Securities and Exchange Commission of Pakistan

Chairman's Six-monthly Review

July-December 2016

I am pleased to present the six-monthly review of the SECP's performance for the half-year ending December 31, 2016. The review is intended to take stock of the extent to which we have achieved our targets of development, facilitation and enforcement.

I take pride in saying that the last six months have been extremely productive and results-oriented for the capital markets of Pakistan. The Capital Market Development Plan (2016-18) continued to be implemented with vigor and focus, providing the market a clear direction. The capital markets witnessed comprehensive reforms and initiatives, benefiting market participants and boosting investor confidence and protection.

Foremost among these landmark successes was the divestment of PSX shares. A consortium of Chinese exchanges and local financial institutions has acquired 40% shares of PSX from the TREC-holders. It is expected to help PSX by opening up opportunities for technological advances, strategic partnerships, product development, market outreach and cross-border listings. Earlier, MSCI had upgraded Pakistan from Frontier Markets to Emerging Markets because of our improved macroeconomic indicators and reform process. On the operational side, new and improved regimes for licensing and operations for infrastructure institutions and market intermediaries were introduced. These were aimed at preventing market abuses and manipulative practices, promoting public confidence in the market and establishing a robust compliance regime. Consequently, risk management, transparency, governance of capital market infrastructure institutions and investor protection have been greatly improved.

The KSE-100 Index reached its highest point at 47,806.97 on December 30, 2016. Its lowest point was at 37,966.76 on July 4, 2016. As of July 1, 2016, the market capitalization was Rs7.58 trillion whereas on December 31, 2016, it stood at Rs9.63 trillion. There was a spurt of market activity in the last quarter of 2016, in which KSE-100 rose by 18% and the average daily traded value reached Rs15.6 billion. Foreign investors were net sellers during the last quarter, amounting to Rs27.2 billion. The mutual fund industry was a net buyer in the last quarter amounting to Rs24.14 billion. The fact that net selling by foreigners was counteracted by net buying from local funds reflects the growing resilience and maturity of the market.

Another very important development was the acceleration in the number of new mutual fund investor accounts opened. During the period under review, 24,320 new mutual fund investor accounts were opened, as compared to the previous six months, in which only 18,234 accounts were opened. This growth was the direct consequence of the SECP's extensive outreach program for investor education and awareness through digital and print media, opening up of an investment hub in Abbottabad and holding of over 40 seminars and engagements to spread awareness about capital market.

In order to facilitate corporate growth, the SECP established incorporation and facilitation wings at the CROs in Islamabad, Lahore and Karachi, which help individuals to get their companies incorporated without paying hefty fees to consultants. Further, the SECP has expanded its outreach to far-flung areas such as Gilgit and Gwadar. Additionally, special facilitation counters were established in Sialkot and Abbottabad. A number of reforms were introduced to further increase the corporatization and to ensure corporate compliance. The Companies Bill, 2016, was finalized and it is expected to be approved by parliament soon.

Talking of the NBF sector, a number of reforms were introduced. Directions were issued to mutual funds to increase investors' level of awareness by emphasizing proper disclosures and transparency, enhancing financial inclusion by catering to low-risk customers, and increasing retail penetration by expanding outreach and strengthening distribution network. The core motive behind these measures was the protection of mutual fund investors.

For the promotion of the insurance sector, the focus remained on providing a conducive regulatory environment for market development in line with best international practices. The Code of Corporate Governance for Insurance Companies to improve governance mechanism was amended, while the Insurance Bill, 2016, was finalized to improve governance, pave the way for risk-based supervision and support the growth of micro-insurance. Additionally, the SECP placed particular emphasis on timely resolution of policyholders' complaints, enforcement actions, licensing of TPAs, product approvals and various other regulatory approvals.

Owing to the SECP's vigorous efforts, tax incentive for Sharia-compliant listed manufacturing companies was approved, while the Income Tax Ordinance was amended to encourage the issuance of sukuk. Finally, disclosure requirements for public listed companies for the purpose of Sharia screening were included in the Companies Bill.

During the period under review, the SECP set up a Systemic Risk Department. It was mandated to work on a war footing to address systemic risk through a comprehensive exercise across the different sectors regulated by it. Based on the recommendations of the department, the SECP took a number of significant measures to strengthen risk management at the clearinghouse of the stock market. The SECP and the State Bank are also working on establishing a Council of Regulators to holistically address systemic risk and market stability across the financial sector. The management of systemic risk was added to the SECP's responsibilities through an amendment to the SECP Act, 1997, and it remains a priority for us.

I would like to acknowledge the invaluable support and cooperation of the government and the Honorable Federal Minister for Finance, Revenue, Economic Affairs, Statistics and Privatization Senator Muhammad Ishaq Dar for extending his guidance and support to the SECP for the effective and efficient regulation and supervision of the capital market. I am certain that many of these key milestones could not have been realized if the patronage of the Finance Minister was not there. I am also highly indebted to Dr. Waqar Masood Khan, former Federal Finance Secretary, who in the capacity of Chairman, Policy Board, was a source of great support. Needless to say, my brother Commissioners are also worthy of praise for steering the SECP in the right direction.

Last but not least, I would also like to acknowledge and commend the efforts of the entire SECP staff for their commitment, dedication and stellar efforts for the realization of the goals and targets of the organization.

Zafar Hijazi

Chairman, SECP

The following is a more detailed description of the achievements of various divisions and departments of the SECP from July to December 2016:

Securities Market

Securities Market Division monitors, regulates, and develops the capital markets and regulates the primary and secondary markets as well as licensed entities and regulated persons through licensing, surveillance, investigation, enforcement, and rule making. It also processes and grants approvals to prospectuses for public offering of both debt and equity securities. Major developments in the securities market for the half-year under review are as follows:

1. As a statutory obligation under the demutualization law, the SECP facilitated timely completion of the divestment of Pakistan Stock Exchange (PSX) shareholding while ensuring absolute transparency, impartiality and efficiency. PSX has signed a share purchase agreement with the Chinese consortium comprising of the China Financial Futures Exchange, Shanghai Stock Exchange and Shenzhen Stock Exchange, along with two Pakistani financial institutions, i.e. Habib Bank Limited and Pak China Investment Company Limited. The foreign investors are expected to benefit PSX through their diverse product offering, indigenously developed technology and their experience with management of successful securities and derivatives exchanges. The divestment deal will also enhance possibilities for increasing PSX outreach in Pakistan and may also open a gateway to cross-border trading for Pakistani capital market and investors. The local financial institutions will benefit PSX through their large branch networks, excellence in corporate governance and knowledge of local market and its laws.

