



Securities and Exchange Commission of Pakistan

BEFORE THE APPELLATE BENCH

In the matter of

Appeal No. 90 of 2019

VIS Credit Rating Company Limited

(formerly JCR-VIS Rating Company Limited)

...Appellant

Versus

Commissioner, Securities Market Division, SECP

...Respondent

Date of hearing:

December 30, 2024

Present:

For the Appellant:

1. Mr. Sarfraz Ahmed, Legal Counsel
2. Mr. Faheem Ahmed, Chief Executive Officer
3. Mr. Bilal Aftab, ED Analytics

For the Respondent:

1. Mr. Sohail Qadri, Director/HOD, Adjudication-I Department, Adjudication Division, SECP
2. Mr. Mehboob Ahmed, Additional Director, Adjudication-I Department, Adjudication Division, SECP
3. Mr. Faisal, Assistant Director, Adjudication-I Department, Adjudication Division, SECP

ORDER

1. This order shall dispose of Appeal No. 90 of 2019 filed by VIS Credit Rating Company Limited *(formerly JCR-VIS Rating Company Limited)* (the "Appellant") under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the order dated October 16, 2019 (the "Impugned Order") passed by the Commissioner, Securities Market Division (the "Respondent") under section 159 of the Securities Act, 2015 (the "Act").

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2. The brief facts of the case are that the Appellant is licensed as a credit rating agency with the Securities and Exchange Commission of Pakistan (the “Commission”). The Commission, in exercise of the powers conferred under section 138 of the Act, conducted an inspection of the Appellant vide its order dated May 15, 2018 to ensure the compliance status of regulatory requirements set forth in the Credit Rating Companies Regulations, 2016 (the “Regulations”). The Report was submitted on December 10, 2018 (the “Report”) after receiving comments of the Appellant on the Letter of Findings (the “LOF”) dated October 19, 2018. The Report revealed the following instances of non-compliance with the Regulations:
- i. **Violation of Regulation 11(A)(h) of the Regulations:** Two members of the rating committee were analysts themselves and acting as member in the rating committee having voting rights, which reveals biasness and conflict of interest in the rating process.
 - ii. **Violation of Regulation 11(B)(l) of the Regulations:** The Appellant failed to conduct internal audit review and did not present the internal audit report to the Board of Directors (the “BOD”). Additionally, the Appellant also failed to develop a separate internal audit department to conduct periodic audit review of compliance of the Regulations.
 - iii. **Violation of Regulation 11(B)(b) of the Regulations:** The Appellant failed to update Human Resource Manual/Policy (the “HR Policy”) in line with the requirement of the Regulations.
 - iv. **Violation of Regulation 11(B)(d) of the Regulations:** The Appellant had not developed and approved risk policy, procedure and TORs for its risk management committee to enable it to identify, assess, mitigate, control and monitor risks arising from its activities.
 - v. **Violation of Regulation 11(C)(b) & (c) of the Regulations:** The Appellant failed to update the manuals for banks, asset management quality and fund stability and did not develop the manual for the industries such as securities brokers, leasing, corporate governance, life insurance and instrument rating. Additionally, the bank loan rating methodology was not updated since 2011 and the Appellant was found to lack consistency in models, methodologies and manuals for preference share rating, broker management rating and asset manager quality.
 - vi. **Violation of Regulation 11(C)(o) of the Regulations:** The Appellant was not in practice of discussion with auditors and creditors of the Company.
 - vii. **Violation of Regulation 11(C)(t) of the Regulations:** The Appellant failed to submit initial indicative ratings to rating committee.





