



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

# ANNUAL REPORT 2005



ANNUAL REPORT 2005

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ





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 2004 to 30 June 2005.



# Abbreviations and Acronyms

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ADB	Asian Development Bank
AGM	Annual General Meeting
ALICO	American Life Insurance Company
AML	Anti-money Laundering
APCRF	Asia Pacific Corporate Registers Forum
APG	Asia/Pacific Group on Money Laundering
ATS	Alternate Trading System
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
CFS	Continuous Financing System
CFT	Countering the Financing of Terrorism
CGAML	Consultative Group on Anti-money Laundering
CIS	Collective Investment Scheme
CLA	Corporate Law Authority
CLD	Company Law Division
CMA	Cost and Management Accountant
COD	Certificate of Deposit
COI	Certificate of Investment
Companies Ordinance	Companies Ordinance, 1984
COT	Carry-over Trading
CPD	Continuing Professional Development
CRO	Company Registration Office
CS	Chairman's Secretariat
CSR	Corporate Social Responsibility
DFI	Development Finance Institution
DTS	Document Tracking System
EFU	EFU Life Assurance Limited
EGD	Electronic Government Directorate
EMC	Emerging Markets Committee
EOBI	Employees Old-age Benefits Institution
FMGP	Financial (non-bank) Markets and Governance Program
FY	Financial Year
HRMS	Human Resource Management System
IAIS	International Association of Insurance Supervisors
IAP	Insurance Association of Pakistan
IAS	International Accounting Standard
ICAP	Institute of Chartered Accountants of Pakistan
ICMAP	Institute of Cost and Management Accountants of Pakistan
ID	Insurance Department
IDF	Institutional Development Fund
IMF	International Monetary Fund
Insurance Ordinance	Insurance Ordinance, 2000
IOPS	International Organization of Pension Supervisors
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
IRC	Information Resource Center
IS&T	Information Systems and Technology
ISE	Islamabad Stock Exchange
IT	Information Technology
JEIS	Junior Executive Induction Scheme
KSE	Karachi Stock Exchange
KSE-100 Index	Karachi Stock Exchange 100 Shares Index
LD	Legal Department
LSE	Lahore Stock Exchange
LUMS	Lahore University of Management Sciences
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
MoIP	Ministry of Industries and Production
MoU	Memorandum of Understanding
MSW	Monitoring and Surveillance Wing
NAB	National Accountability Bureau
NAV	Net Asset Value
NBFC	Non-banking Finance Company
NBFC D	Non-banking Finance Companies Department
NBFC Rules	Non-banking Finance Companies (Establishment and Regulation) Rules, 2003
NBFI	Non-bank Financial Institution
NBP	National Bank of Pakistan
NCCPL	National Clearing Company of Pakistan Limited
NCEL	National Commodity Exchange Limited
NICL	National Insurance Company Limited
NIT	National Investment Trust
NJLI	New Jubilee Life Insurance Company
OECD	Organization for Economic Cooperation and Development
OGDCL	Oil and Gas Development Company Limited
OTC	Over-the-counter
PICG	Pakistan Institute of Corporate Governance
PICIC	Pakistan Industrial Credit and Investment Corporation Limited
PII	Pakistan Insurance Institute
POL	Pakistan Oilfields Limited
Policy Board	Securities and Exchange Policy Board
PRCL	Pakistan Reinsurance Company Limited
PSEB	Pakistan Software Export Board
PSO	Pakistan State Oil Company Limited
PSPD	Professional Services and Policy Division
PTCL	Pakistan Telecommunication Company Limited
QCR	Quality Control Review
REIT	Real Estate Investment Trust
RIA	Regulatory Impact Assessment
ROSC	Reports on the Observance of Standards and Codes
SAAP	Surveyors and Loss Adjusters' Association of Pakistan
SAARC	South Asian Association for Regional Cooperation
SASRF	South Asian Securities Regulators Forum
SBP	State Bank of Pakistan
SCD	Specialized Companies Division
SCRS	Specialized Companies Return Submission and Compliance System
SECP Act	Securities and Exchange Commission of Pakistan Act, 1997
SLIC	State Life Insurance Corporation
SMC	Single Member Company
SMD	Securities Market Division
SME	Small and Medium Enterprise
SMEDA	Small and Medium Enterprises Development Authority
SOE	State-owned Enterprise
SPV	Special Purpose Vehicle
SRO	Self-regulatory Organization
SSD	Support Services Division
TA	Technical Assistance
Takeover Ordinance	Companies (Substantial Acquisition of Voting Shares and Takeovers) Ordinance, 2002
TFC	Term Finance Certificate
The Commission	The Securities and Exchange Commission of Pakistan
UK	United Kingdom
UNDP	United Nations Development Program
USA	United States of America
UTP	Unit Trust of Pakistan
VaR	Value at Risk
VPN	Virtual Private Network
VPS	Voluntary Pension System
VPS Rules	Voluntary Pension System Rules, 2005
WG3	Working Group-3

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## VISION

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*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.*

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## MISSION

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*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.*

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## STRATEGY

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

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# 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 2004 to 30 June 2005.

During the year under review, sustained efforts were made to implement the reform measures identified at the outset of the year. Numerous obstacles faced during this process further strengthened our resolve to pursue the reforms more rigorously for progressive development of our markets and protection of investors.



## Market Development

The buoyant mood in Pakistan's stock markets that prevailed during fiscal year 2004 continued during the current fiscal year. The Karachi Stock Exchange 100 Shares Index (KSE-100 index) ended the financial year 2005 with a gain of 41.1 percent, which translates into 2,171 points at the index level of 7,450. The index closed at its all time high level of 10,303 on 15 March 2005. The market capitalization of Karachi Stock Exchange (KSE) surged up to Rs. 2,068 billion, depicting an increase of 45.53 percent over the last year; in terms of US Dollars, market capitalization of KSE was approximately 35.65 billion at the close of the year. The Karachi stock market continued to be one of the best five performing markets around the world, during the period under review.

The stock market witnessed extreme bullish and bearish sentiments during the period January-March 2005. The bull run in the stock market was triggered during January and it lasted for two and half months. However, a sharp decline commenced on 16 March 2005 resulting in the KSE-100 index declining by 25 percent to as low as 7,708 as on 28 March 2005. This was the fourth set back for the market over the past five years; previous setbacks were in May 2000, September 2001 and May 2002.

Despite the extreme and abnormal volatility in March 2005, financial stability was ensured as a result of the risk management measures introduced by the Commission; the absence of these recent reforms introduced by the Commission would have resulted in a crisis situation and the market being closed. All trades were settled and marked to market losses were collected in accordance with the regulations. The sanctity of the contract and integrity of the system were preserved.

While a crisis was avoided, the Commission did constitute a Task Force to conduct an independent and impartial inquiry into the root cause of the situation. After over three months of deliberation, the Task Force submitted its report to the Commission. Taking stock of the observations made in the report, the Commission immediately commenced the implementation of operational and policy recommendations of the report.

The recommendations of the Task Force included the elimination of Carry-over Trading (COT), which was already being pursued by the Commission. During the year under review, the Commission, after extensive consultation with stock exchanges, finalized a comprehensive time-bound action plan to ensure the smooth phase out of COT/badla. In accordance with the action plan, the phasing out of COT/badla commenced from 8 October 2004. However, after extensive consultations, the deadlines were relaxed to facilitate the market. Despite various obstacles faced during the process, COT was completely eliminated subsequent to the close of the year and a continuous financing system (CFS) has been introduced as an interim measure to replace COT/badla financing in order to enhance the level of liquidity in the market while alternative modes of leverage financing are being developed, which include margin financing and futures market. In this regard, the Commission has ensured that the necessary measures for the minimization of market abuse and the mitigation of risk have been incorporated into the CFS Regulations in order to ensure the preservation of market integrity, investor protection and the restoration of investor confidence. Accordingly, the CFS Regulations provide several crucial risk mitigating measures.

The Commission has been pursuing demutualization for quite some time now and after extensive consultations got the stock exchanges to agree to it in principle. The Lahore and Islamabad stock exchanges have decided to integrate while the KSE is developing its own business plan. Although volatility in the stock market, over-speculation and impediments faced while implementing the reforms during the year did hinder the process, the Commission continued to vigorously pursue demutualization so as to eliminate the inherent conflict of interest on the Boards of the stock exchanges.

Our commitment to the reform agenda also rendered an accelerated growth phenomena for the corporate sector as an exceptionally high number of 3,078 companies registered with the Commission under the Companies Ordinance, 1984 during the year. Initiatives were undertaken during the year to further strengthen and develop the legal framework, curb illegal and fraudulent business activities and enhance compliance of registered entities with legal and regulatory requirements.

The Commission also focused on improving compliance level with the statutory provisions and bringing improvement in the reporting of financial and non-financial information to the stakeholders. Resultantly, companies' compliance with corporate laws and International Accounting Standards has improved considerably. Cases of negligence and professional misconduct by statutory auditors in conducting the audit of companies were also pursued. As a result of enforcement measures, auditors have become more vigilant and conscious in performing their statutory duties which has resulted in improved quality of financial statements.

Subsequent to the close of the year, rules were notified for the conduct of Takaful business in the country. The Rules were drafted by the Task Force, constituted by the Commission towards the close of last year, for the purpose. Enhanced monitoring and enforcement also remained a key area of focus in the insurance sector.

In consideration of its mandate to regulate private pensions in the country, the Commission finalized and notified the Voluntary Pension System Rules, 2005. The Rules, which have been prepared after extensive consultations with the industry, would provide the necessary regulatory impetus to develop this sector in Pakistan.

In the non-banking financial sector, the Commission constituted a Task Force consisting of senior service sector professionals on the establishment of Real Estate Investment Trusts (REITs) in Pakistan. The Task Force is entrusted with the development of a fast-track regulatory framework which conforms to best international practices and is based on such products offered by a REIT that are suitable to the local real estate and capital markets. Development of REITs would deepen the capital market as well as enable greater product diversification for collective investment schemes.

## Regulatory Developments

A key step for successful reforms is for the Commission to have uniform regulatory authority over the various sectors under its purview. In an effort to achieve this and harmonize the regulatory framework, the Commission focused on the development of new laws. A new Securities Act, Futures Act, and Financial Services Commission Act were drafted by independent consultants, keeping in view the expanded mandate and regulatory and developmental role of the Commission. While existing laws are also being updated, Codes of Conduct are also being developed for the various professional service providers in the financial sector.

## Corporate Governance

During the period under review, the Pakistan Institute of Corporate Governance (PICG) was set up as a not-for-profit company, limited by guarantee and without share capital. It has been licensed under Section 42 of the Companies Ordinance. The Institute has been set up in public-private partnership; founder members include, in addition to the Commission, the State Bank of Pakistan (SBP), the three stock exchanges, the industry associations in the financial sector; chambers of commerce and industry; professional bodies of accountants and company secretaries, and academia. The PICG would be involved in training and education, creating awareness, undertaking research, publishing guidelines and other resource material, and being a forum for discussion on corporate governance.

## International Activities

During the year, the Commission was elected as Vice Chairman of the Technical Committee of the International Organization of Pension Supervisors (IOPS). This election is in addition to Pakistan's membership of the IOPS Executive Committee at its founding meeting in July 2004. The agreed upon program of work of the Technical Committee includes work on components of a risk-based approach to supervision; Pakistan, along with Australia, Germany, Netherlands, United Kingdom and the World Bank, were selected to undertake this.

The Commission continued to play an active role in the activities of the International Organization of Securities Commissions (IOSCO). During the year under review, the Commission successfully completed its work on the mandate of "Cross-Border Activities of Financial Intermediaries in Emerging Markets". The survey report, prepared by the Commission, was well received and upon approval of the Emerging Markets Committee (EMC) Advisory Board, it was placed on IOSCO's website. After successful completion of its mandate, the Commission proposed to Working Group-3 (WG3) of the EMC to adopt the new mandate on "Guidance to emerging market regulators regarding capital adequacy requirements for financial intermediaries". The new mandate was duly adopted by WG3 during the Annual Conference held at Colombo, Sri Lanka in April 2005.

The Commission, along with other stakeholders, underwent mutual evaluation by the Asia/Pacific Group on Money Laundering (APG). The evaluation was geared towards assessing Pakistan's legal, law enforcement and regulatory framework in respect of Anti-money Laundering (AML) and Countering the Financing of Terrorism. The draft Evaluation Report for Pakistan, circulated by APG during the year, appreciated the initiatives taken by the Commission to combat money laundering in various areas under its regulatory ambit. Certain recommendations to strengthen the AML framework were also provided. The Commission and various stakeholder institutions in Pakistan reviewed and commented on the report, which was adopted in the annual meeting of APG held subsequent to the close of the year under review.

## Bilateral Cooperation

In May 2005, at the outset of the Annual General Meeting of the South Asian Federation of Exchanges, the Commission initiated a multilateral Memorandum of Understanding (MoU) establishing the South Asian Securities Regulators Forum (SASRF). The MoU was signed by securities regulatory bodies of Bangladesh, Bhutan, Mauritius and Nepal; India and Maldives signed the MoU subsequently. In its first meeting held in Islamabad in May, the Commission was unanimously elected to chair the SASRF in its first year.

The Commission also entered into bilateral agreements with the Australian Securities and Investments Commission as well as the Royal Monetary Authority of Bhutan for coordination and sharing of information.

On the domestic front, quarterly coordination meetings with SBP remained a regular feature as the two regulators maintained close liaison to ensure that there are no gaps in the regulation of the financial sector.

In order to promote corporatization and progressive development of corporates in the country, the Commission constituted a joint Task Force with the Central Board of Revenue to study the tax structure for the corporate sector and recommend a corporate tax policy. Several recommendations of the Task Force were incorporated in the Finance Act, 2005.

## Institutional Developments

During the year, the Securities and Exchange Policy Board (Policy Board) continued to meet every quarter and was apprised of the Commission's achievements.

Institutional strengthening remained a key area of focus as skilled professionals were inducted at various levels in the organization. Focused training programs, local and foreign, were also conducted for existing employees.

## Regulatory Impact Assessment

During the year, the Commission began an internal review process so as to introduce Regulatory Impact Assessment (RIA). However, RIA is a relatively new concept in Pakistan and the necessary skills are not readily available. We are, however, committed to introducing this important concept and integrating RIA widely into our regulatory process; as such, we are acquiring the required skill and expertise in this regard.

## Reform Process

In building upon its efforts of previous year - when the blueprint for the regulation and development of corporate and financial (non-banking) sectors was prepared - the Commission developed a medium term strategy aimed at regulation and development of sectors under its purview. The five-year strategy aligns the Commission's high level strategic initiatives with functional priorities in each of these sectors. The strategic plan will itself be a rolling plan, which will be reviewed and monitored annually to ensure its systemic evolution and successful implementation.

As with all other reform measures, the Commission adopted a participative and consultative process while developing the strategy; detailed sessions in this regard were held with the corporate sector, stock exchanges, non-banking financial sector, and professionally affiliated associations. Various issues faced by each sector were identified and the roadmap for effective regulation and progressive development of the sector, over the next five years, was set out.

The Commission is committed to ensuring investors' protection through risk-controlled regulation aimed at fostering growth of robust corporate and financial (non-banking) sectors in the country. Development of the medium term strategy is indicative of this commitment while a cursory look at our performance of the year under review would reveal rigorous implementation of the reform process.

During the year under review, the Commission undertook focused actions in a variety of areas, some of which have been discussed above. We adopted a proactive and dynamic approach towards regulation and ensured continued development of business sectors under our regulatory purview. The second generation reforms in the capital market were aimed primarily at investor protection. The phasing-out of COT, demutualization of stock exchanges, and elimination of group accounts and introduction of universal client identification system are significant initiatives in this regard. Although the situation prevailing in the capital market during March 2005 raised a number of questions about the Commission's reform process, a general consensus was reached that the reform agenda was exhaustive and being proactively pursued. There was also a realization at the end of the Commission that implementation of the reform process is not dependent on our commitment and perseverance alone; it is highly vulnerable to external forces that must be dealt with in a coordinated manner by all concerned stakeholders.

## Conclusion

The Commission has been pursuing cooperation agreements with its international counterparts as well as with various agencies within the country; cooperation, however, needs to be mutual in order to be effective. Our reform agenda fits in well with the Government's policy and broader reforms of the economy and as such requires necessary support from the Government and judiciary.

While the year under review was marked with considerable challenges in implementation of the envisioned reforms, I assure you that the challenges have only strengthened our resolve and belief in fundamental reforms.

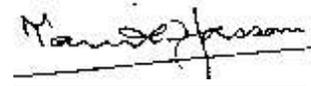
## Acknowledgments

I would like to thank the Policy Board members for their valuable guidance and support throughout the year. I would also like to commend the Commission's employees for their hard work and dedication in meeting the objectives of the Commission in a proactive and diligent manner. In particular, I would take this opportunity to



record my appreciation of the services of Mr. Abdul Rehman Qureshi, whose tenure as Commissioner concluded during the year. We are fortunate that Mr. Qureshi has continued his association with the Commission in the capacity of Adviser.

Lastly, I would like to thank my staff and, in particular, the editorial team at the Chairman's Secretariat for ensuring the quality and timeliness of this report.



Dr. Tariq Hassan



# Medium Term Plan/Strategy for the Regulation and Development of Corporate and Financial (Non-banking) Sectors



**SECURITIES AND EXCHANGE  
COMMISSION OF PAKISTAN**

# 1 Medium Term Plan/Strategy for the Regulation and Development of Corporate and Financial (Non-banking)<sup>1</sup> Sectors

## 1.1 Introduction

Over time, the Securities and Exchange Commission of Pakistan (the Commission) has emerged as the integrated regulator of corporate and financial (non-banking) sectors in Pakistan. It exercises this role under the various laws administered by it.

As the regulator of an emerging economy, the Commission's regulatory philosophy is based on developmental regulation. In this regard, the Commission has developed the medium-term plan/strategy for the five years from January 2006 to December 2010

The plan for 2006-2010 aligns the Commission's high level strategic initiatives with functional priorities. It is a dynamic document requiring a continuous review of the regulatory process and the rapidly changing environment of Pakistan's corporate and financial (non-banking) sectors. A regulatory assessment process should not only adhere to international best practices but should also focus on Pakistan's environment and must continually be vetted by stakeholders.

In terms of best practice, the strategic planning process is results oriented, participative, and consultative. This ensures ownership and commitment of those charged with implementing the plan. While formulating the strategic plan, the Commission engaged in an on-going SWOT analysis identifying internal strengths and weaknesses as well as external threats and opportunities. The Commission also derived assistance from consultants under the Asian Development Bank's (ADB) Technical Assistance (TA) for strengthening regulation, governance and enforcement of financial (non-bank) sectors.

The Commission solicited comments from stakeholders on two occasions. The non-banking financial sector, stock exchanges, and professionally affiliated associations were asked to comment on the 'Blueprint for Regulation and Development of Corporate and Financial (Non-banking) Sectors.' In August 2005, the Commission set up an Advisory Committee to formulate the medium-term plan/strategy for regulation and development of corporate and financial (non-banking) sectors and additional comments were requested. The Advisory Committee represented industry associations, chambers of commerce, capital market participants, and professional institutions. The Commission held several meetings with the members of the Advisory Committee to identify the various issues faced by each sector and to develop roadmaps for the next five years.

The strategic plan outlines supportive initiatives and makes recommendations in order for the Commission to make fundamental, long term changes in the way it conducts its business. The plan is set against the backdrop of a fast changing economic environment in Pakistan and the increasing complexity of financial markets. It goes beyond routine day-to-day operations to a much longer-term development plan for sustainable growth. In order for it to be effective over the next five years, the strategy needs to be made operational through the preparation of successive annual business plans. The allocation of resources for various activities will be guided by priorities given under these business plans. The strategic plan will itself be a rolling plan which will be reviewed and monitored annually by managers. A system of stakeholder surveys will be the main instrument for obtaining feedback on implementation and review.

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<sup>1</sup> Financial (non-banking) sector, for the purposes of this plan/strategy, refers to capital market, insurance sector, NBFC sector, pensions, Islamic financial market, as well as professional service providers in these sectors.

The plan is intended to be comprehensive, charting the strategic development and future positioning of Pakistan's corporate and financial (non-banking) sectors. It is intended for use by the Commission as well as all market participants to provide strategic clarity to the vision and objectives for each sector.

## 1.2 Corporate Sector

### 1.2.1 Vision

A progressively growing and robust corporate sector that adequately protects the rights of stakeholders, provides information in a transparent manner based on international standards, and propels economic growth.

### 1.2.2 Objectives

The Commission has identified the following objectives in support of its vision for the corporate sector:

- i. to build and maintain an enabling environment in which business can succeed;
- ii. to promote corporatization and healthy growth of corporate entities;
- iii. to promote good corporate governance and a corporate culture that ensures transparency and accountability;
- iv. to facilitate corporate compliance;
- v. to engender investor confidence; and
- vi. to promote investment and development of the economy.

### 1.2.3 Current Status

An accelerated growth in the registration of companies has been observed over the past few years. As of 30 June 2005, there were 45,448 companies registered with the Commission under the Companies Ordinance, 1984 (Companies Ordinance). Of these, 44,319 were companies limited by shares, including 2,757 public companies, 41,320 private companies and 242 single member companies (SMCs). In addition, there were 286 associations not-for-profit, fifty-six limited by guarantee companies, 176 trade organizations, 606 foreign companies and five companies with unlimited liability.

The annual corporate growth is now well in excess of 3,000 entities. As compared to the financial year (FY) 2004, corporatization increased by 40 percent during the year ended 30 June 2005.

The Commission regulates the affairs of companies through administering and enforcing the Companies Ordinance. In this regard, it takes appropriate initiatives to strengthen and develop the legal framework, curb illegal and fraudulent business activities, and enhance compliance of registered entities with legal and regulatory requirements. In its developmental role, the Commission has been encouraging development of the corporate sector and ensuring public facilitation, particularly at its Company Registration Offices (CROs) situated in eight cities.

The concept of SMC was launched in the year 2002 through appropriate amendments in the Companies Ordinance, followed by the issuance of Single Member Companies Rules, 2003. The objective was to allow sole proprietors to embrace corporate status. The Commission has since focused on development and corporatization of small and medium enterprises (SMEs). A research study on "Simplification and Promotion of Laws and Procedures for Corporatization of SMEs" was conducted at the behest of the Commission, following which the Commission liaised with the Small and Medium Enterprises Development Authority (SMEDA), Central Board of Revenue (CBR) and State Bank of Pakistan (SBP) in an attempt to create a conducive environment for growth of SMEs and to encourage their corporatization. The reduction in initial fees to be paid on incorporation was also made to boost corporatization of SMEs.

A recent initiative of the Commission was to set up a Task Force jointly with CBR for formulating a corporate tax policy. The Task Force put forth various recommendations for easing structural and administrative problems of

corporate entities, thereby promoting their development and encouraging corporatization. On the basis of the report, the Commission engaged in dialogue with the concerned quarters; several recommendations of the Task force were, as a result, incorporated in the Income Tax law through the Finance Act, 2005.

Conscious efforts have been made to achieve professional and dynamic thinking in the functioning of CROs. The Commission has also set up facilitation counters at the Rawalpindi Chamber of Commerce and Industry and the Sialkot Chamber of Commerce and Industry to provide necessary guidance to the business community on regulatory requirements. Moreover, stamp duty on registration of memorandum and articles of association has been abolished by the provincial governments in Punjab and NWFP, on the recommendation of the Commission. In order to facilitate promoters elsewhere, adhesive stamps have been made available at CROs in Quetta and Islamabad. The Commission has also simplified returns to be filed by companies and removed redundant reporting requirements for listed companies to update them in line with international developments.

The Commission issued a Code of Corporate Governance in 2002, which became applicable, through listing regulations, to companies listed on the stock exchanges. The Code emphasizes openness and transparency in corporate affairs and decision making process of companies. It requires directors to discharge their fiduciary duties in the larger interest of all stakeholders. Moreover, the Code seeks to strengthen corporate working, internal control system and external audit requirements of companies. The corporate and financial reporting framework has also been re-defined to foster better disclosures.

#### 1.2.4 Strategic Initiatives

The Commission plans to undertake the following strategic initiatives with regard to regulation and development of the corporate sector:

- i. Awareness campaigns would be introduced to encourage corporatization.
- ii. The concept of off-the-shelf company would be introduced to facilitate promoters.
- iii. In order to develop a uniform and consistent legal and regulatory system across all sectors, the Commission would amend the existing legal framework for the corporate sector in accordance with the changing national and international trends. A Corporate Laws Review Commission would be set up for the purpose.
- iv. Existing laws would be amended with a view to rationalize statutory requirements and at the same time enhance transparency and disclosure requirements.
- v. Legal regime for substantial acquisition of shares would be improved.
- vi. Shareholder redress mechanisms, including derivative action, would be considered for introduction.
- vii. Model memorandum and articles of association for at least eight sectors in each year would be developed and placed on the Commission's website for public facilitation.
- viii. Abolition of stamp duty on registration of memorandum and articles of association in all provinces would be pursued with provincial governments.
- ix. New laws would be introduced to address the specific needs of various sectors, particularly for the SME sector.
- x. Simplified accounting and reporting requirements for SMEs would be developed.
- xi. Collaboration with SMEDA, SBP, CBR and other concerned agencies would be undertaken to promote SMEs.
- xii. Regulatory impact assessment (RIA) would be introduced to help determine the risks, costs and benefits of a regulatory proposal and to identify who will be affected by the proposed regulation.
- xiii. A study on the utility of cost accounting records would be undertaken and, if necessary, cost accounting records for various sectors would be prescribed.
- xiv. Further automation and introduction of facilities, such as online name reservation; online incorporation and filing of returns; and alert system to advise companies before occurrence of any statutory event would be done.
- xv. Electronic voting/voting by mail would be introduced to facilitate shareholders.
- xvi. One-window operation facility would be established at CROs.
- xvii. Camp offices would be established in small cities.
- xviii. Fast track registration facility would be developed.

- xix. Dormant companies would be cleared up.
- xx. Automated systems would be deployed to ensure effective offsite monitoring of CROs.
- xxi. The Commission's corporate database would be strengthened to provide easy online access to public documents.
- xxii. Data would be shared with other regulatory bodies in the country for policy making and allowing harmonized efforts for corporate sector development.
- xxiii. Good corporate governance practices would be promoted in collaboration with the Pakistan Institute of Corporate Governance (PICG) and companies would be encouraged to adopt the true spirit of corporate governance. This would include enhanced protection of shareholder rights, including beneficial ownership, and increasing the accountability and effectiveness of board of directors.
- xxiv. Code of Corporate Governance, suitably modified as necessary, would be introduced for state owned enterprises (SOEs) and not-for-profit associations.
- xxv. Corporate Governance Index would be introduced.
- xxvi. A Corporate Social Responsibility (CSR) policy and strategy would be developed after suitable consultation. Companies would be encouraged to adopt CSR and its reporting.
- xxvii. In order to increase the corporate sector's regulatory compliance as well as increase awareness about their corporate responsibilities, the Commission would hold awareness campaigns and publish guidance booklets/manuals to improve understanding of the various laws and regulations.
- xxviii. Company law tribunals would be set up to enable effective and timely disposal of company law cases.
- xxix. Alternate dispute resolution mechanisms would be introduced.
- xxx. Measures would be adopted to weed out non-compliant companies and insolvency units would be established.

## 1.3 Capital Market

### 1.3.1 Vision

The development of the capital market as a meaningful alternative for fund raisers (listed companies) and investors, while ensuring compliance with the core principles of securities regulation set out by the International Organization of Securities Commissions (IOSCO), providing for investor protection, improving risk management and governance, and engendering confidence of capital market participants in market integrity.

The development of the Commission as a firm and fair regulatory agency that entertains high standards of integrity, transparency, understanding, and responsiveness.

### 1.3.2 Objectives

In achieving its vision for regulation and development of the capital market, the Commission has set out the following strategic objectives:

- i. to promote fairness, transparency, efficiency, integrity, and reliability of the market for investor protection;
- ii. to enhance accessibility of the capital market for investors and act as a catalyst in capital market formation by increasing listing from non-privatization sources
- iii. to enhance the competitiveness of the capital market in the international arena to facilitate regional alliances; and
- iv. to maintain high professional standards of the Commission as a regulator to promote public confidence and public understanding of the goals and activities of the Commission and generally strengthen supervision of the capital market.

### 1.3.3 Current Status

There are three stock exchanges in Pakistan, located in Karachi, Lahore and Islamabad. Karachi Stock Exchange (KSE) has the largest share in the combined market capitalization and turnover of exchanges. All the three

exchanges are mutual bodies, in which trading rights of members are embedded with ownership rights. Besides stock exchanges, the National Commodity Exchange Limited (NCEL) was set up in 2002 to deal in derivative products, mainly in futures contracts in commodities. However, it is not fully operational. The Central Depository Company of Pakistan Limited (CDC) is an integral part of the capital market. It started operations in 1997 and substantially enhanced efficiency in trading by providing dematerialization of securities. The National Clearing Company of Pakistan Limited (NCCPL) has been fully operational since January 2004 and provides for an integrated system for settlement of trades.

Over the past few years, a number of reform measures have been undertaken in the fields of risk management, governance, transparency and investor protection. The legal and regulatory developments have been plenty to meet with the changing capital market requirements and international best practices. However, the primary legislation governing the securities market, the Securities and Exchange Ordinance, 1969 has become outdated despite piecemeal amendments from time to time.

Equity and debt issues in the primary market are small in number. Over the last five years, only thirty-four equity issues have been made. These issues include offerings of government holdings to the general public in the recent spate of privatization. The Government is contemplating bringing more privatization issues to the stock market; however, only a handful of non-privatization issues are being made.

The corporate bond market remains sluggish in a low interest rate regime. The government bond market is active albeit government bonds and securities are not listed. The Government is the key player in the initial stage of bond market development, in its role as an issuer, regulator, promoter, and catalyst. Efforts are being made by SBP to improve the trading and price discovery of government bonds. The Commission is also liaising with SBP to promote development of corporate debt market.

The derivatives market is at a nascent stage. While NCEL is yet to commence trading in derivatives, a coordinated plan is necessary to establish new derivative products for the organized exchanges.

The secondary equity market is buoyant. Over a period of five years, market capitalization and index have phenomenally increased by 505 percent and 321 percent, respectively. While this has, in large part, been caused by the increasing investor focus on capital market, speculative trading also remains prevalent. In an effort to weed out speculative elements, eliminate manipulation, and dampen excessive market turnover and volatility, the Commission recently phased out carry-over trading (COT) (or badla financing). Continuous financing system (CFS) has been introduced in place of badla, as an interim measure and encompassing certain additional risk management features, to provide leveraged financing to investors.

The clearinghouse has a separate corporate structure in the shape of NCCPL. However, its operations are presently entwined with CDC and it does not have a separate Chief Executive Officer (CEO). The clearinghouse currently has insufficient capital to enable a risk transfer from stock exchanges to take place. The value at risk (VaR) system has not been installed and there is no stock lending and borrowing facility to provide for continuous net settlement. Stock borrowing and lending is a standard feature of all developed markets and, as the legislation permits, is becoming increasingly prevalent in emerging markets.

Internet trading portals are becoming more prevalent in Pakistan as these provide fast and low cost access routes to the central market for both local and foreign investors. However, as has happened internationally, there will be increasing pressure from brokers to internalize order flow leading to the establishment of Alternate Trading Systems (ATSS) which, although not inherently bad for securities markets, can result in market fragmentation.

It is expected that further development of capital markets could support more rapid macroeconomic growth. More developed and efficient securities market, including both equity and debt markets, can also help reduce systemic vulnerabilities in a bank-dominated financial system. The small, but growing, mutual funds industry offers significant potential for expanding the retail investor base.

### 1.3.4 Strategic Initiatives

In order to achieve the objectives of the strategic plan, the Commission along with the exchanges, NCCPL, CDC, and other market participants should ensure that the following strategic initiatives are adhered to and achieved within the agreed-upon time frame.

#### i. Products

In order to develop new products and revitalize the regulatory environment for Initial Public Offerings (IPOs) and listed issuers, appropriate actions would be undertaken to achieve the following:

- An IPO environment that is both attractive to investors and is disclosure based.
- New Capital Issue Rules governing the offering of securities that attract companies to raise capital.
- New listing rules that encourage a variety of existing and new types of products to list on exchange.
- Review and rationalize the delisting process.
- Long term educational programs aimed at encouraging participation in the wholesale debt market.
- Provision of an online trading system in bonds that will alleviate problems and distortions caused by lack of distribution of market information.
- Provision of a robust regulatory environment that enables the development of new derivative products on the organized stock or commodity exchanges, which will improve the protection of investors and lower systemic risk.
- Provision of a regulatory environment that supports the development of innovative and appropriate products for investors.
- Develop a securities lending and borrowing system to reduce the number of settlement failures.
- Development of an appropriate risk management system within the NCCPL based on VaR methodology.
- Dematerialization of the entire outstanding capital of listed securities, including shares, term finance certificates (TFCs) and units of open-end mutual funds.
- Develop an electronic book entry system for settlement of government securities.
- Development of ancillary collateralization and money settlement systems to support the new markets.
- Introduce ability to auction or book-build.
- Allow companies to have a sponsoring broker without the need for an underwriter.
- Review the Code of Corporate Governance.
- Enactment of Futures Trading Act followed by soft launch in gold, listing of other commodities such as rice, sugar etc., introduction of financial futures and introduction of options trading.
- Accommodation of new derivatives trading requirements into the trading system.
- Standardization of various documents required to be submitted by the issuer at the time of application for approval under section 57(1) of the Companies Ordinance.

#### ii. Exchanges

With a view to improve governance and investor protection as well as to encourage trading of equities, bonds, commodities and derivatives, the following initiatives would be undertaken:

- Cooperation with PICG and exchanges to improve standards of corporate governance.
- Creation of vibrant stock exchanges trading equities, bonds, commodities, and derivatives.
- Establishment of self-regulatory structure at the exchanges.
- Separation of Board and management, independent of self interest.
- Merger of Lahore Stock Exchange (LSE) and Islamabad Stock Exchange (ISE).
- Public offering and listing of demutualized exchanges.

- Commencement of work on fraud detection and pattern recognition.
- Introduction of price dissemination system to support agriculture sector.
- Introduction of IP based video surveillance.
- Separation of regulatory supervision of exchange trading from the operation of an exchange company.
- Extension of the Code of Corporate Governance to exchanges.
- Implementation of effective market surveillance and monitoring systems at exchange level.
- Encouraging exchanges to play an active role in international cross-border initiatives with trading links to other international exchanges.
- Enhanced trading platforms that make full use of internet trading and remote trading member access.
- Encourage development of over-the-counter (OTC) market.
- Introduction of ATSS where these can be demonstrated to add to market liquidity and efficiency.

### iii. Clearinghouse

The Commission would encourage the development of a single, well-capitalized clearinghouse based on IOSCO standards. In this regard, necessary measures would be undertaken as given below:

- Separation of clearinghouse from the exchanges and the restructuring of its shareholding ownership into an independent entity with an appropriate board and management structure.
- One independently structured and managed clearinghouse operating, via novated contracts, on a continuous net settlement basis with appropriate capital, margin, guarantee funds and other risk pools to ensure a first class capacity to withstand abnormal systemic risk events.
- Appropriate internal and external systems or linkages to ensure protection of securities and money settlement.
- Introduce Universal Identification Number mechanism which would allow ready differentiation between brokers' proprietary trading, trading done for clients and trading done for brokers from another exchange.
- Structure the sources of risk capital, split between share capital, guarantee funds, risk margins and for catastrophic risk.
- Development of systems and linkages that mitigate risk.
- Deployment of an appropriate VaR system to measure risks.
- Develop Basel II compliant software to compute clearinghouse exposure in real time.
- Market participation stratified between non-clearing, trading only participants, general clearing participants, and direct clearing participants.
- Clearing and settlement processes meeting IOSCO principles and standards.
- Reduction in the settlement period from T+3 to T+2 in the short term and T+1 within 5 years.

### iv. Market Intermediaries

The Commission seeks to ensure that market participants are appropriately licensed and qualified. The following measures would be implemented in this regard:

- Timely and regular inspections of intermediaries.
- Enacting requirements ensuring that Self-regulatory Organizations (SROs) are responsible and proactive in ensuring member compliance to SRO regulations and the law.
- Establishment of regional teams to undertake timely, routine and ad hoc inspections.
- Enhanced rules to assist in inspection/enforcement program.
- Stamping out of abusive practices in order to protect investors.
- Introduction of Code of Conduct governing research analysts and media commentators.
- Satisfactory audit of the SRO's compliance program.
- Compliance with IOSCO principles of regulation with respect to inspections and enforcement.

- Appropriate staff of licensed entities to be registered with the Commission and be required to pass a qualification examination.
- Establishment of rules for registration of staff.
- Introduction of requirements for the registration and accreditation of market advisers working for securities dealers, including the provision by exchanges of appropriate courses.
- Establishment of a Securities Institute to undertake industry training and set educational standards for professional development.
- Establishment of an examination process to be overseen by a Qualification Review Committee.
- Formulation and implementation of rules for market intermediaries including bankers to the issue, registrar/balotter to the issue, underwriters, debenture trustees and advisers/consultants to the issue.

v. Capital Adequacy

In order to install a capital adequacy regime that ensures protection of investors and control of systemic risk, necessary requirements would be introduced, which would be raised in defined steps over a period of five years. In this regard, the following actions would be carried out:

- Installation of a capital adequacy regime that ensures protection of investors and control of systemic risk.
- Have in place adequately capitalized intermediaries making monthly returns, properly completed and monitored by the Commission for completeness and accuracy.
- Have in place systems which ensure that corrective action is undertaken in a timely manner.
- Inactive brokers to have a grace period to either become active or be removed as members of the exchanges.
- Members to be required to corporatize within a reasonable time period.
- Capital adequacy to be shifted from 'Net Capital Balance' calculation to one based on liquid assets available to meet a proportion of total liabilities including adjustments for 'off-balance sheet liabilities'. There will also be a threshold base share capital to commence and remain in business.

vi. Regulation by the Commission

With a view to strengthen regulation of the capital market, the Commission would undertake the following measures:

- Strengthen legislation governing the regulation of the market; new derivatives legislation; new rules governing the conduct of business; new registration requirements for intermediaries; new registration requirements for exchanges; new registration requirements for clearinghouse; and new registration requirements for SROs.
- Clarify stamp duty on convertible bonds and securitized debt to avoid double levying.
- Lower stamp duty for corporate paper to internationally competitive rates.
- Reduce systemic risk through shifting risk management from exchanges to clearinghouse, strengthening capital adequacy requirements of market intermediaries, and introduction of different means of financing for leveraged investors.
- Improve investor protection by a change in the governance structure of stock exchanges, strengthening regulation and enforcement at exchange/SRO level, and introduction of qualifications for market intermediaries.
- In collaboration with market participants, introduce an investor education program.
- Provide a framework for cross-border listing.
- Build regulatory capacity and systems within the Commission by recruiting further market professionals and upgrading surveillance systems for on and off-site inspection.
- Establish a regional inspection team in Karachi.
- In anticipation of increase in cross-border financial services, increase the Commission's profile with

international market participants and regulatory agencies and establish linkages and cooperation with counterparts in the South Asian Association for Regional Cooperation (SAARC). This includes amending the Securities and Exchange Commission of Pakistan Act, 1997 (SECP Act) to give the Commission sufficient investigative power to assist its foreign counterparts and therefore be eligible to become a signatory to the IOSCO's, multilateral memorandum of understanding (MoU). In addition, it would be highly desirable to have regulations to guide it on the detail of entering into cooperative arrangements.

- Introduce an integrated Management Information System (MIS) within the Commission.
- Provide training to employees involved in investigations on “follow the money” and forensic accounting skills.
- Enhance regular on-site supervision of covered financial institutions to ensure that requirements for record keeping are being effectively implemented.
- Strengthen the anti-money laundering (AML) regime through appropriate client identification and documentation of transactions.

## 1.4 Insurance

### 1.4.1 Vision

A customer-focused, innovative, financially strong, and competitive insurance industry owned by fit and proper persons and managed in a prudent manner by professionally able persons.

