



PICG ADVISORY UPDATE- 18
December 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 #	By	Reference	Date	Topic / Update link
1. Amendments				
i	SECP	SRO 1571(I)/2018	Dec 26, 2018	Draft amendments to the Credit Rating Companies Regulation, 2016
ii	SECP	SRO 1521(I)/2018	Dec 14, 2018	Amendments to the Intermediaries (Registration) Regulations, 2017
iii	SECP	SRO 1473(I)/2018	Dec 4, 2018	Amendments to the Real Estate Investment Trusts Regulations, 2015
2. Circulars				
i	SECP	Circular No 24 of 2018	Dec 27, 2018	Guidelines on Grievance Redressal System in Non-Bank Microfinance Companies
ii	SECP	Circular No 23 of 2018	Dec 27, 2018	Regulatory Requirements for the Branches of Non-Bank Microfinance Companies
3. Directive				
i	SECP	SRO 1525(I)/2018	Dec 14, 2018	Additional Fit and Proper Criteria for Sponsors and Beneficial Owners of the Insurance Sector

Sr #	Issued by	Reference	Date	Topic / Update link
4. Others				
i	SECP	SRO 1570(I)/2018	Dec 26, 2018	Independent Directors Databank for Overseas Pakistanis

International

Topic	Links
New Corporate Governance Principles for Private Companies launched - UK's Financial Reporting Council (FRC)	The Wates Corporate Governance Principles for Large Private Companies - Feedback Statement
Report Analyzing Trends in Corporate Governance and Executive Compensation Disclosure in Proxy Filings at the 500 Largest U.S. Public Companies	Corporate Governance Outlook 2019

B. Synopsis of changes

Pakistan

1. Amendments

a. Draft Amendments in the Credit Rating Companies Regulation, 2016

The Securities and Exchange Commission of Pakistan (SECP) has proposed amendments to the Credit Rating Companies Regulation, 2016 to strengthen regulations for credit rating companies.

SECP has now such companies to select independent directors from the data bank of independent directors notified under the Companies Act, 2017. The company shall choose a minimum of two names from the data bank and submit them to the SECP for its approval. The credit rating company shall ensure that such persons are selected from relevant diverse fields of work with appropriate qualification and experience.

The SECP has also made it mandatory for the credit rating agencies to ensure that a periodic or annual review of all policies and assessment of overall level of compliance of the credit rating company is carried out by the internal audit department which reports directly to the board of directors or its audit committee; or through outsourced firm of chartered accountants which has been assigned a satisfactory quality control review rating by the Institute of Chartered Accountants of Pakistan.

Further, amendments were made regarding disclosure of private ratings to the public in certain cases.

b. Intermediaries to ensure AML/CFT Due Diligence

The SECP has amended the Intermediaries (Registration) Regulations, 2017, in the light of recommendations made by the Financial Action Task Force (FATF), an intergovernmental body formed to coordinate efforts on anti-money laundering and countering financing of terrorism (AML/CFT).

Under the Anti Money Laundering Act, 2010, company service providers (Intermediaries) must ensure compliance with the AML/CFT regime, and are obligated to conduct customer due diligence and report suspicious transactions to the Financial Monitoring Unit. So far, 193 intermediaries have been registered with the SECP and listed on its website.

Further, Intermediaries, shall ensure that their clients are not involved in suspicious activities, implying money laundering or terrorist financing and shall also make sure that the client is not placed on the United Nations Security Council's (UNSC) list of designated persons or entities linked to terrorist financing or against whom a ban, sanction or embargo subsists.

c. Amendments to the Real Estate Investment Trusts Regulations, 2015

The SECP has revised the regulatory framework of Real Estate Investment Trusts (REITs) by introducing significant amendments to the REITs Regulations, 2015, with an aim of providing a more conducive regulatory environment for the establishment of a formal real estate sector in the country.

