Muhammad Ishaq Dar, Federal Finance Minister, Yaseen Anwar, State Bank Governor, Dr Waqar Masud, Federal Finance Secretary, and Tahir Mahmood, Acting SECP Chairman, at a meeting of the Federation of Pakistan Chambers of Commerce and Industry in Karachi.

Mr. Asif Arif, Commissioner Insurance, chairing a seminar on the Code of Corporate Governance.

Mr. Nazir Ahmed Shaheen, Executive Director, CCD, chairing a roundtable on NPO regulations, in Karachi.

Mr. Liaqat Ali Dolla, Additional Registrar, CRO Lahore, receiving shield after conducting seminar in ICMAP, Lahore.

Mr. Mahboob Ahmed, Joint Registrar, and Mr. Muhammad Asghar Baig, Deputy Registrar, CRO Faisalabad, conducting a seminar at the Sargodha Chamber of Commerce and Industry.

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SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
SECP

Official Newsletter

SECP Perspective

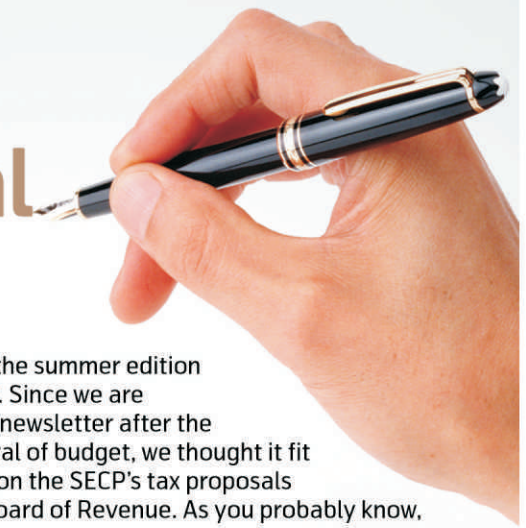
Summer Edition 2013

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.

Shakil Chaudhary Editor | **Sajid Gondal** Deputy Editor | **Muhammad Rabnawaz Awan** Coordinating Editor

Inside

Editorial



We are pleased to publish the summer edition of our quarterly newsletter. Since we are publishing this issue of the newsletter after the announcement and approval of budget, we thought it fit to include a special report on the SECP's tax proposals submitted to the Federal Board of Revenue. As you probably know, some of our proposals have already been accepted.

It also has an insightful article on takaful, the Islamic mode of insurance. The writer has analyzed the low insurance penetration, and faith-based misgiving about the concept of insurance. He suggested that the takaful can prove a ray of hope for our insurance industry. The newsletter also has an informative article 'Managing catastrophic risks through insurance in Pakistan'. In this article the writer has strongly emphasized the need for insurance to mitigate the economic losses that we suffer as a result of natural disasters.

In addition, a well-researched article on money laundering in Pakistan is also part of the newsletter. This is an issue of great importance to us because of concerns about terrorism and the fact that a large size of our economy is undocumented. The newsletter also has a report on the Corporatization and Compliance Department's efforts aimed at corporatization.

We hope our readers enjoy this edition of newsletter. We really look forward to receiving your articles, comments, suggestions, quotations and letters. If you have recently visited any foreign country, you may share your impressions and photographs with us. We need your contribution more than ever because we are increasing the newsletter's pages from 16 to 20. Please email your contribution to us at: **editor@secp.gov.pk**

Managing catastrophic risks through insurance in Pakistan

Current outlook and future opportunities

By Syed Irfan Habib

The 2005 earthquake in Kashmir was devastating in terms of both loss of lives and damage to the public property. It is estimated that more than 780,000 buildings were either destroyed or damaged beyond repair, and many more were rendered unusable for extended periods of time. Out of these, about 17,000 school buildings and most major hospitals close to the epicenter were destroyed or severely damaged. The immediate relief and reconstruction needs were estimated by some donor institutions to be about $5.2 billion while the total economic loss was reported at $48 billion.

The devastation repeated itself during the 2010-11 floods, which mostly affected the low-income households in the rural areas, signifying the need to provide some sort of safety-net like insurance to this target population. Consequently, the national economy was harmed by extensive damage to infrastructure and crops. Structural damages exceeded $4 billion while wheat crop damages were over $500 million. Officials estimated the total economic loss

to be $43 billion.

With the final assessment of Rs240 billion for rehabilitation and reconstruction in flood-hit areas and the limited resources available at its disposal, the government ended up cutting down funds from the Benazir Income Support Program (BISP) from Rs70 billion to Rs50 billion and internally displaced people's allocation from Rs50 billion to Rs40 billion. The reprioritizing of funds of these two areas helped the government allocate Rs30 billion for work in flood-hit areas. Besides, the funds for the Pubic Sector Development Program (PSDP) and provinces' Annual Development Program (ADP) were also substantially reduced to divert another Rs150 billion for development in the flood-hit areas.

Taking account of this scale of devastation in recent years with continued erratic weather pattern and no holistic national policy and measures in place, no practitioner can advocate the idea that the public infrastructure should go unprotected due to the absence of any risk mitigation mechanism.

With no risk mitigation mechanism in place, the government will continue to shoulder the gigantic responsibility of funding these natural and man-made disasters, which will not only divert the priority from the public sector development to mere rescue and rehabilitation activities. This will not only severely hamper the economy, but will also put immense pressure on the already widening fiscal deficit which is inflationary in the medium to long run.