### 1.4.2 Objectives

In achieving the vision, the Commission has set out the following objectives:

- i. public education and awareness;
- ii. development of human resources;
- iii. protection of policyholders' interest by proper prudential supervision of insurers and other professional bodies connected with the business of insurance;
- iv. encouraging organized development of the insurance industry;
- v. fraud prevention by coordinating industry-wide actions; and
- vi. helping to maintain the reputation of the financial sector.

### 1.4.3 Current Status

The insurance sector in Pakistan is underdeveloped relative to its potential. However, there is scope for substantial development if the right macro environment can be established and further liberalization of the sector allowed. This will involve move towards a more market based regulatory and supervisory regime. Immediate challenges include the ongoing rationalization of an overpopulated non-life sector and adjusting to new international accounting and solvency norms.

Pakistan's insurance sector is small even by the standards of its peers in the region. Reasons cited by the World Bank/International Monetary Fund (IMF) for this low penetration range from instability, the historical lack of an entrepreneurial life insurance sector, partly arising from nationalization in the past, the nature of income distribution in Pakistan (growth of life insurance sector is heavily dependent on the size of the middle class), low awareness and compliance (particularly with regard to compulsory motor insurance) and cultural and religious issues, including an aversion to disclosing the existence of assets. However, World Bank/IMF consider that there is considerable scope to substantially increase penetration from the current very low levels as these inhibiting factors are gradually overcome.

The Pakistan insurance market, by law, is divided into life and non-life insurance. There are a number of life insurers active in the sale of investment linked products. The sale of actuarial benefit policies is effectively a monopoly of State Life Insurance Corporation (SLIC), which is operated as a mutual insurer; the great majority

of its profits going to the with-profit policyholders. This makes competition by shareholder companies difficult. SLIC is effectively controlled by the Ministry of Commerce. The Ministry has dual role in regulation and ownership of the entity.

The non-life insurance market has three major components:

- i. an innovative open market sector dealing with non-government associated business, having both local and international ownership links and access to international reinsurance and direct insurance expertise;
- ii. National Insurance Company Limited (NICL) with a monopoly of government associated insurances; and
- iii. Pakistan Reinsurance Company Limited (PRCL) with a monopoly right to a pro-rata treaty share of non-life insurance.

The open market companies include the effective, well capitalized companies offering a broad range of products as well as the under-capitalized, poorly managed companies selling personal lines, largely motor insurance, and failing to behave either legally or ethically when handling claims.

The existence of state owned insurance sector can be viewed as a matter for state policy.

The insurance sector (and till the amendment in its memorandum and articles of association in August 2005, only the non-life insurance sector) is represented by the Insurance Association of Pakistan (IAP). The IAP has been re-established in 2004, at the initiative of the Commission. Presence of an active, collective forum is essential to provide impetus to development of the insurance industry and facilitate a unified approach to issues facing the industry.

#### 1.4.4 Strategic Initiatives

##### i. Legal Framework

The existing legal framework, encompassing the Insurance Ordinance, 2000 (Insurance Ordinance) and the rules framed thereunder, would be reviewed and strengthened to achieve the following:

- The anomalies/shortfalls, identified from time to time, are adequately addressed and the laws, rules and regulations support each other.
- The legal requirements are in line with international best practices, particularly the standards set out by the International Association of Insurance Supervisors (IAIS).
- Minimum capital requirements for life and non-life insurers are raised in a phased manner to Rs. 300 million and Rs. 200 million, respectively, by 2010.
- Solvency and liquidity requirements are clarified and strengthened.
- Enable electronic filing of returns.
- Enhance powers of on-site inspections and enforcement.

##### ii. Public Sector Insurers

The performance and governance of public sector insurance companies has a profound impact on the state of the overall sector. Although outside the jurisdiction of the Commission, it would consider providing suitable recommendations for consideration of the Government to improve the performance, operation and governance and ownership structure of these public sector companies. This would involve proposals for:

- Privatization of SLIC.
- Corporatization of Postal Life Insurance and its privatization.
- Conversion of NICL into a lead risk capacity provider to Pakistan's insurance market for effective utilization of its financial strength (substantial free reserves built up over the years).
- Future role of PRCL.

### iii. IAP

Following declaration of 2005 as the year for development of the insurance industry by the Commission, IAP has developed and submitted to the Commission, a short to medium term roadmap for development of the non-life private sector of the insurance industry. In this regard, the Commission would monitor IAP's progress against the objectives set out in its roadmap over the next five years. It would also undertake the following actions:

- Support NICL and SLIC to become members of IAP.
- Ensure that IAP issues a Code of Conduct, which is adhered to by its members.
- Insurance companies implement and follow good governance practices and IAP proactively promotes corporate governance among its members.
- Encourage IAP to establish a Fraud Prevention wing for industry-wide coordination.
- Develop workable solutions to remove malpractices within motor third party insurance in consultation with IAP.

### iv. Intermediaries

The Commission would work with Surveyors and Adjusters' Association of Pakistan (SAAP) and Pakistan Insurance Institute (PII) for continuous professional development and education of intermediaries, particularly those functional in the field of loss survey and adjustment. In this regard, it would take the following steps:

- Membership of SAAP would be emphasized and all licensed firms of surveyors and adjusters would be required to become members of SAAP.
- Require SAAP to issue a Code of Conduct for its members.
- Support the revamping of PII and its initiatives to provide adequately trained and skilled professionals for the insurance industry.
- Enhance outreach of PII and develop adequate training programs for the industry.

### v. Consumer Interest

The foremost objective of the Commission's regulatory actions is protection of policyholders' interests. The Commission plans to undertake the following steps in this regard:

- Pursue appointment of Insurance Ombudsman and setting up of Insurance Tribunal.
- Suggest to the Government the establishment of a consumer compensation scheme.
- Arrange consumer awareness campaigns in collaboration with IAP.
- Liaise with IAP to establish a wing covering risk management and loss prevention.
- Commence solvency analysis of each company, to be followed up by on-site inspections.
- Require insurance companies to file their rating tables and policy wordings each year with the Commission.
- Encourage suspicious transactions' reporting.

### vi. Product Development and Marketing

The industry efforts to diversify product line and increase its outreach would be supported, particularly in the following areas:

- Facilitating the introduction and development of takaful products.
- Encouraging the development of a range of health insurance products at competitive cost.
- Encouraging initiatives to spread life assurance business to rural areas.
- Examining the prospects and success of providing insurance covers through Bancassurance and determining the related regulatory aspects.

- Reinvigorating efforts to introduce crop insurance.
- Encourage issuance of policies and products denominated in foreign currencies.
- Provide attractive incentives for formation of new life companies preferably in partnership with foreign life insurers.

## vii. Operation of the Commission

Over the course of next five years, the Commission will need to focus on the following activities:

- Receipt and analysis of financial and statistical data presented by the companies that are authorized or seek to be authorized.
- On-site inspection of insurance companies.
- Examination of the results of the exercises described above to ensure that companies meet the requirements of law.
- Consideration and acceptance, or otherwise, of all those persons who seek to be involved in the ownership and operation of an insurance company to ensure that they are fit and proper persons to be so involved.
- Immediate implementation of intervention in the affairs of the company where the activities listed above indicate that action is required.
- Establishment of a part of non-life team of the Commission in Karachi.
- Providing training to employees involved in investigations on “follow the money” and forensic accounting skills.
- Enhancing regular on-site supervision of covered financial institutions to ensure that requirements for record keeping are being effectively implemented.
- Introduce prudential regulations requiring foreign intermediaries in Pakistan and offshore branches or subsidiaries or Pakistan intermediaries to meet the higher of either the home or host standards on AML/ countering the financing of terrorism (CFT).

To achieve the above, the Commission would need to ensure that it has adequate powers granted by law; trained and effective staff having the required professional skills; and administration systems which allow action on current information.

## 1.5 Non-banking Finance Companies

### 1.5.1 Vision

Develop effective regulation and development mechanisms ensuring that investors are adequately protected and empowered to protect themselves, as all forms of Non-banking Finance Companies (NBFCs) become a more integral part of the capital market in Pakistan, providing future economic growth and a viable financial market place for an increasing number of investors.

### 1.5.2 Objectives

The Commission has set out the following objectives for effectively regulating and developing the NBFC sector:

- to facilitate diversification and innovation in products and services of NBFCs;
- to enhance accessibility of the capital market for quality products and capital mobilization by NBFCs;
- ensuring the solvency of NBFCs through mitigation of systematic risk in the financial system;
- to enable NBFCs to mobilize savings for productive investments while protecting investors;
- to update and strengthen the legal framework governing NBFCs for providing a level playing field and augmenting the powers of the Commission; and
- to strengthen market oversight, inspection and enforcement by the Commission.

### 1.5.3 Current Status

In Pakistan, there is a pressing need to further improve the financial health and performance of NBFCs, i.e. investment banks, leasing companies, housing finance companies, discount houses, venture capital companies, asset management companies and investment advisers. The development of the NBFC sector is critical to enhance domestic resource mobilization and to foster competition in the financial sector. A number of Asian countries, including India, Sri Lanka and Bangladesh have achieved rapid savings growth outside the banking system by developing their NBFC sector.

NBFCs are new within the financial system of Pakistan, as compared to banking institutions. It is estimated that they represent 7.5 percent of total financial sector assets. Currently, there are a total of fifty operational NBFCs besides nineteen entities that do not possess a valid license as they are either non-compliant with the licensing requirements, financially sick, or are under winding-up. Of the fifty licensed NBFCs, nine are investment banks, thirteen leasing companies, two housing finance companies, one discount house, three venture capital companies, twelve asset management companies and ten investment advisers. The NBFC sector faces severe competition from commercial banks, development finance institutions (DFIs) and brokerage firms. Commercial banks, with availability of low cost funds and strong balance sheets, and brokerage firms, indulging in underwriting and capital market advisory activities make the NBFCs' environment difficult; the sector is calling for a paradigm shift to embrace the universal licensing regime. Despite the competition, NBFCs have immense importance in the economy and they meet the credit gap in the borrowing profile.

NBFCs are specialists of the intermediation process. Their survival and existence depend upon their ability to offer contracts that serve the needs of specialized customers; maintain a spread between the rate they pay for funds and the rate they receive that will support their costs; and meet commitment to suppliers of funds. The most important NBFCs are fund based, such as leasing companies, investment banks, housing finance, and discount houses. The companies are allowed to raise deposits from the public under the Non-Banking Finance Companies (Establishment and Regulation) Rules, 2003 (NBFC Rules) in the form of Certificates of Investment (COIs) or Certificates of Deposit (CODs) and they must maintain an investment grade credit rating. In addition, the NBFC Rules permit an institution to undertake various business activities by 'step up' in equity capital. For instance, an investment bank's equity is capped at Rs. 300 million, add a 'step up' in the equity of Rs. 200 million and the NBFC can obtain a leasing license; add another Rs. 200 million and obtain a discount house license; add another Rs. 100 million and add a housing finance license, with another Rs. 30 million add investment advisory and asset management license; and a mere Rs. 5 million obtains venture capital company license.

As on 30 June 2005, the total assets and equity of NBFCs engaged in leasing, investment finance services, housing finance services, and discounting services were Rs. 100.5 billion and Rs. 15.8 billion, respectively. Net assets of mutual funds were Rs. 124.571 billion as on 30 June 2005. Over the past few years, the mutual funds industry has been expanding at a rapid pace compared to other constituents of the NBFC sector.

#### i. Investment Finance

The capital adequacy (capital to asset ratio) of licensed investment banks is adequate. However, the composition of the asset base is tilted towards investments and lease finance, which constitute over half of the asset size. Four banks, namely, First Dawood Investment Bank Limited, Jehangir Siddiqui Investment Bank, Crescent Standard Investment Bank Limited, and Atlas Investment Bank Limited have an asset portfolio constituting 69 percent of the total sector.

The increasing cost of funds continues to be a cause of distress for the sector as expensive deposits in COIs/CODs give rise to accruals on payables. The industry's near term objective is to remove anomalies restricting lending working capital loans, personal loans, launching credit cards and home loan mortgages. Investment banks also want to reduce borrowing costs by having the flexibility to borrow funds without setting minimum tenor caps which affect the debt paper in their portfolios.

The industry is also faced with competition from large commercial banks, brokerage houses, introduction of Islamic banking services and accountancy firms offering corporate financial services.

## ii. Leasing

Leasing has 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.

The main competition to leasing companies is from commercial banks. Leasing companies would need to increase the product service lines in order to remain competitive with banks. Although banks were never barred from entering the leasing business, it caught their attention in the last few years as the plunge in interest rates on treasury bills and advances enabled them to earn high, double digit spreads on leasing products.

## iii. Housing Finance

Housing finance has been an under-developed sector and is yet to take off owing to certain constraints and difficulties, such as the complex legal framework, inadequate recovery and tenancy laws, weak enforcement of contracts and ambiguities arising from taxation laws and stamp duties. The housing finance sector consists of two operating companies, namely, Asian Housing Finance Limited and International Housing Finance Limited, while a third one is under voluntary winding up.

Due to the recent shift in the Government's focus towards the housing sector, coupled with other factors including availability of tax incentives, lower interest rates, restructuring of the financial sector, improved risk management practices, and an investment conducive environment, it is expected that the housing finance sector will gain strength in coming years.

## iv. Discounting

Presently, no license has been issued to a stand-alone discount house. In 2004, First Credit and Discount Corporation did not renew its discount license but applied, and was approved, for an investment banking license. In addition, NBP Capital Limited, an investment bank, applied for and was issued a discount house license. Two other discount houses are in liquidation.

Discounting and rediscounting services form the backbone of money market operations in government securities and corporate bonds and a reliable source of market of funds. In Pakistan, commercial banks with larger balance sheets are providing discounting facilities. However, an opportunity exists for expanding money market operations (discounting operations) as a source of fund raising for NBFCs.

## v. Venture Capital

The venture capital sector is in its nascent stages of development in Pakistan. The first venture capital company was registered in the year 2002. Presently, there are three venture capital companies, of which only one has launched a venture capital fund.

Given the large pool of low cost technical manpower available in the country in the fields of information technology (IT), telecommunications and media, the venture capital sector has immense potential to become globally competitive in terms of quality and delivery.

## vi. Mutual Funds

Currently, the mutual funds industry consists of twenty-one closed-end and fifteen open-end funds. The industry now provides multiple options for investment, such as equity funds, balanced funds, asset allocation funds, money market funds, bond funds and funds that invest in other mutual funds. Shariah compliant funds are also available for investors requiring such returns, which are in conjunction with the principles of Islam.

The mutual funds have been exhibiting a growing trend, owing to an effective regulatory regime, presence of qualified and experienced fund managers, continued higher corporate earnings, low interest rates and a buoyant capital market.

## 1.5.4 Strategic Initiatives

The Commission has set out the following activities as part of its medium term strategy for the NBFC sector:

- i. Assist NBFCs' accessibility to the capital market and resource mobilization.
- ii. Encourage good corporate and fund governance.
- iii. Introduce capital adequacy reforms to promote consolidation and mergers of financial institutions in sync with changes in the financial system requirements.
- iv. Develop tools for innovative resource mobilization, in consultation with market participants.
- v. Finalize guidelines on suspicious transactions and disseminate them to all NBFCs.
- vi. Address impediments to further development of investment banking, leasing, housing finance and discounting services.
- vii. Consolidate and build on existing initiatives in pension fund development, promote and reinforce asset backed securitization for the leasing industry, develop the housing finance industry through the introduction of mortgage backed securities, and promote additional Collective Investment Scheme (CIS) products, such as Real Estate Investment Trusts (REITs).
- viii. Explore new product lines such as export financing, trade financing, SME financing, factoring or forfeiting activities, issuance of credit card, issuance of guarantee bonds including performance bond and advance payment guarantees.
- ix. Provide legal framework for and explore possibility of cross-border leasing.
- x. Expand the geographical outreach of NBFCs.
- xi. Update the legal framework for NBFCs either through revising NBFC Rules or notifying a new legislation for NBFCs. The updated legal framework would clarify the current multi-agency regulation and encompass effective enforcement mechanisms. It would also remove such anomalies as have been identified in the existing laws and rules.
- xii. Enhance the 'Fit and Proper' standards rules whereby the Commission will be able to prescribe and review the qualification of individuals elected or appointed as directors or officers of NBFCs and disqualify those found unfit.
- xiii. Develop a regulatory framework and vehicle for REITs.
- xiv. Promote Private Equity Funds.
- xv. Promote market-making in short-term money market instruments.
- xvi. Develop venture capital by reviewing and rationalizing incentive structures for sustainable operations of venture capital companies.
- xvii. Allow NBFCs with suitable minimum investment grade rating to accept funds from the provident funds, pension funds, gratuity funds and trusts.
- xviii. Allow issuance of COIs starting from seven days to five years periods.
- xix. Encourage listing of COIs.
- xx. Accept the 'universal NBFC concept' to provide level playing field to banks and NBFCs through single licensing, no annual renewal, and capital adequacy rules.
- xxi. Require non-traditional activities, i.e. brokerage operations, to be conducted through subsidiaries to ensure transparency and risk management.
- xxii. Build a macro model to make dynamic impact analysis of various policy scenarios. This will increase the scope, coverage and quality of data that will help in exploring the macroeconomic variables and linkages between understanding capital market economic policy and an effective regulatory environment.
- xxiii. Explore the possibility of forming a consolidated NBFC association and issuance of a Code of Ethics for its members. In this regard, membership of the NBFC association would be mandated by law.
- xxiv. Develop SRO capabilities of the NBFC association.
- xxv. Enhance the Commission's monitoring and supervisory skills as well as its enforcement capacities.
- xxvi. Examine members periodically, without notice, for compliance with regulatory requirements.
- xxvii. Compile composite rating of each NBFC through its risk profile, as monitored and inspected by the Commission.
- xxviii. Strengthen supervisory regime by streamlining the data reporting by NBFCs.
- xxix. Explicitly design monitoring and inspection functions to prevent, detect, and prosecute NBFC sector crimes.

- xxx. Launch electronic data submission system, Specialized Companies Return Submission and Compliance System (SCRS), and upgrade the IT system for surveillance and audit.
- xxxi. Develop an Early Warning System by expanding the use of automated tools to organize, analyze, and recognize aberrant patterns and exceptions in information to target high-risk activity, monitor registrants, and more quickly identify violations.
- xxxii. Designate compliance officers-directors in NBFCs, certified by the Commission upon examination as such, to ensure compliance with electronic data filed with the SCRS and other regulatory safeguards imposed on such entity under the laws administered by the Commission.
- xxxiii. Capacity building of existing staff and hiring of those familiar with quantitative techniques and modelling, as necessary for conducting analysis of relevant data.
- xxxiv. Depute a monitoring and inspection team in Karachi.
- xxxv. Amend the MoU between the Commission and SBP to provide an action plan and procedures for joint on-site inspection of NBFCs to clear backlog, where necessary, and minimize cost of supervision.
- xxxvi. Publish a 'NBFC Guide'.
- xxxvii. Publish a Monthly NBFC Monitor, similar to the planned SBP Monthly Inflation Monitor, which analyzes linkages between market developments and industry trends.
- xxxviii. Consider adopting a functional supervision regulatory operations model.
- xxxix. Focus on strengthening the Commission's Business Continuity Process, enhancing its MIS, streamlining its procedures through Business Process Re-engineering, and a stronger risk based and IT audit function.
- xl. Strengthen financial disclosure and audit requirements for NBFCs to protect investors from fraud, insolvency, and misconduct.
- xli. Provide training to employees involved in investigations on "follow the money" and forensic accounting skills.
- xlii. Introduce prudential regulations requiring foreign intermediaries in Pakistan and offshore branches or subsidiaries or Pakistan intermediaries to meet the higher of either the home or host standards on AML/CFT.

## 1.6 Pensions

### 1.6.1 Vision

Encouraging all forms of occupational savings to become a more integral part of employment conditions in Pakistan, providing benefits and financial comfort for an increasing number of people while ensuring that the interests of participating members and those of employers are adequately protected.

### 1.6.2 Objectives

The following are the Commission's objectives in support of its stated vision for pensions industry:

- i. to make the Voluntary Pension System (VPS) a success in Pakistan;
- ii. to use the experience of VPS in developing the next stage of regulating all forms of occupational savings and long-term employer liabilities; and
- iii. to develop legislation governing occupational savings system, encompassing registration of savings schemes and defining minimum requirements on matters such as trustees, trust deeds, custody and custodians.

### 1.6.3 Current Status

Pakistan has a system of compulsory and voluntary occupational savings arrangements. Compulsory arrangements, applying to certain types of employees, include:

- i. employer and employee contributions to the Employees' Old-age Benefits Institution (EOBI), which pays a pension on retirement; and

- ii. gratuities established under the West Pakistan Industrial and Commercial Employment (Standing Orders) Ordinance, 1968.

Voluntary occupational savings arrangements include the following:

- i. occupational pensions - long term employer liability to pay an income at a future date usually from a stand-alone scheme;
- ii. provident funds - normally end of employment agreement to pay a lump sum, based on cumulative contributions and investment returns;
- iii. gratuities - normally period contracts to pay a lump sum, based on an agreed formula where the legislation does not mandate a gratuity; and
- iv. the upcoming arrangements under the Voluntary Pension System Rules, 2005 (VPS Rules) for employer arranged and individual membership, where the ultimate benefit will be income from an annuity or a drawdown method, not necessarily a pension.

The membership of each of these arrangements is limited and although no definitive data is available, any such saving arrangements outside large employers would be the exception. Within the rural community, any arrangements are virtually non-existent.

The existing system of occupational savings may be seen as complex, with a mix of private sector arrangements and obligations and pensions made under the EOBI, as well as the upcoming products under the VPS Rules plus a comparable mix of types of benefits in the public sector. Private sector obligations are sometimes funded, whereas occupational public sector obligations are normally made on a pay as you go basis.

Although elements of a regulatory structure exist, there is no one body which is able to act as regulator or follow a role of developing the occupational savings markets. Hence, these are roles that the Commission would be expected to adopt.

The legislation determining the structure of private sector occupational savings is varied. The existing system of private sector occupational savings schemes has evolved over many years, with interest and involvement of the Ministry of Finance, the Ministry of Labor and CBR, and, more recently, of the Commission.

Under the Rules of Business 20(2)(a), the Ministry of Labor is responsible for “Legislation relating to the welfare of labor; conditions of labor, provident fund... pensions; old age pensions.” CBR acts as quasi regulator, while considering cases of companies looking for tax relief on contributions, to ensure that provident funds, approved superannuation funds and gratuity funds follow an extensive series of rules, under Chapter XV of the Income Tax Rules, 2002 and the Sixth Schedule, Part II of the Income Tax Ordinance, 2001. There is no mention of the words pension or pension scheme in these two parts of the legislation.

An employer's obligation to pay gratuities or make payment from a provident fund is established under the West Pakistan Industrial and Commercial Employment (Standing Orders) Ordinance, 1968.

The role of the Commission as a pension regulator in Pakistan is not well defined, being a brief reference in the SECP Act, as amended by the Finance Act, 2003. Subsequent to this amendment, the VPS Rules were introduced on 27 January 2005, under powers conferred by Section 282B of the Companies Ordinance. In addition, the Commission has the following powers under different laws with respect to occupational savings:

- i. power to make investigations under Section 227 of the Companies Ordinance where companies that have provident funds are obliged to make contracted contributions;
- ii. the role of approving annuity products under Section 63 of the Income Tax Ordinance, 2001; and
- iii. under Section 227 of the Companies Ordinance where an employees' provident fund may invest in certain types of securities, the power to prescribe the conditions on listed securities.

## 1.6.4 Strategic Initiatives

The Commission's strategy for regulation and development of VPS and, eventually, all forms of occupational savings is as follows:

- i. Dedicated resources would be committed to make VPS a success.
- ii. The experience in VPS will be used to develop the next stage of regulating all forms of occupational savings and long term employer liabilities.
- iii. A program would be developed to collect and publish information on all forms of occupational savings and long term employer liabilities to become the authority on the subject as well as help in Government policy objectives.
- iv. Develop legislation enabling the Commission to be the pensions regulator, taking on the relevant parts of the Income Tax law that governs the role of CBR, requiring: that all occupational savings schemes must register as such with the Commission; that no occupational savings scheme that is illegal would be operated; that the Commission may impose conditions of registration through the Occupational Savings Scheme Rules; and defining minimum requirements on matters such as trustees, trust deeds, custody and custodians.
- v. The pension regulatory powers will address minimum standards and controls to address the risk factors described above, allowing the Commission to monitor and ensure that such standards are being followed, with the understanding and support of industry participants.
- vi. Encourage the development of corporate trustees and their capabilities, including the calculation of net asset values (NAV) and those involved in record keeping and administration, and the regulation of custody, either by qualified corporate trustees or banks.
- vii. Update the Trustees Act, 1882 to take account of the broader role of trustees.
- viii. The Commission will work closely with the Ministry of Labor, the Ministry of Finance and CBR in developing a holistic framework for regulation of occupational savings.

## 1.7 Islamic Financial Market

### 1.7.1 Vision

The development and innovation of Shariah compliant products and services, in parallel to conventional financial market, as viable investment alternatives and their effective regulation for investor protection within a harmonized international framework.

### 1.7.2 Objectives

The Commission has set out the following objectives for achieving its vision:

- i. to develop system and resources necessary as the apex regulator of takaful, Islamic capital market and other non-bank financial institutions (NBFIs);
- ii. to facilitate product development and innovation and create an orderly market for Islamic capital market products;
- iii. to standardize, to the extent possible, principles and objectives of regulation and operation of Islamic finance in coordination with relevant jurisdictions; and
- iv. to build capacity of managers and intermediaries for introducing Shariah compliant products and operating Islamic financial institutions.

### 1.7.3 Current Status

The Islamic financial system broadly refers to financial market transactions, operations and services that comply with Islamic rules, principles and codes of practices. The laws and rules of the religion require certain types of activities, risks or rewards to be either prohibited or promoted. While Muslims undertaking financial transactions

are encouraged to use financial instruments that comply with these rules, other investors may find the appeal of these instruments from an ethical standpoint.

Modern Islamic financial products and services are developed using two different approaches. The first approach is by identifying existing conventional products and services that are generally acceptable to Islam and modifying as well as removing any prohibited elements so that they are able to comply with Shariah principles. The second approach involves the application of various Shariah principles to facilitate the origination and innovation of new products and services.

Modern Islamic finance began with the emergence of Islamic banking, where products and services are not based on *riba* (interest). As the industry grew, many other financial products in the insurance and capital market sectors were adapted to incorporate Shariah-compliant aspects. Product innovation has been significant in the Islamic financial services industry over the last decade, resulting in a wide array of Islamic instruments being introduced in the market.

During the last three decades, the Government has taken a number of measures to promote Islamic institutions and products in pursuance of national policy. On the basis of deliberations and recommendations of various committees, both the Commission and SBP have introduced a number of Islamic institutions and products and are keen to develop this segment as a key element of the financial sector in the country.

The Commission has regulatory jurisdiction over modarabas, which were structured in early 1980s to mobilize funds for deployment in activities consistent with Shariah. Presently about thirty modarabas are in operation with assets of Rs. 22 billion. The Commission has also formulated rules for regulation of takaful (insurance based on Islamic economic principles) and issued provisional license to an institution. TFCs, Participation Term Certificates and Musharaka Certificates have been developed as capital market instruments. Leasing has been developed as a NBFC and is gaining increasing popularity. Presently, twenty-three leasing companies are in operation with assets of Rs. 45 billion.

SBP has taken concrete measures for promoting Islamic banking and has established an Islamic Banking Department. Its strategy for promotion of Islamic banking includes establishment of full fledged Islamic banks in the private sector, setting up subsidiaries of commercial banks and allowing stand-alone branches for Islamic banking in the existing commercial banks.

Despite the national commitment and the efforts made, the number of Islamic products and services available in the country remain limited. There is a need for developing wide range of innovative institutions and products to be offered to the general public. Some surveys undertaken have indicated preference of a large percentage of population in Pakistan for Islamic products. The market for Islamic products is also growing in other countries, particularly in the Middle East and the Gulf, indicating a vast potential which remains untapped. Countries like Bahrain and Malaysia are according high priority to Islamic finance and host a large number of Islamic institutions. Bahrain, which has twenty-six Islamic financial institutions has developed regulatory infrastructure for such institutions and has practically become the centre for Islamic Finance.

#### 1.7.4 Strategic Initiatives

##### i. Regulation by the Commission

In order to effectively regulate and develop Islamic financial market in Pakistan, the Commission would undertake the following:

- Dedicate resources exclusively devoted to research, promotion and regulation of Islamic financial products. They would work closely with the Islamic Banking Department of SBP as well as the industry and academic institutions.
- Develop regulatory capacity and infrastructure to regulate and supervise Islamic financial products and services, particularly enhancement in terms of systems development and effective monitoring and enforcement procedures.

- Among other functions, develop regulatory, legal and reporting framework for Islamic institutions and products.
- Networking with other jurisdictions, particularly Bahrain Monetary Agency and Securities Commission of Malaysia which are engaged in similar work.
- Coordinate with international Islamic organizations, particularly the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), International Islamic Financial Market and Islamic Development Bank.
- Develop linkages with major multilateral organizations, like Organization for Economic Cooperation and Development (OECD), as well as with international standard setters or international regulatory bodies, like IOSCO, to ensure greater acceptability of Islamic products by non-Muslim international investors who provide much needed liquidity.
- Encourage interaction among Islamic financial institutions, Shariah scholars and jurists to facilitate discussion and collaboration.
- Provide training to employees involved in investigations on “follow the money” and forensic accounting skills.
- Enhance regular on-site supervision of covered financial institutions to ensure that requirements for record keeping are being effectively implemented.
- Introduce prudential regulations requiring foreign intermediaries in Pakistan and offshore branches or subsidiaries or Pakistan intermediaries to meet the higher of either the home or host standards on AML/CFT.

## ii. Product Development

To meet the liquidity requirements and cater to the risk profile of various investors, following steps would be undertaken:

- Development of innovative Shariah compliant institutions, products and services in order to deepen the capital market and attract both national and international pool of resources.
- Development of secondary market for Islamic financial products.
- Encourage development and widespread use of takaful.
- Strengthen the institutional framework for modarabas, encourage consolidation and encourage new entrants.
- Promote geographical and product diversification by modarabas.
- Promote investor awareness on Islamic products to highlight specific differentiating features of Islamic financial market products.

## iii. Islamic Finance Law

While significant headway towards developing Islamic accounting, auditing and governance standards has been made, a legal framework for the development, operation and regulation of Islamic financial services has still not been formulated. It is time now to consolidate all efforts into one set of laws, principles and objectives that adequately address the distinctive nature of Islamic financial services industry and development of Islamic financial products and market players. The steps contemplated in this regard are as follows:

- Active contribution towards the development of a model law on Islamic finance, by joining hands with other Islamic countries.
- Make the new set of legal framework comprehensive and include all legal and regulatory aspects of contract law, company law, banking law, bankruptcy and insolvency law, tax law and securities law.
- Pool together experiences in the area of Islamic finance from various jurisdictions to make it effective, sustainable, robust and modern.
- To the extent possible, converge Shariah interpretations and Shariah compliances to allow global acceptance of products and services.

- Set unified principles and objectives for development and regulation of Islamic banking, takaful and Islamic capital markets through the model Islamic Finance Law, which would aid in standardization of Islamic financial services in Muslim countries.
- Create a level playing field between conventional finance and Islamic financial services industry.
- For dispute resolution, include expeditious redress systems vis-à-vis judicial relief. Through adoption of unified legal framework based upon model Islamic Finance Law, expeditious dispute resolution would be possible not only in domestic legal systems but also in case of cross-border disputes.

#### iv. Reporting Framework

A robust financial reporting framework for the Islamic financial services industry would be adopted to ensure transparency as well as consistency with globally accepted standards in the following manner:

- Apply International Accounting Standards (IASs) in areas that are not covered by AAOIFI accounting standards.
- Ensure that the auditing profession develops the necessary expertise to conduct audits on Islamic financial institutions and intermediaries.
- Require auditors to provide reasonable assurance that Islamic capital market transactions and products comply with Shariah principles, in addition to complying with the applicable accounting standards.
- Develop a reporting framework for entities engaged in Islamic as well as conventional products and services.

#### v. Capacity Building of Professionals and Intermediaries

Significant steps for enhancing skill set of professionals and intermediaries would include:

- Establishment of dedicated training institutes on Islamic finance, either in collaboration with, or as part of, existing training institutes. A significant step in this direction would be the formation of separate units catering for various sectors within the Islamic financial market.
- Fit and proper test for management and intermediaries to include knowledge of and expertise on Islamic financial products.

#### vi. Policy Initiatives

It would be important to coordinate with concerned authorities to prioritize development of Islamic financial market at the national level. This may be achieved through:

- Inclusion of development of Islamic financial markets in the medium term development framework of the Government.
- Addressing specific tax issues pertinent to Islamic capital market products and services in order to eliminate inconsistencies and uncertainties in the tax treatment between Islamic and conventional capital market transactions.
- Allowing fiscal and monetary relief to encourage participation of conventional issuers and investors in Islamic financial markets.

## 1.8 Professional Services

### 1.8.1 Vision

Development of sound and independent professional services to the corporate and financial sectors, within an effective regulatory framework and catering to the needs of all stakeholders.

## 1.8.2 Objectives

In achieving its vision, the Commission has identified the following objectives:

- i. uniform regulation of all professional service providers;
- ii. ensure proper standards of conduct and professionalism in the services provided;
- iii. inculcate continuing professional development (CPD) of all financial service providers; and
- iv. ensure consistency of treatment of similarly situated intermediaries.

## 1.8.3 Current Status

### i. Accountants

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

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 a company secretary 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 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. Recently, the Commission issued a Code of Ethics for credit rating companies to govern their professional dealings and conflict of interest situations.

#### 1.8.4 Strategic Initiatives

In order to deal with the challenges facing the professional services, the Commission shall undertake the following initiatives:

i. Legal Framework

The laws and regulations governing each class of service provider shall be reviewed and strengthened in the following manner:

- Review the applicable legal and regulatory framework governing professional service providers and develop/revise it in line with international best practices and local circumstances. The updated framework would provide for minimum entry standards, prudential and ongoing capital requirements,

standards for operational conduct as well as recourse in case of inadequate performance of an intermediary.

- Ensure that the legal and regulatory framework applicable to professional services is uniform and consistent. It should allow the Commission to maintain oversight of professional service providers. In this regard, the Commission should also have the regulatory authority to impose administrative sanctions as well as introduce licensing requirements for intermediaries.
- Ensure adequate ethical standards and independence of professional service providers through issuance of codes of ethics.
- Review and rationalize professional tax levied at federal and provincial levels.

## ii. Self Regulation

At present, only the stock exchanges, ICAP, and ICMAP act as SROs among the professional service providers in Pakistan. There are some professional services that have representative associations, either local (like surveyors) or as affiliates/chapter of foreign bodies (like financial analysts). Others have no institutional representation at all, like administrators, receivers or liquidators. In such a scenario, the Commission considers it expedient to:

- Encourage existing SROs to strengthen regulation of members by ensuring compliance with codes of ethics and other binding regulations, investigating cases of professional misconduct, and initiating disciplinary actions either themselves or through referral to the apex regulator.
- Encourage all professional service providers to form representative associations.
- Work with representative bodies to develop strenuous ethical codes and monitor their observance.
- Develop a system whereby the first stage of investigation proceedings against any member are conducted by persons not related to the concerned profession.
- Consider self-regulatory structure for such representative associations as their monitoring and investigative processes mature and their reputation improves. However, caution would be exercised in allowing self-regulation to avoid compromising on the quality, independence and integrity of services.

## iii. Licensing

The Commission would lay down minimum licensing requirements for professional services, being overseen by it, in the following manner:

- Prescribe qualification requirements for all professional service providers, which would entail passing a certification examination.
- Prescribe guidance to ensure adequate ethical standard and independence of professional service providers.
- Work with industry associations in either developing the curriculum for concerned class of service providers or outsourcing to a reputed examination institute. This would be accompanied with study guides and teaching guides, which contain examples and case studies in Pakistan's context.
- The syllabus would cater to intermediaries' generic knowledge relevant to the products and the markets in which they operate and specialist knowledge about the specific products they deal in and the markets in which they operate.
- The syllabus designed would meet the particular needs of the market in Pakistan. In the meantime, it should, as far as practicable, be in line with the syllabi developed by institutions in other market places. This would enable future courses run in Pakistan to be recognized by overseas institutions.
- Relevant information and knowledge of AML, relevant to the field of expertise, would be included to enable intermediaries and experts to guide their clients on AML as well as detect and report suspicious transactions.
- Review and update syllabus to reflect new market developments.

- Issue a license to the intermediary, upon passing the examination and satisfying other conditions for grant of license. The entities under the supervision of the Commission are both corporate and individual. Individuals need to be qualified and for corporate entities, both the directors and relevant employees must qualify.
- Encourage individuals to adopt corporate status, as appropriate, to formalize their business operations and enhance quality of their services.
- Develop exemption criteria and ensure that the criteria are strictly followed in all cases to allow exemption to an intermediary. Senior exchange member-firm owners may be given exemption from certification examinations as long as they can demonstrate that they have qualified staff and that no instances have occurred in which their clients have been abused. However, even these exempted senior members would have to demonstrate attendance on prescribed courses.
- Monitor compliance with the qualification and licensing requirements and upon observing non-compliance, suspend or cancel license, or take other enforcement action, depending on the nature of the breach.

#### iv. Ensuring Quality Education at College Level

The Commission would work with representative bodies and SROs to enhance quality and relevance of education at college level. This would be achieved through the following measures:

- Require all intermediaries to complete approved educational courses. Basic foundation level would be mandatory for all. There would be advanced-level courses for management/supervisory staff as well as for directors of companies, emphasizing on management issues, high level applications of regulatory, technical and ethical standards, risk management and control issues and so on.
- Personnel of licensed intermediaries who are delegated the authority and responsibility to supervise the actions of others, which may influence the investment decisions of clients, must have attended the advanced level courses.
- Other staff and agents would attend programs at a basic level.
- Develop distance learning and e-based programs so as to expand the geographical spread.

#### v. Training of Members

The Commission would encourage representative associations of professional service providers to introduce mandatory CPD for their members to enable them to carry out their duties competently and professionally. The objectives of CPD would be to:

- Ensure that market intermediaries possess professional and technical knowledge and that the knowledge is kept up to date to meet the changing requirements of the markets.
- Encourage awareness programs among accountants for improving the degree of compliance with the International Financial Reporting Standards.
- Provide investors with the comfort of knowing that the licensed persons they may wish to deal with have the necessary skills, experience, knowledge and ethical standards to give them the best advice and service.
- Develop the international recognition of Pakistani professionals as meeting the highest professional standards comparable with the other markets.

vi. Enhancing the Commission's Capacity to Regulate

The Commission should further strengthen its capacity to maintain effective oversight of all intermediaries and professional service providers. Appropriate mechanisms would be developed to ensure independence of intermediaries and availability of necessary enforcement mechanisms in cases of violations. The following further actions would be taken:

- Develop a system of independent oversight of the auditing profession and establish a 'Financial Reporting Oversight Unit' within the organizational framework of the Commission.
- Encourage more credit rating companies to set up their offices in Pakistan.
- Encourage export of professional services.





# The Organization



**SECURITIES AND EXCHANGE  
COMMISSION OF PAKISTAN**

## 2 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 capital market in Pakistan.

The present Chairman, Dr. Tariq Hassan, was appointed to the position in August 2003. In addition to the Chairman, the Commission comprised four Commissioners as on 30 June 2005.



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 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 has specialized in bank finance while working in a leading Wall Street law firm in New York after completing his post graduate studies in the United States of America (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. 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 was the Managing Director of National Development Leasing Corporation prior to his appointment as Commissioner. During the year under review, Mr. Rizvi was the Commissioner in charge of the Professional Services and Policy Division. He completed his tenure as Commissioner in July 2005.



In November 2004, the Federal Government appointed Mr. Salman Ali Shaikh as Commissioner. Mr. Shaikh, who is overseeing the Specialized Companies Division, is a senior emerging markets banker, having over twenty-seven years of experience with leading banks in the country.



