and licensed by the Commission. AMZ Ventures Limited has been set up with the objective of building up transcription production facilities in Pakistan while concurrently acquiring medical transcription companies in the USA.

It was in the year 2002 that TMT Ventures Limited became the first licensed venture capital company in the country. The same year it established Pakistan's first venture capital fund, namely, TMT-PKIC Incubation Fund, in collaboration with Pak-Kuwait Investment Company, to invest in start-up companies in the technology, telecommunications and media industries. TMT-PKIC Incubation Fund, to date, remains the only venture capital fund in Pakistan.

Subsequently, during 2003, TRG Pakistan Limited obtained license from the Commission to undertake venture capital investment. The company provides offshore service facilities mainly in the call center business. Using the principle of labor arbitrage between the USA and Pakistan, it focuses on acquiring USA telephone answering services and call centers and shifting their service delivery to low cost off-shore facilities in Pakistan.

As is evident, the venture capital sector is in its nascent stages of development in Pakistan. However, given the large pool of low cost technical manpower available in the country in the fields of IT, telecommunications and media, the venture capital sector has immense potential to become globally competitive in terms of quality, consistency and delivery.

### 6.3 Performance Review

The ID undertook significant measures to promote sound development of the insurance sector as well as to protect the interests of policyholders. During the year under review, a new company, being the subsidiary of Pakistan Industrial Credit and Investment Corporation (PICIC), was registered as an insurance company.

In view of the need for suitable retirement savings plans, the Government decided to introduce private pension schemes in the country. Regulation of such schemes was entrusted to the Commission. During the year, the Commission set up a task force to prepare a scheme and necessary rules for introduction of VPS in the country. On the basis of recommendations made by the task force and in light of international experiences, a VPS was designed by the Commission. Pursuant to the scheme's approval in principle by the Ministry of Finance, the Commission prepared draft VPS Rules during the year, which would be finalized shortly.

In order to provide a legal framework for takaful business in the country, the ID initiated the preparation of necessary rules during the course of the year. Takaful is an Islamic mode of insurance, which provides for mutual financial aid and assistance to participants in case of occurrence of certain contingencies and whereby participants mutually agree to contribute to a common fund for the purpose.

During the year, the Commission joined the International Association of Insurance Supervisors (IAIS). Its membership was subject to approval in the AGM of IAIS, to be held in Jordan in October 2004. Moreover, the Commission obtained membership of INPRS, subsequent to the close of the year, in consideration of its mandate to regulate VPS.

The main focus of the NBFCD, during the year under review, remained on facilitating the development of non-banking financial sector and mutual funds industry by ensuring the existence of a conducive regulatory environment along with effective monitoring and enforcement activities.

After completion of necessary procedures, licenses to undertake various forms of businesses as NBFCs were issued to six companies and three DFIs. In addition, licenses of existing NBFCs were renewed as necessary to enable them to carry on their operations smoothly. In case of mutual funds, the Commission authorized four open-end and two closed-end funds for public offer during the year. These venues enabled the public at large to participate in portfolio investment schemes. Furthermore, one company was licensed to undertake venture capital investment.

In order to promote sound corporate governance and to introduce a uniform set of requirements, prudential regulations for NBFCs were issued and prudential regulations for modarabas were revised during the year.

The Commission proactively pursued consolidation in the financial sector. In terms of Section 282L of the Companies Ordinance, which empowers the Commission to sanction merger schemes of NBFCs, it sanctioned the merger proposal of four NBFCs. Moreover, it granted No Objection Certificates (NOCs) in response to eight merger proposals received from companies/modarabas during the year.

## **6.4 Development of Laws**

### **6.4.1 Draft Pension Rules**

The Government took a serious note of the lack of awareness among the public about the need for retirement savings and the non-availability of suitable pension schemes in the market. Consequently, it decided that new private pension schemes be introduced in the country and regulation of such schemes was entrusted to the Commission.

During the year, the Commission set up a task force to prepare a scheme and necessary rules for introduction of VPS in the country. On the basis of recommendations made by the task force and in light of the study of Kazakhstan pension system, a scheme of VPS was designed. The same was approved in principle by the Ministry of Finance. Under the proposed system, pension fund management companies would be approved and regulated by the Commission. Life insurance companies would also be authorized by the Commission to run the schemes as well as offer annuity contracts. Certain tax incentives would also be made available to make VPS attractive to fund managers and pensioners.

Upon approval of the scheme of VPS by the Ministry of Finance, the Commission drafted VPS Rules. In this regard, necessary input of the World Bank experts was also sought. The draft Rules were submitted to the Ministry of Finance for necessary action after the close of the year.

### **6.4.2 Prudential Regulations for NBFCs**

During the year under review, the Commission issued the prudential regulations for NBFCs. The objective behind the issuance of these regulations is to provide a uniform set of requirements for NBFCs in order to improve their risk management capabilities and to promote corporate governance in the non-banking financial sector in Pakistan. The regulations became effective from 21 January 2004.

The prudential regulations for NBFCs have been divided into four segments. Part-I contains a comprehensive set of definitions, covering all activities and functions of NBFCs, Part-II lays down guidelines for risk management in respect of corporate borrowers and individual borrowers, Part-III lays down regulations pertaining to the operation of NBFCs, while Part-IV encompasses the KYC and AML requirements.

### **6.4.3 Prudential Regulations for Modarabas**

It was considered expedient to revise the prudential regulations for modarabas to provide an updated framework for governing their operations and risk management processes. The regulations were originally issued in April 2000.

During the course of the year, the revised prudential regulations for modarabas were finalized in consultation with MAP and SBP and issued to modarabas for compliance. The Commission also approved standardized forms for modarabas for taking deposits from corporate and individual investors, in line with the KYC requirements.

## 6.5 Regulatory Actions

### 6.5.1 Registration of PICIC Insurance Limited

During the year, the Commission granted approval to PICIC Insurance Limited under Section 6 of the Insurance Ordinance. The newly established company is a subsidiary of PICIC. It is expected that entry of new insurers will help to strengthen the insurance industry through product diversification, lower premium rates and higher quality of service to policyholders.

### 6.5.2 Issuance of Licenses to NBFCs

Under Rule 5 of NBFC Rules, the Commission issued licenses to nine companies to undertake various forms of businesses as NBFCs. Of these, one company, namely, Dawood Leasing Limited was issued licenses to carry out two different functions. Accordingly, three licenses were issued to companies for undertaking the business of leasing, two for investment finance services, three for housing finance services and two for investment advisory services.

During the year, existing NBFCs applied for renewal of licenses in terms of Rule 5 (4) of NBFC Rules. After detailed examination of their financial health, the Commission renewed twelve licenses.

### 6.5.3 Formation of New NBFCs

During the year, the Commission received six applications to seek permission for forming NBFCs under Rule 4 of NBFC Rules. The Commission granted NOC to PICIC Asset Management Company Limited and Deewan Investment and Finance Corporation while three applicants were asked to complete necessary formalities. One application was refused for non-compliance with the relevant rules and regulations.

### 6.5.4 Public Offering of Mutual Funds

During the year under review, following funds were cleared for public subscription.

#### i. Atlas Income Fund

The Atlas Income Fund was launched with a capital of Rs. 300 million, which has increased to Rs. 380 million. Target investments of the Fund include corporate debt instruments, government securities, COT, etc. Composition of its portfolio depends on market conditions and exposure limits stipulated in NBFC Rules.

#### ii. Crosby Dragon Fund

The Crosby Dragon Fund was established to generate competitive returns for investors while considering their risk aptitude. It was launched with seed money of Rs. 260 million, which has grown to Rs. 378 million. Primarily, it is an equity fund with the option of a mix of investments in selected debt based and fixed income securities. The Fund's investment strategy targets securities having prospects of capital appreciation and marketability.