Taking account of this scale of devastation in recent years with continued erratic weather pattern and no holistic national policy and measures in place, no practitioner can advocate the idea that the public infrastructure should go unprotected due to the absence of any risk mitigation mechanism.

In most developed countries, insurance is one of the principal mechanisms used by individuals and organizations to manage risk. The insurance allows the payment of a relatively small premium for protection against a potentially large loss in the future. The key challenge is how to allocate catastrophe risk among stakeholders in a manner similar to what is done for more frequent, non-extreme events. For automobile coverage, considerable historical data is available and utilized to estimate insurance premiums for individuals with different risk characteristics. The absence of correlation between accidents allows the use of actuarial-based models to estimate risk. With respect to natural disasters, a limited data is available to determine the probabilities of events occurring and their likely outcomes.

In the absence of past data, there is a need for insurers to model the risk. Catastrophe models serve this purpose by maximizing the use of available information on the risk (hazard and inventory) to estimate the potential losses from natural hazards.

In Pakistan, the catastrophe insurance is largely being provided as a tool to protect net-retention of the insurance companies while underwriting risks which are exposed to the catastrophe events, but has no explicit demand from the market. A separate treaty is therefore arranged by the insurers. Moreover, catastrophe insurance is usually issued as part of the fire and engineering policy and have all the terms and conditions including inclusions/exclusion as mentioned in these policy wording. It is also pertinent to mention here that primarily the fire and engineering insurance is usually demanded as a mandatory requirement by the banks for the properties which are to be financed by them. Covers usually include buildings, machinery, business interruption, household contents, stock, stock-in-process etc. Other contents are covered under the fire insurance policy which is extended to cover against the risks of earthquake (fire and shock) and atmospheric disturbances, including flood and other extraneous/additional perils. The risk is placed under fire treaty in accordance with the terms and conditions of the treaty. Natural catastrophe is also covered under contractor's all risks (CAR) and erection all risks (EAR) policies issued under engineering class of business. Other businesses include comprehensive machinery insurance (CMI) and industrial all risks (IAR).

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In the absence of any national catastrophe risk mitigation program and the limitation of the private insurers to underwrite these risks, there is a dire need for a risk sharing mechanism at the national level so that the risk may be adequately underwritten by the public and private stakeholders. Some examples around the world include Turkish Catastrophe Insurance Pool and Caribbean Catastrophe Risk Insurance Facility. While historical trend shows that there has always been a massive gap between economic and insured losses going up to 5 times, these disasters place a significant burden on the public sector. Despite prevention and mitigation efforts, no country can fully insulate itself against extreme natural disasters as majority of the economic losses from these disasters end up with individuals, corporations and governments, both on national and sub-national level. The government budgets are impacted, primary effects including immediate expenses for emergency relief efforts, cost of rebuilding public infrastructure while secondary effects include declined economic output growth, lower tax revenue, budget deficits and increased debts.

Taking account of all the aforementioned limitations, Pakistan needs a rational insurance mechanism for responding to the economic consequences of catastrophic events. Ultimately the risk of catastrophes—both natural and man-made—may be best addressed by a public-private partnership involving individuals, private industry, federal, provincial and local governments.

The writer is an assistant director in the Insurance Division of the SECP. He holds an MBA and the Certificate in Insurance from the Chartered Insurance Institute, UK. The views expressed here are those of the writer and do not necessarily reflect those of the SECP.

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Takaful a ray of hope for insurance industry

By Muhammad Rabnawaz Awan

The insurance business, in a country like Pakistan, where religion takes precedence over other concerns is undervalued. The insurance penetration is extremely low: It is 0.7 per cent of the country's GDP. It is very low even if we compare it with India, where it accounts for 2.5 per cent of its GDP. It will be interesting to note that the rich economies boast the figure as high as seven per cent of their GDP.

There is a dire need to address the faith-based concerns in the insurance sector. And at the same time we should look for the alternative modes of investment. Takaful (the Islamic mode of insurance), can prove one such alternative.

Takaful is an Arabic word stemming from the verb kafal, which means to take care of one another's needs or guaranteeing each other. According to this scheme, the members or participants in a group jointly agree to guarantee themselves against loss or damage. The entire group would assist the affected person to insure his loss and to provide him with financial help. Takaful is a legally binding agreement between all the participants of the scheme to pay any of its members who suffer a loss as specified in the takaful policy document.

The concept of takaful evolved from individual common interest during the industrial era of the early1900s. It has continued to grow quite steadily despite the ups and downs of conventional markets and have proven surprisingly resilient to the extent of attracting non-Muslim scholars to study it in detail. In countries such as Malaysia, takaful is very much thriving due to the primarily Muslim population as well as its own focus on steady growth.

Now takaful is the fastest-growing area of the world insurance market. It is growing at 20 to 25 per cent per annum, compared to the world average growth of conventional insurance. The validity of this growth was made possible in the demand and the prospects of potential rewards both for the customers and entrepreneurs of Islamic insurance. In a marketplace, the attraction of takaful business may be ascribed to its connection with the Islamic Sharia as well as its being a better and more just system. With a growing Muslim population, Pakistan could also become a key player in the global takaful industry.

There is a dire need to address the faith-based concerns in the insurance sector. And at the same time we should look for the alternative modes of investment. Takaful (the Islamic mode of insurance), can prove one such alternative.

