

Newsletter

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Key Feature

CORPORATE GOVERNANCE—SHAPING THE FUTURE OF THE CORPORATE SECTOR IN PAKISTAN

During recent years, good corporate governance has emerged as a key component in the successful functioning of financial markets and the corporate sector. Corporate governance is concerned with promoting corporate practices that ensure transparency and accountability. It entails holding the balance between economic and social goals and between individual and communal aims. Good corporate governance seeks to create an institutional framework that encourages all participants of the governance system to contribute towards better corporate performance through an alignment of their objectives.

The Securities and Exchange Commission of Pakistan (SEC) has taken several important steps to improve corporate governance in the country. While the governance of stock exchanges has significantly improved with the inclusion of independent directors and appointment of independent managing directors, the SEC is actively working on developing the first **Code of Corporate Governance for Pakistan**. The need for corporate governance and steps taken by the SEC are highlighted below.

The Need for Corporate Governance

Financial resource mobilization for companies entails access to public funds, either through public offering of the shares of the company or through credit. Once the general public becomes a significant stakeholder, the functioning of the company no longer remains a cloistered affair. A system of internal governance that ensures adherence to best corporate practices becomes critical to the interest of maximising the value of the company for diverse stakeholders. The Asian Financial Crisis of 1997 highlighted the weaknesses in internal governance of companies as the root cause of economic collapse and brought the need for instituting good corporate governance at the forefront of international debate on remedial measures. The Asian Crisis also casted doubt on the relevance of the neo-liberal view that supports market functioning with minimum state intervention. Additional responsibility was placed on the shoulders of corporate regulators to ensure that they play an active role in formulating the legal and institutional framework to support the enforcement of good corporate governance.

“Sound reporting of corporate financials is a key element of disclosure and transparency. Unless there is adequate and timely disclosure of material information and a high level of transparency, all regulatory efforts are futile. The system critically depends upon it.”

Khalid A. Mirza
Chairman, SEC Pakistan

Pakistan Scenario and the Role of SEC

Several economic analysts in Pakistan attribute weak corporate governance, arising from the lack of proper disclosure, transparency and accountability in the corporate sector, to be among the main reasons for declining investor confidence. It is empirically evident that international capital flows towards economies adhering to better standards of governance. In order to revive investor confidence in the economy, the need for good corporate governance in Pakistan is undeniable.

As a result of recent geo-political developments in the region and the government's economic policies for improving macro-economic indicators, Pakistan's economy seems well poised for a revival. Several foreign investors are exploring investment opportunities in the country. In order to provide the impetus for sustainable economic growth, SEC has taken several steps to eliminate structural

weaknesses in the corporate governance systems in place. One such step has been the support to the Institute of Chartered Accountants of Pakistan (ICAP) in development of a Code of Corporate Governance (the Code). The Code not only incorporates principles of sound corporate practices from around the world, but also tailors them to the particular needs of the country. The SEC actively contributed to the development of the Code and organised seminars in three major cities of Pakistan (Karachi, Lahore and Islamabad) to solicit public opinion. The Code has also been placed on the SEC website and is expected to be finalized shortly.

Features of the Code of Corporate Governance

Salient features of the Code are as follows:

- The Code shall be applicable to listed companies, banking companies, Development Financing Institutions (DFIs), Non-bank Financial Institutions (NBFIs), insurance companies, mutual funds, unit trusts, and companies/corporations held or controlled by the Government. Other companies are encouraged to follow the Code.
- A statement of compliance with the Code shall be published by companies. The statement shall be reviewed by the auditors, to the extent that compliance with the Code can be objectively verified.
- Effective representation of minority shareholders and non-executive directors on the board of companies has been ensured.
- Corporate and financial reporting framework has been re-defined to foster better disclosure requirements.
- Audit Committees are required to be established by all companies within the purview of the Code.

In addition to the development and finalization of the Code, the SEC is also involved in determining an implementation plan for the Code.

Steps to Improve Governance of Stock Exchanges

To improve governance, efficiency and transparency in the stock exchanges, the following measures have been taken:

- Forty percent non-member directors are appointed on the board of each of the three stock exchanges in Pakistan (Karachi, Lahore and Islamabad). Moreover, the directors of stock exchanges cannot delegate operational powers to any person other than the Managing Director.
- The Managing Director of each of the three stock exchanges is appointed/removed with the approval of SEC.
- The number of broker-directors in the Central Depository Company (CDC) has been reduced from five to three (out of a total of nine) and the Board of Directors of CDC cannot delegate operational authority to anyone except the CEO. Furthermore, the SEC has nominated a director on the Board of CDC.
- The Chairman of the CDC is to be a non-broker professional.
- Brokers and Agents Registration Rules have been notified, which define the eligibility requirements of brokers and lay down a comprehensive code of conduct. Only registered brokers are allowed to trade at the exchanges.