#### iii. Meezan Islamic Fund

The Meezan Islamic Fund provides an investment avenue to those who prefer to invest in 'Shariah compliant' instruments. The Fund attracted Rs. 519 million from investors as seed capital. Presently, it has grown above Rs. 1,000 million. Investment strategy of the Fund requires it to invest 50 percent or more of its resources in listed securities. It has appointed a Shariah Adviser, which sets out the criteria for selection of listed or unlisted securities for the Fund.

**iv. Pakistan Capital Market Fund**

This is the first closed-end fund floated since 1996. The size of Pakistan Capital Market Fund was Rs. 1,500 million, of which certificates valuing Rs. 375 million were earmarked for public while those amounting to Rs. 1,125 million were subscribed by pre-IPO investors.

**v. ABAMCO Composite Fund**

The main objective of the ABAMCO Composite Fund is to enable certificate holders to participate in a diversified portfolio of securities in the capital and money markets. The Fund has committed to follow a strategy of investing primarily in companies having market capitalization of over Rs. 1 billion. It has a size of Rs. 3,000 million and is primarily an equity fund with a provision for investment in fixed income securities up to a maximum of 20 percent of its net assets.

**vi. Faysal Balanced Growth Fund**

Approval for public offering of Faysal Balanced Growth Fund was granted in April 2004. Subsequently, it was launched for public offer at the end of April 2004. The Fund follows the policy of investing in equity securities and fixed income instruments.

### 6.5.5 Mergers and Amalgamations

The trend of consolidation in the financial sector continued during the year. Mergers among financial institutions were encouraged to strengthen their capital base and to achieve economies of scale.

In terms of Section 282L of the Companies Ordinance, the Commission is empowered to sanction merger schemes pertaining to NBFCs. During the year, the Commission received the merger proposal of Paramount Leasing Limited, Pacific Leasing Company Limited, First Leasing Corporation Limited and First Standard Investment Bank Limited under Section 282L. This was the first application under the said Section. The Commission – after ensuring that the relevant legal requirements had been duly complied with, the proposed scheme of merger was financially viable and the proposal was in the interest of shareholders – sanctioned the scheme. Accordingly, Paramount Leasing Limited, Pacific Leasing Company Limited and First Leasing Corporation Limited merged into First Standard Investment Bank Limited; the new entity was renamed as Crescent Standard Investment Bank Limited.

The Commission also received the following merger proposals from financial institutions during the year and, after careful review of proposals, granted them NOCs:

- i. merger of NDLC with IFIC Bank Limited of Bangladesh;
- ii. merger of KASB Leasing Company Limited into KASB Bank Limited;
- iii. merger of Industrial Capital Modaraba and First General Leasing Modaraba into Dawood Leasing Company Limited;
- iv. merger of Trust Investment Bank Limited and Fidelity Commercial Bank Limited into Trust Commercial Bank Limited;
- v. merger of Capital Asset Leasing Corporation Limited with International Multi Leasing Corporation Limited;
- vi. merger of Second Tri-Star Modaraba into First Tri-Star Modaraba;
- vii. merger of First Hajveri Modaraba into First Fidelity Leasing Modaraba; and
- viii. merger of First National Modaraba into First Paramount Modaraba.

During the year under review, the High Court allowed the merger of First General Leasing Modaraba and Industrial Capital Modaraba into Dawood Leasing Company Limited. The new entity was renamed as Dawood Investment Bank Limited.

### 6.5.6 Cancellation of Certificates of Registration Issued under Investment Companies and Investment Advisers Rules, 1971

The SCD cancelled licenses of twenty-seven companies, which were previously registered under the Investment Companies and Investment Advisers Rules, 1971 but had not applied for fresh licenses in terms of Rule 5 of NBFC Rules within the stipulated time period. These companies also did not meet the eligibility criteria under NBFC Rules to gain the status of NBFCs.

### 6.5.7 Cancellation of Permission to Issue COIs

During the year under review, permission to a NBFC, engaged in the business of housing finance, to issue COIs was cancelled owing to the fact that it failed to obtain investment grade credit rating as required under NBFC Rules. Permission to issue COIs remained suspended on the same basis in the case of eight other NBFCs undertaking leasing business.

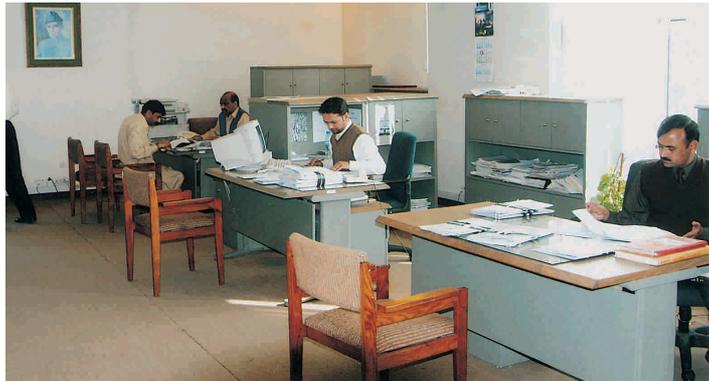
### 6.5.8 Changes in Accounting Regulations and Accounting Formats for Life Insurance Companies

The accounting regulations and formats were notified under the Securities and Exchange Commission (Insurance) Rules, 2002. Accordingly, annual accounts for the year ended 31 December 2002 were prepared by insurance companies in the prescribed manner.

Based on practical difficulties faced by life insurance companies while preparing annual accounts for the year 2002, necessary amendments were made by the Commission in accounting regulations vide Circular No. 1 of 2004 dated 8 January 2004. The salient amendments were as under:

- i. Sub-regulation 1(4) was amended to make Life Insurance Nationalization Order, 1972 applicable to SLIC.
- ii. New standardized formats were included in sub-regulation 3(1) for life insurance companies, i.e:
  - a. Summary of assets (Form LJ)
  - b. Statement of changes in equity (Form LL)
  - c. Statement under Section 52(2)(a)(b) (Form LM)
  - d. Statement under Section 52(2)(c) (Form LN)
- iii. Regulation 8 was reworded to make claims 'Incurred But Not Reported' part of policyholder's liability instead of outstanding claims. Experience Refund of Premium was made part of claims expenses instead of policyholder's liability.
- iv. The following were added to Regulation 12:
  - a. through sub-regulation 12(6), branch overheads were defined in order to bring all companies at par; and
  - b. through sub-regulation 12(7), other acquisition cost was defined.
- v. Sub-regulation 13(3) was deleted as it did not allow accounting for proposed appropriation of profit in the current year's accounts.
- vi. Sub-regulations 15(6) and 15(7) were reworded to incorporate the requirements of Section 21 of Insurance Ordinance.
- vii. Sub-regulation 16(1)(c) was inserted to specify the method of subsequent measurement of financial assets other than available for sale.

In addition, accounting formats were revised to reflect the changes in the accounting regulations and in consideration of the requirements of IAS. Annual accounts for the year 2003 were prepared by life insurance companies on the basis of amended regulations and formats.



Officers of the ID at work

### 6.5.9 Proposal for Amendments in the Fourth Schedule to the Income Tax Ordinance, 2001

Taxation of insurance companies is computed in accordance with the Fourth Schedule to the Income Tax Ordinance, 2001. The provisions of the Fourth Schedule were laid down on the basis of the repealed Insurance Act, 1938. After the promulgation of Insurance Ordinance, relevant amendments in tax structure for life insurance companies could not be made simultaneously.