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- viii. **Violation of Regulation 11(D)(a) & (b) of the Regulations:** The Appellant did not provide supporting documents for compliance with ACCRA Code of Conduct and implementation of the IOSCO principles. Furthermore, the Appellant's Code of Conduct was not updated in line with the applicable regulatory framework.
 - ix. **Violation of Regulation 11(F)(c) of the Regulations:** The compliance officer of the Appellant was involved in the rating operations, which creates a potential conflict of interest.
 - x. **Violation of Regulation 15 the Regulations:** The Appellant deviated from its fee structure and had charged amounts that were lower than those indicated on its website.
 - xi. **Violation of Regulation 17(b) of the Regulations:** The Appellant did not conduct the mid-year review of its outstanding rating.
 - xii. **Violation of Regulation 19(3) of the Regulations:** The Appellant did not conduct the sector specific studies on NPO and NBFC like leasing, modarbah sector and auto mobile industry. Further, it had not updated industry specific studies on confectionery and LPG industries since 2011.
 - xiii. **Violation of Regulation 14(3)(g) read with Annexure H of the Regulations:** In case of Sukuk issued by Hascol Petroleum, the Appellant's report failed to include critical details, such as tenure of the instrument, detail of collateral and name of the trustee.
3. In view of the aforementioned contraventions, a show-cause notice (the "SCN") was issued to the Appellant on July 17, 2019. In response, the Appellant, through its letter dated August 06, 2019, submitted a reply to the SCN and a hearing was conducted on August 07, 2019, which was attended by the Appellant's Authorized Representatives. After thoroughly examining the submissions and considering the facts of the case, the Respondent accepted the justifications provided by the Appellant concerning the alleged violations of Regulations 11(C)(b) & (c), 11(D)(a) & (b), 15, 17(b), 19(3), and 14(3)(g) of the Regulations. However, with regard to the remaining seven established instances of non-compliance, the Respondent, in exercise of the powers conferred under section 159(5) of the Act, imposed a penalty of Rs. 800,000/- on the Appellant.
4. The Appellant has preferred the instant appeal on the following grounds:
- a) The Appellant contends that it adopted fully transparent and collaborative approach to address the observations raised by the inspection team, but asserts that these efforts were not adequately considered at the time of issuance of the SCN.



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- b) With regard to the alleged violation of Regulation 11(A)(h) of the Regulations concerning bias and conflict of interest in rating assignments, the Appellant submitted that the rating exercises conducted on October 16, 2017, and December 20, 2017, as highlighted in the LOF, did not result in any conflict of interest as both were unanimously approved by the rating committee members. The Regulations require a quorum of at least three members in the rating committee, including an independent member and the participation of the analyst was mainly for the purpose of briefing the committee which does not give rise to any conflict or bias. Furthermore, out of approximately 250 ratings conducted in 2017, only two reports were pointed out for such alleged conflict. In the case of Haleeb Foods, the analyst was not part of the rating committee and only briefed the rating committee, the rating committee members then approved the rating unanimously. Whereas, in case of ABL Asset Management, even excluding the analyst the quorum of the rating committee was complete which approved the rating unanimously and the ratings assigned by the Appellant have never been questioned.
- c) Regarding the alleged violation of Regulation 11(B)(l) of the Regulations, the Appellant argued that it had repeatedly approached the relevant department of the Commission for clarification and amendment of the Regulation. The Respondent, however, erroneously proceeded on the basis that no documentary evidence was available. The Appellant, jointly with the Pakistan Credit Rating Agency, submitted a proposal to the Commission, which is available on the Commission's record and the said Regulation was later on amended vide S.R.O No. 1223(1)/2019 on October 10, 2019. Furthermore, the Appellant lacked the financial resources to appoint an independent head of audit but had designated a person as head of internal audit. The Appellant informed the Appellate Bench (the "Bench") during the hearing that after the amendment, the Appellant outsourced its internal audit function to Grant Thornton Anjum Rahman (Chartered Accountants).
- d) The Appellant addressed the Respondent's observation regarding the upgradation of the HR Policy and argued that it had developed a comprehensive HR Policy prior to the promulgation of the Regulations and the said Policy was in line with the applicable laws and covered all aspects required under Regulation 11(B)(b) of the Regulations. The Appellant contends that the Regulation merely requires the development of the HR Policy and there is no such requirement for its up-dation. The Appellant further submitted that it had revised and updated the HR Policy and submitted the revised version to the BOD for approval. Furthermore, under the Regulations, the Appellant is required to appoint independent directors on its Board and as per the Regulations the independent director is required to be a head of human resource



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- committee. The delay for the approval of revisions in the HR Policy were caused primarily due to non-availability of the independent director, which was beyond reasonable control of the Appellant.
- e) The Appellant asserted that the risk management policy and systems were already in place in compliance of Regulation 11(B)(d) of the Regulations and that the Impugned Order failed to appreciate this fact.
- f) Concerning the alleged violation of Regulation 11(C)(o) of the Regulations relating to the record-keeping of discussions with auditors, issuers, management, and creditors, the Appellant highlighted that it is not practical to engage in discussions with creditors or auditors on every rating decision, as per accepted international practices. Moreover, such discussion has no bearing on the rating assignment as all relevant details, including information on creditors, required in a due diligence of the issuer is provided in the financial reports and such financial reports are being regularly audited.
- g) Regarding the violation of Regulation 11(C)(t) of the Regulations, the Appellant argued that it has developed an in-house software for assigning Broker Management Rating ("BMR"), which digitizes the entire rating process. The software inputs necessary data and generates the rating, including the assessment of qualitative factors based on set benchmarks. The Appellant contends that in this fully automated process, it is not feasible for the analyst to provide an indicative rating, as the process is entirely digital. Further, the Regulations only envisages human assessment, which would be redundant when artificial intelligence-based systems are in place.
- h) Concerning the involvement of the compliance officer in rating operations in violation of Regulation 11(F)(c) of the Regulations, the Appellant explained that the instances in question pertained to the star ranking process, which is entirely digital and does not involve human judgment. Therefore, the Appellant asserts that no conflict of interest can arise in such automated rankings.
- i) The Appellant emphasized that the majority of the observations in the inspection report were incremental in nature and it had already undertaken various planning, procurement, and implementation measures to address the same. The Appellant contends that the Impugned Order failed to recognize the steps taken and the measures adopted by the Appellant to ensure compliance with the Regulations, and, as such, the Impugned Order is liable to be set aside.