Measures for Improved Disclosure

The SEC is also taking other measures to improve transparency and disclosure by companies. A notification was issued in November 2001, directing all companies to submit their quarterly accounts, in the same manner as their annual and half-yearly accounts, to their shareholders as well as to the Registrar of Companies, Stock Exchanges and SEC. The SEC has also adopted all International Accounting Standards (IAS), with the exception of two that are not relevant to the circumstances of Pakistan and another one that was recently issued by the International Accounting Standards Board (IASB).

Future of Corporate Governance in Pakistan

As a result of the recent steps taken by the SEC to improve corporate governance and measures taken by the government to achieve macroeconomic stability, the country is already witnessing an inflow of foreign portfolio investment. Along with the implementation of the Code, the SEC will be undertaking a large scale awareness campaign to educate the general public about aspects of corporate governance and shareholder rights. Assistance in this regard is also expected from donor agencies such as the Asian Development Bank (ADB) and the United Nations Development Program (UNDP).

In Focus

STRENGTHENING THE INSURANCE SECTOR

Events of September 11, 2001 have brought the insurance industry to centre stage all over the world and Pakistan is no exception. However, even prior to this, the industry had been witnessing the introduction of more stringent rates and terms for insurance and reinsurance coverage. While international reinsurers have raised insurance rates, particularly for this region, they also seem reluctant to provide cover for losses on account of terrorist activities, riots and strikes.

In view of these developments, the SEC constituted a task force to address the issues of reinsurance cover and losses on account of terrorism. The task force included Mr. Kamal Afsar, Chairman, Pakistan Reinsurance Company Limited (PRCL), Mr. M. A. Lodhi, Chairman, National Insurance Company Limited (NICL), Mr. Moin Fudda, Country Manager, Commercial Union Insurance Company, and Mr. Basit Hassan Syed, International General Insurance Company Limited. The task force, in its report to the SEC, recommended establishment of a Reinsurance Pool that should provide terrorism cover to insurance companies operating in Pakistan.



Chairman SEC receiving report of the task force from Chairman PRCL

Salient features of the proposed Pool are:

- An amount of Rs. 500 million shall initially be contributed to the Pool by the Government of Pakistan.
- The insurance companies will also contribute to the Pool, initially, a minimum of Rs. 250 million out of the premium they earn on account of insurance cover for terrorism.
- Membership of the Pool will be open to all companies.
- The Pool will be attached with PRCL/NICL and it will be supervised by a Technical Committee consisting of professionals from public and private sectors.
- The maximum amount of loss payable through the Pool would be 25% of the sum insured or Rs. 100 million, whichever is less. The Pool will provide 50% of this amount while the remaining 50% will be arranged under the "excess of loss", protection arrangements made by the Pool with specialized international reinsurers who may be willing to provide such cover.

The SEC has endorsed the proposal for a Reinsurance Pool and has recommended it for consideration by the Ministry of Finance

Apart from helping the insurance companies through this difficult period, the SEC is also seeking an enhancement in the claims paying ability of the local insurance industry in order to protect the interests of policyholders. The SEC has accordingly directed all insurance companies to make sound reinsurance arrangements through reinsurance treaties with international reinsurers, which are at least rated "A" by reputable international rating agencies. The Commission has also directed insurance companies to provide evidence of sound and prudent management of their companies.

NATIONAL CLEARING AND SETTLEMENT SYSTEM

The National Clearing and Settlement System (NCSS) started its operations on December 24, 2001 with the induction of two securities, namely Indus Motor Company Limited and BRR International Modaraba. NCSS is an electronic system developed to replace the individual clearing houses operated by each of the three stock exchanges. In order to facilitate the operation of NCSS, SEC has approved the NCSS Regulations and necessary amendments in the CDC Regulations. The Continuous Net Settlement (CNS) feature of NCSS will facilitate trade between brokers who are members of different exchanges as well as between brokers and institutional members.

Operationalization of NCSS is expected to significantly enhance the efficiency and integrity of clearing houses.