In order to align the Income Tax Ordinance, 2001 with Insurance Ordinance, necessary changes were proposed to CBR in consultation with the insurance industry. The proposals were accepted and incorporated in the Income Tax Ordinance, 2001 through the Finance Act, 2004. The salient amendments in the Fourth Schedule to the Income Tax Ordinance, 2001 are as under:

- i. Income of life insurance companies comprises of “Income from Business” and “Income from other Business”. Income from other business has been specifically defined in Rule 1 of the Fourth Schedule.
- ii. “Income from Business” has been defined in Rule 2 of the Fourth Schedule.
- iii. Rule 2 also specifies the add backs to the extent of proportion of surplus not distributed to policyholders.
- iv. Rule 2(2)(b) of the Fourth Schedule has been modified for incorporating the respective statutory funds into it.
- v. Rule 4 of the Fourth Schedule has been deleted being redundant as the valuation of policyholder’s liabilities is now required to be done on annualized basis instead of after two years. Accordingly, adjustment of tax deducted at source now corresponds to the respective year only.

### 6.5.10 Compliance with IAS 12 (Revised)

Consequent upon the adoption and notification of IAS 12 (revised), listed companies were required to provide for unrecognized deferred taxation in their accounts. However, leasing companies were given a relaxation, through the Commission’s circular 16 of 1999 dated 9 September 1999, to provide for unrecognized tax liability arising out of timing difference by way of gradual provision over a period of five years ending 30 June 2003. The capital reserve so created was not to be utilized for any purpose other than to provide for deferred tax liability.

After the close of FY 2003, different quarters, including NBFCs and their auditors, approached the Commission regarding classification and disclosure of capital reserve in the accounts of companies for the period ended 31 December 2003. Accordingly, the Commission, through circular 8 of 2004 dated 10 February 2004, clarified that the said capital reserve represented deferred tax liability, which has been recognized over a period of five years. The transfer to capital reserve was allowed to enable leasing companies to have sufficient profits available upon expiry of the extended time period for applicability of IAS 12 (revised), i.e. 30 June 2003. It was explained that the amount could no longer be treated as a reserve and should instead be disclosed as a liability. Further, in order to comply with the requirements of IAS 12 (revised) with effect from 1 July 2003, NBFCs undertaking the business of leasing were directed to record

deferred tax liability in accordance with the requirements of IAS 8, “Net profit or loss for the period, fundamental errors and changes in accounting policies”.

#### **6.5.11 Deferment of Applicability of IAS 39 and IAS 40 to NBFCs providing Investment Finance Services, Discounting Services and Housing Finance Services**

The NBFCs engaged in the businesses of investment finance, discounting and housing finance reported practical difficulties in giving effect to the requirements of IAS 39, “Financial instruments: recognition and measurement” and IAS 40 “Investment property” due to inconsistencies between the provisions of relevant laws and the requirements of the said IASs. As a result, the Commission, in consultation with the industry association, granted relaxation to such NBFCs from the applicability of IAS 39 and IAS 40, with the direction that such companies would continue to observe circular 11 dated 11 September 2002 of the SBP’s Banking Supervision Department regarding the application of IAS 39 and IAS 40, till further decision.

#### **6.5.12 Deferment of Applicability of IAS 17 to Modarabas**

In view of practical difficulties faced by the modaraba sector in the application of IAS 17 “Leases”, the Commission deferred the applicability of the said IAS to modarabas.

#### **6.5.13 Capping of Illustrative Return of Life Insurance Companies**

With a view to curb the tendency of illustrating unrealistic and excessively optimistic rates of return by life insurance companies to boost their sales of unit-linked policies, the Commission capped the maximum illustrative return to 8 percent with effect from 1 February 2004.

In order to attract policyholders, insurance companies, in the past, were projecting expected rates of return as high as 14 percent. Such high rates of return were not sustainable in the present scenario of falling yields on corporate and government bonds in which the insurance companies invest their funds. In order to check this practice and make projections more realistic, the Commission took the decision to cap the maximum illustrative return for all marketing illustrations at 8 percent. The Commission would, however, review the projected return from time to time based on the movement in interest rates and other investment options.

#### **6.5.14 Circulars**

During the year under review, the SCD issued a number of circulars to modarabas, as detailed below:

- i. In order to maintain discipline in reporting of information to the Credit Information Bureau of SBP, all modaraba companies were issued directions to provide factual and accurate data to SBP on monthly basis.
- ii. In order to ensure timely availability of information relating to accounts of modarabas to certificate holders and investors, modaraba companies were allowed to place the quarterly accounts of modarabas on their websites.
- iii. The modarabas were advised that in cases where depositors/borrowers had not yet obtained Computerized National Identity Cards (CNICs), the modarabas may obtain attested copies of old National Identity Cards and receipts of National Database and Registration Authority – evidencing that the client has applied for CNIC – along with an undertaking in writing that a copy of CNIC will be submitted immediately on receipt for opening of accounts/extension of financing to such clients/borrowers.
- iv. In order to facilitate the modaraba sector and to reduce the financial burden on modarabas, the requirement for depositing filing fee while submitting periodical statements to the Commission under the prudential regulations for modarabas was removed.

## 6.6 Monitoring and Enforcement

### 6.6.1 System Audit of Trustees

During the year under review, system audits of two trustees were undertaken by CA firms, at the behest of the Commission. The reports furnished by the auditors were examined and instructions were issued to trustees to improve their systems.

### 6.6.2 Special Audit of Insurance Companies

While examining the regulatory returns of insurance companies, certain severe irregularities were found in two cases. The Commission, under Section 49 of Insurance Ordinance, ordered special audit of the companies for detailed scrutiny into their affairs. Special audit report of one of the companies was received during the year and necessary action in light of the findings of the report would be taken.

### 6.6.3 Holding of AGMs

NBFCs are required to hold their AGMs at least once in every calendar year within a period of four months of the close of their respective FY. During the year under review, NBFCs were found to be mostly compliant in holding of AGMs in an orderly manner and within the prescribed time period with the exception of four companies. Of these, three NBFCs failed to provide satisfactory reasons for failure to hold their AGMs within the requisite time period. Accordingly, legal proceedings in terms of Section 158 and Section 233 of the Companies Ordinance were initiated against these NBFCs and appropriate orders were passed, including the imposition of penalties.

### 6.6.4 Circulation of Quarterly Accounts

During the year, show cause notices under Section 245 read with Section 476 of the Companies Ordinance were issued to four NBFCs for non-preparation and non-transmission of second quarter's accounts within two months of the close of the quarter. The proceedings in respect of show cause notices were in process as of 30 June 2004.

Moreover, show cause notices were issued to four modaraba companies that were in default of Rule 10 of Modaraba Rules for circulation of quarterly accounts of modarabas. The proceedings in respect of these companies were also in process as at the close of the year.

### 6.6.5 Action against Modarabas with Significant Erosion of Funds

Show cause notices were issued to management companies for winding up of eight modarabas under Section 23 of Modaraba Ordinance in view of their deteriorated financial position. After completion of necessary process, cases for winding up of two modarabas were filed before the Modaraba Tribunal. As for the remaining modarabas, revival plans submitted by two modarabas and proposals for merger of three modarabas were approved while in one case, voluntary change of management was allowed.



Officers of the NBFCD at work

### **6.6.6 Examination of Annual Accounts**

A detailed examination of annual audited accounts of modarabas for the year ended 30 June 2003 was carried out to identify any irregularities or non-compliances with the relevant legal requirements.

On the basis of examination of annual accounts, show cause notices were issued to seven modaraba companies for default in complying with the prudential regulations for modarabas. Penalties were imposed on CEO and directors of a modaraba company. Moreover, management companies of three modarabas were directed to regularize the defaults by 30 June 2004. In two cases, warnings were issued to management companies. In case of another modaraba, necessary clarification/justification was sought before taking any action under the law; proceedings were pending as of the close of the year.