Despite the progress of takaful in Muslim countries, however, takaful still bears the Islamic label. Many non-Muslims and especially foreigners may look at takaful with some suspicion simply due to its connection with Islam. Others may view its focus on ethics as limiting factors. The refusal of takaful operators to engage in conventional interest can be especially confusing to those who do not understand the drawbacks of conventional interest. These concerns must be addressed before takaful can expand beyond Muslim countries into the global arena. It is also worth noting that takaful and Islamic finances in general are relatively new and are primarily regulated by their respective countries. This means that standards and "best practices" are only beginning to emerge that can be adhered to internationally.

In Pakistan, the takaful products were launched in 2005 when the Securities and Exchange Commission of Pakistan (SECP) introduced Takaful Rules. That time only dedicated takaful companies had the permission to offer Islamic insurance products.

Takaful still has low penetration in Pakistan despite the Muslim majority in that country. This challenge, however, has been overcome to some degree as many Muslims now acknowledge the difference between takaful and conventional insurance. Opportunity lies in Pakistan's rural belts but awareness regarding the importance of insurance is rather low. The regulator should play its part for creating awareness, transparent and enabling environment, thereby increasing the insurance density and affordable outreach to low-income people

The launch of new takaful rules in July 2012 by the SECP, has made Pakistan the second country after Indonesia to officially allow takaful windows, which enable firms to offer Sharia-compliant and conventional products side by side. The 2012 takaful Rules have suggested the establishment of a Sharia Advisory Board at the SECP, allowing conventional insurers to have takaful windows, formulation of risk management and rating procedures by takaful operators, and separate solvency requirements for each participant takaful fund. Now it is responsibility of insurance provider to carefully manage the investments money. They must not be tempted to stray from the original spirit of their enterprise. Takaful companies can invest in Shariah-compliant government securities, immoveable property, joint stock companies, redeemable capital, mutual funds, musharika certificates, term finance certificates and participation term certificates, e.t.c. In this way they can utilize the investor money to get maximum returns.

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The analysts, who have deep understanding of insurance industry are optimistic that number of takaful service providers in Pakistan will increase substantially as all life and non-life insurance companies have been allowed to offer takaful products subject to authorization by the SECP under these Rules. These companies have a wide distribution network in the country. This will enable them to tap into the large market which refrains from conventional insurance products considering them un-Islamic. Consequently, it would increase the insurance penetration in Pakistan.

In conclusion, takaful is an ethical financing, the cooperative risk protection method and a bigger substitute to conventional insurance. The Interest-free financing and takaful are mutually reinforcing systems that promote the economic efficiency, communal risk-sharing and individual rewards through self-purification. As the takaful system revolves around active participation by members of the community, it is imperative that public awareness be enhanced. As Muslims and non-Muslims alike come to understand the real benefits of takaful and cooperative risk sharing, the development of the takaful industry will be fast.

The writer has been part of the media department of the SECP since 2008. He holds master's degree in English linguistics.
The views expressed here do not necessarily represent those of the SECP.

Money laundering and Pakistan

By Sabeen Fatima

Money laundering is the process that employs a mechanism to convert the amounts of illegally obtained money to disguise their illegal origin. According to the Financial Action Task Force (FATF), an intergovernmental organization that has been created to develop policies to combat money laundering and terrorism financing, the goal of a large number of criminal acts is to generate a profit for the individual or group that carries the act. This process needs to be looked at critically, as it enables the criminal to enjoy these profits without jeopardizing their source.

It is usually a three-step process: placement, layering and integration. In the initial stage, the launderer injects the illegal amounts into the financial system using bank complicity, currency exchanges, securities brokers, asset purchase, gaming houses or insurance companies among others. After the funds have entered into the financial system, the second stage—layering, takes place. In this stage, money is directed through various financial transactions in order to change the form and disguise the trail. The funds may be channeled through entering into various purchase and sale of investment instruments, monetary instruments, or investing in other activities that make the financial trail more obscure. Having been successful in processing criminal profits through the first two phases, the launderer then moves towards the third stage:

Money laundering weakens the development of important financial institutions in two ways. First, money laundering corrodes financial institutions themselves. There exists an association between money laundering and illegal activities carried out by employees within these institutions.

integration, where funds are accounted for by adjusting an authentic operation. The funds re-enter the legitimate economy by choosing to invest the funds into real estate, luxury assets, front companies, fake loans, foreign bank complicity, false import/export accounts or business ventures.

The beneficiaries of money laundering are drug traffickers, militants, tax evaders and other criminals indulging in predicate offences who want to hide their ill-gotten wealth from the authorities. The phenomenon has disturbing economic, security, and social consequences. The financial institutions are in the vanguard of the battle against money launderers. The money launderers are not only targeting these institutions, but cause them to become a part of the process by default which leads to lower confidence levels and diminishing

At the societal level, laundering is considered an evil activity which has adverse effects on the society as a whole. The fact that the activity of money laundering involves windfall gains inspires criminals to carry on their arrangements because their illicit income goes unnoticed and unquestioned. The increased circulation of money as a result of money laundering has an inflationary effect on the economy which comes down hardest on those earning a living through normal and honest means.

trust by the customers; the perceived risk grows and the institution is now viewed as corrupted.