Mr. Rashid I. Malik, who joined the Commission in January 2005, oversees the Company Law Division and the Support Services Division. A Chartered Accountant (CA) by profession, Mr. Malik possesses over thirty years' experience in business operation, management, finance, and accounting in Pakistan as well as in the United Kingdom (UK).



Mr. Abdul Rehman Qureshi completed his tenure as Commissioner during the year under review. A lawyer by profession, he had been associated with the erstwhile Corporate Law Authority (CLA) since 1976.

## 2.2 Securities and Exchange Policy Board

While ensuring full autonomy of the Commission, the SECP Act provides that the Federal Government shall appoint the Securities and Exchange Policy Board (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, the composition of the Polity Board was as follows:



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



Mr. Nawid Ahsan  
Secretary  
Finance Division



Mr. Tasneem Noorani  
Secretary  
Commerce Division



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



Mr. Tawfiq A. Hussain  
Deputy Governor  
SBP



Mian Mohammad Anwar  
CEO  
Crescent Textile Mills Limited  
(retired on 4 January 2005)



Dr. Mohammad Zubair Khan  
Managing Director  
Financial Techniques Internationale



Dr. Shahida Jaffrey  
Vice Chancellor  
Sardar Bahadur Khan  
Women University



Mr. Zubyr I. Soomro  
Country Head  
Citigroup Pakistan

The Policy Board provides guidance to the Commission in matters relating to its functions and operational performance as well as for formulating 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. 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, three meetings of the Policy Board were held; however, four meetings of the Policy Board were held during the calendar year 2004 as per statutory requirement. The Board was apprised of the Commission's achievements, particularly in relation to demutualization of stock exchanges, the Task Force on rotation of auditors of listed companies and phasing out of COT/badla financing. Approval of budget of the Commission for the FY 2006 was obtained and salary scales of employees of the Commission were also restructured with approval of the Policy Board. The major issues discussed and decided in the meetings were as under:



Policy Board meeting in progress

- i. approval for reduction in transaction fee of stock exchanges/fees on NCCPL and CDC;
- ii. approval of policy guidelines for the appointment of advisers and consultants in the Commission;
- iii. briefing on report of the Task Force on rotation of auditors and the factors necessitating enforcement of a mandatory requirement in this regard;
- iv. briefing on report on Demutualization and Integration/Transformation of the Stock Exchanges;
- v. briefing on the situation of the stock market;
- vi. approval for suitable amendments in the Service Manual of the Commission;
- vii. briefing on the performance of the Commission for the FY 2004; and
- viii. approval of budget of the Commission for the FY 2006.

## 2.3 Bilateral Cooperation

During the year under review, the Commission took the initiative to establish the South Asian Securities Regulators Forum (SASRF). In May 2005, the Prime Minister of Pakistan chaired the signing ceremony of a MoU between the Commission and securities regulatory bodies of Bangladesh, Bhutan, Mauritius and Nepal. The MoU established a voluntary and cooperative body, the SASRF, for increasing mutual cooperation and exchange of information among the member countries.

The first meeting of the SASRF was subsequently held in Islamabad. During the meeting, Dr. Tariq Hassan, Chairman of the Commission and Mr. Deepak Raj Kafle, Chairman of the Securities Board Nepal were elected as the chair and vice-chair of the SASRF, respectively.

The Commission also signed a bilateral MoU with the Royal Monetary Authority of Bhutan in May 2005, which sets forth a statement of intent of the two regulators to establish a framework for mutual assistance. The MoU is expected to enforce/ensure compliance with the respective securities and futures laws and regulatory requirements of the two countries.



Mr. Shaukat Aziz, Prime Minister of Pakistan, chairing the signing ceremony of MoU for SASRF

In June 2005, the Commission entered into a MoU with the Australian Securities and Investments Commission. The MoU recognizes the increasing international activity in financial markets and the corresponding need for cooperation between the relevant national authorities. The MoU would help ensure compliance with the

respective securities and futures laws or regulatory requirements of Australia and Pakistan in addition to formalizing a framework that would facilitate the exchange of information.

The Coordination Committee of the Commission and SBP met regularly throughout the year. The meetings provided a forum to discuss areas of mutual concern and led to enhanced coordination between the two regulators.

During the year under the review, the Commission constituted a joint task force with CBR to study the tax structure for the corporate sector and recommend a corporate tax policy aimed at the promotion of corporatisation and progressive development of corporates in the country. The Task Force made detailed recommendations to CBR and the Commission; several of its recommendations were incorporated in the Finance Act, 2005.

## 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.

During the year, Mr. Abdul Rehman Qureshi - whose tenure as Commissioner had concluded - was appointed Adviser to the Commission. Mr. Mohammad Hayat Jasma acts as Secretary to the Commission. He has been associated with the Commission and the erstwhile CLA for over twenty-five years.



Commission meeting in progress

In addition to the Chairman's Secretariat and the Legal Department, the Commission operationally comprises of five Divisions. Each Division is sub-divided into Departments which are headed by Executive Directors. Presently, the Commission comprises the following five Divisions:

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





# Chairman's Secretariat



**SECURITIES AND EXCHANGE  
COMMISSION OF PAKISTAN**

## 3 Chairman's Secretariat

### 3.1 Operational Structure

#### 3.1.1 Structure

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

During the year, the CS was restructured to better align its functions and responsibilities. It comprises the following Wings:

- Internal Audit
- External

#### 3.1.2 Management Team

Ms. Jaweria Ather, Director, heads the External Wing while Mr. Arsalan Baig, Director, heads the Internal Audit Wing. Both Directors are CAs by profession and are assisted by suitably qualified and experienced professionals in the areas of internal audit, monitoring and compliance, external communication, and project management and execution.



Dr. Tariq Hassan (center), Chairman in a meeting with officers of the CS

### 3.2 Performance Review

The CS undertook focused efforts in diligently and efficiently pursuing its regular assignments as well as those assigned by the Chairman.

A risk-based internal audit approach was developed during the year and an Internal Audit Manual and an Internal Audit Charter were adopted to formalize the structure, processes and reporting of the internal audit function. Besides carrying out pre-audit of payment vouchers and purchases at the Commission, the Internal Audit Wing undertook reviews of internal control environment at CROs of the Commission and audits of Pension Fund and Gratuity Fund. It also followed-up its recommendations rigorously to assess the adequacy of actions taken by the management.

During the year, an Audit Committee was set up and the Internal Audit Wing was required to report to the same. This would help to raise the level of independence and streamline reporting of the internal audit function.

The CS undertook vigilant monitoring to ensure timely disposal of investors' complaints, queries and correspondence, either received at the Chairman's office or online through the Commission's website. During the year, the Monitoring and Compliance Unit received 179 complaints, petitions, and appeals. As many as 198 complaints, petitions and appeals were disposed off, including those brought forward from the previous year. In this regard, the Document Tracking System (DTS) facilitated the CS in standardizing complaint handling procedures for efficient and timely disposal. The DTS also allowed the CS to electronically review the status of any complaint and to identify those that had been pending for long.

During the year under review, the CS interacted with media on key measures and initiatives taken by the Commission. Regular statements were issued to media and press briefings of the Chairman were arranged as

necessary. This helped in maintaining a clear perspective on the reforms of the Commission as well as generating constructive feedback on its actions.

The CS initiated the development of an investor education program, which would involve television broadcasting of programs highlighting the various avenues for investment and the risks associated with them. This is expected to complement the Commission's existing efforts to participate in seminars and investment road shows.

During the year, the Commission entered into bilateral MoUs with securities regulators in Bhutan and Australia. Moreover, a multilateral MoU was signed by the Commission with securities regulatory bodies of Bangladesh, Bhutan, Mauritius and Nepal in May 2005. Through this MoU, SASRF was established to serve as a platform for regional cooperation. In cognizance of the increasing importance of such activities, a Foreign Relations Unit was set up within the CS to undertake dedicated efforts for liaison on regional and international levels.

The CS, in collaboration with the World Bank, developed a new project for capacity building of the Commission. During the year, the World Bank approved grant for the purpose under its Institutional Development Fund (IDF). The Commission also successfully concluded the research-based assignment for corporatization of SMEs, also funded by the World Bank.

The Project Management Unit undertook necessary activities under the ongoing projects for financial sector reforms, corporate governance, and AML. The consultancy assignment under the TA provided by ADB commenced during the year. Similarly, research study on the state of CSR in Pakistan was outsourced to an external consultant under the project on corporate governance, supported by the United Nations Development Program (UNDP). With respect to AML, the Commission participated in mutual evaluation carried out by the Asia/Pacific Group on Money Laundering (APG) to assess the risks of money laundering and the level of preparedness of the financial sector in Pakistan.

The PICG was established during the year as a not-for-profit company, limited by guarantee and without share capital, licensed under Section 42 of the Companies Ordinance. The CS took a leading role in its establishment and was, subsequently, collaborating with its management team to make PICG fully operational at the earliest.

### 3.3 Internal Audit

The Internal Audit Wing serves as an independent appraisal function within the Commission. It works in accordance with an Internal Audit Manual and an Internal Audit Charter, which were approved for the purpose during the year under review. The Internal Audit Manual outlines the standards, guidelines, and procedures for the Internal Audit Wing and encompasses a risk-based audit approach.

The Internal Audit Wing examines and evaluates functions and activities of the Commission as well as assures the management of adequacy of controls and adherence thereto. It recommends/advises the management on the relationship and balance between risk and control and assists in ensuring that:

- i. resources are being used effectively and efficiently;
- ii. assets are adequately safeguarded;
- iii. management information is accurate and reliable; and
- iv. policies, procedures and regulations of the Commission are being complied with.

During the year, the Internal Audit Wing carried out the following major activities:

- i. review of payroll processing, petty cash management, revenue collection, travel, procurement and administration functions;
- ii. audit of Gratuity Fund and Pension Fund for the Commission's employees;
- iii. pre-audit of all payment vouchers at the head office;
- iv. pre-audit of purchases in excess of Rs. 50,000;
- v. monthly review of budget allocations and utilization;

- vi. review of the efficacy of monthly MIS reports and annual accounts of the Commission;
- vii. post-audit of transactions of Human Resource Wing, Administration Wing and Finance Department of the Commission;
- viii. analyzing the control environment at CROs; and
- ix. special investigations.

At the end of each audit assignment, a report of observations and recommendations was prepared for the review of the Chairman and the concerned Commissioner and for necessary action by the Departmental head. Adequate follow-up was maintained to monitor progress of actions taken in response to significant audit concerns.



Officers of the Internal Audit Wing in a meeting

With a view to streamlining reporting process of the Internal Audit Wing in line with best practices, the Internal Audit Wing has been reporting functionally to the Audit Committee and administratively to the Chairman with effect from July 2005. In this regard, an Audit Committee was set up during the year under review, comprising Mr. Abdul Rehman Qureshi, Adviser to the Commission as chair and Mr. Mohammed Hayat Jasra, Secretary to the Commission and Dr. Sajid Qureshi, Executive Director as members.

### 3.4 Monitoring and Compliance

The Monitoring and Compliance Unit within the CS ensures expeditious resolution and disposal of investors' complaints as well as correspondence received at the Chairman's office through regular follow up.

Table 1 below shows that altogether 179 complaints, petitions and appeals were received by the CS during the year, as against 414 receipts during the previous year. Of these and the thirty-nine complaints, petitions and appeals brought forward from last year, 198 complaints, etc. were disposed off while twenty were outstanding at the end of the year.

Table 1: Disposal of Complaints, Petitions and Appeals (1 July 2004 - 30 June 2005)

S. No.	Receipts	Brought Forward	Received	Total	Disposed Off	Outstanding
1	Complaints	26	147	173	160	13
2	Petitions	1	-	1	1	-
3	Appeals	12	32	44	37	7
	Total	39	179	218	198	20

The complaints received by the CS during the year were significantly less compared to the previous year, largely as a result of decentralization of the complaints receiving system. For the purpose, an automated document tracking and management system was implemented throughout the Commission. Complaints of a similar nature were referred to a focal person within each Department to achieve uniformity in responses and timely disposal. The DTS enabled the CS to electronically review the status of any complaint and to highlight those that had been pending for long.

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

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	-	3	3	3	-
2	Transfer of shares under Section 76 of the Companies Ordinance	6	18	24	24	-
3	Verification of transfer deeds	-	10	10	10	-
4	Payment of dividend under Section 251 of the Companies Ordinance	-	22	22	22	-
5	Non-receipt of annual and half-yearly accounts	-	12	12	12	-
6	Complaints against brokers	10	40	50	38	12
7	Miscellaneous	10	42	52	51	1
Total		26	147	173	160	13

The online link established via the Commission's website for electronically lodging complaints was frequently visited by investors as well as the general public. The complaints and queries, received through this link, were expeditiously responded to in coordination with the concerned Departments.

### 3.5 Media and Public Relations

During the year under review, the Media and Public Relations Unit proactively disseminated information pertaining to key measures and initiatives taken by the Commission. It maintained close liaison with the print and electronic media on significant issues. In this regard, regular statements issued to media helped provide wide coverage of the Commission's reforms process while generating feedback from media and the public. Constructive feedback on the reform measures assisted in aligning them to the needs and demands of the concerned stakeholders.

The Media and Public Relations Unit remained vigilant to the media coverage of events pertaining to the capital market and corporate sector. In March 2005 and subsequently, it remained watchful of investor concerns, as appearing in media, and provided necessary information about the Commission's measures in view of the stock market situation.

During the year, press briefings of the Chairman on key issues were arranged from time to time. Moreover, requests for interviews of the Chairman were duly entertained. Meaningful interaction with media helped in deterring speculation and providing a clear perspective on the actions of the Commission.

### 3.6 Investor Education and Publications

Investor awareness/education is of primary importance to the growth and development of the capital market and financial sector. Educated investors, who are able to make informed judgments regarding their investments, are more apt to invest in financial products, thereby promoting higher levels of savings and efficient allocation of capital. Moreover, investor education helps regulators and other financial market participants in achieving the

critical goal of protecting investors while also helping to build investor confidence in securities markets and financial sector.

In order to enhance investor education, focused efforts were initiated by the Commission and it was decided to prepare a series of television programs for the purpose. During the year, the CS completed conceptual phase and finalized the design of the programs. The programs would help investors make informed choices about financial products and investments and also create awareness of the regulatory safeguards that are in place to protect legitimate interests of investors.

During the year under review, the Commission proactively participated in seminars and investment road shows in various cities of the country to highlight the importance of capital market and risks and rewards associated with investing in the same. The Chairman also undertook visits to various chambers of commerce and industry across Pakistan in an effort to encourage businesses to come to the corporate fold.

The CS prepared periodic newsletters to highlight the achievements of and developments at the Commission. The various issues of the newsletter can be accessed through the Commission's website. Other publications of the Commission for the year under review included Single Member Company Guide (in Urdu), Company Mortgages and Charges Guide, and revised and updated version of the Promoters' Guide.

### 3.7 Foreign Relations

The Foreign Relations Unit has been established to centralize coordination with multilateral and international organizations as well as initiate specific assignments in coordination with these organizations. During the year, the Commission became a member of the IAIS and the Asia Pacific Corporate Registers Forum (APCRF). It was already a member of IOSCO and the International Organization of Pension Supervisors (IOPS).

The CS successfully liaised with counterpart regulatory authorities in Bhutan and Australia for entering into MoUs. Bilateral agreements with the Royal Monetary Authority of Bhutan and the Australian Securities and Investments Commission were signed by the Commission in May and June 2005, respectively. In addition, a multilateral MoU was agreed to between the securities regulators of the South Asian region to form SASRF. This would serve as the forum to promote cooperation, facilitate sharing of information and encourage harmonization of regulations and policies between South Asian securities regulators. All concerned jurisdictions, other than India, Maldives and Sri Lanka signed the MoU in May 2005; as of the close of the year, the securities regulators of the remaining countries were in the process of seeking necessary clearance and approvals for signing the MoU.



Discussion being held by officers of the CS

### 3.8 Project Management

The Project Management Unit executes donor-funded projects and assignments of the Commission. During the course of the year, the CS successfully concluded the research-based assignment for corporatization of SMEs. It also developed a new project for capacity building of the Commission, particularly with regard to professional services and policy making. The project was endorsed by the World Bank and grant for the purpose was approved during the year.

At the end of the year, three projects of ADB, UNDP, and the World Bank focusing, respectively, on regulation and governance of financial (non-banking) sector, promotion of corporate governance, and institution of AML measures were in progress. In addition, the Project Management Unit was working in close collaboration with the newly established PICG to make it fully operational at the earliest.

### 3.8.1 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-bank financial market through reform, capacity building and international private sector participation.

Under the FMGP, the Commission is the executing agency for one of the 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, NBFs and insurance companies. The outputs of the consultancy assignment focus on the following four components:

- i. upgrading of the legal and regulatory framework;
- ii. support for development of NBFs 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, NBFs, insurance, and pensions; and
- iv. establishment of sustainable mechanisms for skills development and training.

During the year under review, the consultancy contract under the TA was awarded to International Securities Consultancy Limited, which had emerged as the first-ranked firm on the basis of detailed technical evaluation and contract negotiations. The consultancy assignment commenced in August 2004 with the fielding of several international and domestic consultants at the Commission's head office in Islamabad. It is expected to last till December 2005.

The consultants, on a quarterly basis, delivered suitable outputs within the four components. Over the course of the year, a number of reports were submitted to propose recommendations for amending the legal structure as well as development of the sectors under the Commission's purview. These reports were supplemented with presentations to the Commission. After necessary review and discussions with consultants, the Commission accorded approval to each of the quarterly reports.

The consultants also developed a detailed program of in-country workshops and seminars for the Commission and market participants. The program, which includes over seventy sessions covering various aspects of the financial sector, commenced towards the end of the year under review and would run at regular intervals till the end of the consultancy assignment.

In order to raise stakeholder awareness on corporate governance, the Commission - in collaboration with the Lahore University of Management Sciences (LUMS) - organized the Second Annual Conference on Corporate Governance in Pakistan under the aegis of the TA. The Conference took place on 3-4 June 2005 at LUMS in Lahore. One of the main objectives of this Conference was to bring to the forefront stimulating discussion on various aspects of corporate governance, including corporate governance in the financial sector and the capital market.

### 3.8.2 Project on Corporate Governance

The project to develop and implement good corporate governance practices and promote CSR in Pakistan was undertaken with the technical and financial assistance of UNDP. A result-oriented project, it successfully built upon its first phase, which had concluded in July 2003. Details of activities undertaken during the year are given below.

- i. Research Study on CSR

A research study was started to determine the need for CSR in Pakistan, identify on-ground CSR practices in a wide range of companies, understand their perception of CSR, and threats and opportunities in this regard. The study, titled "Evaluation of the State of Corporate Social Responsibility in Pakistan and Determining Strategy for



Implementation,” was being carried out by an external consultant as of the close of the year. This study would recommend a strategy to effectively implement CSR in the country and assist in ascertaining the direction of future endeavors.

## ii. Corporate Scorecard

During the year under review, a draft corporate scorecard was prepared by the CS, with a view to assist both local and international institutional investors in evaluating the performance of companies in specified areas against targeted benchmarks. Preliminary discussions were held with certain institutional investors in the country and the draft scorecard was suitably revised on the basis of their comments. Subsequent to the close of the year, the revised scorecard, along with a user guide, were placed on the Commission's website and sent to various institutions for soliciting comments. After incorporating the relevant comments, the final corporate scorecard would be shared with institutional investors.

## iii. Capacity Building

The Commission subscribed to a reputed international journal, dealing with topical issues on corporate governance. This helped to enrich understanding on key developments and challenges in the area.

In order to enhance understanding of regional issues and trends in corporate governance, an officer of the Commission attended the 2005 IOSCO Emerging Markets Regional Training Seminar organized by the Financial Supervisory Commission of Taipei on 24-25 February 2005 in Chinese Taipei. Moreover, two officers of the Commission participated in Regional Conference of ICAP and the Institute of Chartered Accountants of India held in Lahore in January 2005. Another officer attended the Conference of South Asian Federation of Accountants, held in Karachi in May 2005.

### 3.8.3 PICG

The PICG was set up in public-private partnership as a company, limited by guarantee and without share capital, on 1 December 2004. It has been licensed under Section 42 of the Companies Ordinance.

The founding members of PICG include the following:

- i. the Commission;
- ii. SBP;
- iii. Federation of Pakistan Chambers of Commerce and Industry;
- iv. Overseas Investors Chambers of Commerce and Industry;
- v. KSE;
- vi. LSE;
- vii. ISE;
- viii. Institute of Business Administration;
- ix. LUMS;
- x. IAP
- xi. Investment Banks Association of Pakistan;
- xii. Leasing Association of Pakistan;
- xiii. Modaraba Association of Pakistan;
- xiv. Mutual Funds Association of Pakistan;
- xv. Pakistan Banks' Association;
- xvi. ICAP;
- xvii. ICMAP;
- xviii. Institute of Corporate Secretaries of Pakistan; and
- xix. Institute of Chartered Secretaries and Managers.

The CS played a key role in facilitating the establishment of PICG. It is also actively collaborating with the interim management of PICG to make it fully operational. The objective is to enable PICG to undertake activities geared towards achieving good corporate governance in the country and creating an enabling environment for effective implementation of the Code of Corporate Governance. It is expected that PICG would be involved in training and education, creating awareness, undertaking research, publishing guidelines and other resource material, and being a forum for discussion on corporate governance in Pakistan.

### 3.8.4 AML

The CS undertakes necessary activities for establishing AML measures in the corporate and financial sectors in Pakistan, under the World Bank's TA for banking sector reforms. It also coordinates and liaises with relevant agencies, both locally as well as internationally, to further propel its AML agenda.

During the year under review, the CS liaised with various agencies to share with them the AML measures instituted by the Commission. Notable achievements were as follows:

- i. The Commission, along with other stakeholders, underwent a mutual evaluation by APG. The evaluation was geared towards assessing Pakistan's legal, law enforcement, and regulatory framework in respect of AML and CFT. As part of the evaluation process, which began in August 2004, relevant information pertaining to the Commission was provided by the CS on a detailed criterion-by-criterion worksheet. Subsequently, APG's evaluation team visited Pakistan and had detailed discussions with stakeholders, including the Commission. In April 2005, APG circulated the draft Evaluation Report for Pakistan. The draft report *inter alia* appreciated the initiatives taken by the Commission to combat money laundering in various areas under its regulatory ambit. Certain recommendations to strengthen the AML framework were also provided. The Commission and various stakeholder institutions in Pakistan reviewed and commented on the report, which was adopted in the annual meeting of APG held subsequent to the close of the year under review.
- ii. The second meeting of the Consultative Group on Anti-money Laundering (CGAML) was held in August 2004. The CGAML serves as a forum for policy guidance on AML and comprises representatives from public and private sectors. Participants of the second meeting agreed that concerted efforts should be undertaken by all concerned, including the regulatory authorities, enforcement agencies and financial and corporate sectors, in designing an appropriate AML framework.
- iii. A mission of the World Bank visited the Commission in October 2004 to gauge its performance on AML. In this regard, a detailed presentation on the AML initiatives of the Commission was delivered. The assessment report concluded that performance of the Commission, over the last year, was impressive and satisfactorily in line with the objectives of the World Bank's TA. It was, however, emphasized that the Commission should focus on more aggressive capacity building activities.
- iv. A team comprising representatives of the European Commission visited the Commission in October 2004 and discussed various issues concerning AML regime. They also discussed the strategy needed to combat money laundering and terrorist financing in Pakistan. This was followed by a Swiss fact-finding mission regarding AML measures in Pakistan in May 2005. A detailed presentation was made to the mission about AML measures introduced by the Commission. The mission expressed appreciation of the initiatives of the Commission to meet international standards on AML.

In order to create awareness on significant AML issues, the CS issued a Brief Series on "Role and Responsibilities of Compliance Officers". This issue, along with earlier ones, are available on the Commission's website.

As part of the Commission's capacity building initiative, two of its officers attended a 'Financial Crime Summit' from 6-8 April 2005 in France. The Summit was organized by three leading solution providers in the financial services arena, namely, Unisys, NetEconomy and Ingenisis. During the course of the Summit, discussion on the



trends/issues on financial crime in Europe and introduction to necessary solutions (systems) for financial institutions took place.

### 3.8.5 Corporatization of SMEs

During the course of the year, the research study on evaluation and simplification of company registration laws and procedures for corporatization of SMEs was completed. The study, carried out by an external consultant, included four deliverables:

- i. Strategy Report;
- ii. Review of the Legal and Regulatory Framework for Corporatization of SMEs;
- iii. Fiscal and Non-Fiscal Barriers to SME Growth, CRO and the Commission's Services and the Relevant Policy Framework; and
- iv. Overall Recommendations Report.

The study was funded by the World Bank under IDF grant to the Ministry of Industries and Production (MoIP). The Commission closely administered the assignment and offered comments on the consultant's reports before they were finalized and sent to MoIP. Upon conclusion of the consultancy assignment in December 2004, MoIP arranged a workshop in Islamabad wherein findings of the study were discussed with a range of stakeholders.

### 3.8.6 Capacity Building of the Commission

During the year under review, the World Bank approved a grant to the Commission under IDF. The objectives of this grant are to:

- i. strengthen the Commission's abilities to build a facilitative and cohesive legal framework for sectors under its purview; and
- ii. develop independent and high-quality professional service providers and encourage a greater role of SROs in the markets.

The Letter of Agreement to initiate the project was due to be signed subsequent to the close of the year.

## 3.9 Annual Plan

### 3.9.1 Work in Progress

- i. Medium Term Strategy

As of the close of the year, the CS was in the process of compiling and refining the medium term strategy of the Commission for regulation and development of corporate and financial (non-banking) sectors. The blueprint, developed earlier by the Commission, served as the starting point of the medium term strategy. It would be based on Divisional plans for the sectors regulated by them, input of the concerned industry associations and professional organizations, draft plans prepared by the consultants under ADB's TA for strengthening regulation, enforcement and governance of non-banking financial markets, recommendations of the Financial Sector Assessment Program carried out last year by the joint mission of the World Bank and IMF, as well as recommendations made in earlier reports on the insurance sector.

- ii. Investor Education Program

In continuation of the work initiated during the year, a pilot program would be produced, followed by production and telecasting of programs targeting investor education. Nationwide telecasting of these programs would ensure outreach to a vast audience.

iii. Report on the Observance of Standards and Codes - Corporate Governance Assessment for Pakistan

A mission for assessment of corporate governance standards and practices in Pakistan visited the Commission in connection with the joint IMF and World Bank program on Reports on the Observance of Standards and Codes (ROSC). The ROSC program benchmarks corporate governance practices against international standards and ensures consistency of policy recommendations across regions. The CS provided necessary information to the mission in this regard.

As of the close of the year, the draft report was in the process of compilation.

### 3.9.2 Future Plans

The following activities would be undertaken during the coming year:

- i. to monitor quality and timeliness of actions taken by various Departments in a sample of cases;
- ii. to develop a media strategy;
- iii. to hold road shows informing investors of the various avenues available for investment as well as the regulatory safeguards in place;
- iv. to facilitate the signing of multilateral MoU of IOSCO as well as bilateral MoUs with counterpart regulatory authorities, as necessary;
- v. to explore and initiate new projects with international and multilateral organizations, targeted at priority reform measures; and
- vi. to further the agenda on CSR and corporate governance for SOEs.





# Legal Department



**SECURITIES AND EXCHANGE  
COMMISSION OF PAKISTAN**

## 4 Legal Department

### 4.1 Operational Structure

#### 4.1.1 Structure

The Legal Wing of the Professional Services Department was made a separate department on 1 December 2004. It now operates under the direct guidance of the Chairman, who is also the reporting Commissioner for the Legal Department (LD).

The purpose behind the restructuring was to enable the LD in fulfilling its mandate of independently managing the legal affairs of the entire Commission and providing impartial legal advice to each operational Division. Moreover, in order to consolidate the strength of the LD and promote efficiency, lawyers who were previously working in different Divisions throughout the Commission were made part of and seated within the LD.

The LD has been divided into the following three Wings according to the type of work that each undertakes:

- Advisory (Internal and External)
- Litigation and Adjudication
- Legislation and General Legal

#### 4.1.2 Management Team

The LD is headed by Ms. Amber Darr, Executive Director. A lawyer by profession, she was practicing as well as teaching law prior to joining the Commission. The Wings are supervised by Joint Directors, who are assisted by Deputy Directors and Assistant Directors. The strength of the LD lies in the variety of professional experience and academic qualifications that its lawyers possess.



Ms. Amber Darr (right), Executive Director with officers of the LD

### 4.2 Performance Review

Legislative reform has been an area of priority for the LD, given the need to update the Commission's legal and regulatory framework for keeping it in sync with market developments, ensuring informed investor decision-making and investor protection and achieving higher standards of corporate governance.

During the year, the LD, in collaboration with operational Divisions of the Commission, drafted a number of laws and rules, particularly in relation to securities market. It also constituted separate legislation teams to review and suggest amendments in the draft legislation developed by consultants under the ADB's TA for strengthening regulation, enforcement and governance of non-banking financial markets. As a result of concerted efforts, drafts of the Financial Services Commission Act, 2005 and the Futures Trading Act, 2005 were suitably revised during the year.

A Research and Development Unit was created within the LD in order to build research strength for the purpose of legislative reforms and to keep abreast of the latest developments, both nationally and internationally.

The LD provided constructive legal advice and comments to Divisions of the Commission on issues of varying nature. In order to enhance delivery in advisory matters, certain lawyers within the LD were assigned responsibilities in relation to particular Divisions and Departments. This helped in providing focused support on legal issues. The LD also gave its comments and suggestions on issues referred to the Commission by the

Government. In this regard, it provided advice to the Government on *inter alia* the establishment of building societies and the privatization of National Investment Trust (NIT) as well as its comments on the Political Risk Guarantee Facilities with ADB.

In order to increase efficiency and centralize the litigation of the entire Commission, all judicial cases are now managed by the LD, with necessary support of the Departments. Previously, litigation was managed by the concerned Department of the Commission. During the year under review, the LD handled a number of cases, including cases challenging the provision of the Code of Corporate Governance for rotation of auditors of listed companies, writ petition and application under Section 292 of the Companies Ordinance to set aside takeover proceedings, appeal before the Supreme Court of Pakistan regarding the interpretation of Section 224 of the Companies Ordinance, petition for winding up of Islamic Investment Bank Limited under Sections 305 and 309 of the Companies Ordinance and criminal prosecution of directors of Islamic Investment Bank Limited pertaining to the Savoy Residences transaction.

The Appellate Bench Registry of the Commission is housed within the LD. The function of the registrar is exercised by a Joint Director, in addition to his duties of the LD.

### 4.3 Development of Laws

During the year under review, the LD assisted in the drafting of *inter alia* the following laws and rules to be administered by the Commission:

- i. Draft Financial Services Commission Act, 2005;
- ii. Draft Securities Act, 2005;
- iii. Draft Futures Trading Act, 2005;
- iv. Draft Commodity Exchange and Futures Contracts Rules, 2004;
- v. Draft Futures Trading Rules, 2005;
- vi. Clearing Houses (Regulation and Registration) Rules, 2005;
- vii. Draft Underwriters (Registration and Regulation) Rules, 2005; and
- viii. Takaful Rules, 2005.

In addition, upon request from the Government, the LD assisted in drafting of the Housing Act, 2004 and Establishment of a National Commission for Human Rights Act, 2004. It also provided comments to the Government on the draft Federal Court Bill, 2004.

### 4.4 Advisory Measures

#### 4.4.1 Internal

Over the course of the year, the LD advised the Divisions on a number of wide-ranging issues, including the following:

- i. the interpretation and intention of the term “any other useful object” contained in Section 42 of the Companies Ordinance;
- ii. whether mutual funds constitute NBFCs for the purposes of the Companies Ordinance and the NBFC Rules;
- iii. the Commission's powers to impose penalties under the Insurance Ordinance and the SECP Act independently of the yet to be established Insurance Tribunal; and
- iv. whether an appeal before the Appellate Bench of the Commission, dismissed in default for non-prosecution by the Appellate Bench, may be restored.

#### 4.4.2 External

The Government often refers issues pertaining to the corporate and financial sectors to the Commission to solicit its comments and suggestions. During the year, the Commission provided advice in relation to *inter alia*:

- i. the establishment of building societies in Pakistan;
- ii. the partial corporatization of the Capital Development Authority;
- iii. the privatisation of NIT;
- iv. the establishment of International Commercial Arbitration Centre of the SAARC countries;
- v. the Agreements for Political Risk Guarantee Facilities under the ADB's FMGP; and
- vi. the provisions relating to the financial services sector in a Bilateral Investment Treaty to be signed by Pakistan.



Officers of the LD at work

### 4.5 Annual Plan

The LD plans to undertake the following activities over the coming year:

- i. build capacity by hiring additional personnel and enhancing resource base;
- ii. improve management of litigation by updating the Court Case Database and the Legal Opinion Database as well as reviewing the panel of advocates for counsel;
- iii. establish a legal resource centre to provide know-how (i.e. sample agreements, letters, orders, laws, etc.) and training to lawyers and other officers within the Commission; and
- iv. enhance online capabilities through making Intra-Law (intranet of the LD) more user friendly and informative.



# Company Law Division



**SECURITIES AND EXCHANGE  
COMMISSION OF PAKISTAN**

## 5 Company Law Division

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

### 5.1 Operational Structure

#### 5.1.1 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 scenarios. 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 legal and regulatory requirements through examination of statutory returns and accounts filed by companies. It also supervises and coordinates the working of CROs.

The Registration Department comprises the following Wings:

- Registration and Licensing
- Investigation and Compliance
- MIS

##### ii. Enforcement Department

The Enforcement Department is responsible for monitoring all listed companies, except NBFCs, modarabas, and insurance companies. It examines their published accounts, monitors compliance with applicable laws, rules and regulations, and takes necessary actions against erring companies, their directors, management, and auditors, as appropriate.

The Enforcement Department consists of the following Wings:

- Enforcement - I
- Enforcement - II
- Enforcement - III

#### 5.1.2 Management Team

As of 30 June 2005, Mr. Javed K. Siddiqui, a CA by profession, was heading the CLD as Executive Director. Pursuant to internal restructuring, Dr. Sajid Qureshi was assigned the responsibility of heading the CLD subsequent to the close of the year. In managing and administering the Registration Department, he is assisted by a Registrar of Companies, two Directors, and an Additional Registrar. There are three Additional Registrars who oversee the



Dr. Sajid Qureshi (right), Executive Director with officers of the CLD

CROs at Karachi, Lahore and Islamabad while the remaining five CROs are supervised either by Joint, Deputy or Assistant Registrars. The Enforcement Department functions through three directors and a team of professionals comprising CAs, cost and management accountants (CMAs), lawyers, and business graduates.

### 5.1.3 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 laws relevant to listed companies.

## 5.2 Sector Overview

The total number of registered companies, as on 30 June 2005, was 45,448. Of these, 44,319 were companies limited by shares, including 2,757 public companies, 41,320 private companies and 242 SMCs. In addition, there were 286 associations not-for-profit, fifty-six limited by guarantee companies, 176 trade organizations, 606 foreign companies and five companies with unlimited liabilities.

Continuous growth in the registration of companies has been observed over the past few years. There was an exceptionally high registration of 3,078 companies with the Commission during the year. This reflected a 40 percent increase over 2,207 companies registered during last year. In terms of the overall registered corporate sector, there was an increase of 4 percent over companies registered up to the FY 2004.

The newly incorporated companies during FY 2005 included 2,983 companies limited by shares, which had authorized capital of Rs. 51.97 billion and paid-up capital of Rs. 9.41 billion. Private companies numbering 2,796 accounted for 94 percent of the 2,983 newly registered, limited by shares companies. Public companies and SMCs had a share of 3 percent each in incorporation.

The chart below depicts the growing trend in incorporation over the period 1999 to 2005.

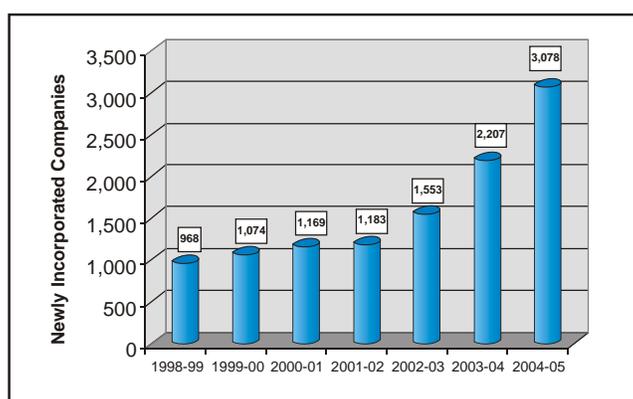


Figure 1: Registration of Companies During the FYs 1999 - 2005

Geographical spread of registered companies, as on 30 June 2005 is given below.

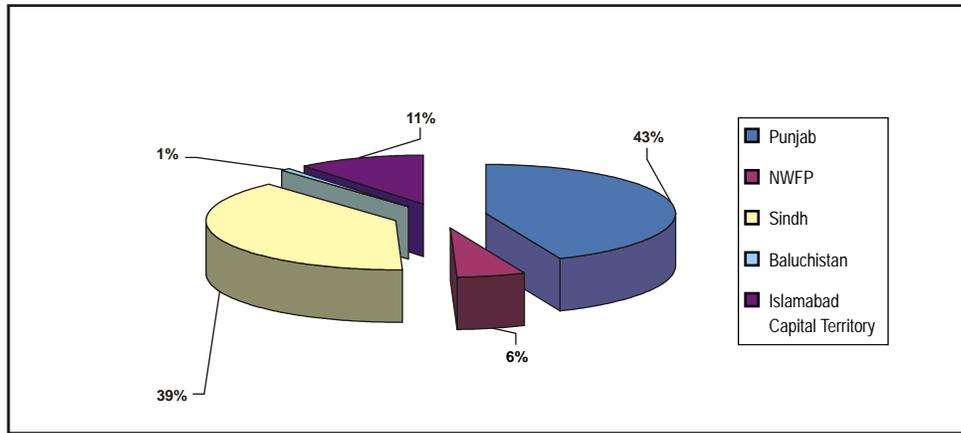


Figure 2: Geographical Spread of Companies

The table below depicts the capital structure of companies limited by shares.

Table 3: Pattern of Paid-up Capital

Paid-up Capital (Rs.)	Listed Companies	Unlisted Public Companies	Private Companies	SMCs	Total
Up to 100,000	1	475	21,494	169	22,139
Above 100,000 to 500,000	1	360	6,379	39	6,779
Above 500,000 to 1 million	-	92	3,445	18	3,555
Above 1 million to 10 million	40	338	7,697	13	8,088
Above 10 million to 100 million	252	646	2,121	3	3,022
Above 100 million to 500 million	226	184	165	-	575
Above 500 million to 1 billion	37	21	13	-	71
Above 1 billion	55	29	6	-	90

Sector-wise distribution of companies limited by shares and their growth over last year are given below.

Table 4: Sector-wise Distribution of Companies Limited by Shares During the FYs 2004 and 2005

Sectors	Number of Companies as at		Growth %
	30 June 2005	30 June 2004	
Auto and Allied	313	270	13.74
Cable and Electrical Goods	357	337	5.60
Cement	72	70	2.78
Fuel and Energy	570	502	11.93
Chemical and Pharmaceuticals	1,534	1403	8.54
Communications	1,692	1458	13.83
Construction	1,139	992	12.91
Engineering	1,446	1371	5.19
Food and Beverages	1,131	1017	10.08
Glass and Ceramics	343	334	2.62
IT	1,395	1228	11.97
Insurance	104	102	1.92
Finance and Banking	521	466	10.56
Jute	17	17	0.00
Leather and Tanneries	286	271	5.24
Paper and Board	400	370	7.50
Power Generation	255	230	9.80
Real Estate Development	625	400	36.00
Services	1,230	804	34.63

Sectors	Number of Companies as at		Growth %
	30 June 2005	30 June 2004	
Sugar and Allied	147	145	1.36
Synthetic and Rayon	74	69	6.76
Textile	3,606	3396	5.82
Tobacco	116	112	3.45
Transport	429	351	18.18
Vanaspati and Allied	312	300	3.85
Agricultural Farming	98	54	44.90
Sports Goods	12	5	58.33
Tourism	168	75	55.36
Lodging	44	26	40.91
Education	78	52	33.33
Trading	851	525	38.31
Footwear	1	1	0.00
Wood and Wood Products	20	15	25.00
Carpets and Rugs	1	1	0.00
Mining and Quarrying	53	41	22.64
Miscellaneous	24,879	24526	1.42
<b>Total</b>	<b>44,319</b>	<b>41,336</b>	<b>6.73</b>

As of 30 June 2005, there were 286 associations not-for-profit licensed under Section 42 of the Companies Ordinance and 176 trade organizations licensed by the Ministry of Commerce. Their areas of operations varied across social services, charity, sports, religion, commerce, etc.