The regulatory framework for Real Estate Investment Trusts (REITs) was introduced in 2008, and then revised in 2010 and 2015, whereby some of the requirements such as capital of the REIT Management Company (RMC), size of REIT scheme and units to be held by a single investor, were relaxed to encourage

launch of REIT schemes. In spite of these improvements, only one REIT scheme was launched mainly because the requirements for setting up a REIT scheme were considered stringent by the industry.

Hence, to promote investment in real estate through the capital market, SECP has approved various amendments after a comprehensive review of the regulations, primarily focusing on simplified regulatory requirements, unitholders' protection and industry dynamics.

The amendments include the concept of private investors along with eligibility criteria to invest in REIT scheme; introduction of grace period for mandatory listing; requirement of valuation from two separate valuers at the time of transfer of real estate to REIT scheme; enhancing RMCs capacity to borrow and issuance of right units.

In case of major decisions pertaining to REITs, the requirement of unitholders' approval has also been prescribed to protect their interest and enhance their role and participation in the decision making process.

2. Circulars

a. Guidelines on Grievance Redressal System In Non-Bank Microfinance Companies (NBMFCs)

The SECP has issued guidelines for Grievance Redress System (GRS) in Non-Bank Microfinance Companies (NBMFCs) to facilitate and guide the NBMFCs on effective and efficient resolution of clients' complaints and protection of their interests. In this regard, the NBMFCs have been directed to exercise extra care while dealing with complaints of illiterate, old age or physically handicapped complainants by ensuring that the understanding capacity of these persons is given ample weightage while deciding on a complaint.

Consequently, the NBMFCs are required to put in place a complaint handling policy and detailed procedures to deal with clients' complaints, duly approved by the board. Further, a key executive shall be designated to look after the complaint handling mechanism which should be visible and easily accessible to all customers, in the hope that this will not only increase customer satisfaction but will also reduce operational and reputational risk of the NBMFC. The NBMFCs are required to ensure that the complaint handling function works independently and has adequate powers and resources.

The complaint handling system should be designed to capture all complaints data for analysis, with information including total number of complaints, complaint grouping by product type, information on resolution times and themes. The analysis report should be shared with the management/board on an annual basis to carve out a plan for the betterment of the complaint management system, reductions in incidence of complaints and bringing about improvements in products, services, processes and delivery channels. The internal complaint handling mechanism of NBMFCs should be subject to internal audit at least annually and any deviation or non-compliance of internal procedures as well as legal /regulatory requirements should be recorded and reported to board of directors.

b. Regulatory Requirements for the Branches of Non-Bank Microfinance Companies

The SECP has also specified the following requirements for compliance by branches of NBMFCs by the end of February 2019:

- (i) Appropriate display of certificate of incorporation and valid license issued by the SECP to conduct the business of microfinancing
- (ii) Properly trained staff/ human resource

- (iii) Security arrangements for the safety of documents and staff
- (iv) Proper client support for filling up of applications and completion of documentation
- (v) Grievance redressal system/ mechanism for prompt and effective resolution of clients' complaints (details given above)
- (vi) Product information relating to various products being offered by the NBMFC at the branch through printed brochures for the information of potential/ existing clients. Both the circulars are available on SECP's website at <http://www.secp.gov.pk>

3. Directive

a. **Additional Fit and Proper Criteria for Sponsors and Beneficial Owners of the Insurance Sector**

The SECP has issued a directive for companies in the insurance sector to comply with additional fit and proper criteria (in addition to requirements notified either through rules, regulations or through other legislative instruments) in order to obtain information about sponsors, promoters and major shareholding of insurers and insurance intermediaries¹, which would now also include shareholding details, including details of ultimate beneficial owners.

The SECP has directed the insurers and insurance intermediaries to submit, at the time of their incorporation, undertaking duly signed by the sponsors, promoters and their ultimate beneficial owners that they have not been convicted in criminal breach of trust, fraud, offences of money laundering, including predicate offences as provided in the AML Act, 2010, or contravened any provision of SECP-AML/CFT Regulations, 2018, or any other AML/CFT requirements notified by the SECP.