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5. The Respondent countered the grounds of the Appeal and proffered arguments as follows:
- a) In response to the Appellant's contentions, the Respondent emphasized that the Impugned Order was not only issued in strict accordance with the law but also after thorough consideration of all the facts and submissions presented in this case.
 - b) The Respondent stated that with regard to non-compliance of Regulation 11(A)(h) of the Regulations pertaining to the issue of biasness and conflict in the rating process and the instances observed therewith, the Appellant admitted to the observations of the inspection team and submitted that such instances occurred a few times in 2017, when it was in the process of appointing external rating committee members, however, it took reasonable steps to remove biasness/conflict in the rating process. The Respondent rebutted the Appellant's argument, pointing out that senior analysts namely; Mr. Waqas Munir and Mr. Maimoon Rasheed were the members of the rating committee with voting rights in the instances noted during the inspection. The Respondent emphasized that holding dual roles as both analysts and voting members of the rating committee creates an inherent conflict of interest and a self-advocacy risk, undermining the transparency of the rating process.
 - c) Regarding the deficiencies in the internal audit review, the Respondent submitted that the Appellant had admitted to not establishing a separate internal audit department or appointing a full-time internal auditor due to financial constraints and the Director (Finance) was designated as the Head of Internal Audit to fulfil the requirement of Regulation 11(B)(l) of the Regulations, which poses an inherent conflict of interest. Additionally, the Appellant also failed to provide documentary evidence regarding discussions held with the Commission for relaxation of the said requirement.
 - d) With regard to the upgradation of HR Policy under Regulation 11(B)(b) of the Regulations, the Respondent argued that the Appellant had failed to provide an updated version of the HR Policy and submitted that the same was under development during the time of inspection. The Appellant during the hearing submitted a copy of its HR Policy namely "Human Resource and Employee Service Rules" updated in March, 2019 but the BOD's approval of the updated HR Policy was still pending at the time the Impugned Order was issued.
 - e) The Respondent further argued that the Appellant had failed to produce evidence demonstrating the development of any policy or procedures to identify, assess, mitigate, control and monitor risks arising from its activities as required by Regulation 11(B)(d) of the Regulations.
 - f) With regard to the non-compliance with Regulation 11(C)(o) of the Regulations, the Respondent stated that the Appellant's defense merely stating its intention to approach the



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Commission for the removal of this requirement was insufficient and did not address the violation.

- g) On the issue of non-compliance with Regulation 11(C)(t) of the Regulations, the Respondent argued that the Appellant's view point that initial indicative rating is not possible in the case of BMR due to its reliance on digital processes is invalid. The Respondent explained that BMR involves both quantitative and qualitative factors, which necessitate an indicative rating from the analyst. This rating should then be forwarded to the rating committee for further deliberation. Furthermore, the Respondent highlighted that, with respect to the credit rating of Shahtaj Textile Limited, the Appellant had acknowledged its failure to adequately document the indicative rating.
- h) The Respondent argued that pertaining to the participation of compliance officer in rating operations in contravention of Regulation 11(F)(c) of the Regulations, the Appellant during the hearing submitted that the instances were observed in the star ranking which is a digital process with no involvement of human opinion, however, the Appellant subsequently rectified this non-compliance.
- i) The Respondent while concluding the arguments contended that the arguments put forth by the Appellant did not alter the facts of the case. The Respondent emphasized that the violations had been firmly established, and as such, the Impugned Order should be upheld. The Respondent, therefore, requested the dismissal of the instant appeal.
6. The Bench has heard the arguments of both parties and perused the relevant record. The Bench is of the view that the Appellant was obligated to adhere to the provisions of the Regulations in both letter and spirit. The Bench concurs with the Respondent's stance that the inclusion of a rating analyst in the rating committee with voting rights constitutes a violation of Regulation 11(A)(h) of the Regulations, as it lead to a conflict of interest, thereby undermining the integrity of the rating process. Furthermore, the Bench notes that this issue is further exacerbated by the fact that the Appellant admitted to having instances of dual roles in 2017, although the Appellant has assured that such occurrences will not be repeated in the future. The Bench acknowledges the Appellant's efforts to address the issue of internal audit review by engaging with the Commission to propose an amendment to Regulation 11(B)(l) of the Regulations and by ensuring compliance through the outsourcing of the internal audit function after the amendment. However, the Bench also notes the Respondent's observation that the Appellant was non-compliant with the said Regulation at the