2. Under the Securities Act, 2015, new licensing and operational regulations were approved for the securities' exchange, Central Depository Company (CDC) and National Clearing Company of Pakistan (NCCPL). These regulations have introduced necessary and improved provisions for licensing, governance, standards of conduct and for other relevant areas. Fresh licenses were issued to the PSX, the CDC and the NCCPL under the Act as well as under these regulations.

3. In order to ensure standardization, integrity, transparency and reliability of the software used for trading/recordkeeping by brokers, regulatory requirement were introduced for brokers to ensure compliance with minimum standards and requirements prescribed by PSX in relation to eligible software vendors and broker software.

4. To improve the liquidity and ensure efficient price discovery, it was made a requirement for the listed companies to ensure minimum specified free float within a given period of time. For this purpose, free float methodology was reviewed and a free float verification system was developed through CDC, whereby free float reports will be generated directly from CDS for PSX and NCCPL.

5. In order to facilitate small investors, a new risk-based know your client (KYC) and customer due diligence (CDD) regime was introduced whereby documentation and due diligence requirements of customers in capital market were segregated based on their risk profile. Simplified KYC requirements are now applicable to small low-risk retail investors to promote the SECP's broader objective of financial inclusion.

6. In order to safeguard investors and as per the new regime introduced for securities brokers, a specimen of risk disclosure document was specified through PSX containing basic risks involved in trading in securities. The risk disclosure document shall be required to be provided by each securities' broker to its customers and the broker shall also be required to obtain written acknowledgment from the customer on the same, prior to commencement of business.

7. In order to facilitate investors in better evaluating market and index performance and making more informed investment decisions, the SECP advised PSX to develop alternative versions of its KSE-100 free float capitalization total return index. Accordingly, PSX has now made available

its KSE-100 full market capitalization and dividend discount versions on its website for the investors.

8. Through regulatory amendments, the Institutional Delivery System facility was made available for all transactions of international broker dealers made on behalf of their clients.

9. In line with the SECP's mandate of financial inclusion and to achieve expansion of scope of capital market services, the CDC has made a mobile platform (M-Access) available for accessing and managing CDC account, through which investors can execute portfolio transfers and access account statements. The CDC has launched promotion of capital market services through social media and is now on Facebook, Twitter and LinkedIn.

10. A new securities broker regime was introduced, categorizing brokers in accordance with their financial strength and capacity to undertake different functions such as trading, clearing, custody and settlement. The revised regime introduces provisions for ensuring investor protection, managing conflict of interest and mandating asset segregation and safekeeping. The regime is being introduced in a phased manner to ensure a smooth transition.

11. The requirement of settlement on a T+1 basis, at least three settlement days prior to the start of book closure date (spot trading) was eliminated to remove practical difficulties in determining shareholders' entitlement and to facilitate foreign investors.

12. Requirements were put in place to provide alerts to investors at the end of each day through SMS and emails regarding transactions executed through their unique identification number (UIN) by their brokers.

13. The Code of Corporate Governance was amended to ensure verification of compliance with Access to Inside Information Regulations, 2016, through external auditors. It may be added here that under these regulations, listed companies are required to maintain a register of people having access to inside information and to update it on a regular basis.

14. The NCCPL and CDC regulations were amended to allow the NCCPL to open a designated account with the CDC to handle securities pertaining to the account to be blocked pursuant to any directive of the court or any other competent authority.

15. The Companies (Buy-Back of Shares) Regulations, 2016, were notified. These regulations allow the listed companies to buy back their own shares and retain them as treasury shares. Earlier regime for buy-back did not allow retaining shares rather it required the companies to cancel the buy-back shares. Now, buy-back can be used as a useful tool for price stabilization in situation of continuous decline in price of a listed share.

16. The Credit Rating Companies Regulations, 2016, were notified to regulate the affairs of credit rating companies (CRAs) fairly. CRAs play a key role in the promotion and development of corporate bond market. Bond market investors consider the opinions expressed by CRAs about creditworthiness of a business or corporate as one of the key aspects while making investment decision. Fair and proactive regulation of CRAs may help confidence building of investors.

17. The public offering of securities and listing of companies is a significant part of the capital market and SECP is striving hard to provide an efficient and hassle-free environment to corporates to raise funds from the capital market to meet their financing needs. In this regard, the following achievements have been witnessed:

    a) Approval for issue, circulation and publication of Prospectus of Loads; Fatima Fertilizer Company Limited (Sukuk Issue) and Roshan Packages Limited were granted. This will enable these companies to raise funds from the capital market to meet their financing needs. In this way, the investors will be able to invest their surplus funds.

b) Held two seminars on IPOs and benefits of listing in Faisalabad and Lahore for awareness of the local business community. The seminars will encourage new listing which is key to bring depth in the securities market.

c) A booklet entitled “Initial Public Offerings, Listing and their Benefits” was published and distributed to the participants of the above-mentioned seminars. The booklet was also circulated to all the CROs for placing at their respective visiting rooms for study by the visitors.

18. Considerable progress was made to promote the electronic trading of agriculture commodities and introduce warehouse receipt financing system through PMEX, including:

a) Promulgation of Futures Market Act, 2016, to provide a comprehensive legal framework for regulating the Commodity Futures Market.

b) Incorporation of Agriculture Promotion Companies (Producer Company & Collateral Management Company) concept in the Companies Bill, 2016, which includes producer and collateral management companies.fk

c) An SECP-led committee, comprising of the State Bank of Pakistan, federal and provincial agriculture secretaries, Pakistan Mercantile Exchange, Zarai Taraqiati Bank and CDC, formulated the draft of Collateral Management and Warehousing Regulations, 2016, to facilitate formation of collateral management company and registration of accredited warehouses. The said framework, after public consultation, was approved by the Commission.

