



PICG ADVISORY UPDATE-12
June 2018

**GOVERNANCE, COMPLIANCE
& CORPORATE REPORTING**

The Update

Corporate governance refers to the way in which corporations are directed, administered, and controlled. It is concerned with both the relationship between internal and external stakeholders as well as the governance processes designed to help a corporation achieve its goals. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies as well as striking a balance between both economic and social goals and between individual and communal goals.

Compliance with applicable laws and regulations is fundamental to good governance. PICG's Advisory Update, therefore, aims at keeping our members updated with regards to the latest local and international governance-related changes to regulations, practices and corporate reporting.

The Update consists of a Summary Table (with links to relevant information) followed by a Synopsis of the changes.

A. Summary Table

Pakistan

Sr #	Issued by	Reference	Date	Topic / Update link
1. Regulations/ Rules issued				
i	SECP	SRO770 (I)/2018	June 13, 2018	Anti Money Laundering and Countering Financing of Terrorism Regulations, 2018
ii	SECP	SRO 769(I)2018	June 13, 2018	Draft Companies (Further Issue of Shares) Regulations, 2018
iii	SECP	SRO 768(I)2018	June 13, 2018	Draft Companies (Related Party Transactions & Maintenance of Related Records) Regulations, 2018
iv	SECP	SRO 758(I)2018	June 11, 2018	Draft Companies (General Provisions and Forms) Regulations, 2018
v	SECP	SRO733 (I)/2018	June 7, 2018	Associations with Charitable and Not for Profit Objects Regulations, 2018
vi	SECP	SRO731 (I)/2018	June 6, 2018	Employee's Contributory Funds (Investment in Listed Securities) Regulations, 2018
vii	SECP	SRO 696(I)2018	June 1, 2018	Credit and Suretyship (Conduct Of Business) Rules, 2018
2. Major Changes to the Code of Corporate Governance				

International

Topic	Links
Japan's Corporate Governance Code – revised	https://www.jpx.co.jp/english/rules-participants/public-comment/detail/d01/b5b4pj0000022v6o-att/20180601.pdf
Proposed Corporate Governance Principles for Large Private Companies- UK	The Wates Corporate Governance Principles for Large Private Companies

B. Synopsis of changes

Pakistan

1. Regulations/ Rules issued

Various Regulations/ Rules have been notified by the Securities and Exchange Commission of Pakistan and State Bank of Pakistan to streamline procedures and improve governance structures of companies in Pakistan.

Following is a summary of such Regulations / Rules (both drafts issued for public comments and final versions) issued during the past couple of months as notifications, circulars, drafts, etc., which have been placed on their respective websites:

a. Final

Sr. no	Name of Regulations / Rules	Effective date	Description
1	Securities & Exchange Commission of Pakistan (Anti Money Laundering & Countering Financing of Terrorism) Regulations, 2018	June 13, 2018	<p>The regulations supersede all earlier circular/notifications which had separate anti money laundering (AML) and countering financing of terrorism (CFT) requirements for financial institutions regulated by the SECP, namely Securities Brokers, Insurance Companies, NonBanking Finance Companies and Modarabas, with the aim to harmonize the AML/CFT regime.</p> <p>The Regulations are fully compliant with the Financial Action Task Force’s (FATF)¹ recommendations, which are mandatory for Pakistan to adopt as a member of the Asia Pacific Group on Money Laundering.</p> <p>The focus of the regulations has been enhanced towards high-risk areas and taking a risk based approach towards combating money laundering and financing of terrorism. High-risk categories include politically exposed persons (PEPs), legal persons and legal arrangements with complex ownership structures and not for profit organizations</p> <p>Simplified due diligence has been introduced for low risk customers (eg. customers dealing in pension schemes, limited services financial products and insurance products with annual premium of Rs. 100,000 or a single premium of Rs250,000), allowing such customers to avail services of financial institutions with relative ease.</p> <p>In order to ensure that criminals are not able to hide their identity through use of complex ownership structure of companies, partnerships, trusts or other similar forms, the financial institutions are required to identify the ultimate beneficial owner, who is a natural person, of all legal persons and legal arrangements before offering their services to them.</p> <p>Financial institutions shall carry out self-risk assessment relating to money laundering and terrorist financing risks faced by them to enable them to implement internal control measures that commensurate with their risk profile.</p>