### **6.6.7 Compliance with Paid-up Capital Requirement**

In order to improve and strengthen the capital base of insurance companies, the minimum paid-up capital requirement was raised to Rs. 100 million in case of life insurance companies and Rs. 50 million for non-life insurance companies with effect from 1 January 2003. The life and non-life insurance companies were directed to further enhance their paid-up capital to Rs. 150 million and Rs. 80 million, respectively, by December 2004. By 30 June 2004, twenty-four non-life insurance companies were in compliance with the requirement of minimum paid-up capital. The fifteen insurance companies that failed to comply with the statutory requirement were directed to achieve compliance by 31 December 2004.

## **6.7 Administrative Appeals**

During the year, the Appellate Bench of the Commission set aside the orders of the Commissioner (SCD) passed in the matters of three modarabas. In another case, the directors of a modaraba company filed an appeal against the order of Registrar Modaraba before the Commissioner under Section 32(2) of Modaraba Ordinance. The appeal was pending adjudication as of the close of the year.

## 6.8 Judicial Cases

### 6.8.1 Cases Pertaining to Insurance

The cases involving insurance companies that were pending as of the close of the year are given below.

**Table 29 - Judicial Cases pertaining to the ID**

S. No.	Title of the Case	Description of the Case	Court in which Case is Pending
1	WP.No.2201/2002 National General Insurance Company Limited Vs. the Commission	Petition under Article 199 of the Constitution for declaration to the effect that order dated 16 July 2002 conveyed to the petitioner was without lawful authority having no legal effect.	Lahore High Court, Rawalpindi Bench
2	WP. No.2227/2002 Union Insurance Company of Pakistan Limited Vs. the Commission	Petition under Article 199 of the Constitution for declaration to the effect that order dated 16 July 2002 conveyed to the petitioner was without lawful authority having no legal effect.	Lahore High Court, Rawalpindi Bench
3	WP. No.2507/2002 Credit Insurance Company Limited Vs. the Commission	Petition under Article 199 of the Constitution for declaration to the effect that order dated 13 August 2002 conveyed to the petitioner was without lawful authority having no legal effect.	Lahore High Court, Rawalpindi Bench
4	WP. No.75/2003 Ittefaq General Insurance Company Limited Vs. the Commission	Petition under Article 199 of the Constitution for declaration to the effect that order dated 1 January 2003 conveyed to the petitioner was without lawful authority having no legal effect.	Lahore High Court, Rawalpindi Bench
5	MA. No.57/2000 Shalimar General Insurance Company Limited Vs. the Commission	Appeal Under Section 110 sub-Section 12 of the Insurance Act, 1938 (repealed).	Sindh High Court, Karachi
6	WP. No. 15595/2003 North Star Insurance Company Limited Vs. the Commission	Petition under Article 199 of the Constitution for declaration to the effect that the show cause dated 23 October 2003 served on the petitioner was without lawful authority having no legal effect.	Lahore High Court, Lahore
7	WP.No.6461/2002 North Star Insurance Company Limited Vs. the Commission	Petition under Article 199 of the Constitution for suspension of order dated 27 April 2004 during pendency of the petition.	Lahore High Court, Rawalpindi Bench
8	Suit No. 594/2004 Muhammad Lalpuria and other Vs. the Commission	Petition under Section 12 of the Insurance Ordinance for declaration that the newly elected directors are not fit and proper within the meaning of Section 12 of the Insurance Ordinance and as such are ineligible to be elected as directors of Adamjee Insurance Company Limited.	Sindh High Court, Karachi

## 6.8.2 Cases Pertaining to Modarabas

The Modaraba Tribunal appointed official liquidator for winding up of Schon Modaraba. In two other cases, notices were issued by the Modaraba Tribunal to declare CEOs and directors of two modarabas as proclaimed offenders.

## 6.9 Developmental Activities

### 6.9.1 Issuance of Musharaka Based TFCs on Profit and Loss Sharing Basis

Due to scarcity of Shariah compliant options, modarabas have limited avenues for resource mobilization. Presently, modarabas can only raise funds through issue of right certificates and musharaka certificates. With a view to assist the modaraba sector in resource mobilization, the Commission allowed modarabas to issue musharaka based TFCs on profit and loss sharing principle. The said decision would result in making available a useful avenue of resource mobilization to the modaraba sector and also add to the growth of corporate debt market under Islamic financial principles.

### 6.9.2 Membership of IAIS

The Commission joined IAIS with effect from 1 January 2004. The membership would be approved in the forthcoming AGM of IAIS, to be held in Jordan in October 2004.

IAIS represents insurance supervisory authorities of some hundred jurisdictions. In addition, there are almost seventy organizations and individuals as observers representing professional associations, insurance and reinsurance companies, international financial institutions, consultants and other professionals. IAIS issues global insurance principles, standards and guidance papers, provides training and support on issues related to insurance supervision and organizes meetings and seminars for insurance supervisors. It actively promotes implementation of principles and standards on insurance supervision and works closely with other financial sector standard setting bodies and international organizations to promote financial stability.

Membership of IAIS would be helpful in strengthening the Commission's regulatory capacity and would also facilitate coordination and interaction with insurance regulators of other jurisdictions. Moreover, the opportunity would enable the Commission to participate in standard setting process for the insurance industry and develop the local sector in line with international best practices. The ID is currently reviewing Insurance Ordinance to propose suitable amendments in line with the standards and principles of IAIS.

## 6.10 Annual Plan

### 6.10.1 Work in Progress

#### i. Takaful Rules

Takaful is an Arabic word meaning a scheme based on mutual assistance in compliance with the provisions of Islamic Shariah.

In pursuance to the Government's objective of Islamization of economy, the Commission decided to allow takaful business in the country. While takaful can be conducted under the framework of Insurance Ordinance, the rules for conduct of takaful business are yet to be formulated. The Commission, therefore, constituted a task force of Shariah experts and others, headed by former Chief Justice of Federal Shariat Court, Mian Mahboob Ahmed, for preparing necessary rules for takaful business.

The task force recommended an initial draft of Takaful Rules, which would be shortly finalized and sent to the Government for its approval.

#### **ii. Information System for Regulation of Insurance Industry**

The ID receives a large amount of data and other information from insurance sector on monthly, quarterly, semi-annual and annual basis under different provisions of Insurance Ordinance. Presently, all the data and information is processed manually, which delays the actions to be taken against erring companies. To overcome the problem, an Information System for Regulating the Insurance Industry is being developed. This system would be a collection of analytical tools designed to provide the Commission with an integrated approach to screening and analyzing the financial condition of insurance companies. The system would assist the Commission in directing resources to areas that require most immediate or crucial action. Under this system, all insurance companies would be required to submit their returns online.

The system will generate key financial information based on financial results obtained from insurance companies through online submission. Some ratios may also be developed, like net change in capital and surplus, net income to total income, adequacy of investment income, non-admitted to admitted assets, change in premium, change in product mix and change in asset mix, etc. to analyze the financial information. The ID will annually review the ratios to ensure that each ratio is current and continues to be relevant to solvency monitoring.

#### **iii. Amendments in Modaraba Ordinance and Modaraba Rules**

During the year under review, an exhaustive review of Modaraba Ordinance and Modaraba Rules was concluded and draft amendments prepared. These amendments seek to make the legal framework for modarabas comprehensive, while addressing the practical difficulties of the modaraba sector. The amendments would be finalized shortly and accordingly notified.

### **6.10.2 Future Plans**

The activities of SCD, planned for the coming year, are as follows:

- i. solvency requirements under the Insurance Ordinance, which had been relaxed till 31 December 2003, would be enforced;
- ii. a licensing manual in line with various provisions of Insurance Ordinance and IAIS standards would be prepared;
- iii. terms and conditions for undertaking discounting services would be incorporated in NBFC Rules;
- iv. rules would be prepared for cross-border investments by mutual funds;
- v. periodic statements for NBFCs, modarabas and mutual funds would be consolidated;
- vi. special audits/investigations/inquiries into the affairs of NBFCs, modarabas and mutual funds would be undertaken; and
- vii. an off-site surveillance manual for NBFCs, modarabas and mutual funds would be prepared.