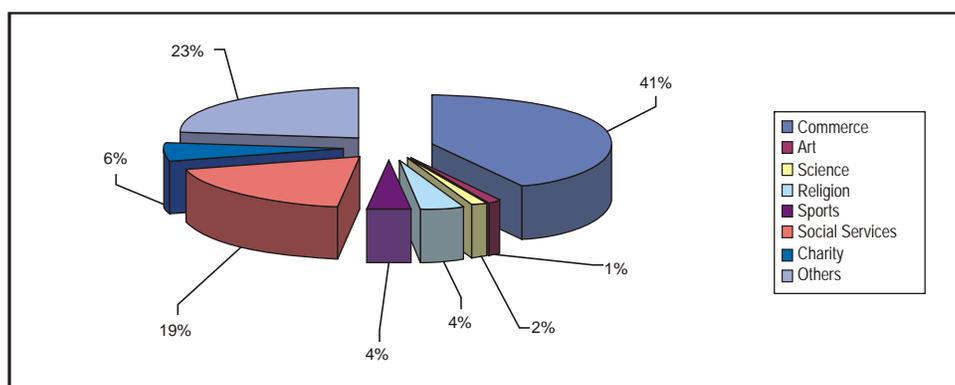


Figure 3: Operations of Associations Not-for-Profit and Trade Organizations

The country-wise distribution of 606 foreign companies, which have established their places of business in Pakistan, as on 30 June 2005 is illustrated below.

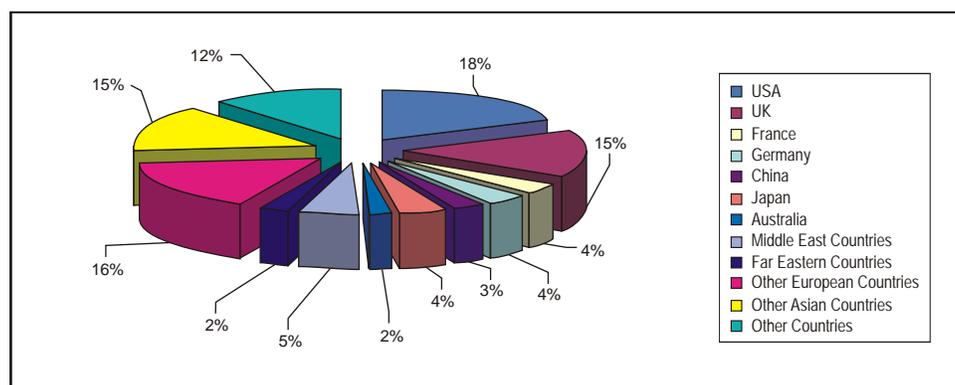


Figure 4: Countries of Origin of Foreign Companies

## 5.3 Performance Review

The Registration Department took a number of measures and reforms to encourage development of the corporate sector and to ensure public facilitation, particularly through timely and effective dissemination of information. During the year, initiatives were undertaken to further strengthen and develop the legal framework, curb illegal and fraudulent business activities and enhance compliance of registered entities with legal and regulatory requirements.

The Commission's targeted efforts for providing impetus to corporatization have resulted in an accelerated growth trend in company registration. Moreover, in line with its endeavors to provide necessary guidance to the corporate sector and public, the Registration Department published various booklets apart from revising and updating existing ones.

The Companies Easy Exit Scheme (CEES) was re-launched in March 2004 and remained operative till 31 December 2004. The re-launch of the scheme received high acclamation from the business community.

The Commission focused on improving compliance level with the statutory provisions and bringing improvement in the reporting of financial and non-financial information to the stakeholders. The regulatory and enforcement actions were directed towards preventing unauthorized inter-corporate financing, non-payment of dividend, irregularities relating to employees' provident fund accounts and non-compliance with other statutory provisions. Moreover, legal actions were taken in order to investigate the affairs of companies in cases where their performance was poor, their affairs were not being managed in accordance with sound business principles and good corporate governance, thereby depriving members from reasonable return, and companies were consistently suffering from losses endangering solvency.

The Enforcement Department reviews financial statements of listed companies to ensure that these are prepared in accordance with identified financial reporting framework in order to promote transparency in the presentation of financial statements. Compliance with corporate laws and IASs by listed companies has improved considerably as a result of vigilance and stringent corporate discipline imposed by the Enforcement Department.

## 5.4 Development of Laws and Regulations

### 5.4.1 Amendment in Companies (General Provisions and Forms) Rules, 1985

In order to rationalize the prescribed qualifications of company secretaries of SMCs, as laid down in Rule 14B of the Companies (General Provisions and Forms) Rules, 1985, an amendment in the said Rule was notified on 9 March 2005, with the approval of the Federal Government.

The amendment was aimed at facilitating SMCs to appoint company secretaries by addressing practical difficulties faced by them in complying with the qualification requirements prescribed earlier. Accordingly, a SMC can now appoint as its company secretary a person holding a bachelor degree from a university recognized by the Higher Education Commission.

### 5.4.2 Amendments in the First Schedule, Third Schedule and Sixth 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. In March 2005, the Commission approved and notified certain amendments in the First Schedule to align its requirements with the relevant provisions of the Companies Ordinance. This was considered essential given the various amendments made in the main body of the Companies Ordinance over time.

It was also observed that amendments were required in Form A in the Third Schedule to the Companies Ordinance in order to capture the relevant information pertaining to the date of appointment of directors. Necessary amendments were accordingly made in the Third Schedule on 31 March 2005.

An amendment in the Sixth Schedule to the Companies Ordinance was notified on 21 February 2005, which would enable the Commission to provide the compiled corporate data and information to various external agencies and the general public at a nominal fee. Availability of such information would greatly facilitate their decision-making on related issues.

## 5.5 Regulatory Actions

### 5.5.1 Mergers and Amalgamations

The Commission, as a policy, has been encouraging mergers and amalgamations of companies to strengthen their capital base and achieve economies of scale. Consolidation within the corporate sector is expected to enhance the capacity to deal with systemic risk and withstand exogenous shocks. At the same time, the Commission ensures that schemes of arrangement proposed by companies are not prejudicial to the interests of minority shareholders. In case a scheme of arrangement is found to be detrimental to the interest of minority shareholders, the concerned Registrar, with the approval of the Commission, makes a representation before the Court under Section 288 of the Companies Ordinance.

During the year under review, the CLD filed oral and written representations in the courts in respect of nine cases of mergers and amalgamations. Decision on four cases was pending at the end of the year while the following schemes were approved during the year:

- i. merger of Umer Fabrics Limited and Nishat (Chunian) Limited into Nishat Mills Limited;
- ii. merger of First Hajvery Modaraba and Fidelity Securities (Private) Limited into First Fidelity Leasing Modaraba;
- iii. merger of CSK Limited into CSK Distilleries Limited;
- iv. merger of Crescent Energy Limited and Crescent (Hattar) Limited into Crescent Textile Mills Limited; and
- v. merger of Colony Weaving Mills Limited and Colony Industries (Private) Limited into Sheikh Spinning Mills Limited.

### 5.5.2 Re-Launch of CEES

The CEES was re-launched by the CLD in March 2004 to cater to the rising demand of the corporate sector. The scheme remained operative till 31 December 2004. It offered an opportunity to dormant private limited, public unlisted and limited by guarantee companies, having no assets or liabilities and not carrying any business, to take advantage of the exit facility and voluntarily get their names struck off the register of companies.

The scheme generated considerable response and as many as 1,519 companies applied under the scheme. The highest number of 583 applications was received at CRO Karachi, followed by 542 at CRO Lahore, 109 at CRO Faisalabad and 106 at CRO Islamabad. The CROs at Multan, Quetta, and Peshawar received ninety-six, twenty-one, and fifty-eight applications, respectively.

### 5.5.3 Approvals and Permissions

The Companies Ordinance contains a number of provisions that mandate approvals either from the Commission or from the Registrar 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 5.



Table 5: Cases Approved under the Companies Ordinance

S. No.	Section of the Companies Ordinance	Nature of Approval/Permission Sought	Number of Cases Disposed Off
1	Section 21	Amendment in memorandum and articles of association	174
2	Section 24(3)	Extension in time for filing the documents on confirmation of alteration	9
3	Section 25	Extension in time for filing the order confirming alteration in memorandum of association with Registrar	2
4	Section 37	Availability of name	9,819
5	Section 39	Change of name	150
6	Section 42	Grant of license to associations	81
7	Section 44	Conversion of public companies into private companies	8
8	Section 57	Registration of prospectus	4
9	Section 86	Further issue of capital	1
10	Section 90	Issue of shares under the Companies Share Capital (Variation in Rights and Privileges) Rules, 2000	1
11	Sections 121,129,132	Registration, modification and satisfaction of charge	7,266
12	Section 131	Condoning delay in submission of particulars of charge	12
13	Section 146	Commencement of business certificate	25
14	Section 158(2)	Holding of annual general meetings (AGMs) at other than registered office	5
15	Sections 158, 233	Extension in period for holding of AGMs by unlisted public and private companies	106
16	Section 170	Calling of overdue meetings	27
17	Section 195	Grant of loans to directors of unlisted public companies	1
18	Section 252	Appointment of auditors	2
19	Section 258	Appointment of cost auditors	58
20	Section 466(6)	Issue of certified copies of documents	23,936
21		Miscellaneous (minor activities, providing information to different agencies and shareholders, etc.)	32,009
Total			73,673

Besides the above, the Commission approved five cases for conversion of private companies into SMCs under Rule 9 of the Single Member Companies Rules, 2003. In addition, CROs allowed inspection of records in 10,077 cases in terms of Regulation 18 of the Companies (Registration Offices) Regulations, 2003.

#### 5.5.4 Capital Issues

During the year, the CLD received eleven applications for issue of capital other than by right issue. Of these, seven companies were allowed to issue further capital otherwise than right issue, amounting to Rs. 17.53 billion. Applications of three companies were rejected due to non-compliance with the legal requirements while one application was pending due to supply of incomplete information by the company.

Under Section 90 of the Companies Ordinance, read with the Companies Share Capital (Variation in Rights and Privileges) Rules, 2000, a company limited by shares can issue more than one kind of share capital having different rights and privileges. During the year under review, eight applications were received. Of these, four companies were allowed to issue preference shares amounting to Rs. 1.06 billion while three companies were allowed to issue preference shares otherwise than right to financial institutions and banks, amounting to Rs. 150.75 million. One application was disallowed as the company failed to meet the legal requirements.

#### 5.5.5 Applications for Withholding of Payment of Dividend

During the year, a company applied for approval to withhold payment of interim dividend under sub-Section (2) of Section 251 of the Companies Ordinance. After examination, the company was allowed to withhold payment of interim dividend till such time that the successors submit documentary proof.

## 5.6 Monitoring and Enforcement

### 5.6.1 Actions against Forex Companies, Multi-level Marketing and Pyramid Schemes

The Commission took strict action against illegal and unauthorized forex companies/international brokerage houses, which were operating their businesses in violation of law; thirty-eight companies engaged in these businesses were identified and action was initiated against them. The Commission filed petitions in the Courts for winding up of fifteen companies. Of these, two cases have been disposed off while remaining thirteen are pending with the Courts. Apart from these, twenty-two unincorporated entities conducting such illegal business were identified. These cases were referred to National Accountability Bureau (NAB).

The Commission further found out that certain companies, firms and individuals were dealing in multi-level marketing (MLM) and pyramid schemes, deceiving general public by inducing them to make easy money and earn sky-high returns in a short span of time; eleven companies engaged in this business were identified and action was initiated against them. The Commission filed petitions in the Courts for winding up in two cases. Moreover, six unincorporated entities conducting such illegal business were identified. The cases of four companies and one entity have been referred to NAB for further action.

A joint task force, comprising of representatives of SBP, Commission and NAB, was formed by the Commission to curb the unauthorized activities of forex companies and for regular follow-up and monitoring of the cases. A media campaign was also launched by the Commission to educate the general public on the concepts of MLM and pyramid schemes. Notices were published in the newspapers as well as placed on the Commission's website to caution the public.

### 5.6.2 Investigations into the Affairs of Companies

The CLD undertakes investigations into the affairs of companies to identify misrepresentations in financial statements, continuous deprivation of reasonable return to shareholders or violation of statutory provisions conducted to defraud creditors or members. During the year, the CLD initiated investigations into affairs of certain companies on account of their dismal performance and on apprehension that the affairs of companies had been conducted and managed in a manner oppressive to members so as to deprive them of a reasonable return. Inspectors under Section 265 of the Companies Ordinance were appointed to examine the affairs of five companies.

In another case, the Inspector's report submitted to the Commission under Section 269 of the Companies Ordinance revealed that management had not produced books of account before the Inspector on the contention that records had been removed by the previous management. The Commission directed the ex-CEO of the company to make good the default and return all the corporate and financial record to the company.

### 5.6.3 Holding of AGM

AGMs provide the forum for shareholders to consider and approve significant matters relating to management and performance of companies, including approval of annual accounts, declaration of dividend, appointment of auditors, and election of directors.

The CLD undertook strict monitoring to ensure that listed companies hold AGMs within the prescribed period of time. Of the 526 companies being monitored by the Enforcement Department, 462 companies held AGM within the timeframe, fifty-eight companies were in liquidation/winding-up and six companies in default.

The extent of compliance is illustrated in Table 6.



Table 6: Extent of Compliance with the Requirement for Timely Holding of AGM

Year	Total Listed Companies	No. of Compliant Companies	Compliance Percentage
2005	526	462	88
2004	536	472	88
2003	582	498	86

During the year, penalties were imposed on nine companies for non-/late holding of AGMs.

#### 5.6.4 Circulation of Quarterly Accounts

A total of 1,581 quarterly accounts of listed companies were due to be filed during the year. As many as 1,375 accounts were circulated by listed companies, exhibiting 87 percent compliance, as shown in the following table.

Table 7: Circulation of Quarterly Accounts

	1st Quarter	2nd Quarter	3rd Quarter	Total
Accounts due	525	526	530	1,581
Accounts submitted	457	458	460	1,375
Compliance percentage	87	87	87	87

In cognizance of non-compliance with the requirements of Section 245 of the Companies Ordinance, penalties on thirty-one companies were imposed during the year.

#### 5.6.5 Disclosure of Information in Case of Special Business

During the year, effective monitoring and vigilance was exercised to ensure that all material information is provided to shareholders in respect of any special business to be transacted at general meetings. In cases where the information provided by companies was insufficient to enable shareholders to take a prudent decision, directions were given to provide all material information to shareholders. Moreover, in case of interest of a director, whether direct or indirect, in such special business, it was ensured that disclosure of nature of such interest was made.

During the year, 281 cases were examined and sixty-four notices of meetings were found to be materially deficient. The companies were directed to circulate the revised notices of meetings to shareholders and to deliberate the non-disclosed information in the meetings.

During the year, seven companies were restrained from passing of special resolutions, which were contrary to the interests of minority shareholders. In another case, a company was advised to defer acquisition of ordinary or preference shares or providing subordinate loans or extending guarantees to the creditors of its subsidiary company because the company itself was uncertain about the mode, exact amount, time frame and return to be charged on the said investment.

A company was restrained from passing special resolution since there was non-disclosure of total investment in the associated company, benefit to the company and shareholders, and interest of directors and their relatives in the investee company. The company was subsequently allowed to propose the resolution after the Commission's concerns were addressed in this respect.

A company had not explained explicitly to shareholders in the statement of material facts the conditions applicable to the subordinate loan and the fact that the said loan would rank below other loans with regard to claims on assets or earnings. Moreover, the benefits likely to accrue to shareholders for advancing loan on

aforesaid conditions were not explained and it was also not charging any return on the investment. The company was directed to undo the irregularities and deficiencies before passing the resolution in the general meeting

During the year under review, show cause proceedings were initiated against eight companies for failure to annex statement of material facts under Section 160 of the Companies Ordinance. The companies were directed to comply with provisions of law with warning to observe strict compliance of law in future and hold general meetings in accordance with the provisions of the Companies Ordinance.

#### 5.6.6 Election of Directors

Under the provisions of Sections 177, 178, 180 and 184 of the Companies Ordinance, a company fixes the number of elected directors not later than thirty-five days before convening of the general meeting at which directors are to be elected and the number so fixed shall not be changed except with the prior approval of a general meeting of the company. Moreover, a director elected shall hold office for a period of three years unless he resigns earlier, becomes disqualified from being a director or otherwise ceases to hold office. Any such vacancy occurring among the directors shall be filled up by the directors and the person so appointed shall hold office for the remainder of the term of the director in whose place he was appointed. Furthermore, no person shall be appointed or nominated as a director or CEO of the company or represent as holding such office, nor shall any person describe or name any other person as a director (or proposed director) or CEO (or proposed CEO) of any company, unless such person or such other person has given his consent in writing for such appointment or nomination.

In view of failure to comply with the aforesaid provisions of the Companies Ordinance, penalties on two companies were imposed during the year.

#### 5.6.7 Engagement of CEO in Business Competing with the Company's Business

In terms of Section 203 of the Companies Ordinance, the CEO of a public company shall not directly or indirectly engage in any business, which is of the same nature or directly competes with the business carried on by the company of which he/she is the CEO or by a subsidiary of such company. During the year, a case of violation of the said provision of the Companies Ordinance was observed where the same person was appointed as CEO by two public companies having the same line of business. Show cause notices were issued to both the companies and proceedings were in process at the close of the year.



Officers of the CLD engaged in a discussion

#### 5.6.8 Appointment of Company Secretary

The Companies Ordinance and the Code of Corporate Governance require listed companies to appoint a whole-time company secretary. The CLD identified seventeen cases of violation of this requirement and initiated necessary proceedings. During the year, eleven cases were disposed of whereas proceedings in six cases were in progress.

#### 5.6.9 Inter-corporate Financing

During the year, proceedings were initiated against seven companies on account of misuse of companies' funds, making unauthorized investments in associated undertakings, non-receipt of trade debt and interest thereon from associated concerns, giving advances to associated companies without obtaining prior shareholders' approval and not charging/non-disclosure of interest on advances due from associated companies.

After completion of due process, two cases were finalized. The CEO and directors of both companies, who were found responsible for the defaults, were fined and held personally liable to pay the penalties. During the year, proceedings against one company were dropped as its explanation was found satisfactory. Proceedings against four companies were being finalized as of the close of the year.

#### 5.6.10 Unauthorized Leasing of Project

During the year, a company was found non-compliant with the provisions of Section 196 of the Companies Ordinance. In terms of sub-Section (3) of Section 196, the directors of a public company or of its subsidiary cannot sell, lease or otherwise dispose of the undertakings of the company (unless the main business of the company comprises of such selling or leasing) except with the specific consent or authorization of shareholders. In the case noted by CLD, management of the company had leased out the project to another company without approval of shareholders. Show cause proceedings were initiated during the year against the company.

#### 5.6.11 Mis-utilization of Security Deposits

In terms of Section 226 of the Companies Ordinance, no company, officer or agent of a company shall receive or utilize any money received as security or deposit, except in accordance with a contract in writing, and all moneys so received shall be kept or deposited by the company or the officer or agent concerned, as the case may be, in a special account with a scheduled bank.

During the year, a company was found to be non-compliant with the aforesaid provisions of the Companies Ordinance since it was not maintaining a separate account for security deposits received from dealers and had kept funds in its bank accounts to meet the amount of deposits to a certain level. On directive issued by the Commission, the company opened a separate account to comply with the legal requirements and avoid mis-utilization of security deposits.

#### 5.6.12 Proceedings on Investors' Grievances

The CLD ensures expeditious and appropriate resolution of investors' grievances. If there has been a violation of any provision of the Companies Ordinance, the CLD takes necessary action against the concerned company.

During the year, the Enforcement Department received 1,409 complaints from shareholders and the general public. Of these, 1,351 complaints were resolved while comments on the remaining ones were sought from the concerned companies. The CROs received sixty complaints in respect of non-listed companies during the year. Of these, combined with the complaints brought forward from last year, fifty-nine were appropriately disposed off while the remaining were at various stages of disposal.

The complaints from shareholders and the general public mainly pertained to the following issues:

- i. non-payment of dividend;
- ii. non-receipt/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. non-receipt of notices;
- vi. mismanagement of companies' affairs;
- vii. improper election of directors; and
- viii. wrongful deduction of zakat.

As a consequence of complaints received by the Commission, proceedings under Section 74 of the Companies Ordinance were initiated against two companies for failure to transfer shares within the prescribed period. Penalty was imposed on the CEO and directors of a company for non-compliance with statutory provisions while the other case was pending adjudication as of the close of the year.

Furthermore, proceedings under Section 75 and 251 of the Companies Ordinance were in progress at the close of the year against three companies, which had failed to issue duplicate shares and pay dividend within the prescribed periods. In another case, show cause notice was issued to a company for failure to maintain a register of members, in terms of Section 147(1) of the Companies Ordinance. Proceedings against the company were in process as on 30 June 2005.

### 5.6.13 Enforcing Compliance with Provisions of the Companies Ordinance

The CLD issued directions, under Section 472 of the Companies Ordinance, in the following cases.

Table 8: Directions to Enforce Compliance with the Companies Ordinance

S. No.	Nature of Default	Direction
1	On the basis of a special resolution, the company had advanced an amount of Rs. 1,140,694 to its associated company, free of interest and contrary to the interests of shareholders.	Directions for recovery of the entire amount due from the associated company were given and were complied with by the company.
2	According to the annual accounts of the company for the year ended 30 June 2002, an amount of Rs 2.180 million was payable by the company to the Employees Provident Fund Trust, which increased to Rs. 4.656 million by 30 June 2004. This amount was not paid by the company to the Fund as per provisions of Section 227 of the Companies Ordinance.	Directions were given for payment of the outstanding amount to the Fund, including mark-up, within a period of one year in four quarterly instalments.
3	The auditors qualified their opinion on annual accounts of the company for the year ended 30 June 2004, stating that the company was not properly maintaining statutory books of account as required under the Companies Ordinance.	Directions were given for making good the default by maintaining all books of account, as required under the Companies Ordinance, and to provide a confirmation certificate from the auditors of the company.
4	Two companies were found non-compliant with Section 227 of the Companies Ordinance due to non-transfer and misappropriation of contributions to Employees' Provident Fund.	The company was directed to make good the default by depositing the total outstanding amount with mark up at 16 percent per annum to the Provident Fund Trust.
5	A company intended to issue 100 percent right shares in violation of the provisions of Companies (Issue of Capital) Rules, 1996.	The company was directed not to proceed with right issue and remove the irregularities.
6	The directors of a company sold land at a low price causing loss to the company.	Directions were given to directors to make good the loss who deposited Rs. 25 million with the company from their own resources.

### 5.6.14 Adjudication of Cases

During the year under review, the CROs and Registrar of Companies adjudicated 4,423 cases for violations under various provisions of the Companies Ordinance and appropriately disposed off 1,291 cases. Necessary actions were taken against companies and their managements where violations were proven.

The Registrars at CROs identified defaults of different provisions of the Companies Ordinance, particularly of Section 476, by 4,380 companies. Of these, adjudication process was completed in case of 1,262 companies and appropriate actions were taken. The Registrar of Companies at the Commission's head office adjudicated defaults of forty-three companies under Section 476 and disposed off twenty-nine cases during the year.

### 5.6.15 Examination of Annual and Interim Accounts

During the year, the Registration Department carried out an examination of annual accounts of 454 non-listed public companies and associations not-for-profit. After following due process, actions were taken against twenty-seven companies that were found to be in default of legal requirements. In addition, show cause notices, warnings and explanation letters were issued to 284 companies. The accounts of 143 companies were found to be in order.

The Enforcement Department undertook examination of annual and quarterly accounts of listed companies in order to identify deficiencies in disclosures and other irregularities. Cognizance of defaults was particularly taken in the following cases.

#### i. Irregularities in Provident Funds

Action against directors of five companies and trustees was initiated for mis-utilization and non-transfer of provident fund to the Employee's Provident Fund Trust. In this regard, orders were made against three companies for non-compliance with Section 227 whereas proceedings in the other two cases were in progress as of the close of the year.

#### ii. Declaration of Dividend

The CLD identified three cases where the companies concerned were in violation of Section 249 of the Companies Ordinance. The said Section requires that dividends shall only be paid out of the profits of the company but restricts dividend payment out of the profits from the sale/disposal of any immovable property or assets of capital nature. Show cause proceedings were initiated against these companies and after providing opportunities of hearing, penalties were imposed on their directors. Besides imposition of penalties, in one case, the directors of the company were directed to make good the loss of capital of Rs. 5.28 million suffered due to their imprudent decision.

#### iii. Surplus Arising out of Revaluation of Fixed Assets

It was observed from the accounts of a company that the amount of incremental depreciation from surplus on revaluation of fixed assets was not transferred to un-appropriated profit/accumulated loss account through statement of changes in equity. Proceedings were initiated under Sections 230, 234 and 235 of the Companies Ordinance but were subsequently dropped as the company made good the default in the subsequent year. However, a warning was issued to all directors of the company to remain careful in future while complying with the requirements of the law.

#### iv. Qualified Audit Reports

During the year, proceedings against two companies were initiated where auditors had expressed a disclaimer and an adverse opinion on the accounts. The proceedings were in progress at the end of the year.

### 5.6.16 Actions against Auditors

Examination of accounts of certain listed companies revealed that auditors had failed to discharge their duties and responsibilities envisaged in the auditing standards and the Companies Ordinance. In such cases, reports issued by the auditors failed to bring out material facts about the affairs of companies. Penal proceedings were initiated against the negligent auditors and penalties were imposed on six firms of auditors. Proceedings against seven firms of auditors were at various stages of disposal on 30 June 2005.

### 5.6.17 Liquidation of Companies

The Commission disposed off 1,001 cases pertaining to liquidation of companies. Of these, twelve cases of winding up were subject to supervision of Court, eighty-eight involved voluntary winding-up and 901 companies

were struck off the register of companies under Section 439 of the Companies Ordinance. The aggregate paid-up capital of liquidated companies was Rs. 4.77 billion.

During the year, two companies were directed to either complete buy-back of shares from the general public or revive their businesses within a given time frame.

The detail of winding up cases during the year under review is reflected in the chart below.

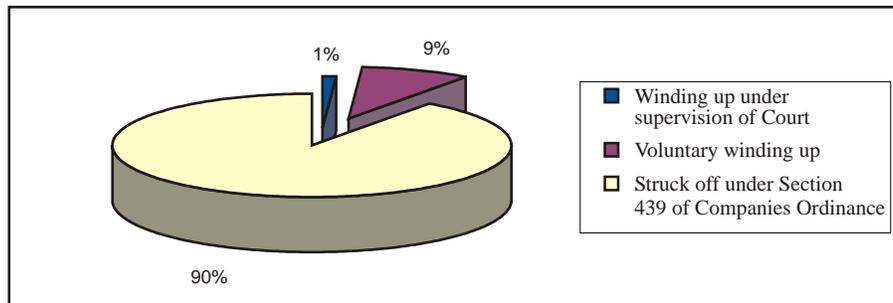


Figure 5: Liquidation of Companies

## 5.7 Administrative Appeals

An appeal against the decision of the registrar at a CRO can be lodged with the Registrar of Companies at the Commission's head office. During the year, a revision application was filed by the management of an unregistered entity against the decision of the concerned registrar, whereby a penalty was imposed for use of the word 'Limited' in the promotional material of the entity. The order passed by the concerned registrar was upheld. The management of the entity filed a review petition with the Commission under Section 484(2) of the Companies Ordinance against the order of the Registrar of Companies, which reduced the penalty imposed by the registrar.

Another revision petition was filed with the Commission under Section 477 of the Companies Ordinance by the director/auditor of a private limited company against the decision of Registrar of Companies under Section 254 of the Companies Ordinance. In terms of the order, penalty was imposed on the concerned director for being appointed as the auditor of the company while simultaneously holding the position of promoter/director. The order of Registrar was upheld; the auditor filed a revision petition under Section 484 of the Companies Ordinance, which was converted into an appeal under Section 33 of the SECP Act. The appellate bench of the Commission decided to reduce the penalty imposed by the Registrar.

During the year, eighteen appeals against the orders of Commissioner (CLD), Executive Director (Enforcement) and Director (Enforcement) were preferred, of which nine appeals were upheld by the Appellate Bench while one appeal was set aside. As on 30 June 2005, eight cases were pending decisions.

## 5.8 Judicial Cases

During the period, eight appeals were filed against the orders of the Commission in the respective High Courts; four appeals against the orders of High Courts were challenged in the Supreme Court of Pakistan. In addition, a review application against the order of the Commission for appointment of Inspector to investigate into affairs of the company was lodged before the Supreme Court of Pakistan and disposed off in favor of the Commission.

In two cases, directors of companies were declared as proclaimed offenders on avoidance of service of notices of court in matter of complaints filed by the Commission for mis-statement in prospectus and for failing to give true and fair view of the state of affairs of the company to the shareholders.

A complaint under Section 268 of the Companies Ordinance against the directors of a company was filed in the Session Court, Karachi for non-cooperation with the Inspector appointed under Section 265 of the Companies Ordinance. In another case, a writ petition, filed against the show cause notice issued by the Commission to an auditor of a company for negligence in duties, was dismissed by the Honorable High Court.



Officers of the CLD in a meeting

## 5.9 Developmental Activities

### 5.9.1 Membership of APCRF

During the year, the Commission became a member of APCRF. The main objective behind this initiative was to benefit from the exchange of ideas with representatives of other registration authorities and to develop the registration and regulatory functionalities of the Commission along modern and effective lines. The Commission also participated in the first AGM of APCRF, held in Australia in March 2005.

### 5.9.2 Establishment of Facilitation Counters at Chambers of Commerce and Industry

The Commission set up facilitation counters at the Rawalpindi Chamber of Commerce and Industry and the Sialkot Chamber of Commerce and Industry, as a part of its endeavors to encourage corporatization in the country and to extend public facilitation. The counters would facilitate registration of companies and provide necessary guidance to the business community on company incorporation and other related regulatory requirements.

### 5.9.3 Corporatization of SMEs

In order to remove impediments to corporatization of SMEs, particularly those identified in the World Bank-funded research study on “Simplification and Promotion of Laws and Procedures for Corporatization of SMEs”, the CLD developed an action plan during the year. The action plan highlighted the decisions and initiatives to be taken by the Commission itself and those where the Commission could initiate a dialogue with other agencies for necessary action.

To implement the action plan, in-house trainings were conducted in Karachi and Lahore in January 2005. The focus of the trainings was to orient registrars from all eight CROs with their role as a facilitator as well as a regulator for the SME sector and to facilitate corporatization while ensuring statutory compliance. The theme of the trainings was promotion of a corporate culture in SME sector of Pakistan that could *inter alia* be achieved through introduction of an active, professional, and dynamic thinking in the functioning of CROs. It was realized that an accelerated effort was required for the effective utilization and implementation of automated systems at the Commission, especially to achieve e-submissions by the SME sector.

The Commission also developed liaison with SMEDA, CBR and SBP in an attempt to create a conducive environment for growth of SMEs and to encourage their corporatization.

During the year, a high profile delegation of the Commission, including its Chairman, visited the Chambers of Commerce and Industry in Sialkot, Peshawar and Hyderabad to accelerate the pace of incorporation through public awareness and facilitation. The benefits of corporatization were elaborated and the business community was urged to play its due role in promoting a corporate culture in the country.

#### 5.9.4 ITCN Asia 2004 Exhibition

The Commission participated in the ITCN Asia 2004 Exhibition held in Karachi from 9-11 August 2004. During the course of the Exhibition, instant assistance on company incorporation was provided and regulatory issues were explained. A fast track Company Incorporation Desk for 'on-the-spot' incorporation of companies was established. The Commission's guidance booklets were widely distributed among the participants to create public awareness. This effort of the Commission was highly appreciated by local and foreign delegates.

#### 5.9.5 Corporate Governance for SOEs

In January 2005, the Commission held a roundtable meeting with listed, public sector companies to discuss pertinent issues relating to governance of SOEs and explore the possibility of extending the Code of Corporate Governance to these entities. The Chairmen and CEOs of leading listed SOEs were invited to the meeting. While appreciating the initiative of the Commission, they highlighted impediments to good corporate governance in the public sector.

#### 5.9.6 Model Memorandum and Articles of Association for Associations Not-for-Profit

During the year, the Commission developed standardized memorandum and articles of association for associations not-for-profit licensed under Section 42 of the Companies Ordinance. The initiative would facilitate promoters desirous of forming associations not-for-profit and seeking licenses from the Commission under Section 42 of the Companies Ordinance. The model memorandum broadly encompasses the objects, including education, research, health, services, arts, science, charity and sports etc., that such an entity may adopt.

#### 5.9.7 Public Guidance Booklets

The Commission has released a series of guidance booklets to build, reinforce and uplift the virtues of corporate governance in the management of corporate entities and to develop public awareness on various statutory matters. During the year, the following booklets were published and placed on the Commission's website:

- i. Single Member Company Guide (in Urdu);
- ii. Company Mortgages and Charges Guide;
- iii. Winding-up of Companies Guide; and
- iv. revised and updated version of the Promoters' Guide.

#### 5.9.8 New Features on the Commission's Website

The CLD introduced new, useful features on the Commission's website to facilitate registration and disseminate information pertaining to post registration compliance requirements. An "Incorporation Fee Calculator" was developed and placed on the website to help computation of incorporation fee at any capital structure as per the rates prescribed under the law. The corporate entities, wishing to enhance authorized capital, can also calculate the fee payable on enhancement in authorized capital.

A comprehensive "Schedule for filing of returns and documents with the Commission" was also added, highlighting the statutory responsibilities of corporate entities under the law. The Schedule covered various aspects of submission of each form/return, such as events that lead to the filing of each return, due filing time and fee, etc.

In order to keep the corporate sector informed regarding the rates of fees to be paid to the registrar and the Commission for corporate activities, as prescribed in the Sixth Schedule to the Companies Ordinance, a "Schedule of Fee" was also placed on the website. It is envisaged that additions to the website would facilitate promoters and management of companies as well as promote statutory compliance by corporate entities.

### 5.9.9 Delegation of Powers to CROs

During the year, the Commission delegated the powers and functions conferred upon it under Section 21 of the Companies Ordinance to registrars at CROs. Section 21 of the Companies Ordinance deals with alteration in object clause of memorandum of association of a company.

By delegating its power to the concerned registrars at CROs, the Commission has decentralized the authority to facilitate corporate entities.

### 5.9.10 Capacity Building

A six-day 'Professional Training Workshop' for registrars was arranged by the Commission at the Institute of Business Administration in Karachi in April 2005. A total of twenty-five participants, performing responsibilities as registrars at the Commission's head office and CROs, attended the said workshop.

The training program was aimed at enhancing the skills, knowledge and understanding of registrars, as required for their effective and efficient performance. The week-long training program covered a diverse range of areas, mainly focusing on company law and regulation, financial accounting and analysis, and regulatory role management.

## 5.10 Annual Plan

### 5.10.1 Work in Progress

#### i. Regulatory Framework 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 effective legislation that would provide the desired framework to deal with such intricate matters. During the year, the Commission completed and finalized the draft Undesirable Companies Bill, 2005 with the view to safeguard the interests of public and to give enabling power to the Commission to proceed against undesirable companies involved in unscrupulous business activities. The draft would be placed for public opinion after finalization and approval by the Commission.

#### ii. Extension of Code of Corporate Governance to Associations Not-for-Profit

In order to extend the Code of Corporate Governance to associations not-for-profit, the Commission was in the process of drafting the Association Not-for-Profit (Licensing and Corporate Governance) Rules under Section 42 of the Companies Ordinance, at the close of the year. The draft rules contain the regulatory framework, requirements and specifically the provisions of the Code of Corporate Governance proposed to be applicable to associations not-for-profit. This initiative of the Commission would go a long way in ensuring effective regulation of this sector.

#### iii. Rules for Housing and Real Estate Development Sector

With the view to closely monitor the real estate development sector, the CLD initiated the process of framing the draft Housing and Real Estate Development Companies (Establishment and Regulation) Rules. The Rules would provide a comprehensive regulatory framework for registration of companies in housing and real estate development sector as well as provide for the post-incorporation compliance and legal requirements. The draft was under preparation at the close of the year under review.

#### iv. Guidelines for the Corporate Sector

In order to facilitate and develop understanding of the corporate sector on important provisions of the law, the CLD took up the task of preparing guidelines in the following areas:

- Issue of preference shares
- Issue of capital without rights offer
- Preparation of interim accounts

#### v. Availability of Name through E-mail

In order to facilitate the company incorporation process and to effectively utilize modern day technologies, an electronic interface for the name availability function of CROs is being developed. The electronic name availability facility would allow promoters to apply for name reservation on e-mail; the registrar will electronically issue a name availability letter reserving the name for a specific period. The name would be allocated on payment of prescribed fee on filing of incorporation documents within the given timeframe.

#### vi. Assisting the Fraud Investigation Unit

The FIU was established at the Commission for the preemption and prevention of white-collar financial crimes. Identification of such crimes is largely a function of the Enforcement Department which reviews the financial reports of companies and identifies areas of further inquiry. Close coordination with FIU and synergic development in this area would be a key second-generation reform area for the Enforcement Department.

### 5.10.2 Future Plans

The CLD plans to undertake the following activities during the next financial year:

- launch a comprehensive corporate awareness program, which would include conducting seminars in various cities, visits to various chambers of commerce and industry, establishment of camp offices in small towns, celebration of a corporate week and publication of guidance booklets;
- pursue with the Commissioner, Islamabad Capital Territory and the provincial governments of Sindh and Balochistan, the abolishment of stamp duty on memorandum and articles of association. Until this is achieved adhesive stamps would be made available at CRO Islamabad and Quetta;
- implement fast track company registration i.e. within same day;
- re-launch the Companies Regularization Scheme;
- introduce the concept of off-the-shelf companies;
- introduce online incorporation of companies and filing of statutory returns;
- build capacity of the Registration Department, Enforcement Department and CROs, particularly through training of staff;
- enhance the scope of auditor's report, if necessary, and maintain strict vigilance on auditors;
- develop a database of financial and non-financial information of companies for effective monitoring;
- undertake studies of various sectors for understanding the key factors affecting their performance in order to make the task of examination of accounts more fruitful and objective;
- enhance compliance with the Code of Corporate Governance; and
- develop capacity to undertake onsite investigations/inspections of companies.





# Securities Market Division



**SECURITIES AND EXCHANGE  
COMMISSION OF PAKISTAN**

## 6 Securities Market Division

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

### 6.1 Operational Structure

#### 6.1.1 Structure

The Securities Market Division (SMD) is responsible for monitoring, regulating, and developing the securities market. It regulates the primary and secondary markets as well as market intermediaries through registration, surveillance, investigation, enforcement, and rule making, with the objective of protecting investor interests. 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 following Wings:

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

#### 6.1.2 Management Team

Mr. Arif Mian, Executive Director heads the SMD. He is a CA by profession. There are three Directors and two Joint Directors heading each of the Wings. They, along with various professionals including lawyers, CAs, CMAs, business graduates and financial analysts, assist in running the SMD.