d) Concept of collateral management and warehouse financing system for red chilli commodity in Kunri, Sindh, was implemented. The requisite infrastructure is available for farmers to avail themselves of the following options:

i) Futures trading through PMEX platform by farmers;

ii) 30-day futures’ contracts;

iii) Financing of red chilli at optimal rates

19. Due to comprehensive reforms, the capital market was strengthened in these ways:

a) Local investors were absorbing all foreign selling, which was a healthy sign. In the past foreign selling used to bring the main index down, however in spite of significant selling by foreign investors, the market continued to gain strength.

b) PSX was not only the top performing market in Asia, but also among the MSCI Frontier Markets. PSX posted 5th highest return in the world.

c) Strong performance of Pakistan equities in 2016 was mainly led by strong local cash liquidity thanks to rising investor confidence.

d) Better security situation, lowering of oil prices and credibility generated by Pakistan’s reclassification in MSCI EM Index had a positive impact on economic recovery.

e) Government also took new taxation measures for real estate sector in 2016, leading many investors to the equity market.

f) In another landmark development, 40 percent strategic stake in Pakistan Stock Exchange was sold to Chinese Consortium valuing the exchange at $215 million.

g) Pakistan successfully completed IMF program and rating agency Standard & Poors upgraded Pakistan from B- to B.

h) Enhanced stakeholders’ confidence due to SECP’s effective law making, complaint handling, investor protection/education initiatives, including JamaPunji, and measures against illegal brokerage operations etc.

Investor Education and International Relations

Investor Education and International Relations Department plans, designs, develops and executes SECP's investor education and awareness program through the virtual 'JamaPunji' web portal and organizes educational seminars, besides ensuring resolution of investors' complaints. The following are the key initiatives achieved by the department:

1. As part of a major drive for investor education, the SECP successfully conducted 42 seminars and awareness sessions in various cities, including Lahore, Islamabad, Peshawar, Faisalabad and Multan. These included sessions for the trainees and employees of E&Y Ford Rhodes in Islamabad, Lahore, Karachi, trainees and employees of A.F. Ferguson & Co. in Islamabad, Lahore, Karachi, university students, HEC Master Trainer Program, faculty members of COMSATS Institute of Information Technology (CIIT), and employees of the National Rural Support Program (NRSP) in the Islamabad region. In addition, multiple batches of students from higher educational institutions were invited to visit the SECP head office to sensitize them about the role of the SECP and its regulated entities.

2. The SECP signed MOUs with the Institute of Chartered Accountants of Pakistan (ICAP), the Institute of Cost and Management Accountants of Pakistan (ICMAP) and the National University of Modern Languages (NUML) to collaborate on promoting financial literacy and investor awareness. The MOUs with Pakistan Expo Center, ACCA and some other universities are in the pipeline. Using social media, informational messages were successfully disseminated among the subscribers of the SECP JamaPunji portal. It is worth mentioning that the SECP also uses its website effectively to disseminate information. Since the launch of new bilingual website on August 14, 2016, 528,711 people had visited the SECP's website by December 31.

3. The SECP also organized Youth Investment Week at the Pakistan Stock Exchange (PSX) on savings and investment for Karachi-based students in September 2016. In addition, awareness session for HR professionals on VPS were conducted in Islamabad.

4. Two self-assessment exercises were spearheaded by the SECP under the World Bank ROSC program. The areas covered included Auditing and Accounting and Corporate Governance of listed companies in Pakistan. As a result of these exercises, enabling provisions were introduced in the Companies Bill, 2016. In addition, changes have also been suggested in the Companies Bills, 2016, to improve transparency and governance of boards of directors of companies.

5. Second progress report on the recommendations of the IOSCO committee review was submitted in the first week of July 2016. The SECP attended the IOSCO board meeting held in Hong Kong during October 2016, and strongly presented Pakistan's perspective on the IOSCO board's priority areas.

6. Investor complaints, apart from providing vital feedback on the functioning of the sectors that we regulate, also highlight the need for strengthening investor protection measures. A weekly complaints and query status reports and monthly status reports with department-wise commentary were circulated on a regular basis for follow-up to the senior management of the SECP. These reports include statistics and analytics regarding complaints aging, service desk audits of complaints and complaint resolution feedback. The initiative is helping SECP better serve investors through improved information dissemination upon enquiry and to better address and resolve investor grievances. Statistical highlights of complaints and queries as reported in the report generated on January 2, 2017, are as under:

   a) Of 2,899 complaints received, 90% of them were settled, while 5% were either sub judice or under follow-up with third parties and only 75 complaints were under direct investigation by relevant departments for the last 15 days or less.

b) 4,119 enquiries were received of which 98% were successfully addressed while the rest were under review by relevant departments for appropriate responses.

Company Law Division

Company Law Division is responsible for incorporation and dissolution of companies and acceptance/ maintenance of information. It also monitors and enforces the corporate legal framework to promote transparency, accountability, good corporate governance and practices. It supervises compliance by listed companies, public unlisted companies, private companies having paid-up capital of Rs100 million and above and companies formed under section 42 and 43 of the 1984 Companies Ordinance (except insurance companies, non-banking finance companies and modarabas) of the corporate legal framework.

Furthermore, it is also responsible for administration of the Companies Ordinance, 1984, and the rules and regulations made under it, along with other relevant laws. It also registers companies, regulates their statutory functions, and monitors corporate compliance. The supervision of the eight Company Registration Offices (CROs) also comes within its ambit. In order to pursue the SECP's mission of investor protection, regulatory reforms were instituted which includes:

1. During the period under review, 3,411 companies were incorporated as compared to 2,771 during the corresponding period of the previous year, signifying a corporate growth of 23% due to various reform measures encompassing reduction in time and cost to register a company.

2. A national level consultative seminar on the draft Companies Bill, 2016, chaired by Senator Mohammad Ishaq Dar, Minister for Finance, Revenue, Economic Affairs, Statistics and Privatization, was held on September 5, 2016, in Karachi. Another seminar chaired by Finance Minister was held on November 23, 2016, in Islamabad. The stakeholders' feedback was taken into consideration while finalizing the draft. Consequently, the draft Bill was approved by the honorable Federal Minister for Finance, and it was presented in parliament in November 2016.