Money laundering weakens the development of important financial institutions in two ways. First, money laundering corrodes financial institutions themselves. There exists an association between money laundering and illegal activities carried out by employees within these institutions.

Second, mainly in emerging countries, consumer faith is vital to the progress of financial institutions, and the apparent threat to depositors and stockholders from institutional deception and fraud is a hindrance to such belief. The most severe microeconomic effects of money laundering are sensed in the private sector using 'front' companies to make illegal gains untainted.

Rather than shielding such institutions from the adverse effects of money laundering itself, there should be an emphasis on the implementation of anti-money-laundering (AML) guidelines by government financial supervisors and regulators, as well as by banks, non-banking financial institutions (NBFIs), and equity markets along with other good-governance practices that are significant to the growth of these economically crucial institutions. Certainly, the rudimentary AML strategies such as KYC procedures and strong internal controls are essential.

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Anti-Money Laundering Act— A way forward

In 2010, the government of Pakistan passed the AML Act. Pakistan is at a high risk for money laundering due to the undocumented economy and the informal sector.

The authorities figured out that the circulation of the Pakistani rupee in other territories is also being used to launder illegal proceeds mainly from narcotics, corruption, extortion and terrorist activities. Since the 1990s the regulators such as the National Accountability Bureau (NAB), Anti-Narcotics Force (ANF) and the Federal Investigation Agency (FIA) are putting in their best effort to combat these crimes and eliminate money laundering. As reported at Financial Action Task Force (FATF), money laundering for different countries ranges from 2 to 5% of its GDP.

Money laundering was estimated to be around 5% before 2000 due to fewer restrictions and the AML laws. After this time period, regulators focused at the strategies to eradicate or lessen this activity. Thus, the values were estimated around 4% from 2000 onwards. Money laundering percentages were multiplied with GDP (in rupees) of Pakistan so as to get the figure in rupees rather than a constant percentage. In 2002, the US Drug Enforcement Administration reported: "Pakistan is not considered a major center for international money laundering activity. However, Pakistan-based traffickers are extensively involved in the production and transportation of opiates and hashish. This suggests that drug proceeds are laundered within the country." A 1996 estimate of the IMF reveals that 'money laundered yearly totals to 2-5% of world GDP, i.e., between 800 billion and 2 trillion US dollars in today's terms.

Research has indicated a correlation between the growth of money and money laundering, which shows that money laundering practices can harm the financial stability of Pakistan.

As the laundered money does not use the formal channels for transactions, money flows into an economy through illegal means but remains unchecked or unrecorded which disturbs the money growth as well as capital markets, currencies and interest rates. The regulators, law enforcers and financial institutions need to identify the methods which are favoring money laundering.

In order to ensure compliance with FATF's AML recommendations, safeguard the interest of depositors from risks arising out of money laundering and terrorist financing, and to reinforce the measures being taken by the banks/DFIs to strengthen their know your customer (KYC)/AML procedures, State Bank of Pakistan decided to set up a separate Financial Monitoring Unit (FMU). The main objectives were to create and deepen the AML and combating the financing of terrorism (CFT) awareness across Pakistan and develop related online services, identify, recruit and train top

The establishment of a robust and efficient regulatory framework with effective enforcement is required to make sure that financial institutions play their vital role in the detection and deterrence of money laundering. Without such a system, even the most comprehensive array of AML/CFT regulations and policies will not be enough.

quality staff in all sphere of FMU's operations, integrate use of latest software tools for data retrieval, mining and analysis and adopt latest techniques for preparing and disseminating strategic reports.

A few recommendations that could possibly help in curbing money laundering are:

1. The government should monitor cash flow at national levels as well as at the borders. International AML/CFT standards for customer identification and due diligence should be implemented earnestly to ensure that banks know and monitor their customers' records, thus decreasing the likelihood of criminal activities. In addition, FATF recommendations should be adopted to ensure that a bank has reliable records in the event of litigation between a customer and a bank.
2. The investigating agencies must be given the appropriate powers and funds to trace, seize and confiscate shady earnings.
3. Rules and regulations should be issued in a clear and precise manner. Insufficient clarity may jeopardize effective implementation and prevent a level playing field. This in turn will lead to confusion and to an uneven application of the rule, hampering the supervisory body from attaining its ultimate objective of compliance. Both the public and private sectors benefit when supervisors and banks collaborate to produce clear rules and regulations.

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The writer is a management executive in the SECP's Enforcement Department. She did her MBA (Finance) at Air University, Islamabad. The views expressed here are based on her research and do not necessarily reflect those of the SECP.

SECP gets taxation regime reformed

The corporate taxation is an essential component of the national business climate, and one of several factors that multinational corporations weigh when deciding how and where to invest. Others include access to human capital, efficient infrastructure, regulatory environment, rule of law, political stability, etc.

The way a country taxes corporations matters for two primary reasons, say economists. First, corporate taxes alter incentives and may distort domestic economic behavior in ways that are harmful for growth.

Second, different tax regimes across the world interact with each other to distort the allocation of international investment. The confluence of these micro and macroeconomic forces has significant consequences for the ability of the country to compete and thrive in an expanding global economy. The tax puts certain businesses at disadvantage.

The Securities and Exchange Commission of Pakistan, working in close conjunction with the Federal Board of Revenue, got the taxation regime for capital markets reformed through the Finance Act 2013-14.