Mr. Arif Mian (left), Executive Director in a meeting with officers of the SMD

#### 6.1.3 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. Central Depository Companies (Establishment and Regulation) Rules, 1996
- x. Companies (Issue of Capital) Rules, 1996
- xi. Companies (Asset Backed Securitization) Rules, 1999
- xii. Companies (Buy-back of Shares) Rules, 1999
- xiii. Share Capital (Variation in Rights and Privileges) Rules, 2000
- xiv. Brokers and Agents Registration Rules, 2001
- xv. Balloters, Transfer Agents and Underwriters Rules, 2001
- xvi. Stock Exchange Members (Inspection of Books and Records) Rules, 2001
- xvii. Members' Agents and Traders (Eligibility Standards) Rules, 2001
- xviii. Public Companies (Employees Stock Option Scheme) Rules, 2001

- xix. Margin Trading Rules, 2004
- xx. Clearing Houses (Registration and Regulation) Rules, 2005

## 6.2 Sector Overview

### 6.2.1 General Yearly Review

The buoyant mood in Pakistan's stock markets that prevailed during the FY 2004 continued during the current FY. The Karachi Stock Exchange 100 Shares Index (KSE-100) index ended the year with a gain of 41.1 percent, which translates into 2,171 points at the index level of 7,450 on 30 June 2005. This compares well with an increase of 55.2 percent during the FY 2004. The KSE-100 index closed at its all time high level of 10,303 on 15 March 2005.

The market capitalization of KSE surged up to Rs. 2,068 billion, depicting an increase of 45.53 percent over last year's market capitalization of Rs. 1,421 billion. In terms of US Dollars, market capitalization of KSE was approximately US\$ 35.65 billion at the close of the year, increasing by US\$ 11.35 billion from last year. During the period under review, the Karachi stock market continued to be one of the best five performing markets around the world.

Table 9: KSE Performance at a Glance

	FY 2004	FY 2005	High FY 2005	Low FY 2005
KSE-100 Index (at closing level)	5,279.18 (End June 2004)	7,450.12 (End June 2005)	10,303.15 (15 March 2005)	4,890.22 (22 September 2004)
Turnover (Shares in million)	389 (Daily average for the year)	343 (Daily average for the year)	1,086.55 (23 February 2005)	62.95 (12 April 2005)
Market Capitalization (Rs. in billion; at closing level)	1,421.58 (End June 2004)	2,068.19 (End June 2005)	2,813.36 (15 March 2005)	1,346.27 (15 September 2004)

The KSE-100 index set various new records during the FY 2005, which include highest-ever closing of the KSE-100 index, the second-highest ever trading volume in a day, and intra-day gains and losses in terms of points.

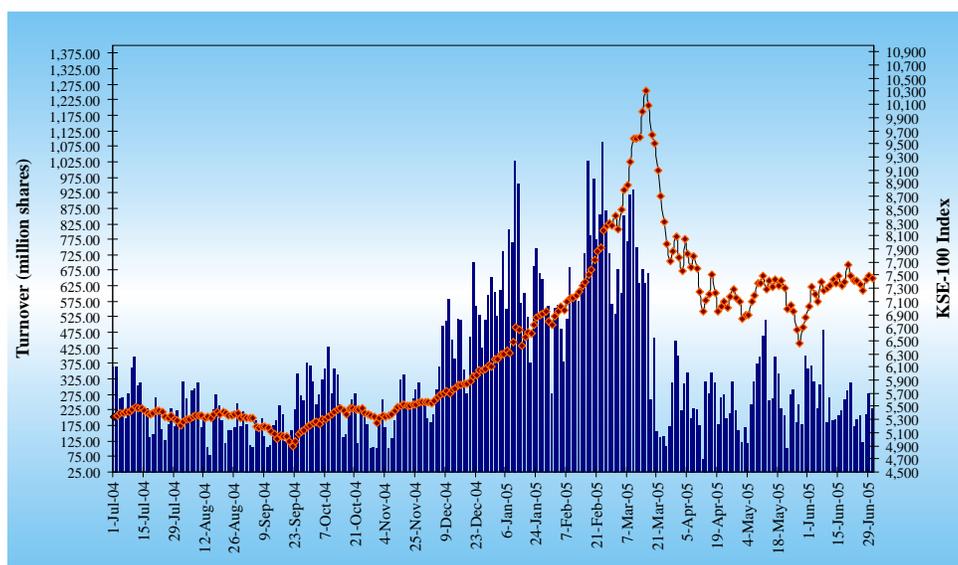


Figure 6: KSE-100 Index and Turnover at KSE (July 2004 - June 2005)

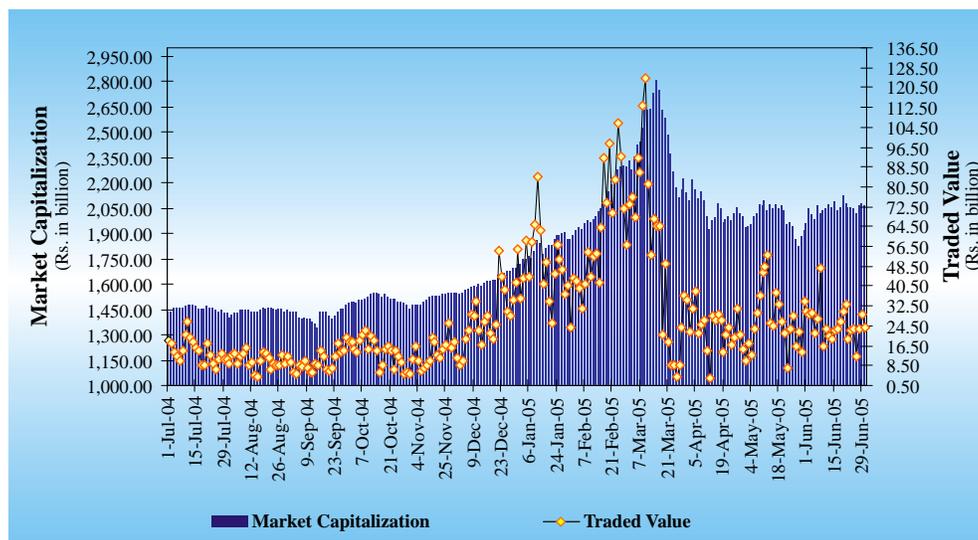


Figure 7: KSE Market Capitalization and Traded Value (July 2004 - June 2005)

Public offerings of the Government's shares in a number of SOEs were a significant feature and contributed to buoyancy in the stock market during the year. These offerings attracted substantial investments, particularly from small investors, and thereby helped to substantially increase the retail investor base.

Activity in the futures market was exuberant during the year as more scrips were allowed to be traded on the futures counter. During February and March 2005, the highest turnover in futures market was recorded with the traded value of the futures market exceeding that of the ready market during March 2005.

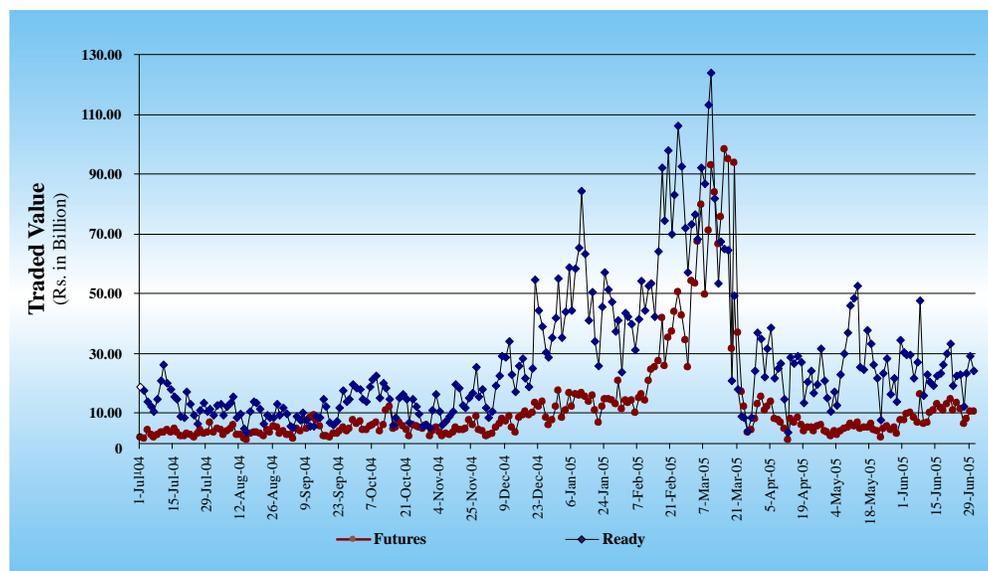


Figure 8: Traded Value in Ready Market and Futures Market at KSE (July 2004 - June 2005)

### 6.2.2 March 2005 Situation

The stock market witnessed extreme bullish and bearish sentiments during the period January-March 2005. The bull run in the stock market was triggered during January and lasted for two and a half months. The KSE-100 index, which was at 6,218 on 31 December 2004, increased to 10,303 on 15 March 2005 i.e. an increase of 65 percent in just two and half months. However, the stock market suffered a sharp decline, which commenced on 16 March 2005, resulting in the KSE-100 index declining by 25 percent to as low as 7,708 on 28 March 2005.

An analysis of the market revealed that this increase in the index by 4,085 points was mainly due to increase in share prices of Oil and Gas Development Company Limited (OGDCL), Pakistan Telecommunication Company Limited (PTCL), Pakistan State Oil Company Limited (PSO), Pakistan Oilfields Limited (POL) and National Bank of Pakistan (NBP), respectively. The impact of OGDCL was 2,327 points while that of PTCL was 775 points, PSO 158 points, NBP 180 points and POL 68 points. Of the five companies, three were on privatization list at the time and their share prices increased mainly due to news reports of indications of buying interest from foreign strategic buyers. As regards NBP, there was enormous buying interest on account of good profitability and substantial increase in investment in NIT units, whose value increased substantially due to increased market prices of equity investments.

An analysis of the bullish behavior of KSE-100 index showed that substantial decrease in the prices of OGDCL, PTCL, PSO, POL and NBP contributed to 68 percent decline, i.e. 1,759 points of the total fall of 2,600 points in the index from its peak of 10,303 as on 15 March 2005.

On 12 April 2005, the Commission constituted a Task Force to review the market situation and investigate and identify the factors that led to the decline in the KSE-100 index and to suggest measures to further strengthen the regulatory regime. The Task Force, headed by Justice (Retd.) Salim Akhtar, submitted its report to the Commission in June 2005.

The Task Force identified the following as some of the reasons behind the March situation:

- i. delay in the privatization of government owned companies;
- ii. withdrawal of badla/COT funds by financiers;
- iii. excessive buy positions by several brokers in the futures market who were not able to get an exit opportunity due to the continuous decline in the market;
- iv. sellers in the March futures contracts carried hedged position from ready market and decided not to square up their positions in the March futures contracts; and
- v. downward circuit breakers blocked the opportunity of exit from the market.

Before March, the Commission had taken steps to ensure that risk management was strengthened at the stock exchanges. Moreover, adequate margins were deposited by brokers at the exchanges and also the quality of margins was such that the clearing house was in a safe position. Margin requirements, mark-to-market margins and capital adequacy limits were all being met by the brokers.

As a result of these measures, sanctity of the futures contract, integrity of the system, and stability of the market were maintained. The stock exchanges remained fully functional throughout this period. There were no settlement issues, no margin issues and mark-to-market losses were collected by the exchanges as per regulations on a continuous basis.

### 6.3 Performance Review

During the year under review, the Commission actively pursued its capital market reform program, geared towards the development of a modern and efficient corporate sector and capital market. Development of laws, rules and regulations to support progressive development of the capital market was a key area of focus.

In June 2005, the Commission notified the Clearing Houses (Registration and Regulation) Rules, 2005. The Rules are aimed at providing the legal and regulatory framework for effectively governing the affairs of a clearing company acting as a clearing house as well as providing for an integrated national clearing system for settlement of trades executed in respect of companies in the Central Depository System (CDS) on all three exchanges. The Rules were finalized in consultation with NCCPL.

In order to provide the enabling environment for margin financing, the Margin Trading Regulations were finalized, keeping in view the comments and suggestions of relevant stakeholders. The Margin Trading Regulations were approved by the Commission in September 2004. Furthermore, the Commission approved the

Regulations for Proprietary Trading, 2004, to ensure fair treatment to clients by brokers and thereby safeguarding investor interests. Moreover, the Commission framed the Regulations for Securities Lending and Borrowing, 2004, primarily to facilitate short selling in the securities market. In order to address regulatory concerns arising from the growth in Internet trading, the Commission also issued the Internet Trading Guidelines, 2005 during the year.

The Commission directed the CDC and Exchanges to abolish the Group Account Facility of CDS participants in order to prohibit unfair trade practices and to prevent misuse in the handling of book entry securities, owned beneficially by investors and maintained by participants in the Group Account of CDS. By 30 April 2005, the Group Account facility stood abolished. The successful closure of Group Account Facility represents a major milestone in the development of the capital market, as it would enhance transparency and eliminate various market ills.

During the year under review, the Commission, after extensive consultation with stock exchanges, finalized a comprehensive time-bound action plan to ensure the smooth phase out of COT/badla. In accordance with the action plan, the phasing out of COT/badla commenced from 8 October 2004. COT was completely eliminated subsequent to the close of the year; albeit CFS has been introduced as an interim measure to replace COT/badla financing in order to enhance the level of liquidity in the market while alternative modes of leverage financing are being developed, which include margin financing and futures market. In this regard, the Commission ensured that necessary measures for the minimization of market abuse and the mitigation of risk were incorporated into the CFS Regulations to ensure the preservation of market integrity, investor protection, and the restoration of investor confidence. Accordingly, the CFS Regulations provide several crucial risk mitigating measures.



Officers of the SMD at work

The Commission directed the stock exchanges to implement various measures for strengthening the risk management system as well as to undertake a comprehensive review of the existing risk management system. These measures and review were targeted at enhancing risk management and protecting investor interest.

The Commission has considerably enhanced its enforcement and monitoring capacity to ensure market integrity and provide protection to investors. During the year under review, the Commission imposed penalties on various companies found guilty of market abuse. The proactive role of the Commission in combating market abuse will lead to greater transparency, improved governance, and accountability, as well as enhanced investor confidence.

## 6.4 Development of Laws

### 6.4.1 Clearing Houses (Registration and Regulation) Rules, 2005

The Commission notified the Clearing Houses (Registration and Regulation) Rules, 2005 on 1 June 2005. These Rules were finalized in consultation with NCCPL and aim at effectively governing and regulating the affairs of a clearing company acting as a clearing house. These Rules also provide for an integrated national clearing system for the settlement of trades executed in respect of companies in CDS on all three exchanges.

### 6.4.2 Margin Trading Regulations, 2004

In order to give effect to the Margin Trading Rules, 2004, the Commission approved the Margin Trading Regulations on 23 September 2004. In this regard, the Commission had earlier constituted a Committee comprising representatives of stock exchanges and the Commission for suggesting comprehensive regulations

for brokers relating to grant of margin financing and margin trading facilities. The Margin Trading Regulations were finalized in view of the recommendations of the Committee.

### 6.4.3 Regulations for Proprietary Trading, 2004

The Commission, on 26 October 2004, accorded approval to the Regulations for Proprietary Trading, 2004. The Regulations would help check market abuse arising from conflict of interest of brokers in proprietary trades. The Regulations *inter alia* provide for the segregation of client accounts and broker/proprietary accounts as well as for appropriate disclosure to a client regarding shares in which the broker intends to trade.

### 6.4.4 Regulations for Securities Lending and Borrowing, 2004

In December 2004, the Commission framed Regulations for Securities Lending and Borrowing, primarily to regulate short selling transactions, and sent them to the stock exchanges for notification and adoption. The Regulations lay down the general requirements, the eligibility criteria for an 'approved intermediary' and the obligations and responsibilities of an approved intermediary. Presently, the CDC is working towards the implementation of the securities lending and borrowing facility through CDS.

### 6.4.5 Internet Trading Guidelines, 2005

Internet trading has been a growing trend in the securities market, worldwide as well as in Pakistan. In order to address regulatory concerns arising from the growth in internet trading and regulate the activity in line with international best practices, the Commission, on 14 March 2005, issued the Internet Trading Guidelines, 2005.

The Internet Trading Guidelines provide an appropriate balance between measures that maintain market integrity and investor protection as well as those that encourage market development and innovation. The said Guidelines *inter alia* include provisions requiring service providers to have adequate controls and procedures in place so as to ensure confidentiality of information, integrity and availability of service as well as contingency plans in the event of a loss of service.

## 6.5 Regulatory Actions

### 6.5.1 Prohibition of Group Account Facility

In order to prohibit unfair trade practices, the Commission directed closure of Group Account Facility of CDS participants. In this regard, directives were issued to CDC and stock exchanges to abolish the facility by 31 March 2005; the deadline was later extended to 30 April 2005 and closure was successfully accomplished.

This measure would prevent misuse in the handling of book entry securities, owned beneficially by investors and maintained by participants in Group Account of CDS. It would also inculcate good governance and encourage transparency and higher standards of disclosure in securities market transactions.

### 6.5.2 Risk Management Measures

In order to strengthen market integrity and minimize systemic risk, the Commission introduced the following risk management measures during the period under review.

#### i. Elimination of COT and Introduction of CFS

COT has often been identified as the root cause of recent market crises and a threat to market integrity. In order to alleviate the problems associated with COT/badla financing, it was decided, in consultation with stock exchanges and other stakeholders, to gradually phase out COT. After extensive consultation with stock exchanges, a comprehensive, time-bound action plan was prepared for the purpose. In accordance with the action plan,

phasing out of COT/badla commenced from 8 October 2004. By the close of the year under review, the number of securities eligible for badla financing was reduced to seven compared to twenty-nine eligible securities in FY 2004.

Subsequent to the close of the year, COT was replaced by CFS and the Commission approved the Continuous Funding System Regulations, 2005 on 22 August 2005. CFS has been introduced as an interim measure to replace COT/badla financing in order to facilitate the adjustment to alternative modes of financing in line with accepted best practice.

To preserve market integrity, investor protection and restoration of investor confidence, it was ensured that the CFS Regulations provide several crucial risk mitigating measures for the minimization of market abuse and the mitigation of risk.

#### ii. Risk Management Measures at Exchanges

During the year under review, the Commission directed stock exchanges to implement various measures for strengthening their risk management systems as well as to undertake a comprehensive review of the entire risk management system currently in place.

The following measures were implemented at stock exchanges:

- **Profit Distribution for Futures Market**  
Distribution of profit to the extent of 30 percent on weekly basis on futures contracts was reduced to 20 percent, as these were unrealized profits till contracts were closed-out/settled.
- **Position Limits for Futures Market**  
Exchanges were directed to apply position limits on futures contracts in line with international practices to check undue concentration by brokers and/or their clients in a particular stock future contract. The position limit in futures trading was fixed at 3 percent in each scrip by each member based on free float. These position limits would prevent cornering/manipulation.
- **Netting in Ready and Futures Market for the Purpose of Capital Adequacy**  
In order to curtail systemic risk, the practice of netting across T+3 and futures positions for determining exposure of a member for the purpose of capital adequacy was discontinued.
- **Collection of Loss Margin in Futures Market**  
The collection of marked-to-market loss in the futures and ready markets was previously at the end of the day and on an hourly basis, respectively, in case broker exposure exceeded Rs. 200 million. This practice was modified to ensure collection of loss margin in futures market twice in a day.
- **Pre-Trade Margin Verification at KSE**  
KSE was directed to implement pre-trade margin verification to ensure that brokers do not exceed the capital adequacy and deposit requirements and to pre-empt any such move on part of a broker. The system would check, at the time of placing an order, whether the concerned member has sufficient margin deposits for the execution of trades in the market.

In addition to the above, the stock exchanges were required to undertake a comprehensive review of the entire risk management system currently in place at the exchanges, including the following measures, and to forward a time-bound action plan for implementation of the same.

- **Percentage of Initial Margin In Ready Market**  
Previously, brokers could deposit the entire initial margin in the form of securities, which was subject to price fluctuation (volatility) and liquidity risk. It was, therefore, considered imperative that a certain percentage of the initial margin be collected in cash. Accordingly, the Commission and exchanges

decided that one-third of margins against exposures and marked-to-market losses in the ready market would be collected in cash.

- **Unique Identification Number**  
All transactions/orders entered in the automated trading system would require mandatory client identification in the automated trading system. This would allow a broker's proprietary trades to be distinguished from clients' trades as well as each client trade to be separated from trade(s) of other clients. The unique global client identification mechanism is being developed by CDC. This measure would significantly enhance management of risk at the client level and improve the surveillance and monitoring capacity of the Commission and exchanges.
- **Segregation of Client Assets**  
In order to ensure that client assets are not misused, exchanges were advised to ensure that brokers segregate each client's assets from their own assets. For this purpose, brokers should maintain a separate bank account, which would include all cash deposits of their clients, along with record/breakdown of client positions. Further a margin deposit, in the form of securities, is to be maintained in a separate sub-account or investor account.
- **Collection of Gross Margin**  
Presently, brokers are allowed to net client positions, i.e. purchase position of one client may be off-set against sale position of another client in the same scrip. This provides opportunity for the broker to overtrade as well as possibility of misuse of investor/client assets. Accordingly, exchanges were advised during the year to collect margin on gross positions. This measure would be implemented once unique/global client identification feature has been put in place.
- **Introduction of Concentration Margins**  
To discourage brokers from concentrating their exposure in a particular share and to reduce systemic risk arising from such concentration, a concentration margin over and above the existing margin would be collected from brokers.
- **Margin based on Volatility and Liquidity of Scrips**  
Currently, a slab-based system is used to determine the margin rate applicable to the exposure of a broker. However, this system does not take into account the individual volatility and liquidity of shares as margin rates only increase when exposures slab changes. The exchanges have, therefore, been advised to work towards the implementation of VaR Model or SPAN.

VaR would take into account risk associated with each share based on historical data. The methods of VaR and SPAN are based on mathematical and statistical techniques and are supported with tailor-made software applications.

### iii. Additional Risk Management Measures

In April 2005, the Commission and Boards of the three stock exchanges held a meeting and decided on the following risk management measures that have since been implemented at the stock exchanges:

- **Deposit against Exposures**  
Deposit against members' exposures, exceeding Rs. 200 million in the futures market, is now being collected as 50 percent in cash and 50 percent in eligible securities or bank guarantees. With effect from May 2005, the total exposure of a member in futures market was restricted to ten times the net capital balance of the member.
- **Change in Circuit Breakers**  
Circuit breakers in the ready and futures market were previously fixed at an upper limit of 7.5 percent or Rs. 1, whichever is higher, and lower limit of 5 percent or Rs. 1, whichever is higher. These have now been

revised and fixed at an upper limit of 5 percent or Rs. 1, whichever is higher, and lower limit of 5 percent or Rs. 1 whichever is higher.

The KSE was advised to develop necessary mechanism in the context of circuit breakers so as to provide an exit option to investors.

- **Reconstitution/Revamping of KSE-100 Index**  
In order to ensure that the KSE-100 index represents a fair picture of the market, the KSE was advised to review/examine international best practices with respect to the construction of market indices based on parameters such as free float rather than the number of outstanding shares. The KSE-100 index is to be accordingly revamped and reconstituted based on free float.
- **Eligibility of Scrips in Futures Market**  
No scrip shall qualify for futures market unless its free float is Rs. 50 million or more. Moreover, the number of contracts opened (open interest) in a scrip, shall not exceed the free float of such scrip.
- **Order in Pre-Open**  
No changes or deletion of orders (either bid or offer) shall be allowed in the pre-open session.
- **Settlement of Futures Contracts**  
Existing futures contracts based on deliverables will be allowed for trading till September 2005 and thereafter will be cash settled.
- **Standardization of Futures Contracts with Multiple Durations**  
In FY 2006 the exchanges will introduce standardized contracts of thirty, sixty and ninety days on cash settlement basis.

### 6.5.3 Rationalization of Fee on Various Regulatees

For carrying out its regulatory functions under the SECP Act, the Commission has been charging a transaction fee from the stock exchanges. Since the Commission spends considerable time and effort on regulating CDC, NCCPL and stock exchanges, it was considered fair to apportion the regulatory cost amongst them. Thus, pursuant to the decision of the Policy Board, the Commission imposed settlement fee of 0.30 per Rs. 100,000 value of trade on NCCPL and a transaction fee of 0.000405 paisa per share on CDC and reduced the transaction fee on stock exchanges from 0.00090 percent to 0.00065 percent of the value of securities traded on all exchanges with effect from 1 November 2004.

### 6.5.4 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 cases regarding issuance of commercial papers, application for registration of Special Purpose Vehicles (SPVs) under the Companies (Asset Backed Securitization) Rules 1999, cases under the Companies (Substantial Acquisition of Voting Shares and Takeovers) Ordinance, 2002 (Takeover Ordinance), applications for relaxation from the requirements of the Companies (Issue of Capital) Rules, 1996 relating to the public offering of securities and cases reported under Section 18-A of the Securities and Exchange Ordinance, 1969, which prohibits submission of more than one application by a single applicant for subscription of shares.

During the year under review, twelve companies issued/offered shares to the public as compared to eleven in the preceding year. Similarly, fourteen companies issued debt instruments, i.e. TFCs to the public as compared to six in the preceding year.

The table below provides a comparison of share capital and TFC offerings during the FY 2005 with the previous year.

Table 10: 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
2005	12	24,335.195	14	16,450.000	16,100.000	16,250.000
2004	11	*48,883.418	06	4,820.000	3,320.000	3,400.000

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

#### i. Share Capital

Of the twelve equity issues during the year, there were seven offerings of fresh equity capital to the general public through which 80.5 million ordinary shares amounting to Rs. 835 million (inclusive of premium amount of Rs. 30 million) were offered. Of these seven public issues, five were oversubscribed while two were undersubscribed. The total amount listed on the exchange was Rs. 2.99 billion while IPOs amounted to Rs. 805 million. The details are given as under.

Table 11: 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	First National Equities Limited	Investment Banks/ Securities Companies	28-29 September 2004	1 November 2004	500.000	375.000	125.000	-	-	134.650
2	AMZ Ventures Limited	Investment Banks/ Securities Companies	1-3 November 2004	13 December 2004	300.000	200.000	100.000	-	-	108.535
3	Network Micro Finance Bank Limited	Investment Banks/ Securities Companies	6-7 December 2004	6 January 2005	100.000	60.000	40.000	-	-	46.960
4	International Housing Finance Limited	Investment Banks/ Securities Companies	28-29 December 2004	7 February 2005	400.000	280.000	120.000	2.50	30.00	179.731
5	Dewan Farooq Spinning Mills Limited	Textile Spinning	27-28 April 2005	6 June 2005	600.000	450.000	150.000	-	-	152.825
6	EYE Television Network Limited	Technology and Communication	27-28 June 2005	8 August 2005	500.000	350.000	150.000	-	-	3.265
7	Zephyr Textiles Limited	Textile	29-30 June 2005	8 August 2005	594.287	474.287	120.000	-	-	10.660
Total					2,994.287	2,189.287	805.000		30.00	636.626

The remaining five equity issues during the year were offers for sale (disinvestments), through which 325.6 million ordinary shares amounting to Rs. 13.71 billion (inclusive of premium amount of Rs. 10.45 billion) were offered to the general public. All offers except one were oversubscribed. During the year, the Government offered shares of Pakistan Petroleum Limited, Kot Addu Power Company Limited and United Bank Limited to the general public for the first time.

Details of the secondary offerings are as follows.

Table 12: Secondary Offerings of 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 Petroleum Limited	Oil and Gas Exploration Companies	19-22 July 2004	16 September 2004	6,858.376	6,858.376	*1,028.752	45.00	4,629.384	20,816.977
2	Jahangir Siddiqui Capital Market Limited	Investment Banks/ Securities Companies	30-31 December 2004	7 February 2005	100.000	100.000	25.000	42.50	106.250	661.421
3	Attock Petroleum Limited	Oil and Gas Marketing Companies	28-29 January 2005	7 March 2005	400.000	400.000	100.000	47.75	477.500	10,795.818
4	Kot Addu Power Company Limited	Power Generation and Distribution	21-24 February 2005	18 April 2005	8,802.532	8,802.532	* 1,584.450	20.00	3,168.900	20,998.890
5	United Bank Limited	Commercial Banks	3-8 June 2005	27 July 2005	5,180.000	5,180.000	518.000	40.00	2,072.000	1,093.090
Total					21,340.908	21,340.908	3,256.202		10,454.034	54,366.196

\* Including the amount of capital offered and retained under Green Shoe Option.

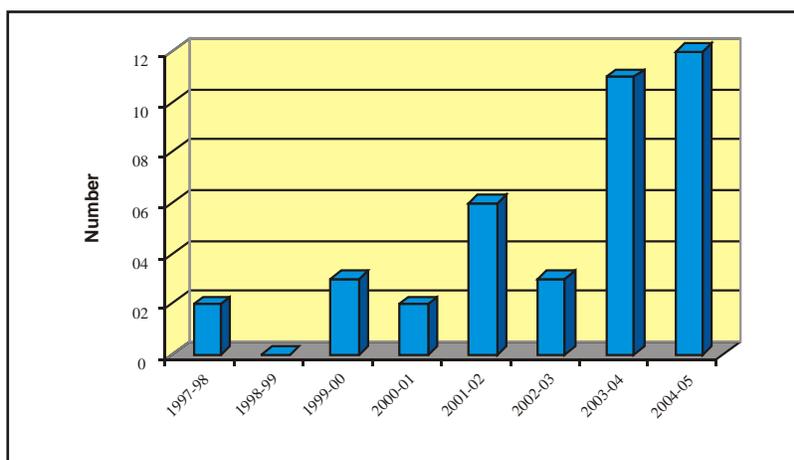


Figure 9: Number of Equity Issues During the FYs 1998 - 2005

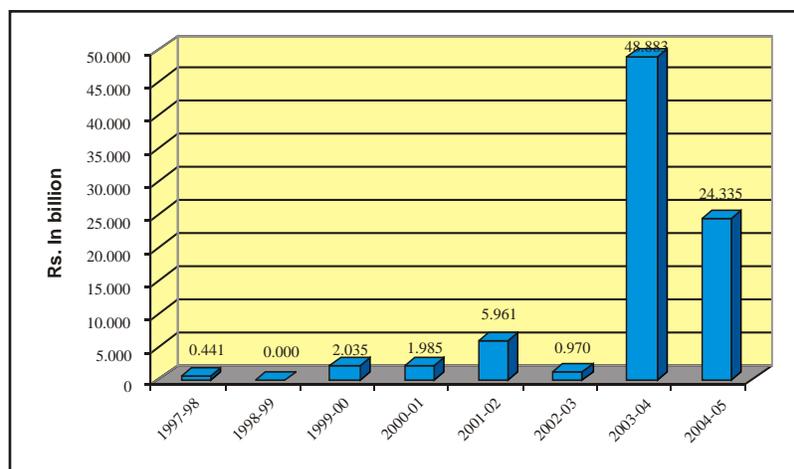


Figure 10: Amount Listed through Equity Issues During the FYs 1998 - 2005

## ii. Redeemable Capital

During the year under review, fourteen companies made public offer of TFCs (including two companies which offered TFCs under securitization arrangement), involving an aggregate amount of Rs. 16.1 billion. An amount of Rs. 16.25 billion (inclusive of green-shoe option) was raised: Rs. 12.380 billion through private placement and Rs. 3.870 billion from the general public.

The table below summarizes the TFC offerings (other than those issued under securitization arrangement) during the year under review.

Table 13: 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	Bank Al-Habib Limited	15 July 2004	30 August 2004	1,350.000	1,150.000	200.000	1,350.000	1,150.000	229.805	1,379.805	N.A.	1,350.000
2	United Bank Limited	26-27 July 2004	27 September 2004	2,000.000	1,500.000	500.000	2,000.000	1,500.000	933.960	2,433.960	N.A.	2,000.000
3	Trust Leasing Corporation Limited (2nd Issue) (First tranche of total authorized Rs. 1000 million)	16-17 July 2004	2 September 2004	1,000.000	300.000	75.000	375.000	300.000	119.730	419.730	N.A.	375.000
4	Bank Alfalah Limited	22-23 November 2004	30 December 2004	1,250.000	1,000.000	250.000	1,250.000	1,000.000	267.100	1,267.100	N.A.	1,250.000
5	Jahangir Siddiqui and Company Limited	20-21 December 2004	18 February 2005	500.000	350.000	150.000	500.000	350.000	166.910	516.910	N.A.	500.000
6	Askari Commercial Bank Limited	3-4 February 2005	11 April 2005	1,500.000	1,000.000	500.000	1,500.000	1,000.000	791.740	1,791.740	N.A.	1,500.000
7	Prime Commercial Bank Limited	9-10 February 2005	9 May 2005	800.000	640.000	160.000	800.000	640.000	243.130	883.130	N.A.	800.000
8	United Bank Limited (2nd Issue)	14-15 March 2005	27 April 2005	2,000.000	1,500.000	500.000	2,000.000	1,500.000	150.005	1,650.005	N.A.	2,000.000*
9	Hira Textile Mills Limited	15-17 March 2005	2 May 2005	250.000	175.000	75.000	250.000	175.000	175.210	350.210	up to Rs.100 million	350.000
10	Soneri Bank Limited	4-5 May 2005	8 June 2005	1,200.000	1,000.000	200.000	1,200.000	1,000.000	400.485	1,400.485	N.A.	1,200.000
11	TeleCard Limited	26-27 May 2005	14 July 2005	2,400.000	1,900.000	500.000	2,400.000	1,900.000	128.490	2,028.490	N.A.	2,400.000*
12	Al-Zamin Leasing Modaraba (2nd tranche of total authorised Rs.1 billion)	30-31 May 2005	11 July 2005		215.000	60.000	275.000	215.000	115.610	330.610	up to Rs.50 million	325.000
Total				14,250.000	10,730.000	3,170.000	13,900.000	10,730.000	3,722.175	14,452.175		325.000

\* Unsubscribed certificates taken up by underwriters.

The detail of TFCs issued to the general public under the asset backed securitization arrangement is given in Table 14.

Table 14: TFC Issues 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	Chanda Oil and Gas Securitization Company Limited	15-16 February 2005	4 April 2005	1,000.000	750.000	250.000	1,000.000	750.000	250.000	1,000.000	N.A.	1,000.000
2	Niamat Basal Oil and Gas Securitization Company Limited	11-12 April 2005	16 May 2005	1,200.000	900.000	300.000	1,200.000	900.000	65.220	965.220	N.A.	1,200.000*
Total				2,200.000	1,650.000	550.000	2,200.000	1,650.000	315.220	1,965.220		2,200.000

\* Unsubscribed certificates taken up by underwriters.

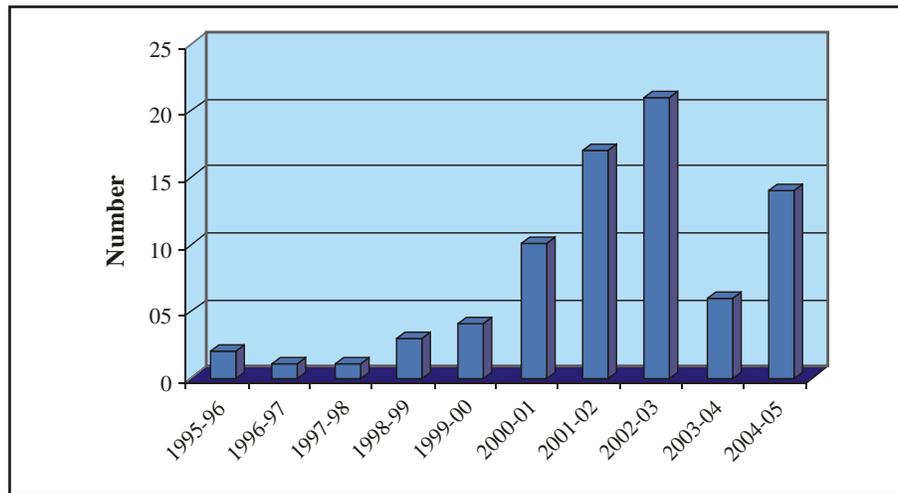


Figure 11: TFC Issues Floated During the FYs 1996 - 2005

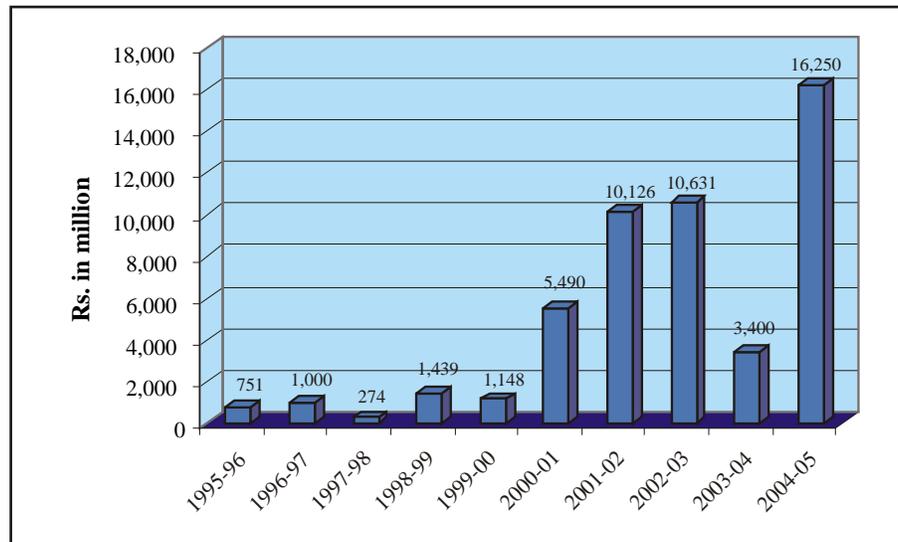


Figure 12: Amount Raised through TFCs During the FYs 1996 - 2005

During the year under review, the Commission registered two companies, namely, Development Securitization Trust Limited and Naimat Basal Oil and Gas Securitization Company Limited as SPVs under the Companies (Assets Backed Securitization) Rules, 1999. The detail is provided in the table below.

Table 15: Registration of SPVs

(Rs. in million)

S. No.	Name of Originator	Name of SPV	Size of Issue	Tenor	Pre-IPO	IPO	Private Placement
					Listed		Non-Listed
1	Associated Constructors Limited	Development Securitization Trust Limited	100.00	30 months	-	-	100
2	Orient Petroleum Inc.	Naimat Basal Oil and Gas Securitization Company Limited	1,200.00	5 Years	900.00	300.00	-

### 6.5.5 Registration of Brokers and Agents

Under the Brokers and Agents Registration Rules, 2001, all brokers and agents must be registered with the Commission. The Commission ensures compliance with the Rules and takes appropriate punitive measures in case of violations.

#### i. Brokers

During the year under review, the Commission granted certificates of registration to thirty-five brokers while seventeen were de-registered due to cancellation or surrender of certificate of registration. Compared with the previous year, the total number of brokers registered with the Commission increased from 286 to 304 as on 30 June 2005.

Table 16: Registration of Brokers

FY	Opening Number of Registered Brokers	Addition During the Year	Cancellation/ Surrender of Certificate of Registration	Closing Number of Registered Brokers
2005	286	35	17	304
2004	278	31	23	286

Distribution of corporate and individual brokers in each stock exchange is given as under.

Table 17: Details of Registered Brokers

Stock Exchange	Corporate Brokers	Individuals	Total
KSE	95	73	168
LSE	47	42	89
ISE	24	23	47
Total	166	138	304

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. Of the 304 registered brokers, corporate brokers accounted for 55 percent of the total registered brokers.

In keeping with last year's trend, a number of individual brokers adopted corporate status during the year. The corporatization and institutionalization of brokers has helped raise standards of brokerage business in the country. A graphical representation is illustrated in Figure 13.

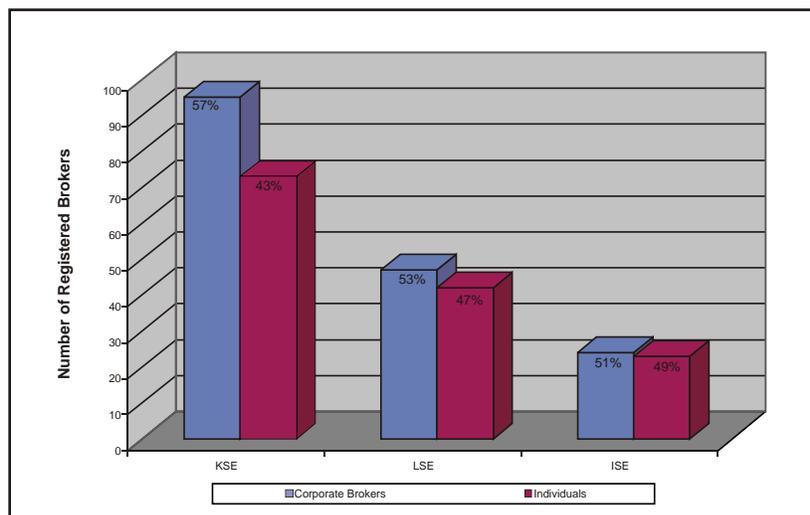


Figure 13: Details of Registered Brokers

ii. Agents

The statistics with respect to registration of agents as of 30 June 2005 are presented in the table below.

