STEWARDSHIP GUIDELINES FOR INSTITUTIONAL INVESTORS

SECURITIES
AND EXCHANGE
COMMISSION
OF PAKISTAN

SECP

INTRODUCTION

Institutional investors are key players in the economy who can exert significant influence over their investee companies due to the substantial stake they hold. This clout provides them with an opportunity to act as "stewards" of capital with ability to encourage good governance and appropriate behaviour of their investee companies, through constructive engagement or purposeful dialogue. Based on in-depth knowledge of the companies and their business environment, Institutional Investors can ensure delivery of sustainable long-term value for their unitholders, investors and beneficiaries. Effective delivery against their stewardship responsibilities, enables institutional investors to contribute to the development of capital market by encouraging improved capital allocation through effective implementation of corporate governance framework, increased transparency and better reporting.

The Stewardship Guidelines issued under section 40B of the SECP Act, 1997 (XLII of 1997) comprise a set of best stewardship principles, and intend to guide institutional investors on effective exercise of their stewardship responsibilities with due regard both to their investors and investee companies.

For the purpose of these Guidelines, Institutional Investors mean Asset Management Companies, Pension Fund Managers, Private Fund Management Companies, Life Insurers and Employees Contributory Funds managed by the Investment Advisors with equity holding in companies listed on Pakistan Stock Exchange.

Adoption of these guidelines is on **'comply or explain'** basis to address the difference in business models and resources of Institutional Investors. Institutional investors should comply with the Guidelines, but when they cannot adhere to any details set forth in the Guidelines due to their business model, strategy and investment policy, etc., they should provide the reason and sufficiently explain alternatives ways to stewardship activities like policy, code, internal controls etc
The institutional investors shall compile a report (the "Report") on how they have fulfilled their stewardship responsibilities as per their policy in an easy understandable format and shall upload this Report on its website on annual basis. Reporting and disclosure on implementation of stewardship responsibilities will help to determine if the guidance has aided in continuous improvement in stewardship role of the Institutional Investor.
The Report should be a single document structured to give a clear picture of how the Institutional Investor has applied the Guidelines. It should focus on activities and outcomes and provide enough information to enable the investor to have a good understanding of the application of the guidelines without having to refer to information elsewhere.

When applying the guidelines, the institutional investors should consider the effective application of the Listed Companies (Code of Corporate Governance) Regulations.

PRINCIPLE 1- STEWARDSHIP POLICY

Institutional Investor shall formulate a clear policy approved by its Board of Directors on how they intend to fulfil their stewardship responsibilities and publicly disclose it.

GUIDANCE

This steward policy should cover the principles and guidelines, investment management philosophy, strategy, rights and duties, and procedures related to their stewardship activities.

Stewardship policy should explain how institutional investors recognize stewardship responsibilities in its culture, value, business strategy and investment belief and how they implement these responsibilities to ensure their investment beliefs, strategy and culture enable effective stewardship. The stewardship policy shall be backed by procedures to be included in the system of internal controls to ensure its effective implementation.

In case where the management of an investment pool is outsourced, where allowed under the applicable regulatory framework, the policy shall provide for the mechanism to ensure that in such cases, stewardship responsibilities are exercised properly and diligently. Institutional Investor shall explain in their stewardship policy how they insured their stewardship reporting is fair and balanced.

Institutional Investor should consider what policies best reflect its role and the scope of its activities considering the costs of implementing a stewardship policy.

OUTCOME

Institutional Investors shall have comprehensive stewardship policy covering all principles on how they intend to fulfil their stewardship role and disclose such policy on its website.

Institutional Investor shall review and regularly update their policy to ensure that their stewardship policy enable effective stewardship and shall explain how their review has led to improvement of the stewardship policy taking due cognisance of the impact of their policy on the larger economic, social and environment concerns of the country.

PRINCIPLE 2 - VOTING POLICY AND IT'S DISCLOSURE

Institutional Investor shall have a clear policy on voting including proxy voting and give adequate disclosure of its voting activity.

GUIDANCE

Institutional investors should formulate and publicly disclose a documented voting policy that includes guidelines, procedures, and detailed standards with regard to the disclosure of their voting activities and records. The detailed standards for voting activities should not solely be comprised of a mechanical checklist, but be designed to contribute to the mid- to long-term value enhancement of investee companies.

An Institutional Investor shall identify in its voting policy the mechanism of voting, e.g. physically attending meeting or voting through proxy. The policy shall identify the factors that it will consider in determining to vote for/against/abstain with regard to a matter identifying conflict of interest in the context of voting and how it will evaluate voting decisions including the protection of rights of minority shareholders.

Institutional investors should build up internal resources, organizational structures, and professional capacity to ensure that their voting rights are effectively exercised in order to enhance the mid- to long-term value of investee companies and to advance the interests of clients and beneficiaries.

Institutional Investors while executing their voting rights shall exercise due care and diligence and disclose in the Report their overall voting policy with respect to their investment and the procedures that they have in place.

Institutional investor should decide on the vote in light of the result of sufficient data collection and analysis, in-depth review, dialogue and engagement, etc., with regard to investee companies.