Earlier, the finance bill had proposed FED on asset management services, which is paid by mutual fund investors as well. Investors in mutual funds were already paying sales tax at the rate of 16 per cent. With the introduction of the proposed levy, mutual fund investors would have to pay a total levy of 33 per cent as well. This tax is in addition to the capital gains tax and the tax on dividends at investor level being paid by them

The way a country taxes corporations matters for two primary reasons, say economists. First, corporate taxes alter incentives and may distort domestic economic behavior in ways that are harmful for growth.

The SECP's initiatives will help achieving the objectives to document the overall economy through corporatization and listing, stimulate capital formation through non-banking sector, mutual funds, etc. and encourage long-term savings through private pensions and insurance.

Through its constant persuasion the SECP has been able realize the tax authorities that, it may not be wise to discourage investment in mutual funds through ill-advised additional taxation. And Mutual funds industry has a huge potential that needs to be tapped for increasing investments.

The federal government has reduced the corporate income tax rate in an attempt to bolster businesses and encourage investment to revive the economy. The cuts, while affecting the state's budget, will ensure the competitiveness of Pakistan's businesses and attract foreign investment. This encouraged corporatization will lead to the expansion of the documented economy, bring more entities within the regulatory net and create greater competition.

The SECP's initiatives will help achieving the objectives to document the overall economy through corporatization and listing, stimulate capital formation through non-banking sector, mutual funds, etc. and encourage long-term savings through private pensions and insurance.

Through another amendment, the FBR also allowed tax credit on investments in mutual funds, voluntary pension schemes, and life insurance schemes as adjustment against the gross tax liability on production of documentary evidence. - *Muhammad Rabnawaz Awan*

Foreign investment a tool of economic growth

By Muhammad Rabnawaz Awan

The foreign direct investment (FDI) has become to be known as one of the most effective method of drawing flows from external sources. The use of this technique has also become a significant aspect of building capital in developing countries around the world. However, the share of investment from these countries in other states has been declining over the past years. For developing countries, the positive impact of foreign direct investment is becoming increasingly popular as a tool for economic growth.

The SECP believes that the favourable environment will restore Pakistan's investment reputation and attract foreign investors in Pakistan. The encouragement of foreign investment in the country and development of corporate sector and capital market in Pakistan is possible only through coordinated efforts of all stakeholders.

The most strongest positives of implementing FDI is the increase in aggregate productivity, increased opportunities of employment, greater outflow of exports and exchange of technological advancement between the investor and country.

Having foreign direct investment in a developing country enables the employment and exploitation of natural and human resources, to implement innovative businesses practices, in terms of management and marketing, and facilitates in reduction of budget deficit. Another benefit of FDI is that it does involve the risks and regulations of external debt and adds value to the human capital through provision of on the job training.

Pakistan with the population of 180 million plus and with its liberal and investor friendly policies is amongst the important emerging economies of the region. It presents the ideal location for access to all the growing markets of the world. But unfortunately foreign direct investment (FDI) inflows have been falling for the last four years.

The figures from the State Bank of Pakistan showed that net FDI from July to September 2012 were just $87 million, compared with $263 million in the same period last year.

The overall FDI inflow during the quarter was $287 million while the outflow was $200 million, with only the oil and gas exploration sector recording a positive net figure. Even the normally popular telecommunications sector registered a net outflow of $100.9 million.

The SECP believes that the favourable environment will restore Pakistan's investment reputation and attract foreign investors in Pakistan. The encouragement of foreign investment in the country and development of corporate sector and capital market in Pakistan is possible only through coordinated efforts of all stakeholders.

This is an alarming situation and demands some serious efforts from authorities. There are three primary reasons for the steady decline of FDI into Pakistan: (i) the energy shortfall; (ii) the poor security situation; and (iii) the global recession. Therefore, any foreign investor, who decides to invest in Pakistan in spite of these adverse and trying conditions, should be given a red carpet treatment, saluted and awarded a medal,

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and their foreign investment into Pakistan should be fast-tracked.

The issue of the security clearance for foreign investors has also been the major cause of this down fall. Currently, all foreign companies setting up businesses in Pakistan and foreign nationals interested in investing in local companies are required to obtain a security clearance (NoC) from the security agencies, which is a prerequisite before registration and acceptance of statutory returns.

The stern security clearance policy adopted by the interior ministry for potential foreign investors or companies prior to getting registered with the Securities and Exchange Commission of Pakistan (SECP) is taking its toll on foreign direct investment (FDI) in the country.

Last year the then Interior Minister, Rehman Malik announced during the meeting with SECP authorities that foreign directors on the board of companies operating in Pakistan will be issued security clearance certificates for travelling to Pakistan after scrutiny that will be valid for the next five years instead of acquiring such certificates each time before they visit here.

One can sincerely hope that present political government will further empower and capacitate the SECP to take measures for attracting the foreign investment in Pakistan.

The writer has been part of the media department of the SECP since 2008. He holds master's degree in English linguistics. The views expressed here do not necessarily represent those of the SECP.