Table 18: Registration of Agents

Stock Exchange	Total Number of Registered Agents as on 30 June 2004	Addition During the FY 2005	Cancellation/ Surrender of Certificate of Registration	Total Number of Registered Agents as on 30 June 2005
KSE	54	57	6	105
LSE	53	24	13	64
ISE	17	16	7	26
Total	124	97	26	195

## 6.6 Monitoring and Enforcement

### 6.6.1 Market Monitoring and Surveillance

The Monitoring and Surveillance Wing (MSW) of the SMD is at the forefront of 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 period under review, MSW continued its efforts to ensure market fairness and actively pursued and implemented measures pertinent to strengthening of the risk management framework. As a result of its surveillance, on occasions that MSW detected suspicious trading activities, it conducted investigations and undertook enforcement actions against responsible participants. Two separate investigations for insider trading and violation of listing regulations in the shares of Fauji Fertilizer Company Limited were initiated after MSW noticed an intermittent trading activity in the said shares; appropriate actions against the concerned elements for violation of relevant securities laws were taken. Similarly, appropriate enforcement actions were taken after investigating price manipulation in the shares of PICIC Growth Fund and PICIC Investment Fund.

## 6.6.2 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.

The statistics of complaints received and handled by the SMD for the FY 2005 are provided below.

Table 19: Statistics of Investor Complaints (July 2004 - June 2005)

	KSE	LSE	ISE	Total
Number of complaints brought forward	47	81	16	144
New complaints/claims received (1 July 2004 – 30 June 2005)	109	44	20	173
Total complaints handled by SMD (1 July 2004 – 30 June 2005)	156	125	36	317
Break-up of total complaints handled by SMD:				
Complaints pending with the stock exchanges as on 30 June 2005	50	25	09	84
Complaints/claims with the stock exchanges against defaulted members as on 30 June 2005	09	-	-	09
Complaints disposed off (1 July 2004 – 30 June 2005)	74	74	25	173
Complaints under examination of the SMD as on 30 June 2005	23	26	02	51

Of the 173 complaints registered with the SMD during the year, 117 were received during the period 1 March to 30 June 2005 as a result of the stock market activity during the period. To address the need for direct nexus with the complainants during this period, the SMD provided special online complaints facility for investors.

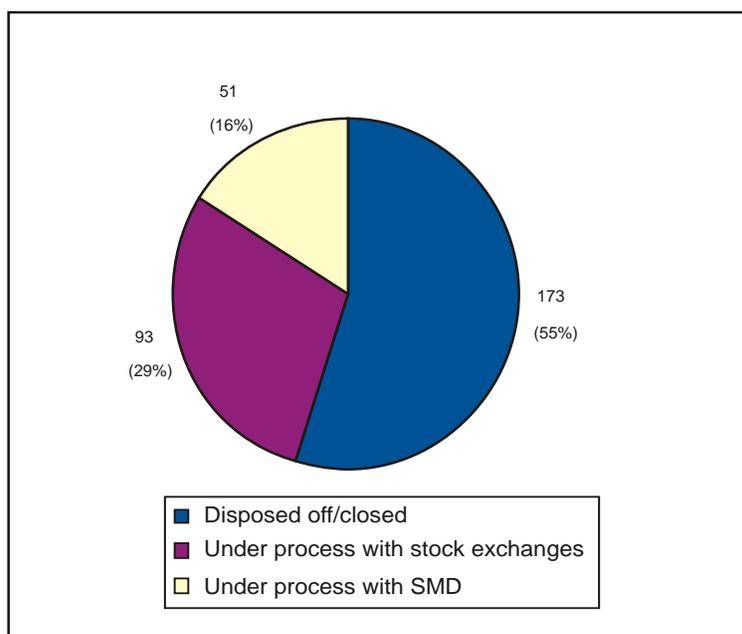


Figure 14: Investor Complaints Handled by the SMD

### 6.6.3 Inspections

The Stock Exchange Members (Inspection of Books and Record) Rules, 2001 empower the Commission to inspect the books and records of members of the exchanges with the objective to improve transparency and ensure fair dealings and compliance with the securities laws. The Rules also specify the books and records to be maintained by members. During the year under review, the Inspection Wing of the SMD completed inspections of five brokerage houses and appropriate actions on the findings of the inspector are being taken as envisaged under the law.

### 6.6.4 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 period under review, seven cases of tenderable gain were finalized. As on 30 June 2005, the status of cases of tenderable gain was as under.

Table 20: Details of Cases of Tenderable Gain

Status	No. of Cases
Amount of gain tendered in favor of the Commission	1
In process	6
Pending with Lahore High Court, Lahore	1
Appeals to be filed by the Commission before Supreme Court of Pakistan against the orders of Lahore High Court, Lahore dated 2 June 2005	2

### 6.6.5 Enforcement Actions against Market Abuses

In order to ensure investor protection and market integrity, the enforcement and monitoring capacity of the Commission was considerably strengthened and the SMD imposed penalties on companies found guilty of market abuse. The proactive role of the SMD in combating market abuse will lead to greater market transparency, improved governance and accountability, and enhanced investor confidence.

#### i. Insider Trading

In the first proven case of insider trading in the history of capital markets in Pakistan, the Commission imposed a fine of Rs. 535,000 on Pakistan Kuwait Investment Company Limited for involvement in insider trading in the shares of Fauji Fertilizer Company Limited.

#### ii. Price Manipulation

A fine of Rs. 500,000 was imposed on Pakistan Industrial Credit and Investment Corporation Limited (PICIC) for price manipulation in the certificate prices of PICIC Growth Fund and PICIC Investment Fund.

### iii. Lack of Proper Disclosure

The Commission issued warnings to the management and Board of Directors of Fauji Fertilizer Company Limited for improper dissemination by the company of certain price sensitive information to the exchanges at different times and directed the company to be careful in future with regard to the compliance of law as well as the listing regulations.

### iv. Imposition of Fine on Brokers

The SMD took the following actions where violations of brokers were noted:

- A fine of Rs. 100,000 was imposed on Al-Mal Securities and Services (Pvt.) Limited, Corporate Member, KSE for various violations of the Securities and Exchange Ordinance, 1969.
- A penalty of Rs. 50,000 was imposed on Mohammad Ayub Younus Adhi, Member, KSE for making false statement and concealing information from the Commission in respect of trading in the shares of Fauji Fertilizer Company Limited.
- Live Securities (Pvt.) Limited, Corporate Member, KSE was warned to be more cautious and vigilant in future with regard to compliance of capital adequacy requirements.

### v. Takeover and Substantial Acquisition of Shares

In order to protect the interests of minority shareholders and to discourage violation of regulatory requirements in respect of substantial acquisition of shares and takeover of companies, the first ever enforcement action under the Takeover Ordinance was taken in the case of Pakland Cement Limited and Saadi Cement Limited.

In the case of Pakland Cement Limited a collective penalty of Rs. 1 million was imposed on the acquirers in proportion to the shares acquired by them for violating various provisions of the Takeover Ordinance. Further, in the interest of the capital market, the acquirers were also directed not to dispose off any of the shares acquired by them in violation of the Takeover Ordinance for a period of three years from the date of acquisition, without prior approval of the Commission.

A similar enforcement action was taken in the case of Saadi Cement Limited where a collective penalty of Rs. 1 million was imposed on the acquirers in proportion to the shares acquired by them for violating various provisions of the Takeover Ordinance. The acquirers were also debarred from disposing off the shares, acquired in violation of the Takeover Ordinance, for a period of three years without prior approval of the Commission

In the case of Essa Cement Industries Limited, a collective penalty of Rs. 1 million was imposed on the acquirers in proportion to the shares acquired by them in violation of the various provisions of the Takeover Ordinance. Further, the acquirers were also directed not to dispose off any of the shares acquired by them in violation of the Takeover Ordinance for a period of three years from the date of acquisition, without the prior approval of the Commission. A penalty of Rs. 200,000 was also imposed on the Manager to the Offer for violation of Section 15 of the Takeover Ordinance.

## 6.7 Administrative Appeals

PICIC filed an appeal against the order of Commissioner (SMD) before the Appellate Bench of the Commission. The impugned order was set aside by the Bench.

First Capital Securities Corporation Limited also filed an appeal against the order of Commissioner (SMD) under Section 224(2) of the Companies Ordinance before the Appellate Bench of the Commission. The Bench upheld the order of Commissioner (SMD).

Appeals against two orders passed by the Commissioner (SMD), in matters of non-compliance with certain provisions of the Takeover Ordinance, were lodged before the Appellate Bench. The Appellate Bench upheld the

order of Commissioner (SMD) to the extent that the acquirers were directed not to dispose off the shares acquired by them for a period of three years from the date of acquisition; penalties imposed on the acquirers were, however, set aside.

## 6.8 Judicial Cases

In September 2004, LSE filed an appeal before the Lahore High Court, Lahore against the order of Appellate Bench in the case of de-listing of a company from LSE. The case is pending decision in the Lahore High Court.

## 6.9 Developmental Activities

### 6.9.1 Demutualization of Stock Exchanges

During the year under review, the Commission initiated an extensive dialogue with the relevant stakeholders soon after the expert committee, comprising of international and national experts, submitted its report on demutualization and integration of stock exchanges in Pakistan. The report recommended a fully integrated, demutualized stock exchange and further that the process of integration and demutualization should take place simultaneously and should be enforced through the enactment of a special law for this purpose. However, if substantial progress towards integration of the existing stock exchanges were not achieved within one year, the report recommended that a New Stock Exchange might be established along the lines of the National Stock Exchange of India.

Several meetings were held between the three stock exchanges and the Commission. In December 2004, the exchanges agreed to an action plan for demutualization. Pursuant to the said action plan, LSE and ISE issued a joint declaration wherein both exchanges agreed in principle to support setting up a unified stock exchange through their merger and integration. In this connection, LSE and ISE submitted their reports and provided a time-bound action plan for establishing an integrated stock exchange. KSE also submitted a draft preliminary report along with the valuation of the exchange and was in the process of making a detailed business plan during the year.

The Commission also appointed a legal expert to draft special legislation to enable demutualization of stock exchanges and possible integration of LSE and ISE.

### 6.9.2 IOSCO

The Commission continued to play an active role in the activities of IOSCO. Presently, the Commission is an active member of the Emerging Markets Committee (EMC), member of the EMC Advisory Board, chair of Working Group-3 (WG3) of EMC on financial intermediaries, member of EMC's Working Group-2 on regulation of secondary markets, and member of Technical Committee and Standing Committee on financial intermediaries.

During the year under review, the Commission successfully completed its work on the mandate of "Cross-Border Activities of Financial Intermediaries in Emerging Markets". In this regard, the Commission prepared a survey report based on responses of more than twenty jurisdictions from emerging markets. The report focused on major impediments to cross-border trading, the regulatory treatment of such trading and cross-border cooperation and information sharing mechanism between jurisdictions. The report was well received and, upon approval of the EMC Advisory Board, has been placed on IOSCO's website.

After the successful completion of its previous mandate, the Commission proposed to WG3 adoption of the new mandate on "Guidance to emerging market regulators regarding capital adequacy requirements for financial intermediaries". The new mandate was duly adopted by WG3 during the Annual Conference held at Colombo, Sri Lanka in April 2005. Upon receiving formal approval of the EMC Advisory Board, work on this mandate would be initiated.

### 6.9.3 Development of OTC Market

In order to make the corporate debt market more vibrant, efficient and liquid, it is planned that corporate debt instruments such as TFCs will be listed and traded on the OTC Market. The development of a separate board for trading of debt securities on the OTC Market is under consideration for the promotion of secondary market for debt securities.

Furthermore, in order to provide incentives for listings on the OTC Market, the Commission simplified the listing criteria and exempted companies from listing and trading fees for a period of one year. The KSE also increased paid-up capital requirement for securities to be listed on its Ready Board from Rs. 50 million to Rs. 200 million, which in turn will encourage listing of small companies on the OTC Market where the minimum capital requirement is Rs. 10 million. Moreover, the Commission on 10 January 2005 approved a separate Code of Corporate Governance for the OTC Market, allowing several relaxations.



Officers of the SMD at work

### 6.9.4 NCCPL

During the year under review, NCCPL developed the Margin Financing Module in the National Clearing and Settlement System to facilitate margin financing transactions between members of the same exchange as well as between members of the exchange and non-exchange member/institutions. NCCPL also conducted training programs for market participants at Karachi, Lahore and Islamabad to familiarize them with the functioning of the Margin Financing Module.

In accordance with the directions of the Commission for the installation of independent management, NCCPL hired a Chief Operating Officer, Chief Financial Officer, and Chief Internal Auditor and is in the process of appointing a CEO. Independent management at NCCPL will not only promote greater transparency and efficiency but also forms an essential part of a modern, progressive capital market.

### 6.9.5 Corporate Debt Market

The Commission has taken various steps in order to develop the corporate debt market such as:

- i. Revision of the Guidelines for the issue of TFCs, whereby:
  - the limit on the amount that can be retained under the Green Shoe Option has been removed;
  - the condition that “In case, issue size is Rs. 1 billion or above, or where the rating assigned is triple B minus (BBB-), the Commission may ask the issuer to get rating from another Credit Rating Agency” has been removed; and
  - the term 'small investors' has been defined as those investors which hold TFCs of up to Rs. 200,000.
- ii. Revision of Guidelines for Issue of Commercial Paper in order to bring them in line with SBP's Guidelines on Commercial Papers.
- iii. Formation of a working group comprising members from the Commission, SBP and various stakeholders and participants to review the impediments to the debt market in Pakistan. The working group has given its recommendations on how to remove these impediments, which have been forwarded to the Ministry of Finance and are being followed up with them.

## 6.10 Annual Plan

### 6.10.1 Work in Progress

#### i. Futures Trading Act and Futures Trading Rules

To introduce derivative products and futures trading, an appropriate regulatory infrastructure is required to be established through legislation so as to ensure the effectiveness and enforceability of futures and derivative transactions. The legislation must also provide for a centralized clearing system as well as recognize the system and the clearing and settlement concepts that it embodies.

During the year under review, the Commission, through the assistance of external consultants under ADB's TA, prepared a draft Futures Trading Act. In addition to providing a regulatory framework for futures trading, the Act would accommodate the issuance of more specific rules, regulations, guidelines, and formats. The Commission would, subsequently, issue Rules under the Futures Trading Act, which would support and allow establishment of standards for ascertaining the financial strength and investment appetite of potential clients and making them sufficiently cognizant of the risks of futures trading.

#### ii. Guidelines for Registration of Brokers and Agents

In line with the registration requirements being followed by other jurisdictions and to address the practical problems faced by the applicants, necessary guidelines are being prepared to facilitate swift and expeditious processing of registration cases.

#### iii. Regulations for Bankers to the Issue

A preliminary draft of the Regulations for Bankers to the Issue has been prepared by the Commission. After review and due deliberations, the Regulations will be issued.

#### iv. Investor Awareness

The Commission has initiated work on a number of areas to facilitate and encourage investor awareness:

- In order to familiarize complainants with general queries and information regarding lodging their complaints including arbitration and related matters, the Commission is preparing a comprehensive list of Frequently Asked Questions.
- In order to increase awareness among investors and to assist complainants, the Commission plans to launch an Investor Help Line. It is expected that through this Help Line, most of the queries can be addressed directly and more efficiently. In addition, it will provide a convenient mode of communication and give the complainants a better opportunity of expressing their concerns.
- The Commission is in the process of preparing a Standard Operating Procedure Manual, keeping in view the activities covered in the process of complaints' resolution. This manual would be supplemented by a Correspondence Manual, which includes standardized letters to be used for correspondence with complainants, members, and stock exchanges with an objective to achieve efficiency, timeliness, and accountability within the Commission.

## 6.10.2 Future Plans

The SMD plans to carry out the following activities during the coming year:

### i. Inspections

- Carry out routine inspections of at least 5 percent of brokers from each stock exchange to review books and records as well as procedures, daily activities and effectiveness of supervision and supervisory controls implemented at the member firm.
- Undertake focused (specific) and for-cause inspections on need basis and monitor compliance by members in specific areas.

### ii. Legislation

- Finalization of new Securities Act to replace the existing Securities and Exchange Ordinance, 1969.
- Finalization of Futures Trading Act and supplementing Rules.

### iii. Regulations

- Introduce new index based on free float of shares.
- Review of the stock lending and borrowing framework and its implementation.
- Regulations for implementation of Universal Client Identification.
- Review of the regulations of the stock exchanges.
- Development of regulatory framework for introducing new products such as Stock Index Futures.

### iv. Education

- Road shows for investor education.
- Introduction of focused investor awareness and education programs.

### v. Risk Management

- Standardization of CDC account opening form and review of the system to be developed by CDC for the purpose of stock lending and borrowing.
- Transfer of risk management from stock exchanges to NCCPL.
- Introduction of new capital adequacy formula and Early Warning Reserve.

### vi. Role in Global Market

- Finalization of IOSCO questionnaire relating to its multilateral MoU.
- Preparation of report on capital adequacy as part of new mandate of WG3 of EMC in IOSCO.





# Specialized Companies Division



**SECURITIES AND EXCHANGE  
COMMISSION OF PAKISTAN**

## 7 Specialized Companies Division

Objectives: *To ensure protection of the interests of insurance policy holders 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.*

*To build and regulate a pensions framework that promotes national savings and provide for retirement benefits.*

### 7.1 Operational structure

#### 7.1.1 Structure

The Specialized Companies Division (SCD) is primarily responsible for regulating and monitoring insurance companies, NBFCs, modarabas and private pensions. 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:

- Life Insurance Wing
- Non-life Insurance Wing

During the period under review, private pensions were being regulated by the Life Insurance Wing.

##### ii. Non-banking Finance Companies Department

The Non-banking Finance Companies Department (NBFCDD) 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 NBFCDD consists of the following Wings:

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

##### iii. Pensions Wing

Subsequent to the close of the year, a separate Pensions Wing was formed within the SCD for regulation of occupational savings in the country. While the Wing would initially be implementing and administering the VPS, it would, on a longer term, devise a regulatory framework for existing occupational saving schemes.

## 7.1.2 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 senior CA and has several years of executive experience with leading business groups. Subsequent to the close of the year under review, Dr. Salim Batla joined as Executive Director of NBFCD. He is assisted by a team of professionals led by three Directors and a Registrar Modaraba.



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

The Pensions Wing is headed by Mr. Akif Saeed, Director who is assisted by a team of professionals with diversified experience and academic qualifications in the fields of business, accounting and actuarial science.

## 7.1.3 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. Voluntary Pension System Rules, 2005
- ix. Takaful Rules, 2005
- x. Prudential Regulations for NBFCs
- xi. Prudential Regulations for Modarabas

## 7.2 Sector Overview

### 7.2.1 Insurance

As of 30 June 2005, there were fifty-five private sector insurance companies operating in the country, of which four were foreign while fifty were local enterprises and one company was registered as Takaful operator. Of the fifty local companies, forty-eight were engaged in non-life insurance business and two in life insurance business. In case of foreign insurers, two companies operated in non-life and two in life insurance sectors. As of the close of the year, thirty-four companies were listed on the KSE, having paid-up capital of Rs. 5,687 million, excluding NICL.

The public sector insurance industry comprised of four SOEs namely, SLIC, NICL, PRCL and Alpha Insurance Company Limited. The latter is the subsidiary of SLIC. While SLIC is engaged in life insurance business, NICL provides non-life insurance coverage to public sector entities. PRCL remains the only local enterprise in the business of reinsurance.

i. Non-life Insurance

The private sector, non-life insurance business was largely dominated by top ten insurance companies which accounted for almost 84 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 16 percent to Rs. 18.05 billion during the year ended 31 December 2004. Of this amount, Rs. 15.18 billion was written by the ten largest insurance companies while thirty-two companies underwrote the balance of Rs. 2.88 billion. The six non-life insurance companies, which were directed to cease entering into new contracts of insurance due to shortfall in paid-up capital during the year 2003 were unable to underwrite new business. The premium underwritten by NICL during the year amounted to Rs. 4.01 billion.



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

Fire and property damage insurance portfolio of non-life insurance sector increased to Rs. 7.26 billion while marine, aviation and transport insurance increased to Rs. 5.29 billion. The motor business insurance, accident and health, and miscellaneous insurance increased to Rs. 6.6 billion, Rs. 0.85 billion and Rs. 1.65 billion, respectively, during the year ended 31 December 2004. The underwritten profit/loss of the non-life insurance sector is estimated at Rs. 2.471 billion.

During the year ended 31 December 2004, total assets of non-life insurance sector increased by 16.3 percent to Rs. 43.468 billion. Investments in shares and debentures, including government securities, constituted the largest component. As compared to the previous year, investments showed an increase of 9.2 percent, rising to Rs. 16.249 billion during the year.

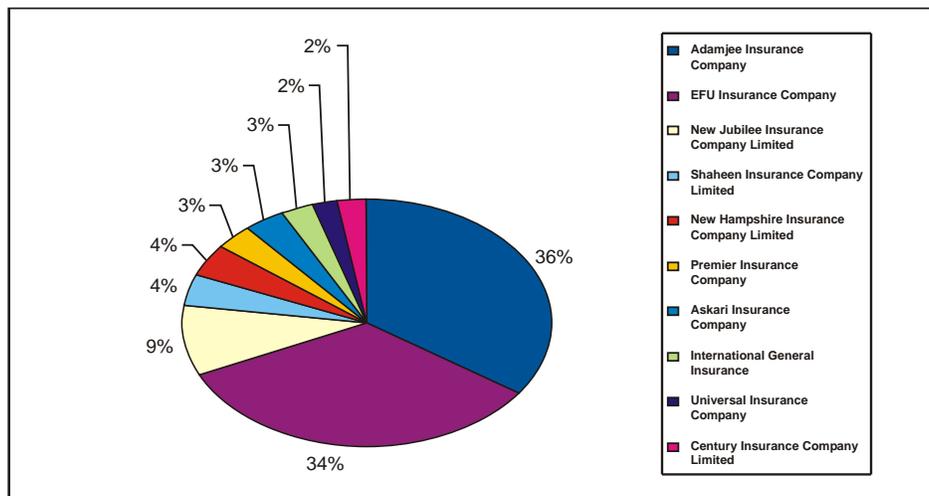


Figure 15: Share of Leading Private Sector Non-life Insurance Companies in Gross Premium

ii. Life Insurance

During the year under review, SLIC had the major share of 76 percent in total gross premium, followed by EFU Life Assurance Limited (EFU) with 13 percent market share. The remaining 11 percent market is shared by New Jubilee Life Insurance Company (NJLI), American Life Insurance Company (ALICO) and Metropolitan Life Assurance Company of Pakistan Limited (METRO). The total premium of life insurance sector has shown a growth of around 12 percent from Rs. 12,990 million in 2003 to Rs. 14,583 million in 2004.

Assets of the life insurance companies grew by almost 15 percent to Rs. 123.9 billion during the year ended 31 December 2004. Major portion of the assets were invested in government securities and listed equities.

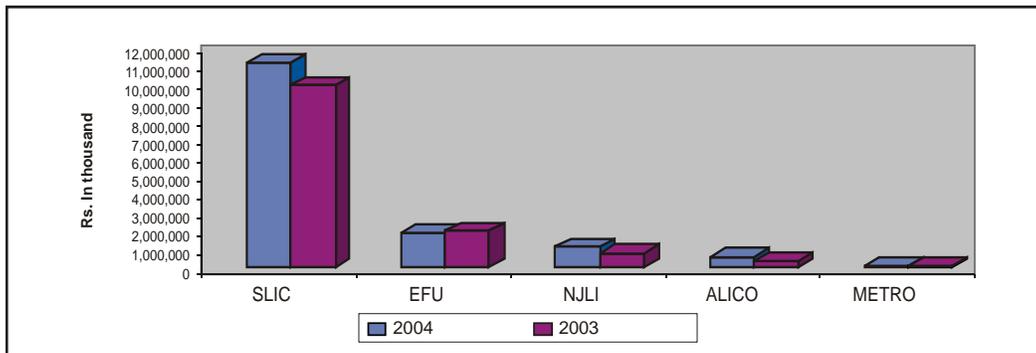


Figure 16: Gross Premium Written by Life Insurance Companies

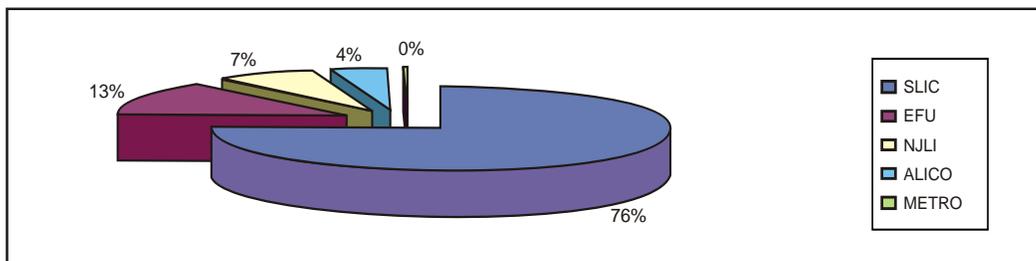


Figure 17: Share of Life Insurance Companies in Gross Premium During the Year Ended 31 December 2004

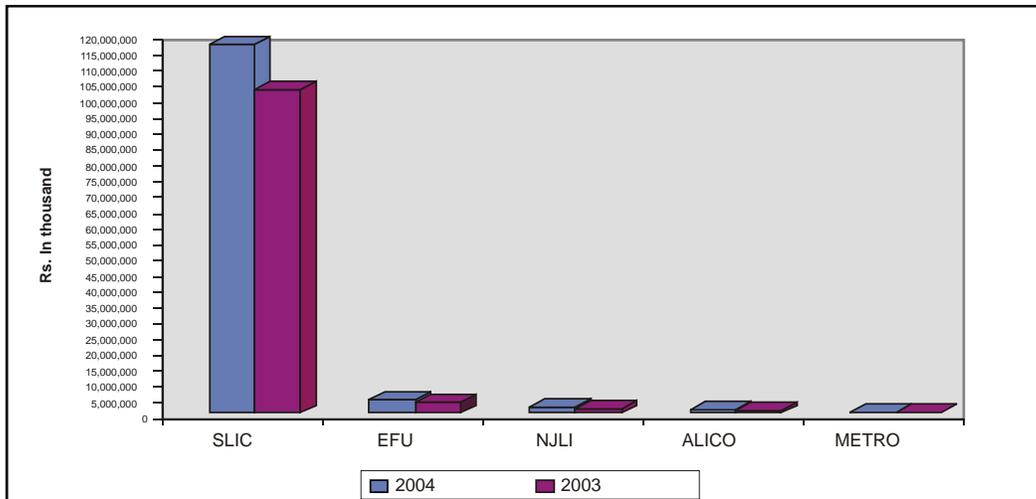


Figure 18: Assets of Life Insurance Companies as on 31 December 2003 and 2004

## 7.2.2 NBFCs

### i. NBFC Regime

The NBFC sector presently comprises of sixty-nine NBFCs. The number of licensed entities among these sixty-nine registered NBFCs is fifty. Licenses of the remaining nineteen entities were not renewed as they were either non-compliant with the licensing requirements, financially sick or under winding-up. Necessary regulatory actions against such companies are in process. The detail of registered and licensed NBFCs is given in Table 21.

Table 21: Composition of NBFC Sector

NBFCs	Registered	Licensed*
Investment Banks	13	9
Leasing	23	13
Housing Finance	3	2
Discounting	3	1
Investment Advisory	12	10
Asset Management	12	12
Venture Capital	3	3
Total	69	50

\*Licensed NBFC does not denote the total number of licenses issued by the Commission for each permissible activity

The traditional model of NBFIs, consisting of a variety of separate, compartmentalized, specialized institutions had led to fragmentation of the financial sector and a proliferation of institutions. Often, these institutions inadequate capital, weak human resource base, low access to technology, and high cost of operations making them vulnerable to credit and market risks. With a view to strengthen the non-banking financial sector, the concept of universal NBFCs was introduced.

The primary objective of implementing the universal NBFC regime was to consolidate the non-banking financial services sector by allowing multiple business activities under one umbrella, so that a variety and range of financial products tailored to the needs of customers could be offered through a one-window operation.



Officer of the SCD at work

The distinctive design of the NBFC Rules allows NBFCs a diverse operational spectrum, which envisages permission to undertake various business activities on progressive enhancement in equity. As a result, the distinction between the various sectors including leasing and investment banking sector has diminished. Out of nine licensed investment banks, four have been granted leasing licenses as well. Similarly, out of fourteen licensed leasing companies, two have been granted investment finance services license and two have been granted housing finance services license. Moreover, NBFCs have been allowed to hold licenses for investment advisory services, asset management services and venture capital investment in addition to licenses for investment finance services, leasing and discounting services. A comparative view of all the fifty licensed entities is presented below.

Table 22: Detail of Licenses Issued

S. No.	NBFCs	Leasing	Investment Finance Services	Housing Finance Services	Discounting Services	Investment Advisory Services	Asset Management Services	Venture Capital Investment
1	ABAMCO Limited	<input type="checkbox"/>		<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2	AKD Investment Management Limited					<input type="checkbox"/>		
3	AlFalah GHP Investment Management Limited					<input type="checkbox"/>	<input type="checkbox"/>	
4	Al-Meezan Investment Management Limited					<input type="checkbox"/>	<input type="checkbox"/>	
5	AMZ Asset Management Limited					<input type="checkbox"/>		
6	AMZ Venture Limited							<input type="checkbox"/>

S. No.	NBFCs	Leasing	Investment Finance Services	Housing Finance Services	Discounting Services	Investment Advisory Services	Asset Management Services	Venture Capital Investment
7	Arif Habib Investment Management Limited					<input type="checkbox"/>	<input type="checkbox"/>	
8	Asian Capital Management Limited					<input type="checkbox"/>		
9	Asian Housing Finance Limited	<input type="checkbox"/>						
10	Askari Leasing Limited	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>			
11	Atlas Asset Management Company Limited					<input type="checkbox"/>	<input type="checkbox"/>	
12	Atlas Investment Bank Limited	<input type="checkbox"/>	<input type="checkbox"/>					
13	BMA Asset Management Limited					<input type="checkbox"/>	<input type="checkbox"/>	
14	Crescent Leasing Corporation Limited	<input type="checkbox"/>	<input type="checkbox"/>					
15	Crescent Standard Investment Bank Limited	<input type="checkbox"/>	<input type="checkbox"/>					
16	Crosby Asset Management Limited					<input type="checkbox"/>	<input type="checkbox"/>	
17	Dawood Capital Management Limited					<input type="checkbox"/>	<input type="checkbox"/>	
18	Escorts Investment Bank Limited		<input type="checkbox"/>					
19	Faysal Asset Management Limited					<input type="checkbox"/>	<input type="checkbox"/>	
20	First Capital Investment Limited					<input type="checkbox"/>		
21	First Credit and Discount Corporation Limited		<input type="checkbox"/>					
22	First Dawood Investment Bank Limited	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>				
23	First International Investment Bank Limited	<input type="checkbox"/>	<input type="checkbox"/>					
24	Grays Leasing Limited	<input type="checkbox"/>						
25	International Asset Management Company Limited					<input type="checkbox"/>		
26	International Housing Finance Limited			<input type="checkbox"/>				
27	Intersecurities Management Limited					<input type="checkbox"/>		
28	Jehangir Siddiqui Investment Bank		<input type="checkbox"/>					
29	JP Morgan Pakistan Limited					<input type="checkbox"/>		
30	KASB Funds Limited					<input type="checkbox"/>	<input type="checkbox"/>	
31	National Investment Trust Limited						<input type="checkbox"/>	
32	Natover Lease and Refinance Limited	<input type="checkbox"/>						
33	NBP Capital Limited	<input type="checkbox"/>			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
34	Network Leasing Corporation Limited	<input type="checkbox"/>						
35	Noman Abid Investment Management Limited					<input type="checkbox"/>		
36	Orix Investment Bank Limited		<input type="checkbox"/>					

S. No.	NBFCs	Leasing	Investment Finance Services	Housing Finance Services	Discounting Services	Investment Advisory Services	Asset Management Services	Venture Capital Investment
37	Orix Leasing Pakistan Limited	<input type="checkbox"/>						
38	Pak Gulf Leasing Company Limited	<input type="checkbox"/>						
39	PICIC Asset Management Company Limited					<input type="checkbox"/>		
40	Safeway Fund Limited					<input type="checkbox"/>		
41	Saudi Pak Leasing Company Limited	<input type="checkbox"/>						
42	Security Investment Bank Limited		<input type="checkbox"/>					
43	Security Leasing Corporation Limited	<input type="checkbox"/>		<input type="checkbox"/>				
44	Sigma Leasing Corporation Limited	<input type="checkbox"/>						
45	SME Leasing Limited	<input type="checkbox"/>						
46	TMT Ventures Limited							<input type="checkbox"/>
47	TRG Pakistan Limited							<input type="checkbox"/>
48	Trust Leasing and Investment Bank Limited	<input type="checkbox"/>	<input type="checkbox"/>					
49	Union Leasing Company Limited	<input type="checkbox"/>						
50	United Asset Management Company Limited					<input type="checkbox"/>	<input type="checkbox"/>	
Total		20	11	5	2	22	13	4

Under the NBFC Rules, these licenses are renewed annually on the basis of performance of the financial institutions during the past year.

The NBFC regime enormously benefited the non-banking financial sector. Most of the above listed NBFCs not only ploughed back their profits but also offered right shares to the shareholders and further strengthened their equity base. Being important components of the capital market, these NBFCs also relied on various capital market instruments to generate funds such as preference shares and TFCs. It also became possible for these NBFCs to invest in assorted financial assets for better diversification and risk management.

The NBFCs face severe competition from commercial banks, DFIs and brokerage firms. Under the Banking Companies Ordinance, 1962, commercial banks and DFIs are allowed to indulge in investment banking and leasing activities, which are otherwise licensed by the Commission specifically for NBFCs under the NBFC Rules. The commercial banking sector has an edge due to its low cost of funds, big equity position on the balance sheet and extensive branch network. Most of the brokerage firms also indulge in the functions which are exclusively licensed to investment banks e.g., underwriting of shares and providing advise on capital market activities. Competing with financial giants in an overlapping financial environment is a significant challenge for NBFCs and, therefore, the paradigm shift from single product companies to Universal NBFCs is an inevitable step towards development of the NBFC sector.

## ii. Operational Highlights

The total assets of NBFCs engaged in leasing, investment finance services, housing finance services and discounting services increased to Rs. 100.5 billion as at 30 June 2005 from Rs. 77.6 billion in the preceding year,

depicting a growth of 30 percent as compared to the previous year. Due to the healthy growth in profits, these NBFCs increased their equity from Rs. 13.2 billion to Rs. 15.8 billion signifying a growth of 20 percent.

Investment banks, leasing companies and housing finance companies are allowed to raise deposits from the public under the NBFC Rules in the form of COIs (which are for a minimum of ninety days) or CODs (which are for a minimum of thirty days). Among other conditionalities, these NBFCs are required to maintain an investment grade credit rating. They are also required to publish credit rating in their advertisements and financial statements. Neither the Federal Government nor the Commission guarantees these deposits. A list of all such NBFCs, allowed by the Commission to raise deposits, along with their respective credit rating, is provided in Table 23.

Table 23: Detail of NBFCs Allowed to Raise Deposits

Name of NBFC	Credit Rating				Amount of Deposits (Rs. In thousand)
	Credit Rating Firm	Date	Long-term	Short-term	
Askari Leasing Limited	PACRA	December 2004	A+	A1	4,310,307
Atlas Investment Bank Limited	PACRA	December 2004	A+	A-1	1,520,015
Crescent Leasing Corporation Limited	JCR-VIS	March 2005	A+	A-1	912,871
Crescent Standard Investment Bank Limited	JCR-VIS	April 2005	BBB+	A-2	4,483,217
Escorts Investment Bank Limited	JCR-VIS	January 2005	A	A-2	1,099,510
First Credit and Discount Corporation Limited *	JCR-VIS	May 2005	BBB+	A-2	-
First Dawood Investment Bank Limited	PACRA	February 2005	A+	A-1	2,590,634
First International Investment Bank Limited	PACRA	December 2004	A	A-1	1,486,687
Grays Leasing Limited	JCR-VIS	November 2004	BBB+	A-2	56,630
International Housing Finance Limited	JCR-VIS	July 2004	BBB+	A-3	56,630
Jehangir Siddiqui Investment Bank	PACRA	March 2005	A+	A-1	2,080,651
Natover Lease and Refinance Limited	JCR-VIS	February 2005	BBB-	A-3	15,471
Network Leasing Corporation Limited	PACRA	December 2004	BBB	A-3	75,000
Orix Investment Bank Limited	PACRA	December 2004	A	A-1	1,275,432
Orix Leasing Pakistan Limited	PACRA	January 2005	AA+	A1 +	3,429,128
Pak Gulf Leasing Company Limited	JCR-VIS	October 2004	BBB+	A-2	5,769
Saudi Pak Leasing Company Limited	JCR-VIS	September 2004	A-	A-2	1,766,765
Security Investment Bank Limited	JCR-VIS	April 2005	A	A-1	519,706
Security Leasing Corporation Limited	JCR-VIS	November 2004	A	A-1	598,100
Sigma Leasing Corporation Limited	JCR-VIS	November 2004	BBB+	A-2	206,882
Trust Leasing and Investment Bank Limited	PACRA	November 2004	AA-	A1+	258,516
Union Leasing Company Limited	PACRA	December 2004	A+	A-1	1,872,160

\* Permission granted post 30 June 2005

### iii. Mutual Funds

Currently, the mutual funds industry consists of twenty-two closed-end and fifteen open-end funds. Net assets of mutual funds have increased from Rs. 92 billion on 30 June 2004 to Rs. 124.571 billion on 30 June 2005. Over the past few years, this industry has been expanding at a rapid pace compared to other constituents of the NBFC sector. The mutual funds industry now provides multiple options for investments such as equity funds, balanced funds, asset allocation funds, money market funds, bond funds and funds that invest in other mutual funds. Shariah compliant funds are also available for investors requiring returns which are in conjunction with the principles of Islam. The mutual funds industry continued to attract attention of entrepreneurs and investors during the period under review.

Key statistics of the closed-end mutual funds as on 30 June 2005 are given in the table below.