3. The following regulatory frameworks were either optimized or developed:

a) Regulatory framework for not-for-profit companies was reviewed in the backdrop of international best practices and draft "Associations Not for Profit (Licensing and Corporate Governance) Regulations, 2016" were prepared and are likely to be placed for public consultation in the next quarter.

b) Amendments to the Companies (Registration Offices) Regulations, 2003, were suggested, which are aimed at providing enhanced facilitation to the corporate sector and maximizing the use of information technology.

c) Rationalization of fee structure through amendment to the sixth schedule attached to the Companies Ordinance, 1984.

d) Amendments to the Public Sector Companies (Corporate Governance) Rules, 2013 were proposed.

e) Draft of Corporate Restructuring Companies Rules, 2016, were prepared and sent to the State Bank of Pakistan for comments after which the same shall be published in the official gazette to obtain public opinion.

f) After an extensive consultative process, the SECP notified the Employees Provident Fund (Investment in Listed Securities) Rules, 2016. The new rules emphasize on improving/tightening governance structure of the employees' provident fund/trust, coverage of risk vis-à-vis ensuring possibility of maximum return on the fund.

g) In order to obtain feedback from market participants about the draft set of principles, the SECP, in collaboration with International Finance Corporation and Centre for International Private Enterprise, held roundtable conferences. In the wake of the roundtables, the SECP approved 13 Principles of Corporate Governance for non-listed companies that are applicable in two phases. Phase 1 Principles are applicable to all non-listed companies except small sized companies and public sector companies that are governed under the Public Sector Companies (Corporate Governance) Rules, 2013. Whereas Phase 2 Principles are applicable to public interest and large sized companies only. The principles will change the governance paradigm for the NLCs by enabling the corporate sector to adopt the best international practices.

h) Roundtable on Valuers Registration and Governance Regulations was conducted, which was a step towards finalizing the regulatory framework for valuers, which is presently non-existent.

i) Circular No. 30 of 2016, dated September 16, 2016, was issued to clarify that any further issue of capital shall be limited to the authorized capital of the company.

j) Enabling provisions for establishment of Audit Oversight Board (AOB) were enacted through the SECP (Amendment) Act, 2016. The members of the AOB have since been notified by the federal government and it has started functioning. It will regulate the auditing profession in the country. Its functions include registration and de-registration of auditing firms, oversight and review of the Quality Assurance Board of the Institute of Chartered Accountants of Pakistan.

4. In order to facilitate investors and the public and expand its outreach, the SECP has taken the following measures:

a) The SECP revamped its three big Company Registration Offices located in Karachi, Lahore and Islamabad by establishing facilitation desks for swift incorporation of companies. Additionally, the SECP introduced swift incorporation as now companies can be incorporated within two hours. As a result, a 23% increase in new incorporation was observed during the period under review as compared to the previous corresponding period.

b) Realizing the needs of local investors and the corporate sector, the SECP expanded its outreach through establishment of facilitation centers in Sialkot and Abbottabad.

c) Short version of memorandum of association for 70 sectors was prepared and placed on the SECP's website to facilitate new incorporators on the same day under the Swift Incorporation Scheme (SIS).

d) In order to facilitate foreign investors, Promoters' Guide was translated into six languages, i.e., Turkish, Arabic, Persian, German, Urdu and Chinese, which were made available on the SECP's website.

e) Various awareness raising sessions were held in Islamabad, Lahore, Karachi and Faisalabad with respective trade organizations/associations to increase corporatization and optimize compliance. Moreover, various in-house sessions were also arranged at CROs in Lahore, Peshawar, Faisalabad and Quetta with company representatives, corporate consultants regarding corporatization and compliance activities, eServices regime, and Companies Easy Exit Regulations.

f) A comprehensive media campaign was launched for the awareness of the public regarding drastic reduction in fees and other reform and facilitation measures introduced by the SECP.

5. A revamp of eServices system was initiated to convert it into new Business Process Management in IBM environment. The new system is expected to be more friendly for the internal as well as external users and to enhance efficiency

and convenience for the public. One hundred and sixty-nine "Business Process Documents" (BRDs) were redesigned during the period under review for standardization, clarity, addition of new features and removal of redundant processes.

6. In furtherance of Corporate Social Responsibility Voluntary Guidelines 2013, SECP has given the mandate of formation of CSR national forum to a core committee comprising of Pakistan Institute of Corporate Governance, Pakistan Centre of Philanthropy and Pakistan Stock Exchange. The core committee shall work towards raising awareness about CSR-related activities by companies and send its proposal for strengthening the CSR framework in view of report and explain approach towards such activities.

7. Furthermore, the SECP has expanded its outreach to far-flung areas such as Gilgit and Gwadar and additionally special facilitation counters were established in Sialkot and Abbottabad. A number of facilitative, regulatory and enforcement reforms were introduced to further increase the corporatization and compliance in the country. Efforts were made to improve corporate compliance by management of companies and to ensure compliance with the legal framework. Efforts were made to ensure compliance with the mandatory requirements of law by the public sector companies as 68 orders were issued to these companies. The law governing the operations of Companies Registration Offices namely, Companies (Registration Offices) Regulations, 2003, was amended to cope with recent facilitative reforms.

8. Far-reaching reforms have or will benefit the corporate sector in these ways:

   a) The Employees Provident Fund (Investment in Listed Securities) Rules, 2016, aim at securing contribution by employees to provident funds as well as adding value in the form of sustainable returns.

   b) Principles of Corporate governance for non-listed companies (NLCs) shall strengthen corporate governance framework in public companies for prudent decision making, adding value to the business thereby ensuring long-term continuity and success.

   c) The AOB will positively improve the integrity of auditing profession in the country. Besides IOSCO Principle 19 regarding independent auditor oversight was marked NOT IMPLEMENTED in 2015 assessment and establishment of AOB and making it operational will improve Pakistan rating in this principle. This was also part of policy recommendations of REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC) - ROSC 2005 and will impact the Pakistan rating.

   d) Draft Valuers Regulations shall fill in the regulatory gap existing in the financial system for registration and regulation of valuers. At present, no such arrangement exists in the banking or corporate sectors.

9. The SECP's enforcement actions provided relief to shareholders of listed companies that were not operational. The shareholders in these companies had been affected because of declining share price and limited trading activity in the shares of these companies at the stock exchange. Out of 9 companies given time for revival, 5 have either commenced operations or have taken steps towards revival like import of plant and machinery and merger with other operational companies. Furthermore, enforcement action regarding maintenance of website by listed companies is evident from the fact that almost all operational listed companies have their own websites, which provide the information mandated by the SECP, thus enhancing the ease to access information. And relief was provided to shareholders through resolution of complaints in a timely manner.