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date of issuance of the Impugned Order, which was a mandatory requirement and no exception to this requirement was available under the Regulations.

7. With regard to the non-compliance with Regulation 11(B)(b) of the Regulations, the Bench concurs with the Appellant that the said Regulation mandates the development of HR Policy, however, the Bench is of the view that the Regulation imposes an ongoing obligation, not merely to develop an HR Policy but to ensure that it remains current, effective and compliant with the evolving standards. The Appellant's failure to provide the duly approved HR Policy until after the inspection and up to the date of issuance of the Impugned Order, renders it non-compliant. The Appellant's justification for the delay in seeking approval due to the unavailability of an independent director is not found tenable, as the requirement for the appointment of independent directors on the board of a credit rating company is not an unknown obligation. The Appellant is expected to have in place adequate mechanisms to ensure the timely appointment of its directors, including independent directors, and to address any potential impediments or delays in the process with due diligence and efficiency. The Bench further observes that the Appellant's submission concerning the development and implementation of a risk management policy and systems is insufficiently substantiated. The supporting evidence provided with the Appeal, i.e. Annexure H titled "*Brief Summary of Salient Features of Risk Management Systems and Controls*", is merely a brief outline of certain operational controls and risks, which does not adequately demonstrate the requisite depth and comprehensiveness required for establishing a fully developed risk management framework, policy or system. Consequently, the Appellant's assertion of compliance with Regulation 11(B)(d) of the Regulations remains unsupported by adequate evidence.

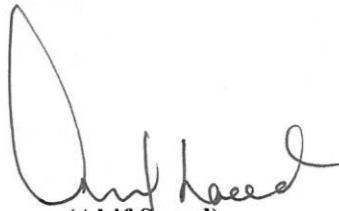
8. The Bench acknowledges that, while it is a generally accepted international practice that not every rating necessitates interaction with auditors or creditors, Regulation 11(C)(o) of the Regulations unequivocally requires the record-keeping of such discussions. The Appellant's failure to demonstrate compliance with this explicit requirement renders it non-compliant. The Bench recognizes the technological advancements implemented by the Appellant, but concurs with the Respondent's stance that human judgment is essential in the final evaluation of ratings, especially with regard to qualitative factors. BMRs generally involve a range of qualitative factors, such as HR management and infrastructure-related considerations, rendering it impractical for the process to be entirely automated. Consequently, the necessity of an indicative rating from the analyst becomes paramount to ensure that the rating committee is able to make a fully informed decision



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while considering all relevant aspects before finalizing the rating. The Bench is of the view that while technology may facilitate data collection, quantitative analysis, and the optimization of certain procedural elements, the interpretation, analysis, and contextual judgment fundamental to a comprehensive and accurate rating, cannot be entirely substituted by automation. The Bench therefore concludes that the Appellant's failure to provide an indicative rating constitutes a violation of Regulation 11(C)(t) of the Regulations.

9. The Bench is of the view that the participation of the compliance officer in the rating process, even within the context of star ranking, may give rise to potential conflicts of interest, notwithstanding the fact that the process is digital. While the Bench recognizes the corrective actions taken by the Appellant subsequent to the inspection to ensure compliance with Regulation 11(F)(c) of the Regulations, the contravention at the time of the inspection remains a valid concern. The Bench holds that a credit rating company is obligated to discharge its duties in a fair, efficient, transparent and ethical manner, while upholding the highest standards of service in the performance of its functions. Licensed entities are expected to exercise high level of vigilance in adhering to the applicable Regulations and must not seek excuses to evade compliance.
10. In view of the foregoing, we find no reason to interfere with the merits of the Impugned Order, therefore, by maintaining the Impugned Order, we hereby dismiss this Appeal without any order as to costs.


(Akif Saeed)
Chairman/Commissioner


(Zeeshan Rehman Khattak)
Commissioner

Announced on:

28 FEB 2025