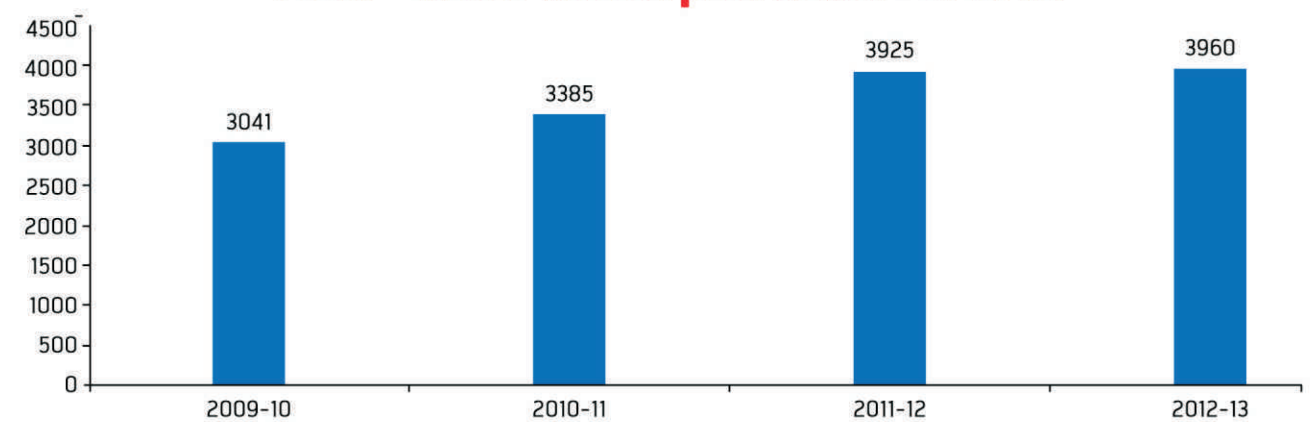
Corporatization trends and impediments

By Muhammad Umair

Political ups and downs, elections, new government, new budget, stock market soaring to record levels - put all these things together, without much guesswork involved, yes we are talking about financial year 2012-13.

Despite of rapidly changing political and fiscal scenarios, the SECP continued to provide impetus for corporatization and its healthy growth, as it is doing since many years. Although, if we talk about numbers, there hasn't been 'significant' growth in the number of companies, but the numbers were better, if not too superior, when compared with preceding financial year. The SECP registered 3,960 companies in FY 2012-13.

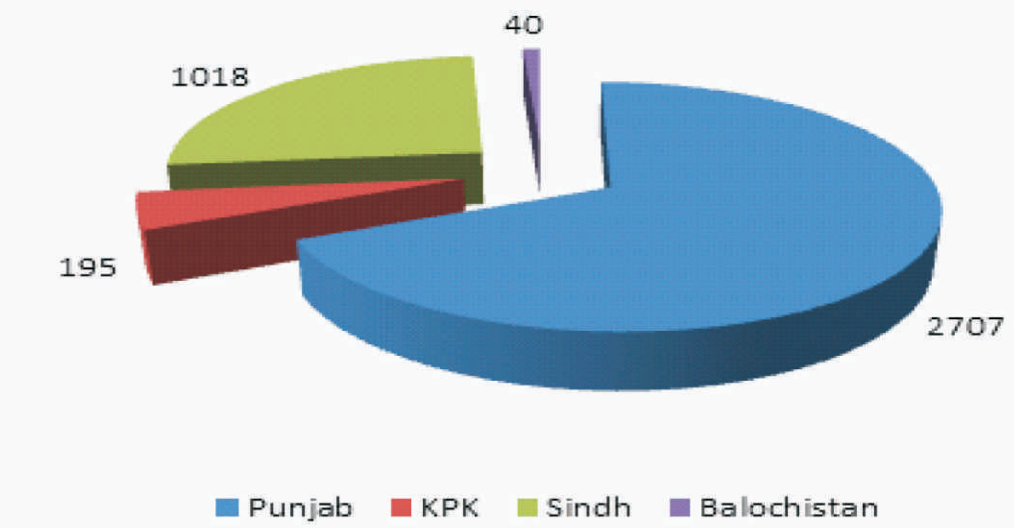
Year-wise incorporation trend



Analyzing the corporatization trend, it can be seen from the table below that the provinces of Khyber Pakhtunkhawa and Baluchistan witnessed substantial downward trend compared with performance in preceding FY. The law and order situation in these two provinces in the last FY can be perceived to be the reason why people did not take much interest in going for the corporatization way. The Sindh almost retained its numbers as that of preceding FY and as such just a small growth was witnessed. The security situation and its implications on business environment, especially in Karachi, seem to have hampered the growth in Sindh, as well. The province of Punjab—for the purposes of this analysis Punjab includes the I.C.T.—registered 6% growth, while also claiming the biggest share of pie in the corporate portfolio.

FY	Punjab	KPK	Sindh	Baluchistan
2011-12	2544	269	1002	110
2012-13	2707	195	1018	40
Growth	6%	-28%	2%	-64%

Province-wise corporatization for FY 2012-13



For the purpose of documentation of economy in general and corporatization in particular, the SECP introduced various facilitation measures, including the provision of fast-track registration services (FTRS), which enables promoters to incorporate their company within 4 working hours. Furthermore, to evoke the true spirit of eServices, the SECP is also working on provision of online payment facility, which envisages enabling companies to deposit fees to the SECP via online fund transfers and credit/debit cards. Foreign investors have also been facilitated by streamlining the procedure for foreign directorship, in coordination with the Ministry of Interior.