Specialized Companies

Specialized Companies Division performs the functions of licensing, registration, provision of regulatory framework and granting necessary regulatory approvals to the NBF sector which includes mutual funds, REIT funds, pension funds, private funds, modarabas, microfinance, leasing companies and investment banks. It also entails centralized functions of onsite inspection, offsite surveillance and enforcement of the NBF sector.

1. In order to further the SECP's mission of investor protection, many regulatory reforms were instituted for the mutual fund industry. They were aimed at improving access to finance and promoting a culture of savings and investment, leading to increase in the participation of retail investors in the capital markets, safeguarding investors' interests, meeting the changing industry dynamics, implementing international best practices and strengthening mutual funds. They include:

    a) Standardized methodology was introduced for calculation and disclosure of total expense ratio (TER) for mutual funds to bring about uniformity and to provide investors with an opportunity to make informed investment decisions based on enhanced disclosures of TER in fund manager's report and financial statements of mutual funds.

    b) Cooling-off rights were given to first-time investors of mutual funds allowing them to obtain refund of their investment within three business days of the date of issuance of investment report to investor. The motive was to allow the investor to withdraw his investment in case of mis-selling by the mutual fund and thus protect the investor interests.

    c) Asset management companies (AMCs) were directed to provide potential investors with key information about a fund in a simple and accessible format prior to their account opening.

    d) Requirements for distributors selling mutual funds of a single AMC were prescribed. A new class of mutual funds distributors comprising of qualified and experienced individuals were introduced who can distribute the mutual funds units of a single AMC only by complying with minimum qualification. This requirement is likely to provide job opportunities to individuals interested in carrying out the distribution function of AMCs. This shall also encourage the establishment of a vibrant distribution network.

    e) All asset management companies were directed to use standardized benchmarks for their collective investment schemes. This measure was taken to increase investor awareness and to provide ease of reference to the investors. They are now able to make more uniformed comparisons of performance set against their benchmarks.

    f) The SECP has allowed AMCs intending to increase their outreach beyond big cities to charge marketing and selling expenses. The objective of this initiative is to increase the retail penetration of mutual funds and distribution network of AMCs across the country.

    g) Additional requirements were introduced with regards to liquidity management, internal credit assessment and identification of clients to curtail/manage large redemption risk for the money market schemes.

    h) To increase retail outreach, Sahulat Sarmayakari Account for low-risk customers and branchless banking account holders was introduced.

    i) Modarabas were advised to expand their outreach especially to SMEs. In this regard, four modarabas opened the first Islamic financing facility center in Rawalpindi to provide affordable financing on Sharia principles to the common people to buy motorcycles and other products.

2. Comprehensive review of the modaraba regulatory framework was completed. New Modaraba Act, 2017, was proposed to be introduced in place of existing Modaraba Ordinance, which was approved by the committee formed by the Commission. It is being vetted by the Prosecu-

tion and Legal Affairs Division.

3. The net assets of mutual funds increased to Rs626 billion in December 2016 from Rs485 billion in June 2016, while the total assets of VPS grew to Rs23 billion from Rs19 billion. The assets under the management of investment advisors increased to Rs140 billion from Rs139 billion, whereas, the REIT assets grew to Rs40 billion in December 2016 from Rs27 billion in June 2016. The total assets of modarabas increased to Rs41 billion in December 2016 from Rs36.8 billion in June 2016.

4. The SECP filled up the regulatory vacuum that had held back the growth of microfinance sector. In order to support the sector, various radical measures were taken during the period under review, with the specific objectives of improving access to finance to the most marginalized and financially excluded section of Pakistani society by amending the regulatory framework for NBMFCs. This led to the licensing of 15 NBMFCs, while another 19 are at various stages of licensing. At the moment, the non-bank microfinance sector serves over 2 million borrowers having gross loan portfolio of over Rs44 billion. It is expected that the borrower base will be increased to 10 million by the end of 2020. This will mean new job opportunities, emergence of a livelihood backbone, and empowerment of women by providing access to finance to them.

5. The SECP arranged an interactive session at the SECP head office on October 8, 2016, to receive feedback from the industry participants and to get a firsthand account of practical difficulties that the NBMFIs face during their registration/licensing and their concerns on post-licensing requirements. Forty-four participants representing 31 NBMFIs, as well as the CEO and a team of Pakistan Microfinance Network attended the session. Their concerns were adequately addressed through further facilitation.

6. One new pension fund manager was registered, whereas private equity and venture capital licenses were given to three fund management companies.

7. During the period under review, a sum of Rs32.69 million was raised at the Abbottabad Sarmayakari Markaz. And 104 investor accounts were opened with various AMCs situated at the Abbottabad Sarmayakari Markaz.

Insurance

Insurance Division regulates, supervises and promotes sound development of the insurance sector, which includes life and non-life insurance companies, takaful operators, insurance brokers, insurance surveyors and other intermediaries. It is responsible for policy reform, actuarial work, re-insurance treaty, facultative reinsurance approval, registration and de-registration. Its initiatives can be categorized into three areas, i.e. licensing/approvals, policy making and Policyholders complaints resolution and enforcement. The major achievements relating to the licensing/approvals and policymaking are given below.

Licensing/Approvals

1. Sixty new life insurance products and supplementary benefits, including group life insurance, group health insurance, individual health insurance and unit-linked insurance products were approved.

2. Second third-party administrator for health insurance was licensed due to which it is expected that the health insurance industry as well as the public at large will witness greater efficiency and better quality of health insurance services in the near future. It will also open more avenues for other investors to explore this untapped investment opportunity.

3. Two insurance companies were authorized/licensed to start their window takaful operations to capture greater share of the market by offering Sharia-compliant products for Islamic insurance market.