Insight INVESTING IN THE STOCK MARKET

Know What Investment Products are Available

The following types of securities are available on the stock market for investment:

- Ordinary shares of listed companies
- Mutual funds certificates
- Corporate bonds i.e., Term Finance Certificates (TFCs)
- Government securities i.e., Federal Investment Bonds(FIBs), Pakistan Investment Bonds (PIBs) and Special US Dollar Bonds.

Know Your Investment Profile

A wise investor chooses an investment product not only according to his goals and the amount of capital available, but also according to his own tolerance for risk. All investments carry a certain degree of risk. You have to determine whether you are a “risk-taker” or a “ risk-averse” person. You can pursue an aggressive, moderate or conservative investment policy, according to the extent of risk you intend to take. In other words, you should pursue an investment strategy that fits your risk profile.

Do Your Homework Before You Invest

Don't put in your money until you have understood all relevant information regarding the investment.

Prepare yourself for the vigorous homework of analyzing company annual reports, accounts and other statements while keeping abreast of what's happening in the industry, country and elsewhere in the investment world. Consult your investment adviser/broker or a friend to get latest market information about shares you intend to buy or sell. Be skeptical of anything picked up from rumors, particularly if you cannot explain their choice by rational reason.

Think Long-term

Bear in mind that even in the best of securities/shares, there can be short-term aberrations, so have the sustaining power to hold your investments for longer periods. Studies have shown that investments properly timed and based on strong fundamentals have been very profitable for investors, in the longer term.

Avoid Putting All Your Eggs in One Basket

The best way to minimize risk is to diversify your investments across various investment products. If equities are your sole investments, it makes sense to diversify within manageable companies and sectors. In this way the loss made by some investments can be absorbed by the gains made in others, keeping the overall return on investments, positive.

Beware of Scams

Be ware of promises of quick profits or sky-high returns. Remember: higher the gain on investments, higher is the risk involved. This is the fundamental risk-reward trade-off.

Selection of Broker

Be careful in selecting your broker. Ensure that he/she is licenced to trade by the SEC and that the stock broking firm has a good track record. Give clear instructions to avoid ambiguity, check trade confirmation received from the broker and keep a record of your transactions.

A seminar on Code of Corporate Governance was arranged in Islamabad in November 2001 by the Overseas Investors Chambers of Commerce and Industry (OICCI) under the auspices of SEC.

At the Commission

AMENDMENTS IN COMPANY LAW

The SEC constituted a Committee in October, 2001 to review the Companies Ordinance, 1984 in order to address practical difficulties in the application of law and to improve the Ordinance for efficient regulation and development of the corporate sector in the country. The Committee has prepared the draft amending Ordinance and has elicited opinion of the public and legal experts on the same. Significant amendments in the draft Ordinance include the following:

- The period for presenting the annual audited accounts in Annual General Meetings (AGMs) of listed companies has been reduced from six months to four months.
- Maximum limit of 30% of paid-up capital plus free reserves for investment in associated undertakings has been removed and the power of the regulator to grant waiver has been done away with.
- A new concept of single member company has been proposed to enable a sole proprietor to enjoy the privilege of limited liability and have the status as well as benefits of a corporate entity.
- Minimum number of members of a public limited company, except a listed company, have been reduced from seven to three.
- Appointment of a whole-time qualified company secretary for listed companies has been made mandatory.
- A company may remove its auditors through special resolution but appointment of new auditors against the vacancy will be made with the approval of SEC.
- Quorum for general meetings of listed companies has been increased to ten members.
- Subsidiary companies of listed companies are to prepare their accounts in accordance with the requirements of the Fourth Schedule.
- Consolidation of accounts of holding companies and their subsidiaries has been made compulsory.



Left—Right: Masoud Naqvi, President, Management Association of Pakistan (MAP), Sadia Khan, Executive Director (Specialized Companies Division), SEC, and Khalid A. Mirza, Chairman, SEC



Audience at the Seminar

*Comments, queries and suggestions may
please be addressed to:*

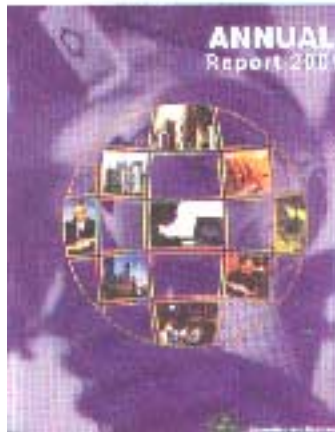
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SEC has published its second annual report covering the period July 1, 2000 to June 30, 2001. The report is also available at the SEC website.