Table 24: Key Statistics of Closed-end Funds

S. No.	Name of Fund	Listed Capital	Total Net Assets	Par Value	NAV per certificate	Market Value	Dividend Payout (%)	
		(Rs. in million)	(Rs. in million)	(Rs.)	(Rs.)	(Rs.)	June 2004	June 2005
1	ABAMCO Capital Fund	2,029.42	3,029.02	10.00	14.93	10.05	20%B 50%R	12.5%I
2	ABAMCO Composite Fund	3,295.50	3,389.67	10.00	10.29	6.85	NIL	12.5%I
3	ABAMCO Growth Fund	275.63	898.33	10.00	32.69	22.80	25%B 100%R	26%I
4	ABAMCO Stock Market Fund	875.00	1,447.55	10.00	16.54	11.25	25%B 50%R	15%I
5	Al-Meezan Mutual Fund Limited	1,426.00	1,670.88	10.00	13.97	10.50	10% 15%B	17.50% 10%B 50%R
6	Asian Stocks Fund Limited	900.00	818.99	10.00	9.10	10.50	800%R	N.A.
7	Atlas Fund of Funds	500.00	526.58	10.00	10.53	7.50	NIL	5%B
8	BSJS Balanced Fund	1,185.75	1,620.93	10.00	13.67	9.20	12.5%B	12.5%I
9	Dominion Stock Market Fund	50.00	N.A.	10.00	N.A.	1.10	NIL	N.A.
10	First Capital Mutual Fund Limited	150.00	142.56	10.00	9.50	5.35	NIL	N.A.
11	First Dawood Mutual Fund	500.00	502.98	10.00	10.06	8.50	NIL	10%
12	Golden Arrow Selected Stocks Fund Limited	351.17	626.34	5.00	8.92	7.05	17.5% 20%B 300%R	40%I
13	Investec Mutual Fund	100.00		10.00	N.A.	0.80	NIL	N.A.
14	Meezan Balanced Fund	1,200.00	1,346.64	10.00	11.22	8.20	NIL	10%
15	Pakistan Capital Market Fund	1,500.00	1,960.64	10.00	13.08	12.70	8.25%	30%
16	Pakistan Premier Fund Limited	1,181.25	2,206.94	10.00	18.68	16.05	12.5% 25%B 50%R	15%I 25%B
17	Pakistan Strategic Allocation Fund	3,000.00	3,651.95	10.00	12.17	9.95	NIL	25%
18	PICIC Growth Fund (ICP S.E.M.F.)	1,575.00	9,047.05	10.00	57.44	52.40	45%	25%B 35%
19	PICIC Investment Fund	2,841.25	5,882.73	10.00	20.70	16.45	35%	35%
20	Prudential Stock Fund Limited	60.00	13.23	10.00	2.20	3.00	NIL	N.A.
21	Safeway Mutual Fund Limited	453.75	881.71	10.00	19.43	19.95	25%B 150%R	N.A.
22	Tri-Star Mutual Fund Limited	50	N.A.	10		1.55	NIL	N.A.
Total		23,499.71	39,664.71					

I: Interim B: Bonus R: Right

Key statistics of open-end mutual funds as on 30 June 2005, based on un-audited monthly statements, are given below:

Table 25: Key Statistics of Open-end Funds

S. No.	Name of Fund	Net Assets	Par Value	NAV	Market Value		Dividend Payout (%)	
		(Rs. in million)	(Rs.)	(Rs.)	Offer Price (Rs.)	Re-purchase Price (Rs.)	June 2004	June 2005
1	National Investment (Unit) Trust	61,002.00	10.00	38.12	42.20	40.70	Rs. 2.55	Rs. 3.30
2	Atlas Income Fund	1,147.62	500.00	546.09	556.84	545.92	3.75%	9.75%
3	Atlas Stock Market Fund	918.42	500.00	562.65	574.66	562.62	N.A.	N.A.
4	Crosby Dragon Fund	419.99	100.00	110.97	103.50	110.97	2%	N.A.
5	Dawood Money Market Fund	1,835.85	100.00	109.71	110.79	108.62	7%B	9.7%B
6	Faysal Balanced Growth Fund	1,761.35	100.00	112.90	116.40	114.00	NIL	12.5%B
7	Meezan Islamic Fund	2,005.99	50.00	76.21	77.27	75.72	15%B	35%B
8	MetroBank Pakistan Sovereign Fund	464.41	50.00	44.70	44.74	44.70	NIL	N.A.
9	Pakistan Income Fund	3,706.55	50.00	54.85	55.55	54.80	9%B	9.6%B
10	Pakistan Stock Market Fund	2,712.99	50.00	115.10	118.23	115.80	60%B	20%I, 50%B
11	Unit Trust of Pakistan (UTP)	3,443.55	5,000.00	8,035.00	8,368.00	8,124.00	25%	30%B
12	United Money Market Fund	3,033.17	100.00	104.70	103.90	102.86	30%B	20%B
13	UTP Aggressive Asset Allocation Fund	130.57	50.00	50.37	50.34	50.06		
14	UTP Income Fund	1,377.87	500.00	561.16	553.50	542.50	6.2%B	10.25%B
15	UTP Islamic Fund	947.20	500.00	632.00	660.50	641.00	17%B	10%B
Total		84,907.53						

I: Interim B: Bonus

### 7.2.3 Modarabas

In pursuance to Islamization of economy, the Modaraba Companies and Modaraba (Floatation and Control) Ordinance (Modaraba Ordinance) was promulgated in 1980, followed by the issuance of Modaraba Companies and Modaraba Rules, 1981 (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.

Over the last two decades, modarabas have provided attractive investment opportunities to investors based on dividend yield. At present, thirty-six modarabas constitute the modaraba sector, of which thirty-one are operational. The sectoral overview, based on the data of operational modarabas as on 30 June 2005, reveals that the aggregate paid-up fund of the modarabas was Rs. 7.86 billion. The total assets of the modaraba sector stood at Rs. 22.13 billion while the total equity amounted to Rs. 10.42 billion. At the close of the year under review, the aggregate market capitalization of modarabas was Rs. 8.35 billion.

Key statistics of the modaraba sector based on the un-audited financial statements as of 30 June 2005 are presented in Table 26.

Table 26: Key Statistics of Modaraba Sector

Number of modaraba companies	51
Number of modarabas	36
Number of modarabas under winding up	04
Number of modarabas under floatation	01
Number of modarabas whose prospectus have been submitted to the Religious Board for approval	03
Number of intra-sector mergers	04
Total paid-up fund (Rs. in million)	7,863.774
Total assets (Rs. in million)	22,128.140
Total equity (Rs. in million)	10,420.117
Total liabilities (Rs. in million)	11,708.024

Major source of funds for modarabas consists of equity and borrowing from banks and financial institutions on Murabaha/Musharaka basis. The funds raised through borrowing from banks and financial institutions amounted to Rs. 5.44 billion as of the close of the year. The funds generated from issuance of TFCs, Certificates of Musharaka etc. amounted to Rs. 0.95 billion. All the funds raised through the said sources were utilized mainly in leasing, extension of Musharaka and Murabaha facilities, investments in shares of listed companies, and trading activities.

Table 27: Major Source of Funds of Modaraba Sector

Source	Amount (Rs. in million)
Long Term Borrowings	
Murabaha	1,459.493
Musharaka	1,760.551
TFC	625.000
Certificates of Musharaka	263.071
Short Term Borrowings	
Murabaha	707.967
Musharaka	1,514.766
Profit-loss sharing	36.342
Mark-up arrangements	25.000

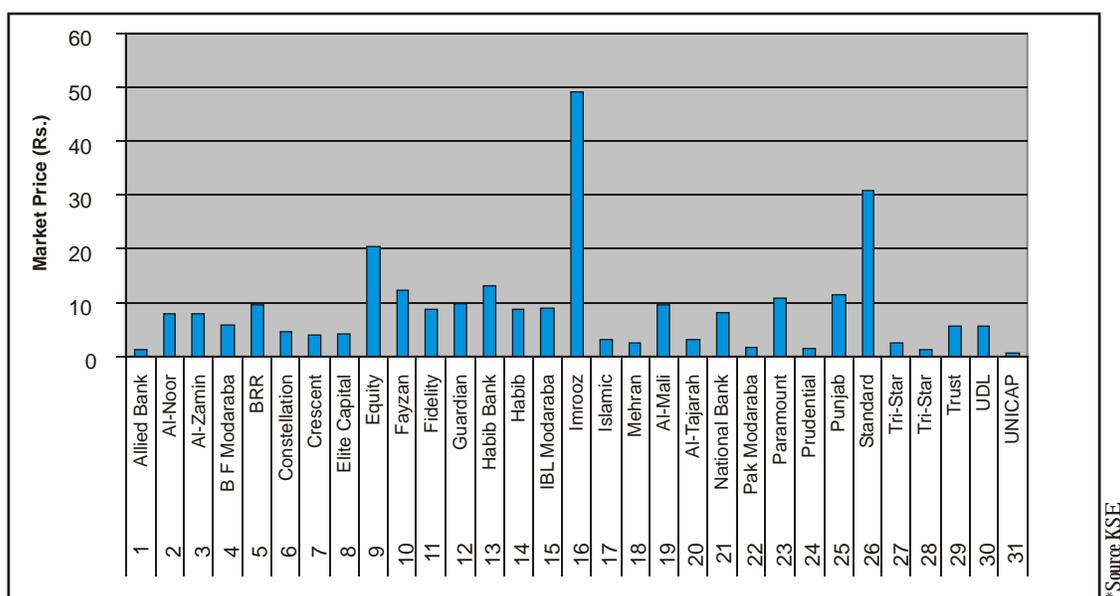


Figure 19: Average Trading Market Price of Modaraba Certificates for the FY 2005

\*Source: KSE

The modaraba sector has shown an improving performance over time. It is expected that the growth trend would continue in future and the sector would play a vital role in development and growth of the economy and capital market.

#### 7.2.4 Private Pensions

In Pakistan, both private and public sectors offer occupational saving schemes in the shape of gratuities, provident funds, and pensions. Under private sector schemes recognized by CBR, the employer, participant, and the invested assets enjoy certain tax advantages. Individuals may also establish annuity arrangements under a product operated by a life insurance company established under Section 63 of the Income Tax Ordinance, 2001 and approved by the Commission.

Public sector gratuity and pension schemes are non-contributory, unfunded, and based on pay-as-you-go. In addition, provident fund payment is also made, to which both employer and employees contribute.

At the moment there is no register of occupational savings schemes, nor are there collected statistics, published or otherwise, on the number, assets or membership of private sector gratuity funds, provident funds or pensions in Pakistan, or of any pension demographics, whether by age, gender or region.



Officers of the Pensions Wing in a meeting

The Income Tax Ordinance, 2001 and the Income Tax Rules, 2002 set out an extensive list of requirements for the recognition of provident funds, superannuation funds and gratuity funds for tax purposes. This means that employer contributions are a tax deductible business expense, that assets accumulate free of any income or gains taxes, and that provident fund and gratuity payments are in most circumstances tax free in the hands of the recipients. As such, the CBR, which acts as the tax gatherer under the Income Tax Ordinance, may be seen as a quasi regulator for the schemes.

### 7.3 Performance Review

Over the course of the year, the ID took appropriate measures to ensure the protection of interests of policyholders and promoting sound development of the insurance industry. The regulatory and enforcement actions of the ID were focused on non-compliance with statutory provisions, poor financial performance, inadequate or misleading disclosures in accounts and inadequate reinsurance treaty arrangements. As a result of corporate discipline imposed by the ID, compliance with the Insurance Ordinance and IASs by insurance companies has notably improved.

The cases of negligence and professional misconduct by statutory auditors in conducting the audit of insurance companies also remained an area of focus with the ID. As a result of enforcement measures, auditors have become more vigilant and conscious in performing their statutory duties which has resulted in improved quality of financial statements.

During the year under review, the Commission finalized and notified the VPS Rules. In consideration of its mandate to regulate private pensions in the country, the Commission also attained membership of IOPS.

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

After completion of necessary requirements, seventeen fresh licenses were issued to various companies for different activities permitted to NBFs; seven new NBFs were also formed during the year. In case of mutual funds, the Commission approved the public offering of six new funds of which four are closed-end and two are open-end.

With a view to develop the capital market and to enable greater product diversification for CIS, the Commission constituted a task force, consisting of senior service sector professionals, on the establishment of REITs in Pakistan. The task force is entrusted with the development of a fast-track regulatory framework which conforms to international best practices and is based on such products offered by a REIT that are suitable to the local real estate and capital markets.

## 7.4 Development of Laws

### 7.4.1 VPS Rules

In November 2004, the Commission notified the draft Voluntary Pension System Rules for soliciting views and comments of stakeholders. As an open door policy and to build consensus over the proposed rules, the Commission held a meeting with all stakeholders in December 2004. In light of the views/suggestions of the stakeholders for improvements in the proposed rules, the draft rules were revised and sent to Ministry of Finance. The final VPS Rules were thereafter notified in the official gazette on 27 January 2005.

Under the VPS Rules, a new system for voluntary pension is being introduced in the country. Asset management companies and life insurance companies, duly licensed by the Commission under these Rules, would be authorized to offer and manage pension fund schemes. Such entities shall be referred to as licensed pension fund managers. Life insurance companies would also be authorized to offer annuity plans under the system.

### 7.4.2 Takaful Rules

In pursuance of the Government's objective of Islamization of economy and to develop Islamic financial products, the Commission allowed takaful business in the country. Although takaful business can be conducted under the Insurance Ordinance, necessary rules for the conduct of takaful business were yet to be formulated.

Towards the close of last year, the Commission had constituted a Task Force of Shariah experts and others, headed by former Chief Justice of Federal Shariah Court, Mian Mehboob Ahmed, to formulate rules for the conduct of takaful business. The Task Force held several meetings during the period under review and after detailed deliberations with religious scholars and other experts on takaful submitted its report to the Commission. The Task Force, in its report, prepared rules for the conduct of takaful business and made recommendations on certain key policy issues with regard to takaful operations in the country. The Takaful Rules were notified subsequent to the close of the year.

## 7.5 Regulatory Actions

### 7.5.1 Enhancement of Paid-up Capital Requirement for Insurance Companies

Life and non-life/general insurance companies were required to enhance their paid-up capital to Rs. 150 million and Rs. 80 million, respectively, by 31 December 2004. During the course of the year, the Commission issued reminders and held meetings with insurers who were falling short of the paid-up capital requirement limits. As a result of these concerted efforts, all the insurance companies (life and non-life) have complied with the requirement of enhancing their paid-up capital.

## 7.5.2 Issuance of Licenses to NBFCs

Under the NBFC Rules, the licenses issued to NBFCs are subject to annual renewals. During the year, the Commission renewed licenses of NBFCs complying with the prevalent regulatory framework; seventeen fresh licenses were also issued during the period.

## 7.5.3 NBFCs in Financial Distress

Due to rapid shifts in market dynamics and inefficient management, some of the financial institutions accumulated losses and their equity eroded. Such entities were not issued licenses since they did not qualify as such under the NBFC Rules due to lack of requisite equity. Citibank Housing Finance Limited had sufficient equity but decided to wind up voluntarily. The table below lists the entities not licensed by the Commission to undertake any form of business allowed to a NBFC.

Table 28: List of NBFCs in Financial Distress

S. No.	Name
1	Asian Leasing Corporation Limited
2	Asset Investment Bank Limited
3	Capital Assets Leasing Corporation Limited
4	Citibank Housing Finance Limited
5	Dadabhoy Leasing Company Limited
6	English Leasing Limited
7	Franklin Investment Bank Limited
8	Inter Asia Leasing Company Limited
9	International Multi Leasing Corporation Limited
10	Islamic Investment Bank Limited
11	Lease Pak Limited
12	National Asset Leasing Corporation Limited
13	Pakistan Industrial and Commercial Leasing Limited
14	Prudential Discount and Guarantee House Limited
15	Prudential Fund Management Limited
16	Prudential Investment Bank Limited
17	Speedway Fondmetall Limited
18	Tri-Star Investments Limited
19	Universal Leasing Corporation Limited

In order to clean up the non-banking financial sector, the NBFCD initiated action against concerned entities under the provisions of Companies Ordinance. Consequently, petitions for winding up of ten entities were filed in the courts of competent jurisdiction, which are currently *subjudice*.

## 7.5.4 Formation of New NBFCs

During the period under review, seven NBFCs were formed under Rule 4 of the NBFC Rules while five applications were at various stages of processing as at the close of the year. The newly established NBFCs are:

- i. Alfalah GHP Investment Management Limited
- ii. BMA Asset Management Company Limited
- iii. Noman Abid Investment Management Limited
- iv. Pak Kuwait Financial Services Limited
- v. AKD Investment Management Limited
- vi. KASB Funds Limited
- vii. Askari Asset Management Limited

### 7.5.5 Formation of New Modaraba Management Companies

During the course of the year, the following three modaraba management companies were registered under Section 6 of the Modaraba Ordinance:

- i. Total Hospitality Management (Private) Limited
- ii. Global Econo Trade (Private) Limited
- iii. Vanguard Modaraba Management Company (Private) Limited

### 7.5.6 Registration of Investment Companies

Investment companies, earlier granted registration under the Investment Companies and Investment Advisors Rules, 1971, were advised to get registered in terms of Rule 38 of the NBFC Rules. During the period under review, seven companies, which had completed formalities and presented necessary documents, were granted registration under the NBFC Rules. Compliance proceedings against four companies, which did not fulfill the requirements of registration, were in process at the close of the year.

### 7.5.7 Public Offering of Mutual Funds

During the period under review, more than a dozen applications were received for floatation of mutual funds. The proposals were examined and public offering of following six funds was approved in accordance with the NBFC Rules:

- i. Atlas Fund of Funds

Atlas Fund of Funds is the first of its kind closed-end fund in the country. It has been structured with the objective of providing investors a one-window facility of investment in diversified portfolio of securities. The fund follows preset criteria to select securities for investment.

- ii. Atlas Stock Market Fund

Atlas Stock Market Fund is an open-end fund. It has been structured to achieve a good rate of current income with prospects of gradual appreciation in the value of investment. It follows pre-determined guidelines for selection of securities and accepts only those securities in the portfolio Fund which fulfill the laid down criteria.

- iii. Pakistan Strategic Allocation Fund

Pakistan Strategic Allocation Fund is a value-based asset allocation fund. It is a closed-end fund set up with the objective to invest either in equity or fixed income securities depending on the valuation of the equity market. It has evolved a quantitative model, the output of which guides investment strategy for buying equities when they are cheap and selling when they are expensive. The Fund invests in equities listed on the stock exchanges of Pakistan and fixed income securities, including carry-over market, bank deposits, treasury bills, inter-bank market, TFCs and government bonds, etc. on the basis of results shown by the model.

- iv. Meezan Balanced Fund

The investment objective of Meezan Balanced Fund, a closed-end fund, is to generate long-term capital appreciation as well as current income by creating a balanced portfolio that is invested both in good quality equity securities and Islamic income instruments such as TFCs, COIs, Certificates of Musharaka, Islamic Sukuk and other such Shariah compatible instruments. It also intends to capitalize on the opportunities of realizing capital gains by continuously monitoring earning potential of securities and the market behavior.

v. First Dawood Mutual Fund

The investment objective of First Dawood Mutual Fund, a closed-end fund, is to earn regular income while focusing on growth stocks. The Fund primarily invests in equity securities. However, in case the stock prices are considered inflated by the fund management, it will invest up to 50 percent of its assets in fixed income securities to avoid any major/sudden diminution in the value of Fund and also to protect the Fund from erosion.

vi. UTP- Aggressive Asset Allocation Fund

UTP-Aggressive Asset Allocation Fund has been launched with the objective of providing returns higher than a balanced fund. The Fund aims at taking advantage of shifts in macro-economic trends by investing in asset classes that are projected to gain the most in given circumstances. The Fund has the flexibility to invest in one class of assets or a combination of fixed income and equity securities including reverse repo transactions. It has declared to invest primarily in value stocks and equity securities having potential for growth. It invests in fixed income investments including COT (till such time that it remains an available instrument), investment grade debt securities, money market instruments, commercial papers, inter-bank market and reverse repo transactions, long-term debt securities and government bonds. The selection of securities for the portfolio of the Fund depends on expected returns and risk parameters defined by the management company.

### 7.5.8 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 merger proposal of ABAMCO Limited with Confidence Financial Services Limited. ABAMCO Limited held 77.78 percent shares of Confidence Financial Services Limited and remaining 22.22 percent shares were held by a director of ABAMCO Limited. Since both the companies were associated concerns and in the same business of investment advisory services, they were encouraged to merge their operations. Management of Confidence Financial Services Limited proposed amalgamation with ABAMCO Limited, which effectively was its holding company. The Commission considered the scheme of amalgamation and accorded sanction.



Officers of the NBFCD at work

The Commission also received the merger proposal of Ibrahim Leasing Limited into Allied Bank of Pakistan during the year and, after careful review of the proposals, granted the No-objection Certificate.

During the year under review, the High Court of Sindh approved merger schemes filed by modaraba companies for merger of First Hajveri Modaraba into First Fidelity Leasing Modaraba and First National Modaraba into First Paramount Modaraba.

### 7.5.9 Constitution of the Seventh Religious Board for Modarabas by the Federal Government

In pursuance of Section 9 of the Modaraba Ordinance read with Rule 6 of the Modaraba Rules, the Federal Government on 22 March 2005 issued notification for reconstitution of the Religious Board for Modarabas.

Justice (Retd.) Mian Mahboob Ahmed, Maulana Syed Zakar Hussain Sialvi and Dr. Sher Muhammad Zaman were appointed as Chairman and Members of the Board, respectively. The Board was re-constituted for a term of

three years and started functioning with immediate effect. The first meeting of the Board was held on 18 April 2005.

#### 7.5.10 Registration, Modification and Vacation of Charges of Modarabas

Rules 27 and 28 of the Modaraba Rules require every mortgage or charge created by a Modaraba to be registered with the Registrar Modaraba. During the period under review, thirty-seven cases of registration, modification, and vacation of mortgages/charges created by various modarabas were registered and registration certificates were issued.

#### 7.5.11 Appointment of Auditors of Modarabas

Rule 19 of the Modaraba Rules requires that terms of appointment of statutory auditors should be renewed annually with the approval of Registrar Modaraba. During the period under review, the Modaraba Wing approved thirty-one cases for appointment of auditors.

#### 7.5.12 Issuance of Right Modaraba Certificates on Premium

In terms of Rule 20(B) of the Modaraba Rules, permission to issue Right Certificates on premium was granted to two modarabas.

#### 7.5.13 Permission to Raise Deposit from General Public on Musharaka Basis

After completing the due process of law, permission was granted to two modarabas to raise funds from general public through issuance of Certificates of Musharaka.

#### 7.5.14 Permissions for Transfer of Major Shareholding of Modaraba Companies

In terms of conditions of registration certificate of a modaraba company, any change in major shareholding of the company is required to be approved by the Registrar Modaraba. During the period under review, approvals for transfer of major shareholdings were granted to three modaraba companies.

#### 7.5.15 Circular for NBFCs Raising Foreign Currency COIs/CODs

During the period under review, a circular was issued to streamline the procedure for raising and utilization of foreign currency deposits by NBFCs. The circular aimed at optimization of foreign exchange risk for the protection of depositors.

## 7.6 Monitoring and Enforcement

### 7.6.1 Special Audit of Insurance Companies

On scrutiny of the regulatory returns/financial statements received from insurance companies, irregularities were observed in twelve cases. The ID, under Section 49 of the Insurance Ordinance, appointed auditors to carry out special audit of these insurance companies in order to have detailed investigations into their financial condition.

### 7.6.2 Off-site Examination of Audited Accounts and Periodic Returns

Annual audited accounts and periodic returns of NBFCs and modaraba were examined in order to ensure compliance with the relevant laws administered by the Commission and the IASs. Moreover, the financial health and the risk exposures of the entities were assessed and necessary remedial measures and enforcement actions were proposed to safeguard the interests of depositors and investors.

On the basis of examination of accounts, several violations were observed and appropriate actions were taken. Broad nature of the violations observed is given below:

- i. non-compliance with minimum required equity for the NBFC's business;
- ii. non-presentation of a true and fair view of the state of the company's affairs;
- iii. deposit raising from general public without having the requisite permission of the Commission;
- iv. non-compliance with the requirements of IASs and Fourth Schedule to the Companies Ordinance;
- v. non-disclosure of credit rating in financial statements;
- vi. non-compliance with various exposure limits as prescribed by NBFC Rules and Prudential Regulations;
- vii. non-transmission of timely information to stakeholders;
- viii. non-filing of periodic returns with the Commission;
- ix. non-holding of AGMs; and
- x. continuing business as an investment company without having the requisite registration.

### 7.6.3 On-site Inspections

During the period under review, the NBFCD conducted on-site inspection of two NBFCs and one modaraba. The on-site inspections revealed financial crimes and mis-appropriation of funds by the managements. Furthermore, the inspections indicated poor corporate governance in these entities and the need for the Commission to strengthen on-site monitoring of the NBFC and modaraba sectors. The broad nature of the violations observed during on-site inspections is given below:

- i. Mis-appropriation of public funds of more than Rs. 400 million by the management of a NBFC. The questionable role of the board of directors and serious corporate governance lapses were exposed.
- ii. Misuse of proceeds from disposal of NBFC's assets as major portion of the recoveries was being utilized for payment of salaries and administrative expenses, rather than paying off the depositors.
- iii. The modaraba in question had lent, indirectly, about 40 percent of its capital to its management company which had become insolvent and bankrupt.
- iv. The NBFCs were submitting false and incorrect information to the regulator, shareholders and other stakeholders.

Based on the findings of on-site inspections, the Commission decided to file criminal complaints against the persons responsible, in the respective High Courts, for mis-appropriation of public funds, mis-management of NBFCs and making of false statements to the Commission and shareholders.

### 7.6.4 Investigation

In terms of Section 265 of the Companies Ordinance, investigation proceedings were initiated against four mutual funds for defrauding their members.

### 7.6.5 Special Audit of NBFCs

During the year under review, the NBFCD ordered special audit of some of the entities for detailed scrutiny. Special audit reports received during the year were analyzed and necessary enforcement actions in light of the findings of the report were recommended to the respective regulation wings.

### 7.6.6 Other Enforcement Actions

Enforcement actions were initiated against fourteen entities undertaking the businesses of investment finance services, leasing, housing finance services and discounting services for violation of different provisions of the Companies Ordinance and NBFC Rules. A synopsis is given in Table 29.

Table 29: Nature of Violations by NBFCs

Reference	Nature of Violation
Companies Ordinance	
Section 158	Non-holding of AGM
Section 245	Non-submission of quarterly accounts
Section 282 D	Non-compliance to directions issued
Section 282 J (3)	Winding up of a company
NBFC Rules	
Rule 7 (1) a	Accounts not being true and fair
Rule 7 (2) b	Selling of an asset without prior approval
Rule 7 (2) h	Investment in unquoted shares without prior approval
Rule 12	Raising deposits without investment grade credit rating
Rule 15	Investment in equities more than liquid net worth
Rule 16	Investment in equity exceeding per party limit

The show cause notices were duly adjudicated and fines were imposed on the directors and CEOs held responsible for the violations.

The NBFCD took strong note of violations of legal provisions by NBFCs undertaking the business of investment advisory services and asset management services as well as by mutual funds. During the year, show cause notices were issued and on the basis of these proceedings, the NBFCD imposed penalties on CEOs and directors of companies/funds and issued warnings, as necessary, in twelve cases.

In the modaraba sector, the NBFCD issued show cause notices to fourteen modaraba management companies and auditor of a modaraba. In five cases, penalties were imposed on CEOs and directors of the concerned modaraba management companies for violations of provisions of the Modaraba Ordinance and Modaraba Rules. Warnings were issued in another five cases.

## 7.7 Judicial Cases

### 7.7.1 Cases Pertaining to Insurance

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

Table 30: Judicial Cases pertaining to the ID

S.No.	Title of the Case	Description	Court in which Case is Pending
1	WP No. 2201/2002 National General Insurance Company Limited vs. the Commission	Petition against the order to cease underwriting new insurance contracts.	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 of Islamic Republic of Pakistan 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 of Islamic Republic of Pakistan 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. 75/2000 Ittefaq General Insurance Company Limited vs. the Commission	Petition under Article 199 of the Constitution of Islamic Republic of Pakistan 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	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	North Star Insurance Company Limited vs. the Commission	Suit for declaration and permanent Injunction to the effect that show cause notice dated 23 October 2003 was without lawful authority having no legal effect.	In the Court of Senior Civil Judge, Lahore
7	North Star Insurance Company Limited vs. the Commission	Suit for declaration and permanent injunction to the effect that show cause notice dated 23 October 2003 was without lawful authority having no legal effect.	District Court, Lahore
8	North Star Insurance Company Limited vs. the Commission	Petition under Order 39 Rule 2(3) read with Section 151 CPC against the Order dated 1 October 2004.	Additional District Court, Lahore
9	C.P. No 453/2005 Beema Pakistan Company Limited vs. the Commission	Petition under Article 199 of the Constitution of the Islamic Republic of Pakistan to the effect that Order dated 8 April 2005 was without lawful authority having no legal effect.	Sindh High Court, Karachi
10	Civil Suit No. 522 of 2005. Muslim Commercial Bank vs. Abdul Hameed Adamjee, the Commission and others	Suit for declaration and permanent injunction.	Sindh High Court, Karachi

### 7.7.2 Winding Up of NBFCs

At the close of the year under review, the following NBFCs were facing winding up orders initiated by the Commission:

- i. Franklin Investment Bank;
- ii. Islamic Investment Bank Limited;
- iii. Prudential Discount and Guarantee House Limited;
- iv. Prudential Investment Bank Limited; and
- v. Speedway Fondmetall Pakistan Limited.

### 7.7.3 Winding Up of Modarabas

The Registrar Modaraba filed cases with the Modaraba Tribunal, Karachi for winding up of two modarabas, namely, First Dadabhoy Modaraba and Unity Modaraba through two separate orders.

## 7.8 Developmental Activities

### 7.8.1 Membership of IOPS

The Commission attained membership of IOPS in 2005. The primary goal of IOPS is to serve as the standard-setting body on pension supervision-related regulatory issues, and also to promote international cooperation on pension supervisory issues and encourage international contact among pension supervisors including regulators, policy-makers, research organizations, and private sector parties interested in pension supervision.

During the course of the year, the Chairman of the Commission was elected as Vice Chairman of the Technical Committee of IOPS. This election is in addition to Pakistan's membership of the IOPS Executive Committee at its founding meeting in July 2004. In its meeting in December 2004, the Technical Committee discussed and agreed upon a program of work. Pakistan, along with Australia, Germany, Netherlands, UK and the World Bank, was selected to work on components of a risk-based approach to supervision. The agreed program includes work on standards and good practices in pension supervision, information gathering and analytical projects, and international cooperation.

## 7.8.2 Database of Accounts and Returns

In order to enhance its efficacy and assist insurers, the ID placed formats of returns/forms on its website in Microsoft Excel format. Although the insurers would still need to submit hard copies of their returns, electronic copies would assist in maintaining a database of accounts for proper analysis and compilation of the Insurance Year Book.

## 7.9 Future Plans

### 7.9.1 Work in Progress

#### i. Amendments in the NBFC Rules

The NBFC Rules were reviewed with a view to suggest amendments that would result in strengthening the regulatory regime for NBFCs and to make the legislation concurrent with international best practices. The envisaged amendments would facilitate orderly growth in the NBFC sector, while ensuring transparency in their operations to protect the interests of all stakeholders.

#### ii. Regulatory Framework for REITs in Pakistan

With a view to develop the capital market and to enable greater product diversification for CIS, the Commission constituted a task force consisting of senior service sector professionals on the establishment of REITs in Pakistan. The task force will develop a fast-track regulatory framework, conforming to international best practices and based on such products offered by a REIT that are suitable to the local real estate and capital markets.

#### iii. SCRS

Presently, the NBFCD receives printed versions of various periodic returns such as weekly, fortnightly and monthly returns from NBFCs and modarabas. In order to rationalize the returns and ensure efficient delivery of the information, an information system, named SCRS, is being developed to allow electronic submission. In addition to easing the information submission burden on the sector, the system will contribute towards detection of early warning signals emanating from the financial data and timely initiation of corrective measures, where necessary.

#### iv. Tax Issues of VPS

In order to ensure successful implementation of VPS, the Commission is coordinating with CBR to resolve certain tax related issues.

#### v. Guidelines on Registration of Pension Fund Managers

The Commission is developing necessary guidelines under the VPS Rules which would serve as the primary document for registration of pension fund managers. The guidelines would prescribe the criteria for registration, circumstances in which the registration would be cancelled, obligations of the pension fund manager and restriction on the pension fund manager.

#### vi. Guidelines on Authorization of Pension Fund

Guidelines under the VPS Rules are also being developed for authorization of pension fund managers. These guidelines would prescribe the terms and conditions for authorization, circumstances in which the authorization would be withdrawn, disclosure and reporting requirements, procedures, and format for submission of application/documents by pension fund managers.

## vii. Guidelines on Appointment of Trustees

Guidelines for appointment of trustees under VPS Rules would prescribe the eligibility criteria of a trustee and requirements for appointment of a trustee of a pension fund manager. They would set out the terms and conditions for approval of a trustee, disclosure and reporting requirements, procedures, and format for submission of application/documents by the pension fund manager/trustee.

### 7.9.2 Annual Plan

Over the course of the next year, the SCD would undertake the following activities:

- i. facilitate promotion and development of takaful, NBFCs and modaraba sector;
- ii. encourage introduction of new insurance schemes such as bancassurance and crop insurance in consultation with the insurance industry;
- iii. encourage and facilitate the process of activating the IAP;
- iv. recommend raising the minimum paid-up capital requirement for the insurance industry in a phased manner;
- v. prescribe, in consultation with the Pakistan Society of Actuaries, the basis for policyholder liabilities worked out through an actuarial valuation;
- vi. review the Insurance Ordinance and related rules/regulations and propose necessary amendments, with particular focus on strengthening on-site inspection, powers of intervention, enforcement and prescription of rules by the Commission;
- vii. encourage licensed surveyors to be members of SAAP and develop a Code of Conduct for these intermediaries;
- viii. carry out off-site surveillance proactively, based on periodic returns and market information;
- ix. place on-site inspection staff at Karachi, where 84 percent of the NBFCs are located;
- x. conduct on-site inspections of entities, especially deposit raising institutions to determine their true financial health and their compliance level with specific reference to NBFC Rules and regulations;
- xi. prescribe a comprehensive package of guidelines under the VPS Rules to facilitate stakeholders in the launch of VPS; and
- xii. coordinate with CBR regarding existing occupational saving schemes so as to collect data for understanding scope and coverage of these schemes.





# Professional Services and Policy Division



**SECURITIES AND EXCHANGE  
COMMISSION OF PAKISTAN**

## 8 Professional Services and Policy Division

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

### 8.1 Operational Structure

#### 8.1.1 Structure

The Professional Services and Policy Division (PSPD) is entrusted with oversight and development of professional services and SROs as well as streamlining the policy making function of the Commission. It conducts research on national and international practices concerning corporate and non-banking financial sectors to assist in development of targeted policies. In addition, the PSPD is responsible for updating laws administered by the Commission in collaboration with concerned Departments of the Commission.

The PSPD encompasses the following two Departments:

- Professional Services
- Policy

#### 8.1.2 The Management Team

As of the close of the year under review, the PSPD was headed by Dr. Sajid Qureshi, Executive Director. He is a lawyer by profession and possesses several years of experience, both locally and internationally. Subsequent to the close of the year, ensuing to restructuring at the Commission, Mr. M. Hayat Jasra was assigned the portfolio of Executive Director, PSPD in addition to his responsibilities as Secretary to the Commission. He is assisted by two Directors along with a team of professionals in overseeing the functions of the Division.



Mr. M. Hayat Jasra (extreme right), Executive Director in a meeting with his team

#### 8.1.3 Laws Administered

- Chartered Accountants Ordinance, 1961
- Credit Rating Companies Rules, 1995

### 8.2 Performance Review

The PSPD undertook focused assignments to improve the regulatory framework exercised by the Commission and to enhance oversight of professional services.

During the year under review, for engendering investor confidence and bringing about transparency in the rating process, a code of conduct for credit rating companies was issued in consultation with credit rating companies and SBP. Besides extensive consultation, international best practices were also considered while developing the Code. The Code was enforced in February 2005 and the PSPD subsequently undertook effective monitoring for ensuring its compliance by the credit raters.

The Commission, along with CBR, set up a Task Force to formulate corporate tax policy. The Task Force, in its report of April 2005, submitted various recommendations for addressing structural and administrative problems of corporate entities for encouraging corporatization and progressive development of corporates. On the basis of the report, the Commission engaged in dialogue with the concerned quarters and proposed several

recommendations of the Task Force for consideration of the Government. Most of these proposals were incorporated in the Income Tax law through the Finance Act, 2005.

In view of practical difficulties faced in implementation of the requirement of the Code of Corporate Governance to rotate auditors of listed companies, the Commission reviewed and modified this requirement. Accordingly, all companies (listed or otherwise) in the financial sector should rotate their external auditors after every five years while all other listed companies should, at a minimum, rotate the engagement partners after every five years. The modified clause of the Code of Corporate Governance would achieve the intent behind rotation of auditors in the most plausible manner.

During the year, the PSPD concluded the research study on “Impact of Universal Banking on the Business of NBFCs”. Moreover, research on performance of the modaraba sector as well as an analysis of stock market indices was carried out.

## 8.3 Sector Overview

### 8.3.1 Credit Rating

The significance of credit rating is gradually increasing in Pakistan. Currently, there are two credit rating companies operating in the country, namely, Pakistan Credit Rating Agency Limited and JCR-VIS Credit Rating Company Limited. These companies have been duly licensed by the Commission to assign ratings in terms of the Credit Rating Companies Rules, 1995. During the year under review, 192 ratings were issued for various companies.

The Commission is proactively seeking to promote the development of credit rating services and to encourage establishment of more credit rating companies in Pakistan. Furthermore, the recently issued code of conduct for credit rating companies will serve to streamline the rating process.

### 8.3.2 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 of 30 June 2005, the membership of ICAP was 3,574, of which 731 members were working overseas. During the year under review, ICAP admitted 213 new members.

In order to ensure that the members of ICAP maintain the highest ethical and technical standards, a Quality Control Review (QCR) Program has been instituted by ICAP. During the year, QCRs of twenty-eight audit firms/offices were conducted by ICAP. As of 30 June 2005, there were ninety-five practicing firms, which had been awarded satisfactory rating under the QCR Program.

ICAP has also instituted a Financial Statements Review Program, effective 1 July 2005. The objective of this program is to enhance the quality of services provided by its members in achieving reliable financial reporting by listed companies in accordance with the applicable laws and accounting standards. The Quality Control Review Committee of ICAP will be responsible for monitoring the program through the Professional Standards Compliance Department. The Committee will report to the ICAP Council on the implementation of the program on a quarterly basis.

As a SRO, ICAP takes disciplinary actions against members in cases of negligence or misconduct. During the year under review, forty-five cases were disposed off. In eleven cases, reprimands were issued while in another nine cases, reprimands were issued and penalties imposed on the members concerned. The remaining twenty-five cases were closed as no merit was found in the complaints. There were thirty-four cases pending adjudication in High Courts at the end of the year.

## 8.4 Development of Laws

### 8.4.1 Proposals for Finance Act, 2005

The Commission furnished proposals to the Government for its consideration in the Finance Bill 2005 in order to remove irritants to smooth functioning of companies and financial institutions as well as to encourage their progressive development. These proposals were based on the suggestions received from different quarters and, largely, on the recommendations of the Task Force on Corporate Tax Policy, jointly formed by the Commission and CBR.

Most of the recommendations of the Commission were accepted by the Government and included in the Finance Act, 2005. These included the following:

- i. The definition of “small company” has been added in the Income Tax law.
- ii. Corporate tax rate for small companies has been slashed by 50 percent; these companies would now be taxed only at 20 percent. This is expected to encourage businesses to enter into the corporate net.
- iii. Withholding tax of 3.5 percent on supplies has been a major irritant for companies, particularly in comparison to non-corporate entities in the same business. The withholding tax requirement on supplies, services and contracts for small companies has been abolished.
- iv. Non-listed companies that get listed on a stock exchange would receive a tax rebate of 1 percent. It is hoped that this would serve as an incentive for larger companies to solicit public participation in their securities.
- v. Losses on amalgamation, which were hitherto allowed to be adjusted on amalgamation of companies in the financial sector, can also be adjusted by industrial undertakings. This is expected to encourage revival of sick units.
- vi. Group relief has been available to companies in the industrial sector only. This concession would now be available to companies in services sector as well.
- vii. Capital gains on dealings in listed securities were taxable in the hands of insurance companies although other investors were tax exempt in this regard. The disadvantage for insurance companies has now been removed.
- viii. In case of investment in TFCs, up to the value of Rs. 150,000, there would be no withholding tax on the return on these TFCs. This exemption would encourage investment in TFCs and also remove the disadvantage vis-à-vis National Savings Schemes.
- ix. Limit of investment in IPO by salaried persons has been increased from Rs. 100,000 to Rs. 150,000 to allow enhanced participation in new offers of securities.
- x. The prescribed ceiling for admissibility of depreciation on value of leased cars has been removed, which will help promote the leasing sector.
- xi. Pension funds registered with the Commission have been allowed certain tax benefits, including tax credit on employees' contributions of up to Rs. 500,000 in a tax year, tax exemption on the income of a pension fund and tax exemption on profit of a pension fund manager on redemption of seed capital. These incentives would provide the much needed boost to development of private pensions in the country.
- xii. Capital gains of stock exchange brokerage firms shall not be taxed if they convert into corporate brokerage houses by 30 June 2006. It is hoped that brokers will take advantage of this facility.