OUTCOME

Institutional Investor shall carefully record and analyse voting rights exercised in accordance with its relevant policies, so as to facilitate disclosure of the voting activities. For instance, votes cast in favour, against or abstaining from various types of motions made by investee companies.

Institutional Investors shall disclose in the Report a summary of their voting activities including proxy voting as it gives the investor greater clarity on how the votes are cast.

PRINCIPLE 3-MONITORING INVESTEE COMPANIES

Institutional investors shall monitor their investee companies in order to enhance investee company's long- term value and protect their long-term investments.

GUIDANCE

Institutional Investors need to monitor all factors that could affect the value and sustainable growth of investee companies; for example, including not only financial factors such as capital structures, remuneration, business performances, etc., but also non-financial factors such as compliance with Listed Companies (Code of Corporate Governance) Regulations, business strategy, risk, audit quality etc.

The Institutional investors should take into consideration their investment policy and internal capacity to determine the appropriate scope for the monitoring of the aforementioned financial and non-financial factors so as to ensure effective stewardship activities. The Institutional Investors shall identify the levels of monitoring for different investee companies, areas for monitoring, mechanism for monitoring. The Institutional Investors may also specifically identify situations where they do not wish to be involved in monitoring of the investee companies e.g. in case of small and short-term investments.

OUTCOME

Institutional Investors shall formulate a policy on monitoring the investee company especially specifying the instances where they want to be involved with the investee company and instances which need to be disclosed in the Report.

PRINCIPLE 4- POLICY ON ENGAGEMENT WITH THE INVESTEE COMPANIES

Institutional Investor shall develop a policy for engagement with the investee companies.

GUIDANCE

Engagement is purposeful dialogue with investee companies with the aim of preserving or enhancing value on behalf of beneficiaries or clients. It is typically an extension of monitoring activities and arises when institutional investors have a close and full understanding of the specific circumstances of the investee company in matters of performance, governance or risk management. The most common forms of engagement with investee companies are via management discussion and exercising their rights to speak and vote at general meetings.

Engagement with investee companies entails dialogue on matters such as strategy, long-term performance, risk, capital structure, and corporate governance, including culture and remuneration as well as on issues that are the immediate subject of votes at general meetings. Engagement should not include seeking inside information.

The Institutional Investors may also specifically identify situations where they do not wish to be engaged with the investee companies e.g. in case of small and short-term investments.

Institutional Investor should have clear policy about their investee companies' adherence to Listed Companies (Code of Corporate Governance) Regulations and how they will engage with their investee companies if they have concerns.

OUTCOME

Institutional investor shall disclose a summary and assessment of the effectiveness of their engagement activities in the Report.

PRINCIPLE 5-MANAGING CONFLICT OF INTEREST

Institutional investor shall put in place a robust policy on identifying and managing conflicts of interest that may impair their stewardship behaviour, to advance the interest of investors.

GUIDANCE

Institutional investors have the duty to act in the best interests of their clients and beneficiaries. During the course of their stewardship activities, institutional investors may face a conflict-of-interest situation where their own interests with investee companies prevent them from faithfully promoting the best interests of clients or beneficiaries.

Institutional Investors should seek to avoid conflict of interest situations. Nevertheless, as conflicts of interest may inevitably arise from time to time, they need to identify, understand, minimise and manage such conflicts in a transparent manner. Conflicts may arise as a result of:

a) ownership structure;
b) business relationships between institutional investors and the investee company;
c) differences between the stewardship policies of institutional investors, investee company and investors;
d) cross-directorships;
e) equity managers' objectives; and
f) consumers interests diverging from each other.

A conflicts of interest policy should include not only the basic principles for institutional investors about the need to prevent conflicts of interest, but also concrete plans for identifying, monitoring, and preventing any conflicts of interest issue.
In instances where an institutional investor becomes involved in the board of directors of investee companies it shall indicate in its stewardship policies the mechanism by which conflict of interest will be avoided.

OUTCOME

The policy shall explain on how they will identify and manage actual or potential conflict of interest which may include establishment of Chinese walls.

Institutional Investor shall disclose and report examples of how they have addressed actual or potential conflicts

PRINCIPLE 6 - INCORPORATING SUSTAINABILITY CONSIDERATIONS

Institutional Investor shall integrate their policy with corporate governance and sustainability considerations including environmental, social and governance (ESG) factors to deliver sustainable returns in the long-term interest of investor.

GUIDANCE

Institutional investors should develop a policy on how it incorporates sustainability consideration, including ESG, into its investment analysis and activities. Institutional Investor shall identify and explain the process they have used to integrate stewardship and material ESG issues with the interest of investor.

Examples of ESG factors of the investee company that the institutional investors evaluate may include, but not limited to the following–

a) Environmental and social impact
b) Diversity targets and policies, including gender;
c) Employee benefits and corporate culture; and
d) Products, customers and supply chain;

OUTCOME

Institutional Investors shall develop a policy and disclose in the Report on how it incorporates sustainability consideration, including ESG, into its investment analysis and activities.

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