June 12,1999 Explanation of Salient Features of Changes in Corporate Laws and Capital Market Related Announcements in the Federal Budget.

The budget announced by the Finance Minister today contains significant amendments in the corporate laws and provides incentives for the development of capital market. These changes and fiscal incentives are positive steps towards liberalization the corporate laws and provide for new modes of mobilization of resources in the corporate sector. These are discussed in the following paragraphs:-

1. Empowering companies to buy back their own shares.
The amendment proposed in Section 95 of Companies Ordinance removes the prohibition on listed companies to buy back their own shares. Most of the countries following English model of company law have already removed such a restriction. While allowing companies to repurchase their shares, adequate safeguards have been provided in a proposed new section 95A against any possibility of manipulation by companies. According to the proposed amendment, companies shall be able to purchase their own shares under the following legal framework:-

Approval by shareholders in a general meeting through a special resolution.
which shares shall be purchased and the period within which purchase is to be made; source of funding; effect on the financial position of the company; nature and extent of the interest of every director.
Purchase shall be in cash and shall be out of the distributable profits only.
Companies after repurchase shall have to maintain an adequate debt equity and current ratios to be prescribed.
Directors of company shall make declaration of solvency to give comfort to the creditors.
Purchase shall be made through tender system.
The shares purchased shall not be resold and shall be cancelled.

2. Enabling companies to establish Employees Stock Open Schemes.
While making offers of right shares to the existing shareholders, companies shall be able to allocate a certain percentage of further issue of capital , for issue to their employees under an "Employees Stock Open Scheme". Securities and Exchange Commission of Pakistan would be notifying detailed rules on the subject. Such schemes shall, however, be subject to prior approval by the Commission. The change in the law is intended to create a sense of participation among the employees of the company.

3. Powers of companies to issue more than one kind and class of share capital.
Presently, Companies Ordinance, 1984 allows companies to issue only one kind of share capital namely ordinary share capital. Practically laws of all countries which are following English Model of Company Law allow companies to issue different classes and kinds of shares catering to the need of companies and preferences of the investors as well as financial agencies. With the objective of strengthening our corporate sector, it has been

decided to allow companies to issue different kinds and classes of shares. Such shares could include non-voting shares which would possibly be subscribed by foreign investors and may also include the concept of "Golden Share" to be used for facilitating privatization.

4. Prohibition of distribution of gifts to shareholders during Annual General Meetings.
It has been noticed that Annual General Meetings of a number of listed companies are not serving the purpose of holding the management accountable for unsatisfactory performance since the management is able to divert the attention of shareholders by giving lavish gifts in the meetings. Some shareholders also attend the meeting only for receiving gifts and do not participate in the deliberations involving evaluation of the performance of companies. Although SECP has been issuing directions to companies not to give gifts in the AGMs, the directions could not be enforced due to lack of any legal provisions. It has, therefore, been considered necessary to legally prohibit distribution of gifts in all meetings of the shareholders.

5. Providing for Institutional framework for securitization.
A number of countries are encouraging corporate entities to mobilize resources through the mode of 'securitization'. Under this process, receivable assets of a company are securitised and used for raising resources. The process involves establishment of 'Special Purpose Vehicle" (SPVs) which helps in securing the investors from insolvency risks of the company. The mode of securitization has become extremely popular in other countries of the world. Institutional framework for such a mode of financing has been absent in Pakistan thus denying the companies access to an important source of financing. In order to promote this concept, amendments in the Income Tax Law are proposed to be effected. It is hoped that a number of companies would avail of this opportunity being provided. The process would also help in deepening our TFCs market and may also lighten the financial institutions from undue burden of borrowing.

6. Development of Term Financing Certificate Market.
An important requirement of industrial development is availability of long term funds. Efforts are being made to promote and develop market for Term Financing Certificates which can help companies to raise long term funds. The proposal to exempt institutional investors in TFCs from 10% withholding tax at the time of payment would help in developing the market.