¹ The Financial Action Task Force (FATF) is an inter-governmental body established in 1989 by the Ministers of its Member jurisdictions, with headquarters in Paris, France. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. The FATF is therefore a “policy-making body” which works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas.

		Other new provisions cover correspondent relationship between Pakistani financial institutions and their foreign counter parts, assessment of money laundering risks of any new product or technology before its launch, implementation of AML/CFT controls at financial group level and AML/CFT requirements for foreign branches and subsidiaries of Pakistani financial institutions.
2	Associations with Charitable and Not for Profit Objects Regulations, 2018	<p>The regulations specify procedure for grant of license to associations with charitable and not for profit objectives, incorporation of association as a public limited company, conditions applicable to such companies, fit and proper criteria for the promoters, members, directors and chief executive officer, provision for revocation of license and subsequent transfer of assets to another company licensed under section 42 of the Companies Act, 2017 (Act) and monthly reporting requirements.</p> <p>The regulations require that the company licensed under section 42 of the Act shall utilize all its money, property, donations or income or any part thereof solely for promoting its objectives, and no portion thereof shall be distributed by way of profit to the members of the company or their close relatives. The limit of liability for each of its members shall not be less than Rs100,000 and each promoter shall undertake to donate a reasonable amount of not less than Rs200,000 as a start-up donation. The company shall also ensure compliance with the conditions prescribed in relation to anti-money laundering and counter financing of terrorism under the applicable laws.</p> <p>All the existing companies licensed under section 42 of the company law are required to immediately comply with all the requirements of the regulations.</p>
3	Employee's Contributory Funds (Investment In Listed Securities) Regulations, 2018	<p>The Companies Act, 2017, enhanced the scope of investment out of various contributory funds, instead of just provident fund, which necessitated the notification of these regulations to improve the safety regime for employees contributing to various contributory funds while keeping in view the growth perspective of the return on such funds. Previously, the employees' contributions were regulated under the Employee's Provident Fund (Investment in Listed Securities) Rules, 2016.</p> <p>With continuous innovation in equity and debt markets and development of new products by non-banking finance companies for better returns, contributory funds now have better choices available in the market. As risk and return go hand in hand, the regulations have been issued with a view to protect the hard-earned money of employees' by prescribing requirements regarding investment out of contributory funds maintained by the companies.</p> <p>Three separate asset classes have been introduced, i.e. money, debt and equity market. Sector-wise investment limits have also been introduced along with security-wise limits on investments other than investment through collective investment schemes. The assigned minimum rating of AA on bonds, redeemable capital, debt securities or instruments issued by a statutory body or listed debt securities has also been reduced/ revised to A instead of AA.</p> <p>In addition, trusts or funds ought to amend the trust deed and include a clause providing one time option to new employees to either allow or not allow the fund or the trust to make any investment out of their contributory fund or trust under these regulations.</p>

3	Credit and Suretyship (Conduct Of Business) Rules, 2018	June 1, 2018	<p>Insurance companies may now issue contracts of guarantees/bonds including fidelity bonds, custom bonds, bid bonds, mobilization advance guarantee, administration bonds and payment bonds to a party or a group. Under the said rules, "insurer" means a non-life insurer who is registered under the Insurance Ordinance.</p> <p>The SECP has also set a limit on the net retained exposure under any type of guarantee/bond issued by the insurer to a party or a group (ie. not in excess of 2.5 % of shareholders' equity as per the latest available audited accounts of the insurer on the date of issuance of a guarantee/bond) Subject to the limit prescribed, an insurer shall procure collateral in case of guarantees/bonds upto the amounts specified by SECP.</p> <p>The guarantee/bonds issued shall not be construed as bank guarantees issued by commercial banks and such guarantees/bonds shall be claimable in accordance with the terms and conditions provided in the contract of guarantee in which such disclaimer shall be stated. Every guarantee/bond issued by an insurer shall explicitly state the date of expiry of that guarantee/bond, and the sum insured/amount of guarantee/bond shall be capped, which shall also be explicitly stated in the guarantee/bond contract.</p>
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b. Drafts issued