In a country such as ours, where people have this rather 'cultural' tendency to shy away from the very idea of documentation of any kind, relative tax disadvantage, compared with informal forms of business such as partnership and sole proprietorship, outweighs all the other benefits of corporatization.

As per my personal experience, wherever, I went for seminar or event promoting corporatization, the first question prospective promoters ask is: 'What benefit do we get by registering as a company and what is the tax benefit for corporates?' The first part can easily be explained by listing benefits such as distinct legal status of company, limited liability, easy transferability of ownership, defined legal framework, ability of pooling and raising funds, and above all enhanced credibility, however, for answer to the second part, there is as such no tax benefit.

In order to educate and promote awareness among the stakeholders, number of seminars was arranged throughout the country in FY 2012-13. The participation was also made in many conferences aimed at pitching for corporatization to potential promoters.

In a country such as ours, where people have this rather 'cultural' tendency to shy away from the very idea of documentation of any kind, relative tax disadvantage, compared with informal forms of business such as partnership and sole proprietorship, outweighs all the other benefits of corporatization, at least for smaller businesses/ entrepreneurship ventures. With the looks of it, the new government has given a clue to promote documentation of economy through corporatization by its recently announced gradual decrease in corporate tax rate, from 35% to 30% over the course of 5 years. It is envisaged that this step will help bring about right balance in 'advantages of corporatization' and thus will help in achieving the larger goal of documentation of economy.

This writer is assistant director in the SECP's Corporatization and Compliance Department. The views expressed here do not necessarily represent those of the SECP.

Financing constraints: Determinants of firm growth in Pakistan

By Sajid Gondal

The small firms play a central role in the economy, and make important contribution to total employment, job creation and GDP growth. However, this contribution is facilitated if access to finance is made available for small and medium size businesses. It is evident that the lack of finance hampers the enterprise growth.

According to the SBP data, there are 3.2 million economic establishments in the country of which more than 90% are SMEs. The SME sector employs 75% of the non-agricultural workforce and contributes 30% towards the national GDP. If provided with easy access to external finance, these small firms can serve as a catalyst for growth.

However, it is observed that often entrepreneurs in Pakistan are not entertained by the banks as traditionally, banks lend to brands rather than financing business plans. To this end, access to finance is a real concern for many small businesses in Pakistan.

A developed financial market creates a disproportionately favorable environment for young firms that would otherwise find it more difficult to raise low cost capital. In Pakistan, financial market is yet underdeveloped as compared to other developing countries. Therefore, Pakistani businesses have limited options of obtaining finances from external sources which imposes a substantial growth penalty on these firms.

According to the World Bank Development Indicators 2011, with credit to the private sector at 23.5 percent of gross domestic product (GDP), Pakistan ranks lowest not only compared to other South Asian countries such as India (46.8 percent) and Bangladesh (41.5 percent), but also in comparison with other developing countries (World Bank, 2011). It observed that a similar trend prevails at the sources of micro-level working capital finance. The average percentage of working capital financed through commercial banks is extremely low (6.5 percent) compared to other South Asian countries such as Bangladesh (32 percent), Sri Lanka (21 percent), and India (16 percent).

Further, World Bank, in its Investment Climate Assessment Surveys revealed that low financial deepening in Pakistan also comes across when comparing perceptions of managers in Pakistan on the severity of finance as a growth constraint. In this survey, Pakistan ranked third-highest with almost 40 percent of firms reporting lack of access as a major obstacle to growth.

Besides the above, the economic environment is plagued by uncertainty, rising nonperforming loans, and excessive public sector borrowing, which has crowded out private sector credit. Moreover, with a tight monetary policy to rein in inflation, the severity of the financing constraint for private sector businesses has become magnified. In this context, development of alternative sources of financing is required to have a positive impact on national growth and per capita income.

Though, the regulators are doing a great job in ensuring the soundness and health of our financial system. But have the regulators done enough for the mainstream small business category? If the lending growth figures of SBP are reliable then it would be easy to conclude much still remains to be done.

Recently, the Governor, State Bank of Pakistan Yaseen Anwar also pointed out that the banks continue to be main provider of debt in the system. In absence of active capital market, commercial entities fail to procure long term debt financing, and rely on short, medium term loans from banks. He was speaking at a seminar on Role of Financial Institutions & Capital Markets in Pakistan s Economy at PAF Air War College, Karachi.

He stressed for need of coordinated efforts and support of regulators (SBP & SECP) and banks for development of fixed income market that is necessary to diversify financial sector, which in turn would enhance its role in supporting economic growth.

SECP Summer Edition 2013 Perspective

Governor SBP stressed the need of developed capital market as an alternative to banking centric financial system. There should be a market place that provide a variety of options like SME exchanges, pension's schemes, micro-insurance companies, and commodity trading service to mutual funds, where the little masses would utilized their savings and companies may get their due finances.

The responsibility of creating an enabling environment for the development of capital market lies on the Securities and Exchange Commission of Pakistan. It is has been reported in press that the SECP has devised a Future Road Map and Strategy that seeks fiscal measures like elimination of presumptive tax regime and exemptions and allows incentives for long-term savings like insurance, private pension schemes and equal tax treatment for investment in different asset classes.