The background of the page features the national coat of arms of Malaysia, which includes a crescent moon and a star at the top, a shield with a book and a sheaf of rice, and a banner at the bottom. The shield is divided into four quadrants: the top-left contains a book, the top-right contains a sheaf of rice, the bottom-left contains a gear, and the bottom-right contains a bar chart. The shield is flanked by two mythical creatures, a lion and a tiger, and is topped by a crown.

**PROFESSIONAL SERVICES AND  
POLICY DIVISION**

**S E C**

# Professional Services and Policy Division

**Objective:** *To regulate and promote professional services and introduce policies to attain the aims and objectives of the Commission.*

## 7.1 Operational Structure

### 7.1.1 Structure

Pursuant to restructuring within the Commission in September 2003, a new Division by the name of Professional Services and Policy Division (PSPD) was formed to consolidate and centralize the functions of the Commission pertaining to policy making and oversight of professional services. The PSPD undertakes research on international practices in the sectors under the Commission's purview; maintains oversight and promotes development of professional bodies and SROs; and provides legal support to the Commission.

The PSPD comprises the following two Departments:

- Professional Services
- Policy

The Professional Services Department (PSD) is further divided into Legal Wing and Financial Services Wing.

### 7.1.2 Management Team

The PSD is headed by Mr. M. Hayat Jasra, Executive Director, who is also Secretary to the Commission. He has been associated with the Commission and previously with the CLA for over twenty-five years. He is assisted by a Director and a team of professionals in overseeing the functions of the Department.



Mr. M. Hayat Jasra (left), Executive Director with officers of the PSD

Mr. M. Javed Panni, Executive Director heads the Policy Department (PD). He has over thirty years of experience in corporate and capital market regulation while working with the erstwhile CLA and the Commission. There are two Directors who, along with other professionals, assist the Executive Director.



Mr. M. Javed Panni (left), Executive Director with officers of the PD

## 7.2 Sector Overview

### 7.2.1 Credit Rating

Credit rating is a relatively new concept in Pakistan. The legal framework for credit rating companies is provided through the Credit Rating Companies Rules, 1995, which *inter alia* require credit rating agencies to enter into a joint venture or technical collaboration with an internationally recognized credit rating institution for a period of five years and to undergo licensing that is renewable annually. Currently, two companies, namely, JCR-VIS Credit Rating Company Limited and Pakistan Credit Rating Agency Limited have been licensed by the Commission to assign ratings. During the year under review, the credit rating companies issued 200 ratings for various companies.

### 7.2.2 Accountancy Profession

The profession of chartered accountancy in Pakistan is self-regulated by ICAP under the Chartered Accountants Ordinance, 1961, with oversight by the Commission. As on 30 June 2004, the membership of ICAP was 3,377, of which 653 members were overseas. During the year under review, ICAP admitted 214 new members.

Members of ICAP are expected to maintain the highest ethical and technical standards. In this regard, ICAP has instituted a Quality Control Review (QCR) program to ensure that audits are conducted in accordance with applicable standards and legal requirements. The program is undertaken under the framework approved by the ICAP Council. During the year, QCRs of thirty audit firms/offices were conducted. As of 30 June 2004, ninety-six practicing firms had been awarded satisfactory rating under the QCR program.

As a SRO, ICAP takes disciplinary actions against members if cases of negligence are identified/reported. During the year, ICAP disposed off forty-two cases. References were made to the relevant High Courts in three cases while in another three cases, reprimands by name were issued along with penalties imposed on the members concerned. In ten cases, reprimands (with or without name) were issued. The balance twenty-six cases were closed as no merit was found in the complaints.

## 7.3 Performance Review

During the year under review, the PSPD was involved in a number of projects aimed at improving the regulatory framework exercised by the Commission. These projects included proposals for amendments in laws administered by the Commission and development of guidelines on certain regulatory matters. In addition, the PSPD provided opinions and commented on matters referred to the Commission by other regulatory bodies and Government departments; it suggested amendments in the Business Rules, 1973 besides furnishing comments on draft laws, including the draft Electronic Crimes Bill and the draft State Bank of Pakistan Act, 2003.

A major step was taken towards improving the reporting framework of listed companies with the revision of the Fourth Schedule to the Companies Ordinance. The revision was done after an extensive review of applicable accounting standards and financial reporting developments. The revised Fourth Schedule is applicable to all listed companies and their subsidiaries.

During the year, an Intralaw website of Legal Wing of the PSD was established to provide link to various statutes, rules, regulations and notifications. Additionally, the website contains link to the orders passed by the Appellate Benches of the Commission and a database of pending appeals. A centralized, online database containing detailed information about cases filed by or against the Commission in courts of law was also developed.

## **7.4 Development of Laws**

### **7.4.1 Substitution of Fourth Schedule to the Companies Ordinance**

The Fourth Schedule to the Companies Ordinance lays down matters to be disclosed in the balance sheet and profit and loss account of listed companies and their subsidiaries. It was observed that the provisions of the Fourth Schedule, which were framed almost two decades ago, had become redundant. As a result, disclosure requirements needed to be updated and brought at par with international standards.

During the year under review, the Commission concluded an in-depth study, in consultation with ICAP, to revise the Fourth Schedule with a view to simplify its requirements and remove inconsistencies and overlap with IASs. The revised Fourth Schedule to the Companies Ordinance was notified vide SRO 589(I)/2004 dated 5 July 2004.

### **7.4.2 Proposals for Finance Act, 2004**

The Commission annually furnishes proposals to the Government for its consideration in the Finance Bill in order to provide a conducive environment for the development of corporate and financial sectors. During the year under review, a number of proposals were submitted to the Government, of which the following were accepted through the Finance Act 2004:

- i. to encourage consolidation in the financial sector, financial institutions have been allowed the benefit of set-off of business losses upon amalgamation if they amalgamate at any time up to 30 June 2006;
- ii. tax credit has been allowed on profit on debt paid to a listed company;
- iii. NBFCs have been allowed to create a reserve for bad consumer loans as permissible to commercial banks;
- iv. venture capital companies and venture capital funds have been allowed exemption from withholding tax so as to encourage establishment of venture capital projects; and
- v. computation of profits and gains of life insurance business for tax purposes has been rationalized in line with international best practices.

## **7.5 Judicial Cases**

The requirement of the Code of Corporate Governance for listed companies to change their external auditors after every five years was challenged by A.F.Ferguson and Co., a firm of chartered accountants, and the Commission was impleaded as one of the defendants in the civil suit filed before the Sindh High Court. After hearing the arguments of the parties, the Sindh High Court dismissed the civil suit. The plaintiff preferred an appeal against the said decision, which is presently pending adjudication. A similar writ petition under article 199 of the Constitution was filed before the Lahore High Court, Lahore and the same is presently pending adjudication.

## **7.6 Developmental Activities**

### **7.6.1 Guideline on Issue of Shares at a Discount**

Under Section 84 of the Companies Ordinance, all companies, whether listed or unlisted, are required to obtain the Commission's approval before issuing shares at a discount. It was observed that, in most instances, companies applying for the Commission's approval did not provide adequate information, thereby delaying the review and approval process. In order to enable the Commission to take a quick decision on such applications, the "Guideline on Issue of Shares at a Discount" was issued during the year. The Guideline lays down the desired information that applicants should furnish along with their applications so as to establish that:

- i. injection of fresh capital at a discount would enable the company to increase its profits and amortize the discount;
- ii. all material facts arising out of the issue have been brought to the attention of shareholders while seeking their approval to issue shares at discount;
- iii. issue of shares at a discount has not been used as a tool to increase the voting percentage of directors; and
- iv. preferential allotment of such shares would not be used by insiders as a means to obtain quick gains through disinvestments.