Sr. no	Name of Regulations / Rules	Public comment deadline	Description
1	Draft Companies (Further Issue of Shares) Regulations, 2018	June 27, 2018	<p>The draft regulations aim to streamline all legal and procedural requirements for issue of further capital, optimum disclosures by companies to all stakeholders and protecting the rights of shareholders.</p> <p>Currently, companies issuing shares by way of right issue, bonus issue, other than right, shares having differential rights & privileges, shares at discount or employee stock option schemes are required to comply with the requirements of the Companies Act, 2017. However, for right issue and bonus issue by listed companies, compliance with applicable requirements of Companies (Issue of Capital) Rules, 1996 and Guide on issue of shares otherwise than right is mandatory, in addition to the requirements of the Act. Likewise, companies issuing different kinds of shares with varied rights and privileges are required to comply with the requirements of the Act and Companies' Share Capital (Variation in Rights and Privileges) Rules, 2000, and public companies issuing Employee Stock Option Scheme are required to comply with the requirements of the Public Companies (Employees Stock Option Scheme) Rules, 2001 and Guidelines for the Structuring and Offering of the Employees Stock Option Schemes, 2016.</p> <p>In addition to the above, companies are required to comply with certain directives, periodic disclosure and reporting requirements. Hence, the SECP has notified these draft regulations with a view to consolidate relevant requirements of the Act, varied directives and specify certain additional conditions/ requirements.</p>

	<p>Draft Companies (Related Party Transactions & Maintenance of Related Records) Regulations, 2018</p>	<p>June 27, 2018</p>	<p>The regulations highlight the approval process for related party transactions (RPTs), the responsibility of the Board, records to be maintained of RPTs and contracts or arrangements in which directors are interested as well as other information to be disclosed by directors.</p> <p>The regulations also require that the board of directors of companies ensure that they educate and train their directors and relevant employees so that they can identify and report RPTs to the board or other authorized persons.</p> <p>The regulations specify the minimum parameters that the policy approved by the board for RPTs shall have, namely:</p> <ol style="list-style-type: none"> maximum limits for RPTs for a year for each class of transactions; minimum information required including nature of related party relationship at the time of approval; limitations/conditions applicable in case of certain/particular RPTs; potential risks of RPTs and mitigating measures; procedure to be followed for reporting failure to place RPTs for approval by the appropriate forum within prescribed time; and pricing policy. <p>Further, the regulations provide the conditions for a transaction with related parties to be characterized as an “arm’s length transaction”, ie. only if it is carried out in a way, as if:</p> <ol style="list-style-type: none"> the parties to the transaction were unrelated in any way; the parties were free from any undue influence, control or pressure; through its relevant decision-makers, each party was sufficiently knowledgeable about the circumstances of the transaction, sufficiently experienced in business and sufficiently well advised to be able to form a sound judgement as to what was in its interests; and each party was concerned only to achieve the best available commercial result for itself in all the circumstances. <p>As per Regulation 4(2), “RPTs entered into by a company in its ordinary course of business on an arm’s length basis shall not be subject to the policy of the company for RPTs”.</p>
<p>2</p>	<p>Draft Companies (General Provisions & Forms) Regulations, 2018</p>	<p>June 25, 2018</p>	<p>The SECP has issued 40 different forms and returns to be filed by the corporate sector covering areas such as submission of requisite documents, annual returns, altered memorandum and articles of association and returns of transfer of shares, etc by way of these draft regulations.</p> <p>Regulation 4 provides a table stating the Form name, description and section/ regulation reference for each form.</p> <p>Under the new filing procedure, the SECP said that any form, return, application, document or report required to be filed or lodged by a company under any provision of the Companies Act or these regulations shall be filed or lodged online either through E-service or in physical form to the Commission or the registrar, through authorized intermediary or authorized officer; and signed and verified by the authorized intermediary or authorized officer, along with relevant fee stated in the Act.</p>