4. The licenses of 9 brokers, 370 surveying companies and authorized surveying officers were renewed.

Policy and Regulation Making

1. Draft Insurance Bill, 2016: As part of the project for strengthening the regulatory framework for insurance sector in Pakistan with the technical assistance of the World Bank, significant reforms were proposed to be introduced in the insurance regulatory framework. The Finance Minister reviewed the draft and directed the SECP to start stakeholder consultation. Subsequently, a concept note elaborating on significant reforms was shared with industry stakeholders in three roundtables conducted in Karachi, Lahore and Islamabad for the purpose of stakeholder consultation. Thereafter the draft Insurance Bill was formulated, which is proposed to replace the Insurance Ordinance, 2000. The Bill was placed on the SECP's website on December 29, 2016, to elicit public comments. The potential impact of this reform is to provide a conducive regulatory environment to encourage market development, alignment with ICP's of the International Association of Insurance Supervisors (IAIS), address entity specific and systemic risks by phased shift towards risk-based supervision (RBS) and risk-based capital (RBC) regime and the regulatory gaps in existing law.

2. Amendment to the Code of Corporate Governance for Insurers: The Code of Corporate Governance for Insurers was notified in 2016. The purpose of formulating a comprehensive corporate governance framework is to improve the governance of the insurance companies keeping in view the best international practices in the insurance sector.

3. Addition of Register for sharing Group Health Insurance Claims Experience in Centralized Information Sharing Solution for Insurance Industry (CISSII): An MOU was facilitated by the SECP between the insurance companies underwriting health insurance and the Central Depository Company of Pakistan on July 28, 2016. The SECP issued a regulatory directive on September 21, 2016, to insurance companies for notifying mandatory participation in the information sharing solution and start sharing information regarding group health claims experience from November 1, 2016. It is envisaged that this reform will improve underwriting and pricing practices as well as encourage healthy competitive environment in group health insurance business.

4. Amendments to Small Dispute Resolution Committees (Constitution and Procedure) Rules: In order to expedite and ensure amicable settlement of grievances of insurance policyholders, the Commission in 2015 formulated three Small Dispute Resolution Committees under these rules. The SDRC Rules have recently been amended to increase the pecuniary value of sum assured, increasing the jurisdiction of the three SDRCs, which shall bring a greater number of insurance policies/grievances within the ambit of the SDRCs for speedy settlement of complaints.

5. Draft Credit and Suretyship (Conduct of Business) Rules, 2016: In order to bring a mechanism for regulation of credit and suretyship business by insurance companies, the SECP issued Draft Credit and Suretyship (Conduct of Business) Rules, 2016. The draft rules are aimed at formulating a comprehensive framework to regulate the guarantee business, thereby ensuring maximum protection of the interests of insurance policyholders and gaining confidence of the public.

6. Unclaimed Dividends and Insurance Benefits and Investor Education and Awareness Fund (Amendment) Bill, 2016: A meeting to discuss the issues in respect of unclaimed dividends and insurance benefits and investor education and awareness fund (amendment) Bill, 2016, under chairmanship of Finance Secretary was held on August 17, 2016. As resolved in above meeting, the Insurance Division conducted consultation sessions with life, non-life insurers and PRCL on August 22, 2016, August 23, 2016, and September 1, 2016. On the basis of stakeholder consultation, the draft Bill was amended and forwarded to the Prosecution and Legal Affairs Division (PLAD) for its onward proceedings.

It is envisaged that these reforms will bring about substantial improvement in providing conducive environment to support market development and enhance policyholders' confidence.

Islamic Finance

Islamic Finance Department is responsible for creating regulatory framework for Sharia-compliant companies to ensure that they undertake their business activities in accordance with Shariah. The following are the measures taken by the department for the Islamic capital market:

1. Due to the vigorous efforts of the SECP with the support of FBR, tax neutrality for Sukuk vis-a-vis conventional instruments was achieved through an amendment to the Tax Ordinance on August 31, 2016.

2. A 2 percentage point tax rebate for Sharia-compliant listed manufacturing companies was introduced through the Finance Act, 2016. The Sharia-compliance criteria for benefiting from this tax rebate was notified. This tax rebate for qualifying listed manufacturing companies, along with tax neutrality for sukuk, shall facilitate the growth of Islamic capital market.

3. A holistic Sharia governance framework is being drafted under the enabling provision in the proposed Companies Bill. Completion and promulgation of this Sharia governance framework shall be a priority of the Islamic finance department in the coming year.

4. The SECP's Forum on Islamic Finance was established. It comprises representatives of industry. It is a consultative forum, which provides feedback on Islamic finance initiatives by the SECP.

5. Disclosure requirements for companies listed on PSX for the purpose of Sharia screening were included in the Companies Bill.

6. A meeting of Sharia Advisory Board (SAB) was held on July 29, 2016, in which two concept papers on Islamic financing products were reviewed for public listed companies and non-banking micro-finance Institutions along with comments of Mutual Funds Association of Pakistan on standardized offering document and trust deed for Islamic mutual funds.

7. Numerous offering documents, trust deeds and prospectus were reviewed in the context of Sharia compliance during the period under review.

Systemic Risk Department

Systemic Risk Department is responsible for monitoring, identification, analyses and managing the systemic risk by using various methodical approaches such as stress testing for the purpose of performance of its functions. The following are the key elements of the department:

1. Reducing system risk is one of the three objectives of securities' regulation along with protecting investors and ensuring that markets are fair, efficient and transparent. In 2016, systemic risk was formally included in the Securities and Exchange Commission Act of Pakistan (Amendment) Act, 2016, "to identify and address the factors resulting in systemic risk in the markets regulated by the Commission." Subsequently the Market Risk Wing under the Securities Market Division was turned into the Systemic Risk Department under the Chairman's office. Working closely with a cross functional committee of executive directors heading various departments, the department is now analyzing system issues across the SECP and sharing its analysis and recommendations with the Commission.

2. The initial focus of the department was on the clearinghouse of the stock market, National Clearing Company (NCCPL), which is at the heart of systemic risk in the capital market. One of the key risk management measures that needed to be placed at the NCCPL was daily stress testing to judge adequacy of resources available in extreme but plausible market conditions. Accordingly, the department studied local needs and international practices and after an elaborate analysis, a methodology to implement stress testing was developed.

3. As each investor in the stock market is assigned a unique identification number, which is mapped to every order placed by that investor, the department was able to come up with a detailed methodology to determine risk profile of each investor based on time-tested and logical principles. Details of the stress testing model were thoroughly discussed with the risk unit of the National Clearing Company, officials of the Central Depository Company (CDC), and a foreign consultant sponsored by USAID. Extensive testing of beta version is being conducted using sample data from the clearinghouse and further consultation on the methodology is also under way. Consultation on stress testing will remain an ongoing feature as our market structure and products will continue to evolve.