The Guideline also identifies cases where issue of shares at a discount might be contemplated to meet regulatory requirements for minimum paid-up capital or equity and lays down that such proposals are not in sync with the concept of raising the level of capital.

It is expected that the Guideline on Issue of Shares at a Discount would help in clarifying and expediting the process for seeking necessary approvals under the law.

### **7.6.2 Task Force on Rotation of Auditors**

The Code of Corporate Governance requires listed companies to rotate their statutory auditors after every five years. The accounting profession has been apprehensive about the efficacy of this requirement. In order to address these apprehensions, the Commission constituted a task force to consider the desirability of mandatory rotation of auditors in local circumstances, keeping in view the international developments in the matter. During the year, the task force met a number of times to deliberate on the issue and reviewed the comments of major stakeholders received in this regard. The task force would submit its report after considering the dynamics of the matter.

### **7.6.3 Coordination Committee of ICAP and the Commission**

A Coordination Committee of ICAP and the Commission was constituted during the year for ongoing dialogue on all matters of mutual interest, including the Commission's concerns regarding the QCR program. The Committee meets, as and when necessary, to deliberate on important matters and to make appropriate recommendations.

### **7.6.4 Independence of Credit Rating Companies**

In order to curb the unhealthy tendency of rated entities shifting from one credit rating company to another for avoiding a rating, the Commission directed credit rating companies not to accept a new client without approval of the Commission and without obtaining material information from the outgoing rating company.

### 7.6.5 Establishment of an Information Resource Centre

During the year under review, the Commission undertook the establishment of a resource centre, which would eventually be linked with other libraries within the country as well as abroad for internet library loan and networking. It would be equipped with the latest information and communication technology tools and would facilitate users through an Online Public Access Catalog. The resource centre started functioning during the year and is expected to be fully operational within the coming year.

### 7.6.6 Creation of a Public Warning System

The Commission has the general responsibility to protect investors from illegal, unauthorized and fraudulent business activities. In cognizance of this responsibility, the Commission established a warning system for the protection of public against unauthorized and *ultra vires* businesses, as is done by regulatory agencies in various other jurisdictions. The system would enable the Commission to issue public warnings and would be useful in tackling the problems arising out of investment frauds, forex scams and similar unlawful activities. Such warnings would be placed on the Commission's website.



Officers of the PSPD at work

## 7.7 Annual Plan

### 7.7.1 Work in Progress

#### i. Review of Companies (Issue of Capital) Rules, 1996

In order to ensure that the issue of capital is effectively regulated and that investors have adequate protection, the PSPD undertook to revamp the Companies (Issue of Capital) Rules, 1996. These Rules were found to be lacking in providing a strong regulatory framework for issue of capital and addressing the developments that have taken place over the years. During the year under review, the revised Rules were drafted and circulated within the Commission for comments. They would be finalized shortly in consultation with other stakeholders.

#### ii. Research on Impact of Universal Banking on NBFCs

Internationally, the banking sector has witnessed increasing diffusion between commercial and investment banking activities. This has paved the way for greater reliance on universal banking, whereby a wide range of financial services are provided under one umbrella.

In Pakistan, SBP has allowed commercial banks to undertake financial services additional to their core banking business. The financial sector in Pakistan has, as a result, witnessed an emerging trend of universal banking through expanding scope of commercial banks and recent mergers and acquisitions among banks and NBFCs. During the course of the year, the PD initiated a research on the impact of universal banking on the business of NBFCs. The study will assess the overall competitiveness of NBFCs vis-à-vis commercial banks in areas such as lease finance, consumer finance, asset management and resource mobilization, etc. and will identify suitable measures to meet resultant challenges.

### **iii. Draft Code of Conduct for Credit Rating Companies**

A draft code of conduct for credit rating companies was evolved, based on the issues identified by IOSCO's technical committee, for bringing greater transparency in the activities of credit rating companies. The draft Code focuses particularly on addressing the issue of conflict of interest. It is presently under consideration of the Commission.

## **7.7.2 Future Plans**

The planned activities of the PSPD for the coming year include the following:

- i. to review and propose amendments in laws administered by the Commission, including the Companies (Appointment of Legal Advisers) Act, 1974, Companies (Appointment of Legal Advisers) Rules, 1975, Companies (Buy-back of Shares) Rules, 1999 and Public Companies (Employees Stock Option Scheme) Rules, 2001;
- ii. to establish and regularly update a panel of advocates for the Commission; and
- iii. to identify issues relating to cross-border listing and suggest measures to make cross-border listing possible.





**SUPPORT SERVICES DIVISION**

**S E C**

# Support Services Division

## 8.1 Operational Structure

### 8.1.1 Structure

The Support Services Division (SSD) is responsible for facilitating the overall operations of the Commission and ensuring its smooth functioning. It has been organized into the following departments:

- Administration
- Finance

The Administration Department is further organized into Human Resource Wing, Administration Wing and IT Wing.

### 8.1.2 Management Team

Mr. Abdul Rehman Qureshi, Commissioner heads the SSD. There are three Directors heading each of the Wings within the Administration Department and a Director heading the Finance Department.

## 8.2 Human Resource

The Human Resource Wing is entrusted with a variety of activities, particularly to assess the staffing needs of the Commission; undertake recruitment and training of employees; process employees' transfers, retirements and dismissals; develop and improve personnel policies and procedures; coordinate with Divisions on matters of staff development; organize training programs; manage employees' benefits and compensation; and maintain personal records of employees.



Officers of the Human Resource Wing in a meeting

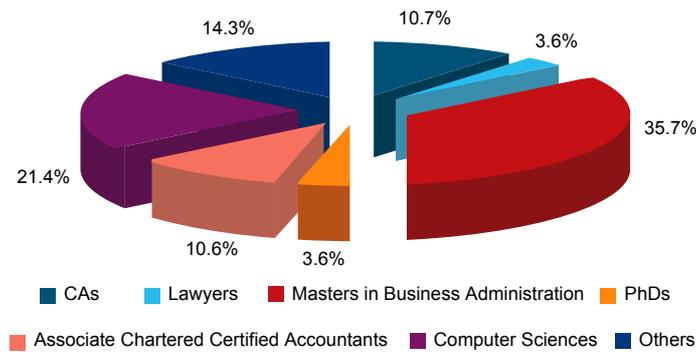
### 8.2.1 Recruitment

The Human Resource Wing follows transparent and objective recruitment procedures. The process is aimed at inducting suitably qualified and experienced professionals in line with the staffing needs of the Commission.

During the year under review, the Commission hired twenty-eight officers with expertise in different disciplines, like accountancy, business administration, law and computer sciences. The Commission continued with its policy of being an 'equal opportunity employer' so as to further improve gender balance among its employees.

The details of professionals recruited during the year are illustrated below.

**Chart 18 - Professionals Inducted during the FY 2004**



### 8.2.2 Junior Executives Induction Scheme

The Junior Executives Induction Scheme (JEIS) was advertised during the year for inducting a new batch of young professionals. The scope of the scheme was broadened by inviting applications from partly qualified professional accountants. The scheme generated considerable interest and in response to the advertisement, approximately 1,500 applications were received as compared to 1,000 received during the last year.

As many as 348 candidates appeared for written examination of JEIS. As in previous years, in order to maintain transparency and impartiality in the selection process, the test was conducted by the Institute of Business Administration, Karachi. The Commission's Selection Committee interviewed fifty successful candidates of which ten were selected for appointment at the Commission. The selected Junior Executives were placed in different Divisions of the Commission during the course of the year.