### 8.4.2 Amendments in Chartered Accountants Bye-laws, 1983

Over time, a number of institutions have been established to provide quality coaching and education to the students of chartered accountancy. The Chartered Accountants Bye-Laws, 1983 did not permit these institutions to impart training to students and the ICAP to regulate the period of training courses. The Bye-Laws also did not authorize ICAP to constitute boards such as Quality Assurance Board and Accounting Standards Board in consonance with international practice. Furthermore, the need to include members other than chartered accountants in such Boards was not recognized. These lacunae have been removed by appropriate amendments in Bye-Laws 99(1), 72(1) (2), 78, 79, 80(1) (2), 82, 83 and 84 of the Chartered Accountants Bye-Laws, 1983.

### 8.4.3 Modification of the Code of Corporate Governance for Rotation of Auditors

The Code of Corporate Governance was incorporated in the listing regulations of the stock exchanges during the year 2002. The clause (xli) of the Code required all listed companies to rotate their external auditors after every five years. In view of certain genuine concerns and practical difficulties of companies, the requirement for rotation was reviewed and modified to provide that:

- i. all companies (whether listed or otherwise) in the financial sector shall change their external auditors after every five years; and
- ii. all listed companies, other than those in the financial sector, shall, at a minimum, rotate the engagement partner after every five years.

The revised clause of the Code of Corporate Governance has been suitably incorporated in the listing regulations of the stock exchanges. In case of non-listed companies, the requirement is being applied by the Commission while approving auditors for appointment.

## 8.5 Regulatory Actions

### 8.5.1 Code of Conduct for Credit Rating Companies

Credit rating companies in Pakistan have long since been following individual procedures for the purpose of rating. In order to standardize the rating process and to provide a transparent procedural framework for credit rating companies, the Commission issued a directive to credit rating companies laying down a detailed code of conduct.

The code of conduct has been developed keeping in view international best practices and ethical requirements in the business of credit rating. It is aimed at eliminating any biases and conflicts of interest in the rating process to ensure credibility of ratings issued by rating companies. Salient features of the code are as follows:

- i. The credit rating companies are required to give due consideration to factors such as objectivity, independence, transparency and proper disclosure during the rating process.
- ii. Certain provisions have been specified to be incorporated in the rating agreement with the client, which would clearly stipulate the responsibilities of both parties involved.
- iii. Credit rating companies are required to develop and maintain a website on which press releases and rating reports would be kept available for at least three years after the rating.
- iv. Credit rating companies would establish and document policies and procedures to ensure that no conflict of interest arises that would jeopardize the objectivity of the ratings.
- v. Necessary policies would be developed to ensure confidentiality of information obtained by credit rating companies from the rated entities.
- vi. Credit rating companies would not be involved in creation of false market and passing of price sensitive information to any players in the capital market.
- vii. Credit rating companies are required to acquire and maintain membership of the Association of Credit Rating Agencies in Asia and follow the best practices and guidelines issued by it from time to time.



Officers of the PSPD engaged in a discussion

### 8.5.2 Deferment of Transfer Pricing Requirements

The Fourth Schedule to the Companies Ordinance and the listing regulations of the stock exchanges include certain provisions with respect to related party transactions and transfer pricing. In view of varied concerns communicated to the Commission from time to time about availability of relevant information for purposes of measurement and disclosure of related party transactions on arm's length basis and verification of the same by auditors of companies, the Commission deferred application of clause 6 of Part I of the Fourth Schedule to the Companies Ordinance until 31 December 2005. The stock exchanges were also directed to defer application of relevant provisions of the listing regulations in this regard.

At the close of the year, the Commission had initiated establishment of a task force to analyze the concerns of corporate sector and auditors with respect to measurement of related party transactions on arm's length basis and their disclosure in the financial statements. The task force would also review allied issues and present a report for consideration of the Commission before 31 December 2005.

### 8.5.3 Circular on Holding of Election of Directors

As a result of amendment in Section 158 of the Companies Ordinance, companies are required to hold their AGMs within four months from the close of the financial year, as against six months prior to the amendment. Previously, elections of directors were held in the AGMs. However, upon amendment in Section 158 of the Companies Ordinance, a time lag occurred between holding of AGM and election of directors; as a result, most of the companies were holding two general meetings, one as AGM within four months of the close of the year and another as Extraordinary General Meeting for election of directors on conclusion of their term of office.

Taking cognizance of the difficulty faced by companies, the Commission issued a clarification through its Circular No.3 dated 10 May 2005 that election of directors may be held prior to the expiry of three years' tenure of directors. This would enable companies to hold elections of directors in the AGM. Regardless of early elections, the newly elected directors will take office only after completion of the three years' tenure of existing directors.

## 8.6 Monitoring and Enforcement

### 8.6.1 Compliance with the Code of Conduct for Credit Rating Companies

In order to monitor compliance of credit rating companies with the code of conduct, compliance reports were sought by the Commission. Review of these reports showed full compliance with the code of conduct by credit rating companies.

### 8.6.2 Review of Progress on ICAP's Disciplinary Actions against its Members

The Commission considered it essential that disciplinary cases of chartered accountants for professional misconduct, which were pending with ICAP, be disposed off expeditiously. In this regard, the Commission required ICAP to investigate and appropriately dispose off all such cases, particularly those pending decision for a long time. It was also suggested to investigate and dispose off all cases of a firm together to save time taken in arranging multiple hearing opportunities.

## 8.7 Judicial Cases

The directive of the Commission for rotation of auditors of listed companies after every five years, as included in the Code of Corporate Governance and incorporated in the listing regulations of the stock exchanges, was challenged through writ petitions in the Sindh High Court, Karachi as well as in the Lahore High Court, Lahore and Rawalpindi Bench. The petition before the Sindh High Court was dismissed last year, whereupon the plaintiff preferred an intra court appeal in the Sindh High Court. The suits were appropriately defended in the courts and were withdrawn by the petitioners during the year under review.

## 8.8 Developmental Activities

### 8.8.1 Corporate Tax Policy

During the year, the Commission and CBR jointly set up a Task Force for formulating a corporate tax policy aimed at encouraging corporatization and progressive development of the corporate sector. Mr. Justice (R) Saleem Akhtar, former Tax Ombudsman, was appointed as the Chairman of the Task Force. In addition, the Task Force comprised of Mr. M.S. Lal, Member CBR, Mr. Abdul Rehman Qureshi, Adviser to the Commission; Mr. Ahmad Khan, former Member, CBR/Monopoly Control Authority; Mr. Mukhtar Ahmad Gondal, Member Income Tax Tribunal; Mr. Abdul Hameed Chaudhry, CA; and Syed Mohammad Shabbar Zaidi, CA. Syed Fayyaz Mahmud, Director in the Commission acted as Secretary to the Task Force.

The Task Force submitted its report to the Commission and CBR in April 2005. The report put forth various recommendations for easing structural and administrative problems of corporate entities, thereby promoting their development and encouraging corporatization. On the basis of the report, the Commission engaged in dialogue with the concerned quarters; several recommendations of the Task Force were, as a result, incorporated in the Income Tax law through the Finance Act, 2005.

This initiative of the Commission proved to be instrumental in promoting corporatization of businesses and addressing practical difficulties faced by them, as evident from the rising trend of incorporation.

### 8.8.2 ROSC - Accounting and Auditing

During the year, the World Bank and IMF undertook an analytical study of the accounting, auditing and financial reporting regime for corporate entities in Pakistan, on the request of the Government. The Commission is a major stakeholder in this regard, having the regulatory authority to enforce accounting standards and reporting requirements and possessing oversight of the activities of ICAP. It provided necessary support and assistance to the World Bank-IMF mission in carrying out the study.

The draft ROSC - Accounting and Auditing was shared with the Commission during the year. Once finalized, the ROSC will assist PSPD in undertaking necessary reform measures for addressing institutional, regulatory and legal weaknesses in the accounting and auditing framework.

### 8.8.3 Research on Impact of Universal Banking on the Business of NBFCs

Given the increasing involvement of banks into diversified non-banking financial services, a research study was conducted on "Impact of Universal Banking on the Business of NBFCs". The study concluded that the scenario in Pakistan is consistent with the international trend; however, certain steps are required to fine-tune the universal regime provided to NBFCs so as to extract maximum benefit from the NBFC model and to provide them a level playing field vis-à-vis banks.

### 8.8.4 Research on Performance of the Modaraba Sector

The Modaraba Ordinance was promulgated in 1980 to provide the necessary legal framework for organizing business enterprises according to the injunctions of Islam. Initial response to this sector was slow; however, against the backdrop of better corporate results, the sector flourished rapidly over the period 1990-93, when more than fifty modaraba companies were registered.

After 1993, growth in the modaraba sector has been stagnant. In order to assess and evaluate the reasons for this situation, the PSPD undertook a comprehensive study. For the purpose, structured questionnaires, focusing on regulatory, management and business environment aspects, were circulated among the concerned stakeholders. Based on the feedback so received and its indigenous research, the PSPD prepared a report on the performance

of the modaraba sector and gave certain policy recommendations to alleviate the situation. The report was submitted to the Chairman as well as the NBFCD.

### 8.8.5 Analysis of Stock Market Indices

The PSPD undertook a comparative review of local and international stock market indices to assess the composition and basis of KSE-100 index. Based on this analysis, necessary measures for improvement were shared with the concerned stakeholders for feedback, so that stock market indices could be suitably aligned to reflect true market movement.

## 8.9 Annual Plan

### 8.9.1 Work in Progress

#### i. Amendments in the Chartered Accountants Ordinance, 1961

In order to upgrade the provisions in the Chartered Accountants Ordinance, 1961, a Chartered Accountants (Amendment) Bill 2005 has been prepared and forwarded to the Finance Division for approval by the Federal Government. Through appropriate amendments, the Chartered Accountants (Amendment) Bill is expected to help ICAP discharge its self-regulatory function more effectively as well as enable the Commission to maintain strict oversight of the accountancy profession in Pakistan. The Chartered Accountants Ordinance, as amended, will result in streamlining the operations of ICAP, facilitate initiatives such as the QCR Program and expedite disposal of complaints of professional misconduct in an independent and transparent manner. The objective is to respond to challenges faced by the profession in the fast-changing global environment.

#### ii. Draft Underwriters (Registration and Regulation) Rules, 2005

A review of the Balloters, Transfer Agents and Underwriters Rules, 2001 was carried out by the Commission in order to improve the regulatory framework governing these intermediaries in the capital market. On the basis of this review, it was envisaged that separate rules for underwriters, transfer agents and balloters be developed to ensure effective legal and regulatory requirements for each of these service providers. As a first step, new rules for underwriters are being developed, which may, among other things, also permit underwriting by mutual funds.

#### iii. Draft Amendments in the Employees' Provident Fund (Investment in Listed Securities) Rules, 1996

The Employees' Provident Fund (Investment in Listed Securities) Rules, 1996 do not permit provident funds to invest in index funds despite their increasing popularity on account of potential for growth and lower risk. In view of this and based on a review of allowable practice in other countries, the Commission has proposed amendments in the Employees' Provident Fund (Investment in Listed Securities) Rules to allow employees' provident funds to make investments in index funds. During the year, the proposed amendments were sent to the Ministry of Finance for approval and onward vetting by the Ministry of Law, Justice and Human Rights. Upon completion of due process, the draft amendments will be notified for soliciting public opinion.

#### iv. Notification of Islamic Financial Accounting Standard on Murabaha

Murabaha serves as a Shariah compliant mode of financing and is a step towards Islamization of the economy. The accounting treatment of murabaha varies across financial institutions, which has hampered the general acceptance of this mode of financing and reduced its utility. In order to overcome this impediment, a special committee was formed by ICAP to develop the first Islamic Financial Accounting Standard on murabaha. The standard will introduce uniform requirements for disclosure and presentation of murabaha in the financial statements of banks and other financial institutions.

During the year, the Islamic Financial Accounting Standard on Murabaha was approved by the Commission and forwarded to the Ministry of Finance for necessary action. After its approval and vetting, it would be notified under Section 234 of the Companies Ordinance.

v. Minimum Disclosure Standards for Offering Documents and Trust Deeds of Mutual Funds

The PSPD is seeking to lay down minimum disclosure requirements for offering documents and trust deeds of mutual funds and standardize the same. At present, different mutual funds include varying provisions in these documents. Standardization would help to facilitate investors in decision making as well as enable the Commission to thoroughly review the offering documents and trust deeds.

### 8.9.2 Future Plans

The activities of the PSPD, planned for the coming year, are:

- i. to draft new laws or propose amendments in existing laws administered by the Commission, including *inter alia* Companies (Issue of Capital Rules), 1996, Rules for Registration of Balloters, Rules for Registration of Consultants to Public Issues and Rules for Registration of Share Transfer Agents;
- ii. to propose necessary revisions in the Fifth Schedule to the Companies Ordinance, in coordination with ICAP;
- iii. to carry out research on good governance in line with international best practices in order to further improve and update the Code of Corporate Governance for listed companies;
- iv. to study and provide necessary recommendations for development of credit rating in the country;
- v. to develop guidelines regarding minimum disclosure standards for abridged prospectus in order to facilitate issuers and investors;
- vi. to prepare a Code of Conduct for asset managers and a Code of Conduct for research/financial analysts issuing reports and making investment recommendations for the capital market;
- vii. to conduct research on the role of research/financial analysts in the capital market, their desired qualifications and international regulatory framework/licensing requirements and make necessary recommendations in this regard;
- viii. to carry out research on practices of dividend declaration in different jurisdictions and draw a comparison with Pakistan; and
- ix. to prepare guidelines for use of the Commission in considering applications for non-consolidation of accounts of group companies.





# Support Services Division



**SECURITIES AND EXCHANGE  
COMMISSION OF PAKISTAN**

## 9 Support Services Division

### 9.1 Operational Structure

#### 9.1.1 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 Information Systems and Technology (IS&T) Wing.

#### 9.1.2 Management Team

Mr. Rashid I. Malik, Commissioner heads the SSD. Subsequent to the period under review, Mr. Javed K. Siddiqui was assigned the portfolio of Executive Director, SSD. There are two Directors overseeing the functions of the Administration Department and one Director heading the Finance Department.



Mr. Javed K. Siddiqui (right), Executive Director in a meeting with officers of the SSD

### 9.2 Performance Review

The various Wings of the SSD worked closely with each other as well as with other Departments of the Commission to develop efficient procedures and a congenial working environment.

Significant initiatives were undertaken by the Human Resource Wing during the year, including assessment of work load at the Commission to determine manpower requirement in various Departments and enhancement of salary structure with approval of the Policy Board. As many as eighty-two new officers were employed during the year in a transparent manner and with regard to gender balance.

During the year under review, a Training Unit within the SSD was established, initially to work with consultants under ADB's TA for strengthening regulation, enforcement and governance of non-banking financial markets and eventually to centralize training and staff development functions. The Training Unit would serve as the focal point to assess training needs of the Commission's employees, arrange suitable training opportunities and evaluate the effectiveness of training programs. A number of training programs aimed at enhancing the skill base of employees were arranged throughout the course of the year.

The Administration Wing undertook a number of targeted measures for improving health care facilities and overall working environment. Existing facilities at the children daycare center were improved and additional space was made available.

The IS&T Wing, in coordination with user Departments, developed and implemented tailor-made systems. The new applications helped in further automating the Commission's regulatory, monitoring and supervisory functions as well as support services. In this regard, the IS&T Wing initiated a number of in-house projects as well as those with external support, including that of the Electronic Government Directorate (EGD). During the year, the e-services project and the e-surveillance project were launched; their successful implementation would pave way for online submission of returns and documents as well as online monitoring of market activity. The

IS&T Wing also enhanced the IT infrastructure at the Commission to accommodate existing and future processing needs. In addition, it initiated work for upgrading the Commission's website in order to make it more user-friendly and informative.

The Finance Department efficiently discharged its functions with regard to preparation of the Commission's budget for FY 2006 and monitoring utilization of resources against budget for the year under review. It also prepared regular MIS reports for review of the Commission. Moreover, annual financial statements for FY 2004, along with auditor's report, were submitted to the Federal Government within the prescribed period.

The Finance Department undertook a review of the Accounting Policies and Procedures Manual, which was implemented after necessary modifications. The Department functions within a strict internal control system and, during the year, it continued to ensure compliance with the Commission's policies and procedures in financial matters.

### 9.3 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.

#### 9.3.1 Work Load Analysis

The work of the Commission has increased manifold in recent years, with the result that its human resource requirement has substantially increased as well. Human resources are a critical element in enabling the Commission to effectively exercise its regulatory and enforcement authority as well as to encourage development of sectors under its purview and new fields of activity, such as derivatives trading, private pensions and Islamic financial products.

During the year under review, the Human Resource Wing hired the services of a consulting firm to perform work load analysis in order to assess additional manpower requirement at various Departments of the Commission. Based on a comprehensive study, the consultants recommended certain additional positions; as a result, seventy-one additional positions in grades five to nine were approved by the Policy Board.

#### 9.3.2 Recruitment

During the year, as many as eighty-two new appointments were made in different Departments of the Commission. The Commission continued with its policy of being an 'equal opportunity employer' and encouraged female candidates to apply against advertised positions. Females recruited during the year represented almost a quarter of the total recruitment.

The newly appointed officers possessed expertise in different disciplines, like accountancy, business administration, and law. Details of professionals inducted during the year are illustrated in Figure 20.

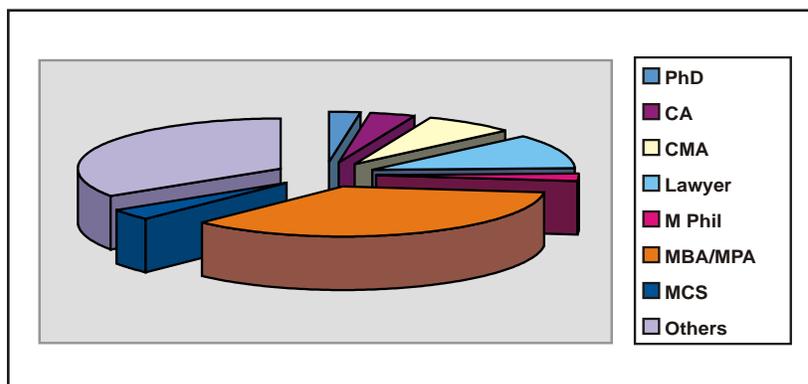


Figure 20: Professionals Inducted During the FY 2005

### 9.3.3. Junior Executive Induction Scheme

The Junior Executives Induction Scheme (JEIS) was advertised during the year for inducting a new batch of young professionals. The scheme generated considerable interest and in response to the advertisement, over 1,200 applications were received.

As many as 600 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 thirteen 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 and, based on their performance and internal staffing needs, were appointed in relevant Divisions of the Commission.

### 9.3.4 Revision of Salary Scales

The Commission employs a number of professionals and considers it expedient to provide them with market based compensation and conducive human resource policies in order to ensure employee retention. In this regard, the Policy Board, in May 2005, approved a more competitive salary structure - at par with the prevailing market rates - for all grades of employees of the Commission. The revised salary scales took effect from 1 July 2005.

### 9.3.5 Training and Development

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, employees from different Departments of the Commission and CROs attended as many as twenty-two local trainings and nine foreign trainings. In certain programs, participation of a number of officers was arranged, keeping in view the relevance of training to their core job responsibilities.

### 9.3.6 Human Resource Management System

During the year, the Human Resource Wing started maintaining human resource data on a computerized database, the Human Resource Management System (HRMS). This would ensure that accurate and reliable information is available on a timely basis. HRMS provides different reports and an effective information system for making important human resource related decisions.

## 9.4 Administration

The Administration Wing provides support services relating to transport, equipment, office supplies, furniture and fixture; hiring and maintenance of office premises; maintenance of assets; mail receipts and deliveries; printing of reports; and other allied matters. It has been extensively engaged in developing a conducive environment for Divisions at the head office of the Commission and for CROs to efficiently discharge their duties.

### 9.4.1 Extension of Children Daycare Centre

Due to increasing demand for the facility, the Commission provided additional space to the children daycare centre, which had been established last year at the Commission's head office. Moreover, air conditioning and other facilities were provided at the centre to ensure comfort and hygiene to children.

The availability of daycare facility at the Commission's office has largely facilitated employees in shouldering their parenting responsibilities while performing their duties at the Commission.

#### 9.4.2 Medical Facilities

During the year under review, the Administration Wing provided extensive medical support to employees and their families. In this regard, as many as ninety cases of hospitalization were dealt with in accordance with the medical policy of the Commission.

In order to control the spread of hepatitis, fifty-five employees were screened for Hepatitis B and C; screening of remaining employees would be undertaken shortly. The health care facility provided by the resident doctor at the head office of the Commission was also used by a number of employees during the year.

#### 9.4.3 Staff Welfare

The Administration Wing took a number of other measures to promote staff welfare and provide a congenial working environment:

- i. bottled water is being provided to all employees at the Commission's head office;
- ii. split air conditioners were installed at certain points to facilitate officers at times the central air conditioning was switched off; and
- iii. new extensions were added to telephone exchange at the head office of the Commission to cater for the increase in staff.

### 9.5 IS&T

The IS&T Wing provides a range of services for various management support functions, specialized applications, MIS applications and managed workstations. Major areas of operations include software systems and database maintenance/development; website/intranet engineering and maintenance; local area/wide area networking connectivity and central services; managed workstation services; hardware maintenance services; and training in IT products and services.

The IS&T Wing also carries out training in IT, including training of IT staff at CROs, end-user trainings, and preparation of training manuals and interactive Compact Discs for the purpose.

#### 9.5.1 Major Projects

Some of the major IT projects being carried out at the Commission are as follows.

##### i. E-Services Project

The E-Services project is being funded by EGD, on the request of the Commission. The first phase of the project was completed during the year and a requirement specification firm, a legal consultant and a media firm were assigned necessary tasks. Moreover, business process analysis of the Departments was carried out in-house and was supplemented with a seminar on the subject to educate both IS&T employees and Departmental staff.

The system being developed under the project will enable companies to submit returns and other documents electronically, using a pre-defined format and a software application. The system will aim at reducing undue paperwork and improving various processes within the Commission.

## ii. E-Surveillance Project

The E-Surveillance Project caters to a market surveillance solution at the Commission for online monitoring of market activity. In this regard, the IS&T Wing and the SMD, in collaboration with consultants working under the ADB's TA for strengthening regulation, enforcement and governance of non-banking financial markets, identified international firms offering such solutions. During the year, a Request for Information was sent to those firms, on the basis of which their proposals were received and detailed presentations of their solutions were made at the Commission. As of the close of the year, the special procurement committee, commissioned for the purpose, was at the final stages of evaluating the vendors for implementation of market surveillance solution.

### 9.5.2 Development of New Systems and Applications

During the year under review, the IS&T Wing developed various applications in-house and outsourced others. Besides the systems initiated and developed in previous years, the following were the major systems and applications on which work was undertaken during the year under review.

#### i. Résumé Submission System

This system is used for receiving online résumés and provides an automated short-listing procedure, based upon the candidates' input.

#### ii. Corporate Registration System/Document Management System Integration

The Corporate Registration System at CROs in Karachi and Lahore was linked to the Document Management System, thereby facilitating retrieval of documents for improved decision making.

#### iii. Intranet of LD

An intranet portal for the LD was developed, which was integrated with other applications developed for use of the Department.

#### iv. Enhancement of Enforcement and Monitoring System

Enhancement of the existing Enforcement and Monitoring System provides for initial review of accounts, submission of returns as well as detailed examination of accounts.

#### v. Online Query Management System

Online query submission and tracking system results in efficient handling of electronic queries, complaints and suggestions by immediately forwarding such requests to the concerned officers for response and keeping track of the status of requests.

#### vi. Online Name Reservation Facility

This useful utility incorporated on the official website of the Commission will facilitate name searches for companies in the process of registration.

#### vii. Online Submission System for NBFCS

This online application encompasses a wide range of functions including online submission of returns, comprehensive reporting for the purpose of audit, analysis and comparison of various reports.

### 9.5.3 Infrastructure Enhancement

The IT infrastructure at the Commission was enhanced to accommodate existing and future processing needs. In this regard, following major activities were carried out.

#### i. Server Consolidation

In view of the increased processing requirements, server consolidation was carried out to ensure centralization, data integrity, application integration and reduced infrastructure costs to the Commission.

#### ii. Network Security Enhancements

With an increased number of employees, data processing, and sensitive applications, data security is a foremost consideration. For the purpose, an elaborate Intrusion Detection and Prevention system was commissioned to ensure data protection.

#### iii. Server Optimization and Enhancement

To cater for increased processing requirements, optimization of servers, increase in Random Access Memory and other enhancements were carried out during the year.

#### iv. Network Expansion

Given the increase in the number of new applications connecting CROs with the Commission's head office and the increased number of users, the network was expanded to allow fast access to data.

#### v. Comprehensive Tape Library Solution

A comprehensive tape library solution was implemented to ensure proper backups with least usage of network. This comprehensive automated solution leaves no room for human error in the backup process and provides for expeditious disaster recovery.

#### vi. Uninterrupted Power Supply

Fluctuations in power supply can cause data loss as well as result in malfunctioning of computers and other equipment. In order to avoid this situation, every floor at the Commission's head office was provided with an uninterrupted power supply.

#### vii. Communication Link Enhancement

To facilitate communication between CROs, head office and external parties, the communication link between various sites was enhanced to ensure speedy processing and access.

#### viii. Disaster Recovery Center Bandwidth Enhancement

The disaster center bandwidth was enhanced to achieve continuous connectivity with disaster recovery center. This helps to provide quick responses to data requests and ensures timely recovery of data in case of data loss.

#### ix. Physical Security

Physical security of the entire IT infrastructure, particularly that of server room must be ensured. In this regard, processes such as administrative and authentication control combined with restricted physical access, tight security and vigilant monitoring were implemented to ensure security of systems and data.

### 9.5.4 Information Resource Center

The Information Resource Center (IRC), as a part of IS&T Wing, has evolved into a rich and exceptional source of references proving to be extremely beneficial for the operations of all the Divisions of the Commission. It has undertaken various activities some of which are as follows.

#### i. Online Application for IRC

A state-of-the-art application has been developed for management, retrieval and automatic dissemination of information available at the IRC. It includes advance features of search, reservation of books, access to online resources, and recommending additional resources for the IRC. The system supports many different interfaces for users within the Commission.

#### ii. Online Resources

The IRC has subscribed to the following national and international online resources:

- Pakistan Law Site
- Indlaw Communication
- World Bank E-Library
- World Development Indicators Online
- Global Development Finance Online
- HEC Digital Library databases including 17,000 full text journals

#### iii. Linkage with other IRCs and Libraries

The IRC has created a link with other national and international IRCs and libraries for inter-library loan and networking.

## 9.6 Finance

The Finance Department is responsible for directing and controlling the areas of accounting, financial reporting, treasury management and budgeting. A multi-user accounting software is being used for the maintenance of books of accounts and a sound accounting system is in place. The Finance Department works within a transparent and effective internal control system. Moreover, policies and procedures are well documented, regularly reviewed and improved upon, and consistently adhered to.

The Finance Department follows the relevant requirements of the SECP Act in processing payments, recording transactions, and preparing and maintaining books of accounts.

### 9.6.1 Approval of Budget

The Finance Department prepared the Commission's budget for FY 2006 and obtained its approval from the Policy Board in May 2005 as per requirement of Section 24 of the SECP Act.



Officers of the SSD at work

## 9.6.2 Financial Statements

The SECP Act requires that audited financial statements of the Commission should be submitted to the Federal Government within 120 days of the close of the year. During the year under review, financial statements for the year ended 30 June 2004 were prepared by the Finance Department and audited by Taseer Hadi Khalid and Co., CAs. The audited accounts were sent to the Federal Government on 21 October 2004, after approval by the Commission and the Policy Board.

## 9.6.3 MIS

A MIS, providing overview of financial performance and financial position of the Commission, is in place and MIS reports are circulated on a monthly basis. These reports give details of revenue generated and expenditure incurred by each Division at the head office of the Commission and each CRO. It also gives comparison of actual results with budget to ensure that revenue targets are met and expenses do not exceed the approved limit. During the year, MIS reports were placed before the Commission every month and formed an essential part of the Commission's decision making process.

## 9.6.4 Investment of Surplus Funds

During the year, funds considered surplus and not required for immediate use were invested in short term and long term deposits. Prudent investments by the Commission would help in steady growth of financial resources.

# 9.7 Annual Plan

## 9.7.1 Work in Progress

### i. Recruitment against Approved Positions

As of the close of the year, the Human Resource Wing was actively seeking to fill in the additional positions approved by the Policy Board to meet the demands for additional manpower in various Departments.

### ii. Renovation and Maintenance of Office

The Administration Wing plans to undertake renovation of the Commission's head office in Islamabad, including redesigning, reshaping and refurbishing. In this regard, award of contract was at final stages at the year end.

### iii. Website Upgradation

During the year, the IS&T Wing was working on revamping the Commission's website to make it more user-friendly and informative. The new website, when launched, would include separate web pages for Departments of the Commission, online forms and other resources.

### iv. Data Warehouse Project

The Commission intends to launch a data warehouse to allow for data analysis and strategic decision making. During the year, the IS&T Wing prepared a PC-I and submitted it to EGD for approval. Work on the project would be initiated shortly after approval.

### v. Capacity Enhancement for SMEs

In order to help SMEs in legal, technological and educational sphere so that they can use IT infrastructure more effectively, the IS&T Wing furnished a project proposal to EGD. Approval was awaited at the year end.

vi. ISO 9001:2000 Implementation

During the year, the IS&T Department worked in collaboration with Pakistan Software Export Board (PSEB) for implementation of ISO 9001:2000. A consultant from PSEB visited the Commission to provide an introduction to the project and necessary work in this regard was initiated.

vii. Database Clustering Solution

The database clustering solution is being implemented to ensure high level of data availability together with an increased scalability of the databases. It also provides higher processing power and minimum response time for any query.

viii. Case Management and Investigation System

In order to improve overall public and company related services at the Commission by enhancing company information accumulation, analysis ability, case handling and investigation, IS&T Wing is procuring an online case management and investigation system. A project proposal has been submitted to EGD for external funding.

ix. Online Registration/Licensing System for Brokers and Agents

A system is being developed for online registration and licensing of brokers and agents. This would facilitate brokers and agents by accelerating the registration and licensing process.

### 9.7.2 Future Plans

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

- i. implementing a goal-oriented performance evaluation system;
- ii. providing proper career management of employees for career progression and development;
- iii. undertaking specific IT projects, namely, Database Clustering and Storage Consolidation, Monitoring of Specialized Companies, Financial System, Integrated MIS, Beneficial Ownership System Redevelopment, Data Warehouse, Alert System for Companies, and establishment of a Call Center;
- iv. acquiring network vulnerability assessment tools;
- v. carrying out information system audit;
- vi. coding and physical verification of fixed assets and preparing a fixed assets register;
- vii. reviewing and updating internal controls at the head office and CROs, including monitoring and evaluation visits to CROs;
- viii. implementing online banking services;
- ix. preparing revenue reconciliations for fee collected from companies, stock exchanges, CDC and NCCPL;
- x. designing and construction of the Commission's building in Islamabad;
- xi. renovating and remodeling of office space at the Commission's head office; and
- xii. renovating and remodeling of CROs Islamabad, Lahore and Karachi.

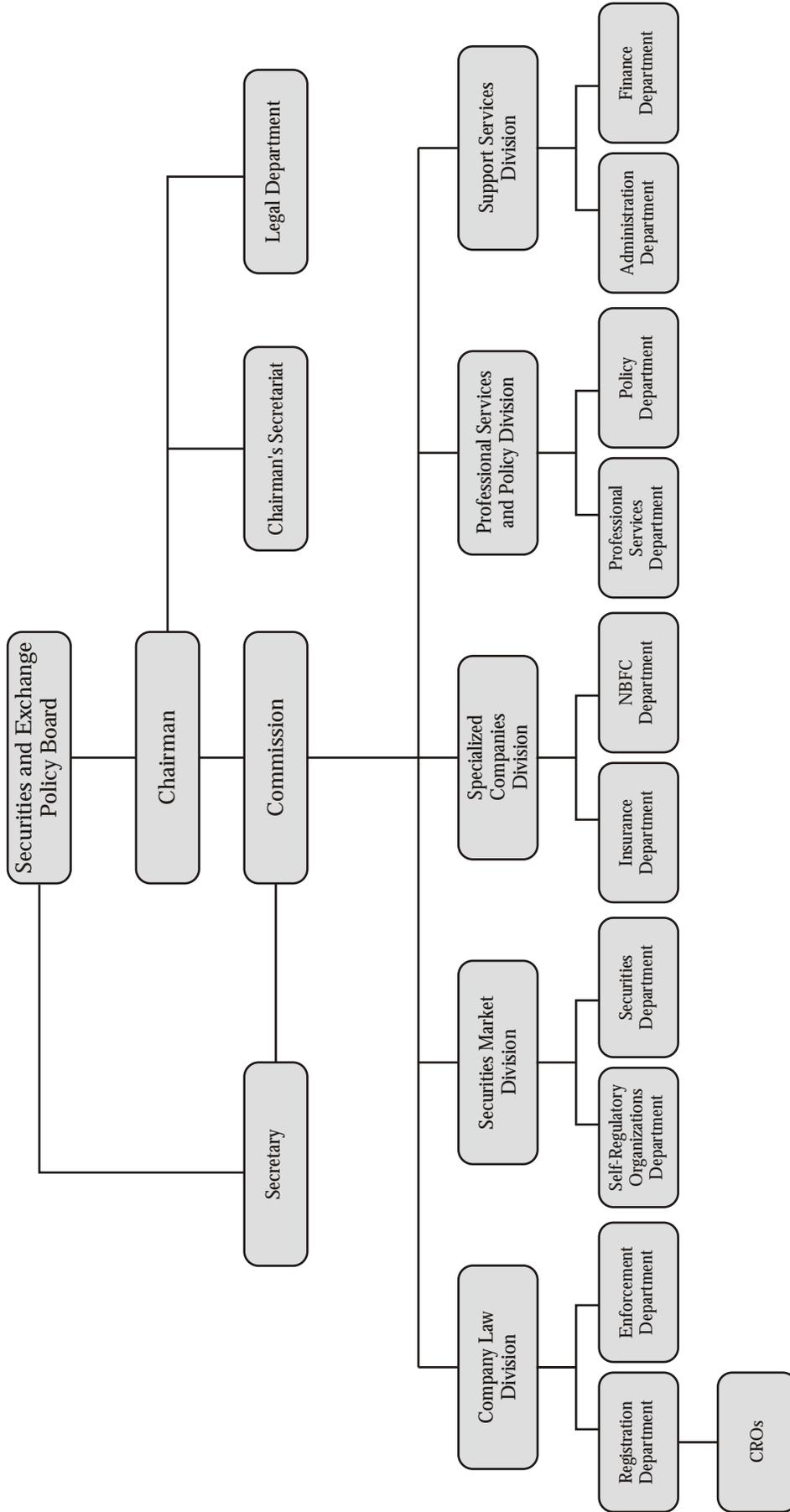


# ANNEXURE



**SECURITIES AND EXCHANGE  
COMMISSION OF PAKISTAN**

## Annexure A - Organizational Structure



## Annexure B - Management Directory

Name	Designation	Email Address	Telephone Number
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## Annexure C - List of Publications

In addition to the quarterly newsletter, the Commission has prepared the following publications:

Title of Publication	Date of Publishing
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
Brief Series on Corporate Governance	Initiated in January 2003
Brief Series on AML	Initiated in March 2003
Insurance Guide	August 2003
Promoter's Guide	August 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
Company Mortgages and Charges Guide	April 2005

All publications are available at the Commission's website [www.secp.gov.pk](http://www.secp.gov.pk).

## Annexure D - List of Trainings

During the year, participation of the Commission's employees was arranged in the following training programs.

### Local Trainings

- i. Seminar on the “Power of Positive Culture, Communication and Motivation” held on 10 July 2004 by Institute of Bankers in Islamabad.
- ii. Dinner Talk on “Boom in Stock Exchange: Myth or Reality” organized by Institute of Bankers on 16 July 2004 in Islamabad.
- iii. Workshop on “Project Management” organized by ICMAP on 23-24 July 2004 in Islamabad.
- iv. Capacity Building Training organized by the Commission for Junior Executives and Assistant Directors on 8-15 October 2004 in Islamabad; attended by 25 officers.
- v. Orientation on “Corporate Registration and Compliance System” arranged by the Commission on 29 November 2004 at CRO, Faisalabad, on 30 November and 1 December 2004 at CRO, Multan and on 2 December 2004 at CRO, Islamabad.
- vi. Course on “Financial Derivates” at LUMS on 2-4 December 2004; attended by four officers.
- vii. Course on 'Leading with Emotional Intelligence' on 9-11 December 2004 at Pakistan Institute of Management Sciences; attended by three officers.
- viii. Study visit to ISE on 14 December 2004.
- ix. Workshop on “Strategic Leadership” organized by Pakistan Institute of Management on 13-14 January 2005 in Lahore; attended by three officers.
- x. Workshop on “Beyond the Secretarial Role” organized by Management Association of Pakistan on 18-19 January 2005 in Karachi; participated by two private secretaries.
- xi. Workshop on “Conflict Management” held on 28 February-2 March 2005 by Pakistan Institute of Management in Lahore; attended by four officers.
- xii. Workshop on “How to Implement Computerized Accounting System” held on 28 February-3 March 2005 by Pakistan Institute of Management in Lahore.
- xiii. Course on “Financial Reporting-International Stream” organized by Ascend, Institute of Accountancy on 28 February-30 April in Lahore.
- xiv. Workshop on “Developing an Effective Public Relations Strategy” organized by Pakistan Institute of Management on 7-10 March 2005 in Karachi.
- xv. Workshop on “Interpersonal Skills and Conflict Resolution” organized by ICMAP on 17 March 2005 in Islamabad; attended by five officers.
- xvi. Workshop on “Regional Conference on WTO, Basel Committee and the Financial Sector Industry” held on 17-19 March 2005 in Karachi; attended by three officers.
- xvii. “Pre-Budget Seminar” organized by ICMAP on 9 April 2005 in Islamabad; participation by four officers.
- xviii. Course on “Project Management with Primavera Software” held on 09-10 and 16-17 April 2005 in Center for Advance Studies in Engineering, Islamabad.
- xix. “Stress Management” workshop organized by ICMAP on 25 April 2005 in Islamabad; attended by two officers.
- xx. Course on “International Accounting Standards” held at National Institute of Banking and Finance, Islamabad on 23-26 May 2005; attended by twenty five officers.

- xxi. Seminar on Budget 2005-2006 organized jointly by ICMAP, ICAP and Rawalpindi Income Tax Bar Association on 11 June 2005 in Islamabad; attended by two officers.

## Foreign Trainings

- i. Asian Roundtable on Corporate Governance organized by OECD 2-3 November 2004 in South Korea.
- ii. Seminar of the IOSCO's Asia Pacific Regional Committee held on 26 November 2004 in Singapore.
- iii. Conference on "Regulation of Takaful" on 10-13 January 2005 in Jordan.
- iv. "South Asia Student Leader Conference" held on 9-16 February 2005 at the USA Embassy in Nepal.
- v. Participation in "2005 International Institute for Securities Market Development" held from 18-28 April, 2005 in USA.
- vi. Workshop on "Self-Assessment of IAIS Insurance Core Principles" held on 25-29 April 2005 in Cambodia.
- vii. Technical Workshop on "10-year Master Plan for Islamic Financial Services Industry" held on 31 May-1 June 2005 in Dubai.
- viii. Course on "Business Process Management" held on 12-18 June 2005 in the UK.
- ix. Annual Real Estate Investment World - Asia 2005 Conference held on 27-29 June 2005 in Singapore.



# ANNUAL REPORT 2005

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