2. Major Changes to the Code of Corporate Governance

With the issue of the revised Code by way of the Listed Companies (Code of Corporate Governance) Regulations, 2017, notified via SRO 1216 (I)/2017, dated November 22, 2017, various changes were brought about. In this regard, we are bringing your attention to a couple of the major changes that we feel companies should be aware of to ensure compliance with all factors of the code:

The SECP issued regulations specifying the manner and procedure for selection of independent directors from a databank, and in January 2018 notified that the Pakistan Institute of Corporate Governance (PICG) would be responsible to maintain such databank of independent directors.

We are pleased to inform you that the databank of independent directors is now functional.

All individuals who have attended a Directors Training Program (DTP) (not necessarily only at PICG), will be invited by PICG to input their details and/or CV in the database, the access of which shall be given to companies for appointment purposes after receiving authority to do so from the respective individuals. Further, those claiming exemption from attending such DTP based on their qualification and experience are now required under the new Code to obtain approval from SECP subject to the provision of relevant details and a specified fee (ie. Rs 500,000 as per SRO 228(I)/ 2018 dt February 8, 2018).

Companies are encouraged to ensure that all directors on their boards are compliant with the relevant regulations.

As per **Regulation 10(3)(v)** regarding 'responsibilities of Board of Directors and its members' under the Listed Companies (Corporate Governance), Regulations 2017:

'a formal and effective mechanism is put in place for an annual evaluation of the board's own performance, members of board and of its committees;

Hence, a formal board performance evaluation process should be in place including the evaluation of committees as well as individual directors. Companies are free to undertake this internally or may find it preferable to engage external consultants to facilitate the process.

External and third party facilitation is independent from the company and provides transparency to the process, demonstrating a board's commitment to accountability and also helps bring an objective viewpoint to lead the board to an understanding of the issues to be resolved and can diagnose the root cause of the performance problem. It is designed to facilitate open and honest review of the board's workings rather than to point finger of blame.

PICG has been assisting companies undertake board performance evaluations since 2013. We offer online assessments which are customized in accordance with the Listed Companies (CG) Regulations, 2017 and SBP guidelines on Board Performance evaluation for banks. We also assist, develop and review internally designed board performance evaluation questionnaires for companies.

a. Japan's Corporate Governance Code - Revised

Japan has revised its Corporate Governance Code, marking the Code's first update since the Financial Services Agency (FSA) and the Tokyo Stock Exchange, Inc. (TSE) introduced the original version in 2015. The TSE has partially revised the Securities Listing Regulations pertaining to the revision of Japan's Corporate Governance Code with effect from June 1, 2018. The FSA of Japan is responsible for ensuring the overall stability of the financial system in the country and protecting the users of financial instruments and services, such as depositors, insurance policy holders, investors and the like; and facilitating the smooth function of financial services.

The Corporate Governance Code establishes fundamental principles for effective corporate governance for listed companies in Japan. It is expected that the Code's appropriate implementation will contribute to the development and success of companies, investors and the Japanese economy as a whole through individual companies' self-motivated actions so as to achieve sustainable growth and increase corporate value over the mid- to long-term.