The Junior Executives inducted during the previous year completed their on-job training in various Divisions. Based on their performance and internal staffing needs, they were promoted as Assistant Directors and appointed as such in relevant Divisions of the Commission.

### 8.2.3 Training Programs and Seminars

Every year, the Human Resource Wing arranges participation of the Commission's officers in training programs, seminars and conferences within and outside the country. These programs are aimed at enhancing employees' skills, knowledge and understanding required for efficient and effective performance.

During the year under review, officers of the Commission participated in the following foreign trainings, seminars and conferences:

- i. study tour to the Companies Commission of Malaysia from 7 to 9 July 2003;
- ii. IOSCO's Executive Committee, Technical Committee and EMC Advisory Board Meetings held in Athens, Greece from 23 to 26 September 2003;
- iii. Contractual Savings Conference on Regulatory and Supervisory Issues in Private Pension and Life Insurance organized by the World Bank in Washington D.C., USA from 3 to 7 November 2003;
- iv. Conference on Private Pension in Asia and 2004 Asia-Pacific INPRS Meeting in Manila, Philippines from 30 March to 1 April 2004;
- v. joint workshop of Asian Institute of Management and ADB Institute on Development Perspective for Upgrading Accounting and Auditing Competency held in Manila, Philippines from 12 to 16 April 2004;

- vi. International Institute for Securities Market Development organized by the USA Securities and Exchange Commission from 19 to 29 April 2004;
- vii. IMF and World Bank meeting held in Washington D.C., USA from 24 to 25 April 2004;
- viii. Annual Conference of IOSCO held in Amman, Jordan from 17 to 20 May 2004; and
- ix. expert meeting on Enhancing the Capacity of Financial Markets to Promote Intra-investment in Jeddah, Saudi Arabia from 26 to 27 June 2004.

The Commission also organized local trainings throughout the year for its employees. Some of the major local trainings undertaken include:

- i. special computer course at National Institute of Public Administration, Karachi from 16 to 23 July 2003;
- ii. visit to KSE to study stock exchange practices from 17 to 18 October 2003; and
- iii. Career Planning and Management workshop organized by LUMS from 30 March to 2 April 2004.

#### **8.2.4 Human Resource Manual**

During the year under review, the Human Resource Wing prepared a Manual to set out procedures aligned with the policies laid down in the Service Manual of the Commission. The Manual delineates workflows and competent authorities as appropriate and includes existing practices with necessary improvements as well as lays down certain new procedures.

#### **8.2.5 Enhancement in Employees' Benefits**

During the year under review, the rest and recreation policy of the Commission was revised. Under the new policy, employees would be entitled to fifteen days of annual rest and recreation leave with allowance equal to a half month's gross salary.

Furthermore, approval of the Policy Board was sought to allowing a special allowance at 20 percent of basic salary to employees of the Commission to cope with inflation and to make the salary structure more competitive. The special allowance became effective from 1 July 2004.

### **8.3 Administration**

The Administration Wing provides various support services relating to transport, equipment, office supplies, furniture and fixture; hiring and maintenance of office premises; and other related matters. It has been actively working to enable efficient discharge of duties by CROs and the Divisions at the head office of the Commission.



Officers of the Administration Wing in a meeting

### 8.3.1 Hiring and Maintenance of Offices

During the year under review, an additional floor was acquired at the Commission's head office to house the PSPD. State-of-the-art offices were set up with Local Area Network (LAN)/Wide Area Network (WAN) connectivity, computer equipment and telephony services. Certain refurbishment was also undertaken at the CRO, Karachi.

### 8.3.2 Children Day Care Centre

During the year, a day care facility was established at the Commission's head office to facilitate officers to shoulder their parenting responsibilities while performing their duties at the Commission. The day care centre is fully equipped to cater to the health care as well as entertainment needs of children. Its establishment particularly seeks to facilitate young parents working at the Commission.

### 8.3.3 Medical Consultant

The Commission also engaged the services of a Medical Officer at its premises to provide medical consultancy and first aid to the employees of the Commission.

## 8.4 IT

The IT Wing provides a range of services for various management support functions, specialized applications, MIS applications and managed workstations. Major areas of its operations include software systems and database maintenance/development; website/intranet re-engineering and maintenance; LAN/WAN connectivity and central services; managed workstation services; hardware maintenance services; and training in IT products and services.



Officers of the IT Wing at work

### 8.4.1 Information Technology Strategy Plan

The IT Wing is working towards automation of systems and procedures within the Commission. To achieve its objective, the IT Wing prepared an Information Technology Strategy Plan (ITSP), which was also presented before the Policy Board during the year. Automation of the Commission's internal and external communication and processes, including online submission of résumés, bids, quotations, general enquiries and complaints to the Commission would be possible after successful implementation of ITSP.

The ITSP has been divided into the following parts:

- i. Business Development and Regulations Process, which covers electronic incorporation of companies, submission of returns and monitoring and surveillance.
- ii. Business Process Management and Content Management, which will help set out the technical approach to automation of the Commission's offices with incorporation of workflow automation and content management.
- iii. Applications Development for Divisions of the Commission, which will help to automate the routine regulatory actions and will also provide for improved organization and analysis of data. A number of applications in this regard have already been developed.
- iv. Creation of a comprehensive Data Warehouse based on data being captured by existing as well as future applications.
- v. Information Gateway for exchange and dissemination of information among international and national organizations, companies and the general public.
- vi. IT Consolidation for enhancement in existing hardware, improving network connectivity between head office and CROs, etc.

The Commission submitted a proposal to the Electronic Government Directorate for the funding of Business Process Management and Content Management solution. The proposal was approved subsequent to the close of the year and necessary processes were accordingly initiated.

#### **8.4.2 Development of New Systems and Applications**

During the year under review, the IT Wing developed its capacity for in-house software development and maintenance by creating a core software expert team through induction of suitable professionals.

Besides the systems developed in previous years, the IT Wing initiated and, in some cases, completed work on a number of software systems to automate various functions at the Commission. In this regard, the major systems and applications on which work was undertaken during the year were as follows.

##### **i. Electronic Profile System**

The system allows employees to create their electronic profile with details of qualifications, experience, employment history and training.

##### **ii. Online Query Management System**

A number of online forms have been linked to the Commission's website for submission of online queries and registering complaints, etc. While previously the responses to these queries were processed offline, the new system provides a completely automated environment.

##### **iii. Document Tracking System**

This system keeps track of the actions taken on documents received at the Commission along with time taken to respond to them.

##### **iv. Corporate Track Record System**

It allows recording of information regarding each of the corporate members of a company as well as its auditors, lawyers, brokers, etc.

##### **v. Legal Opinions Management System**

The system maintains record of legal opinions and replies to legal queries sent by all Divisions to outside parties. This helps in tracking opinions given by the Commission on different occasions and in ensuring consistency of opinions on an issue. The Legal Opinions Management System incorporates a search facility and features like record management, auto-generated email alerts, system security, data validation and masking, etc.

**vi. Brokers and Agents Registration System**

It is an automated system for close vigilance of activities of brokers and agents and seeks to facilitate enforcement of the Commission's regulatory functions.

**vii. Purchase Management System**

The system has been developed for Administration and Finance Departments to automate the purchase function.

**viii. Inventory Management System**

It is one of the key systems of the Enterprise Resource Plan and addresses the difficulties previously encountered in manually handling the data and maintenance of inventory records.

**ix. Help Desk Management and Facilitation System**

The system provides for online submission of problems by users, which are forwarded through an automatic distribution and management component to the relevant coordinator within the IT Wing.