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The Securities and Exchange Commission has already started implementation of its future road map by issuing fresh regulations for insurance sector, initializing the commodity trading and started revision of corporate laws as a whole. If implemented in true spirit, it will provide a gateway for the development of an innovative capital market aimed at availability of wide range of financial products, promotion of innovative insurance products impacting grass root level, participation of youth in private pension, engendering culture of documentation and disclosure and consistent fiscal policy across sectors. Subsequently, the strategy will promote entrepreneurship in the country which would translate into more businesses, more jobs and increase in per capita income as well as growth in national GDP.

The writer is a deputy director in the media department of the SECP. He holds a mass communication degree from National University of Modern Languages , Islamabad. Earlier, he had worked for Dawn News and Deutsche Press Agency. The views expressed here are those of the writer and do not necessarily reflect those of the SECP.

Activities of the SECP

SECP gets taxation regime reformed

In June 2013, working in close conjunction with the Federal Board of Revenue, the Securities and Exchange Commission of Pakistan, through the Finance Act 2013-14, got the taxation regime for capital markets, corporate and non-banking financial sectors reformed.

Corporate governance rules for NGOs discussed

In June 2013, the Securities and Exchange Commission of Pakistan Executive Director Nazir Ahmed Shaheen addressed roundtable conferences in Lahore and Karachi. Draft Licensing and Corporate Governance Regulations for Associations Not-for-Profit discussed in these events.

SECP acts against Takaful operators

In July 2013, the Securities and Exchange Commission of Pakistan (SECP) passeded nine orders against insurance companies, including three takaful operators for compromising the principles of Islamic Shariah.

Code of Corporate Governance awareness session

In June 2013, Mr.Asif Arif, the SECP Commissioner insurance, addressed the awareness session held in collaboration with the ICAP and was attended by around 200 members of ICAP.

Experts compare notes on draft regulations for NGOs

In July 2013, the Securities and Exchange Commission of Pakistan (SECP) organized a round table conference on Corporate Governance Regulations for not-for-profit associations. The conference was aimed at seeking feedback and suggestions from stakeholders on newly drafted licensing procedure and rules for NGOs. It was attended by representatives of NGOs, accountants, lawyers, consultants and members from the civil society.

Micro-insurance business: SECP issues Code of Consumer Protection

In June 2013, the Insurance Department issued a 'Code of Consumer Protection' applicable on all insurers in the business of micro-insurance. The Commission issued the draft of the Securities and Exchange Commission (Micro-insurance) Rules of 2013.

Reporting Net Capital Balance: SECP issues guidelines for brokers

In July 2013, the Securities and Exchange Commission of Pakistan has issued guidelines for stock exchange brokers to ensure that consistent approach should be followed while complying with the regulatory requirements of Securities and Exchange Rules, 1971 (SEC Rules) in calculating and reporting Net Capital Balance (NCB).

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SECP holds seminar on online filing of returns

In collaboration with the ICAP, the SECP organized an awareness seminar on mandatory online filing of returns/documents. It was done for the benefit of the corporate consultants/practitioners, corporate managers, company secretaries and members of professional accounting bodies regarding mandatory online filing of returns/documents in the light of SRO211(1)/2013.

Mr. Liaqat Ali Dolla, in charge, Lahore CRO, highlighted the importance of the mandatory online submissions, the role of SECP in a growing economy and also appreciated the efforts of the ICAP for holding the seminar.

SECP issues draft Regulations for Third Party Administrators

During the month of August the Securities and Exchange Commission of Pakistan (SECP), after detailed deliberations with the stakeholders, has proposed the draft regulations for Third Party Administrators (TPA) for supporting the health insurance business.

SECP registered 316 firms in July

In July, the Securities and Exchange Commission of Pakistan (SECP) registered 316 new limited liability companies, raising the total corporate portfolio to 62,228 companies.

Last year in same month, 315 companies were registered. During the month under review, the SECP also issued licenses to three non-profit associations under Section 42 of the 1984 Companies Ordinance.

Anti-money Laundering Act, 2010: SECP issues clarification to insurers

During the month of August ,the SECP, taking cognizance of the concerns raised by the insurance companies and, after undertaking extensive deliberations with the relevant authorities and stakeholders, deemed it appropriate and expedient to issue certain clarification, to remove the difficulties faced by the insurers in complying with the SECP's directive issued vide SRO 20(1)/2012 dated January 11, 2012 on Anti-money Laundering and Combating the Financing of Terrorism (AML/CFT.

SECP issues draft regulations for information sharing

In August, the Securities and Exchange Commission of Pakistan (SECP) issued the draft regulations for the information sharing with the name of Draft Centralized Information Sharing Solution for Insurance Industry (CISSII) Regulations, 2013. The draft regulations have been published to solicit public opinion and comments from the stakeholders. In its first phase, the CISSII means for information sharing among the life insurance companies. This technology-based information sharing solution is being implemented by the Central Depository Company (CDC), which will provide the necessary technological infrastructure to develop and maintain this arrangement.

Earlier, the SECP as a part of its ongoing insurance reforms, emphasized the need for coordination between the life insurance companies regarding the sharing of the critical information such as the conduct of agents, postponed or declined life insurance risks and claims experience, among many others. It was proposed that a formal information-sharing mechanism be developed and managed by an independent body, possessing the capacity and technology infrastructure to manage such large data warehouse and support the efficient dissemination of the data. Accordingly, earlier this year, a memorandum of understanding was signed by all life insurers, family Takaful operators and the CDC whereby the latter was mandated to develop and maintain the information sharing solution.