4. In addition to working on stress testing, the department has recommended many measures to reduce systemic risk at the NCCPL. One such measure pertains to margin eligible securities. The SECP has revamped the criteria to determine eligibility for listed shares pledged as collateral to the clearinghouse. The revised criteria take into account both financial strength of the company and the liquidity of the shares of the company. The revised criteria underwent a public consultation and it is being implemented by the NCCPL. The improvement in the eligibility criteria strengthens the management of risk because in case of a default by a clearing member, the clearinghouse will be better able to sell the margin securities.

5. In order to enhance investor protection from broker defaults, the SECP, at the recommendation of the department, has changed the account opening form so that the investors shall be encouraged to keep custody of their securities as well as their cash with either the CDC or NCCPL. This custodial arrangement ensures that investor's assets shall remain protected regardless of a broker default.

6. The SECP and SBP are also working on establishing a Council of Regulators to holistically address systemic risk and market stability across the financial sector. It is expected to become operational in the first half of 2017.

Enforcement Measures

The purpose for enforcement actions was to ensure meticulous compliance of the regulatory framework and to safeguard investors' interests. The idea was to deter any intentions of malpractices and violations of the regulatory framework by the regulated entities. The following enforcement actions were taken by the divisions:

Securities Market Division

1. A complaint was filed with the FIA regarding several social media accounts that were identified to have been spreading market rumors with the potential to cause loss to the public. The FIA in this regard took cognizance of the same. Furthermore, a brokers' watch list was developed to closely monitor vulnerable brokerage houses. A comprehensive review of the PMEX was carried out to ascertain compliance status of applicable regulatory framework. A raid at an illegal brokerage agent in Rahim Yar Khan was conducted. It was done with the assistance of law enforcement agencies and local civil administration. A comprehensive review exercise of segregation of client assets of a substantial number of brokers from Karachi, Lahore and Islamabad was initiated.

2. The SECP also conducted theme-based reviews to ascertain the brokers' compliance with respective regulatory framework in the area of trading by employees, internet-based trading, brokers' website maintenance, duplicate mobile number and email address against more than one trading accounts.

3. Thirty-seven enforcement actions were taken against brokers, beneficial owners of listed companies and chartered accountant firms for non-compliance with the regulatory framework while show-cause notices were issued to 42 entities for alleged violations of regulatory framework including non-filing of financial information online through Financial Reporting System (FRS) by the brokers. Proceedings in 23 were

concluded. A gain of Rs2.694 million made by beneficial owner of a listed company on purchase and sale, within a period of six months, was recovered and credited to Federal Consolidated Fund. Because of aforesaid enforcement actions and legal proceedings, the brokers have started filing financial information online through FRS.

4. Further, in order to facilitate the Brokers/TREC holders, the SECP has prepared a manual for filing the online quarterly financial information through financial reporting system. The manual is both in English and Urdu. It provides the instructional guidelines to the brokers/TREC holders to file their quarterly financial information with the SECP.

5. Fifty-nine adjudication recommendation notes were forwarded to the Adjudication Department for non-compliance with the requirements as laid down in the Pakistan Stock Exchange Rule Book, which included late disclosure of material information and violations of Book Building Regulations, 2015. Three criminal references were forwarded to Legal Department for involvement in the scheme of price manipulation, making false statement and non-cooperation with the investigation officers.

6. A comprehensive review of the CDC was also carried out to ascertain compliance status of applicable regulatory framework. Seven inspections of brokers were completed. NCB Guidelines were issued in September 2016, to clarify calculation methodology and disclosure requirements as intended under the relevant regulatory framework. The SECP arranged interactive sessions with the auditors on NCB. To enhance cooperation with other relevant agencies the SECP organized a training session of NAB officials regarding capital markets.

7. Letters under section 97 of the Securities Acts, 2015, were written to various companies to address abnormal price and volume in different scrips.

8. Ninety-nine brokers were reviewed for segregation of client assets to ensure fair dealings in securities markets.

9. Review of financing and lending provided by 27 brokerage houses to ensure compliance of respective rules and regulations.

10. Thematic review of trading by the employees of the brokerage houses conducted and cases forwarded to relevant department for necessary action.

11. Thematic review of Internet-Based Trading System under Internet Trading Regulations was conducted, and 13 cases were forwarded to the relevant department for necessary adjudication against those brokers who were found non-compliant with respect to the required regulations.

12. Websites of the brokerage houses were reviewed. This revealed that 326 brokerage houses were not maintaining functional websites or their websites were not fully compliant with the directive of the SECP.

13. A theme-based review was conducted to ascertain compliance with the CDC regulations. Accordingly, 54 cases were forwarded on account of same mobile number used against more than one account, to relevant department for necessary adjudication.

14. A theme-based review was conducted on account of same email against more than one account, to ascertain compliance with the CDC regulations. Accordingly, 40 cases were forwarded to relevant department for necessary adjudication.

15. A number of letters were issued to the non-filers of returns in the Financial Reporting System. Awareness and training sessions for the TREC holders on FRS in Islamabad, Lahore and Karachi were arranged. Fifteen cases were forwarded to the relevant department for necessary adjudication.

Company Law Division

16. Orders under section 231 of the ordinance were issued for onsite inspection of books and papers

of 4 companies out of which two were completed. Under activation drive, 1,570 companies were activated and revenue of Rs9.9 million was generated and notification u/s 439 in respect of 3843 companies was issued.

17. Nine non-operational listed companies gave firm commitments to restart operations as a result of active engagement with non-operational/ non-performing companies to provide relief to shareholders. Accounts of 152 companies, both listed and non-listed, along with other regulatory compliances, such as maintenance of website etc. examined. Ninety-two non-compliances requiring adjudication were identified and in 20 cases of minor defaults, warnings were issued. Forty-seven instances of non-filing or delay in filing of quarterly accounts and non-holding or delay in holding of AGMs by listed companies were identified. Moreover, investigation proceedings and inspections of books of accounts in 10 companies were initiated. Sixty-seven new show-cause proceedings were initiated, whereas, 52 proceedings were concluded with penalty/ warning. In addition, 39 applications for extension in time for holding AGM, withholding of dividends and holding of meeting in a place other than registered office were handled. Thirty-five stakeholders' queries were addressed and 187 complaints handled.