**x. Court Cases Database**

The database keeps track of all cases filed by or against the Commission in various courts of law and maintains an up-to-date status of each of these.

**xi. Intranet of the IT Wing**

The intranet site, referred to as "IntraIT", holds key organization wide information for the employees of the Commission. It also acts as a portal for an automated, paperless environment and disseminates information and knowledge on valuable uses of IT. A quarterly electronic newsletter "Communiqué" is also placed on IntraIT to provide relevant information about IT issues.

**xii. Intranet of the Human Resource Wing**

This is an initiative to share information relating to human resource matters with the employees of the Commission. The portal contains links for editing personnel profile, claiming reimbursements as well as viewing notable events. There is an integrated module for leave quota management to facilitate online leave application processing.

**8.4.3 Training in IT Products and Services**

During the course of the year, the IT Wing continued to provide formal and informal training to officials of the Commission in IT systems. It also developed an orientation package for new entrants in the Commission to brief them about IT systems and applications within the Commission.

**8.5 Finance**

The Finance Department is responsible for directing and controlling the areas of accounting, treasury management and budgeting. It administers the Commission's revenue and maintains relevant records, while ensuring that all revenues are properly recorded in light of the provisions of the SECP Act and are duly reported in an appropriate manner. The Finance Department is also responsible for preparation of periodic financial reports for use of the Commission. In this regard, a multi-user accounting software is used for the maintenance of books of account and a sound accounting system is in place. A transparent and effective internal control system is also followed in recording and monitoring of financial transactions. Policies and procedures are well documented and the Finance Department ensures adherence to the same.

### 8.5.1 Budgetary Reports

The Finance Department formulates budget and authorization requests and monitors utilization of the Commission's resources. As such, it is also responsible for budget justification and execution.

The Finance Department developed, implemented and monitored the Commission's budget for the FY 2004. It also prepared the budget for the FY 2005, which was approved by the Commission and the Policy Board in May 2004 as per requirement of Section 24 of the SECP Act.

### 8.5.2 Financial Statements

Financial statements of the Commission for the year ended 30 June 2004 were prepared by the Finance Department and were audited by Taseer Hadi Khalid and Co., CAs. These were submitted to the Federal Government within the timeframe provided in the SECP Act.

### 8.5.3 MIS

Monthly MIS reports, providing an overview of financial performance and financial position of the Commission, were introduced in January 2002. These reports give details of revenues generated and expenditures incurred by each Division at the head office and CROs. The MIS reports include the following:

- 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.

During the course of the year, MIS reports were placed before the Commission every month to apprise it of the revenue and expenditure position and formed an essential basis for the Commission's decision making.

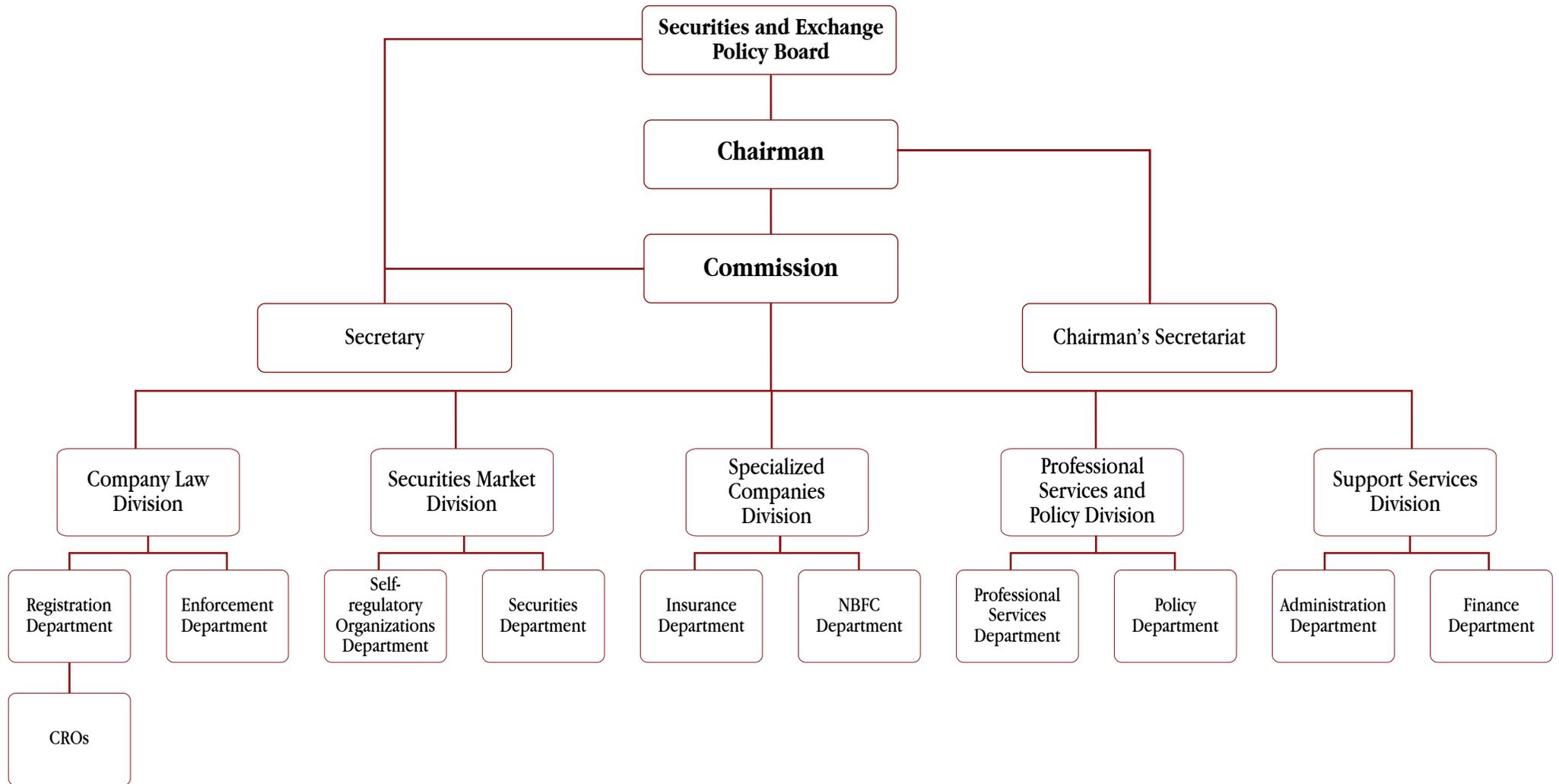
## 8.6 Annual Plan

The SSD plans to carry out the following activities during the coming year in addition to its routine functions:

- i. undertake a comprehensive training and development program for capacity building of the Commission;
- ii. introduction of IT-based systems to support the monitoring and supervisory functions of the Commission; and
- iii. review and implementation of the Accounting Policies and Procedures Manual.

# Annexure

# Annexure A - Organizational Structure



## Annexure B - Management Directory

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## Annexure C - List of Publications

In addition to quarterly newsletters, the Commission has prepared the following publications:

<b>Title of Publication</b>	<b>Date of Publishing</b>
Investor Guide – Volume I	August 2002
Investor Guide – Volume II	August 2002
Investors' Guide to Lodging Complaints	August 2002
Code of Corporate Governance	November 2002
Frequently Asked Questions on Corporate Governance	November 2002
Insurance Guide	August 2003
Promoter's Guide	August 2003
Brief Series on Corporate Governance	Initiated in January 2003
Brief Series on Anti-money Laundering	Initiated in March 2003
Manual on Corporate Governance	January 2004
Directors and Secretaries Guide	March 2004
Guide on Accounts and Accounting Reference Dates	July 2004
Single Member Companies Guide	December 2004

All publications are available at the Commission's website [www.secp.gov.pk](http://www.secp.gov.pk).

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