The changes to the Code -- which focus on unwinding cross shareholdings, broader adoption of compensation and nomination committees, and greater diversity on boards -- are important steps in moving Japan closer to global governance practices. Companies are told to be aggressive, and should go beyond the recommended two and appoint "a sufficient number" of independent directors if deemed necessary. The Code also encourages companies to take into consideration such factors as "gender and international experience" and appoint more women and non-Japanese on their Boards.

The revised code also has recommendations for reforming corporate leadership. It calls for transparent and fair procedures on the appointment and dismissal of senior management, including CEOs.

The previous document asked companies to disclose their cross-shareholding policy, but the new version goes a step further by urging companies to disclose plans for reducing such arrangements with banks and business partners and annually evaluate whether each cross-shareholding is still appropriate based on its benefits and risks.

On business strategies and plans, companies have been asked to provide "clear and logical" explanations to shareholders on the allocation of management resources by reviewing their business portfolio and investments in fixed assets, R&D, and human resources.

b. Proposed Corporate Governance Principles for Large Private Companies- UK

The Financial Reporting Council, on behalf of James Wates CBE, has published a consultation on corporate governance principles for large private companies (the Principles), open to public comment for 12 weeks. The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the competent authority for audit in the UK the FRC also sets auditing and ethical standards and monitors and enforces audit quality.

In January 2018, The Department for Business, Energy and Industrial Strategy (BEIS) appointed James Wates CBE as Chairman of a Coalition Group, comprising members from the FRC, British Private Equity and Venture Capital Association, the Climate Disclosure Standards Board, the Confederation of British Industry, ICSA: the Governance Institute, the Institute of Business Ethics, the Institute of Directors, the Institute for Family Business, the Investment Association, and the Trades Union Congress. The Coalition Group was established to develop a voluntary set of corporate governance principles for large private companies.

Development of the principles follows the Government’s 2016 Green Paper and the BEIS Select Committee’s report of April 2017 which considered the need for improved transparency and accountability in this area. The 2016 Green Paper investigated the role of corporate governance in large private companies and asked whether such companies should meet minimum corporate governance reporting standards. It observed that the declining trend in the number of publicly listed companies coincided with an increase in the number of private companies, which were excluded from the levels of public scrutiny and corporate governance to which many public companies were subject.

The aim to finalise them for publication in December 2018 to align with the introduction of the Government’s new reporting requirement contained within The Companies (Miscellaneous Reporting) Regulations 2018 which were laid before Parliament on 11 June 2018.

The Principles comprise six high-level principles, accompanied by guidance notes. They are based on some of the key principles of the revised UK CGC, but are framed in more general and flexible terms. The six principles are:

Purpose - An effective board promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose.

Composition – Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company.

Responsibilities – A board should have a clear understanding of its accountability and terms of reference. Its policies and procedures should support effective decision-making and independent challenge.

Opportunity and risk – A board should promote the long-term success of the company by identifying opportunities to create and preserve value, and establishing oversight for the identification and mitigation of risks.

Remuneration – A board should promote executive remuneration structures aligned to the sustainable long-term success of a company, taking into account pay and conditions elsewhere in the company.

Stakeholders – A board has a responsibility to oversee meaningful engagement with material stakeholders, including the workforce, and have regard to that discussion when taking decisions. The board has a responsibility to foster good stakeholder relationships based on the company’s purpose.

The Wates Principles will be voluntary but companies that choose to adopt them are expected to follow an “apply and explain” approach, whereby they apply all of the six principles and clearly explain how their governance practices achieve the outcomes embedded in the principles.

“Corporate Governance” means a structure for transparent, fair, timely and decisive decision-making by companies, with due attention to the needs and perspectives of shareholders and also customers, employees and local communities.

- Japan’s Corporate Governance Code

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<http://picg.org.pk/publications/>



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- o Company Secretarial Teams
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KARACHI

01 - 02

AUGUST, 2018

TRAINING INVESTMENT

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Discounted price for PICG
members Rs. 100,000/-

Link to register:

<https://goo.gl/forms/WzSxUHDDJA0ge19z2>

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