18. More than 400 proceedings were initiated related to various matters including non-compliance with legal obligations regarding auditors' report, quality of boards, abuse of directors' power, non-holding of annual general meetings, violations identified in issues of capital, investment in associated companies, misstatement of facts in the notices to shareholders and disclosure of directors' interest. Furthermore, the SECP strengthened its database for risk profiling of listed companies by including risk indicators such as non-payment of dividend during last five years, companies on defaulters' counter of the PSX, modified auditors' report and adverse financial leverage. The focus on the high risk companies, proceedings against directors, inspections/investigations and winding up of non-operational companies was reinforced.

Specialized Companies Division

19. Fifty offsite examinations of AMCs, mutual funds, pension funds, investment advisors, leasing companies, investment banks, REIT scheme and modarabas were performed. Inspections of four AMCs, having 45 mutual funds, were completed, while inspections of two AMCs having 41 funds are in progress.

20. Enforcement actions included 66 compliance letters and 12 warnings. Due to adverse financial condition, a direction was issued to an investment bank prohibiting it to raise fresh deposits in any form and not to repay/settle deposits of sponsors/directors/associated companies etc.

21. Snap checks of different AMCs were performed to assess compliance with requirements for charging of front-end load. As a result of the snap checks, three AMCs were found non-compliant and each one of them was penalized. Subsequently, a comprehensive thematic exercise was conducted for the mutual fund industry regarding the practices followed by AMCs with regard to compliance of Circular No. 23 of 2013 (regarding mis-selling of units) and Circular No. 26 of 2015 (regarding charging of front-end load). In a matter pertaining mis-selling of units of mutual funds, a penalty was imposed on the respective AMC. Similarly, malpractice with respect to charging of front-end load by an AMC was noted and the respective investors were subsequently refunded an amount of Rs19.865 million charged as front-end load by the AMC.

22. Standardized format of account statement for mutual funds and pension funds and modules for preserving information of key executives of the NBFCs and modarabas were developed. To further enhance effectiveness of supervision, checklists for evaluation of information systems during inspection and for monitoring compliance level of micro-NBFIs were developed.

23. Quarterly performance data of mutual funds and pension funds was compiled and placed

on SECP's website. Six sector reports were issued and their summaries were uploaded on the SECP's website on a monthly basis, for the information of investors and industry.

Insurance

24. Surprise visits of 62 branches/offices of 34 insurance/takaful companies were made to assess compliance with the requirements of Circular 5 of 2016 (Disclosure of awareness message about availability of complaint forums) and non-compliant entities were issued warnings.

25. Inspections of two insurance companies were completed. An investigation, on the basis of a complaint against an insurance company, was also completed while an investigation of another insurance company is in progress.

26. During the period under review, 25 show-cause notices and 21 orders imposing a fine of Rs1,236,000 against insurance companies were issued.

27. A total of 155 policyholder complaints were resolved by the Insurance Division during the period, providing compensation of Rs20.47 million to the aggrieved policyholders. Furthermore, 21 policyholder complaints were resolved by the Small Dispute Resolution Committees providing an aggregate compensation of Rs702,900 to insurance policyholders.

Future Roadmap

In its endeavor to pursue higher standards and grounds, the SECP has chalked out a future course of action for the next phase. Over the next few months, the following actions are envisioned for the growth and development of the corporate sector and capital market:

- Post-divestment of PSX shares, relevant regulations are being augmented to prescribe framework for self-listing and public offering of PSX shares, in accordance with requirements of demutualization law.

- Efforts will be made for centralization of KYC process through the establishment of a central repository of all KYC information for entire capital market, which will perform independent verification of such information. The rules for the said purpose were submitted to the Ministry of Finance.

- For development of the debt market, efforts will be made for the establishment of an independent bond pricing agency to provide fair valuations of debt securities based on comprehensive data collection, validation, pricing, and dissemination to the stakeholders. Rules for the same are in the process of finalization.

- Regulatory framework will be introduced to enable the CDC to offer services as a general/professional clearing member, to facilitate clearing and settlement of trades by trading-only brokers, to help achieve segregation of core brokerage functions.

- Various rules and regulations will be framed under the Futures Market Act, including regulations for futures brokers, futures exchange and clearinghouse etc.

- Efforts shall be made to bolster activity and introduce new products for derivatives and Islamic capital market. A committee of industry experts was constituted to suggest measures for activation of existing derivative products and launch of new products. Efforts are underway for activating exchange traded funds and possibility of introducing Sharia-compliant leverage products is being assessed in coordination with stakeholders.

- New rules and regulations will be issued, including laws relating to public offering and disclosures.

- The CRO Regulations will be amended to ensure smooth functioning of CROs to reflect present practices/procedures and to meet future requirements will be drafted.

- Framework for registration of consultants/intermediaries providing corporate filing services will be introduced.

- Facilitation to the public and company representatives will be provided on Saturdays.

- e-Services will be revamped to make them cost-effective, efficient and user friendly

- The modaraba regulatory framework will be amended to implement the original modaraba concept, resolve the funding issues and introduce the concept of unlisted modarabas for the growth of the sector. The new Modaraba Act is in the pipeline.

- VPS Rules will be amended to further empower the unitholders.

- Potential investors will be approached to increase the outreach and to highlight changes in the regulatory framework, which have been made for ease of doing business that have resulted in opportunities for them to invest in the financial sector.

- One hundred percent offsite review of all NBFCs will be carried out.

- Performance data of all mutual funds and pension funds will be compiled on a quarterly basis for uploading on the SECP's website.

- Thematic inspection of mutual fund industry regarding equity trading of funds will be conducted.

- A performance-based fee model for asset management companies will be developed.

- Guidelines for stress testing for income and money market funds will be developed.

- Insurance Bill, 2016, will be finalized.

- Draft Insurance Rules, 2016 (Merging of Insurance Rules, 2002 and SEC (Insurance) Rules, 2002) will be notified.

- The Insurance Accounting Regulations, 2016, will be prepared.

- The Reinsurance Broker Regulations, 2016, will be prepared.

- The Regulatory Requirement for Reporting of Family Window Takaful Operations by Life Insurers will be introduced.

- The Credit & Suretyship (Conduct of Business) Rules, 2016, will be notified.

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