In addition, an insurer shall also submit an undertaking, duly signed by the proposed directors or chief executive or principal officer of the insurer and an affidavit on an annual basis that its key officers, have not been convicted in criminal breach of trust, fraud, offences of money laundering.

Moreover, insurance brokers at the time of seeking approval for issuance of license in terms of the Insurance Rules, 2017, shall submit to the SECP an undertaking duly signed by the proposed directors or chief executive, principal officer and key officers of the insurance brokers regarding non-involvement in money laundering related offences as mentioned above.

The insurer during the execution of various processes relating to insurance policies (including but not limited to the issuance, underwriting, endorsement, withdrawal, claim, or maturity) shall ensure that there is no conflict of interest of the insurance intermediaries with any terms of the AML/CFT requirements notified by the SECP.

It has also been specified that at the time of acquisition of a shareholding, or any part in case of nonlife insurer, of more than 10% in an insurance company, the acquirer(s) or the authorized person in case of the corporate entity shall submit an undertaking that the acquirer/beneficial owners have not been convicted in criminal breach of trust, fraud, offences of money laundering, etc

Any person who contravenes or fails to comply, or submits an affidavit which is false, or where under a misstatement is made, shall be liable to a penalty under Section 40A of the SECP Act, 1997 which may extend to Rs 10 million and where contravention is a continuing one, with a further penalty which may extend to Rs 1 lakh for every day after the first during which such contravention continues.

¹ The term 'Insurance Intermediary' includes insurance agent, corporate insurance agent, insurance surveyor, insurance broker and third party administrator (for health insurance).

4. Others

a. Independent Directors Databank for Overseas Pakistanis

Section 166 of the Companies Act 2017, the SECP has prescribed the manner of selection of independent directors and maintenance of a databank of independent directors. In this regard, in addition to PICG, the SECP has now also authorized the Overseas Pakistani Foundation (OPF) of the Ministry of Overseas Pakistanis & Human Resource Development, Government Of Pakistan, to create and maintain databank of independent directors and post such data on its website for use by the company making the appointment of such directors.

The responsibility of exercising due diligence before selecting a person as an independent director from any data bank shall lie with the company or the Government, as the case may be, making such appointment.



International

a. New Corporate Governance Principles for Private Companies – FRC, UK

The UK's Financial Reporting Council (FRC) has published the final version of the new corporate governance principles, also known as the Wates Principles², for private companies and each principle is supported by guidance to companies. The principles aim to help companies comply with new corporate governance disclosure requirements introduced in June 2018, under the Companies (Miscellaneous Reporting) Regulations 2018. These apply for accounting periods starting on or after 1 January 2019 to all UK-incorporated companies with more than 2,000 employees, or a turnover of more than £200 million and a balance sheet of over £2 billion, assessed for the individual company rather than on a consolidated basis. It does not apply to listed companies that are already subject to similar legal corporate governance requirements.

The Companies (Miscellaneous Reporting) Regulations 2018 states:

26. (1) The directors' report must include a statement (a "statement of corporate governance arrangements") which states:

- a) which corporate governance code, if any, the company applied in the financial year,
- b) how the company applied any corporate governance code reported under sub-paragraph (a), and
- c) if the company departed from any corporate governance code reported under sub-paragraph (a), the respects in which it did so, and its reasons for so departing.

(2) If the company has not applied any corporate governance code for the financial year, the statement of corporate governance arrangements must explain the reasons for that decision and explain what arrangements for corporate governance were applied for that year.

The six principles are:

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

Board 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.

Board Responsibilities - The board and individual directors should have a clear understanding of their accountability and responsibilities. The board's policies and procedures should support effective decision-making and independent challenge.

Opportunity and Risk - A board should promote the long-term sustainable 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 long-term sustainable success of a company, taking into account pay and conditions elsewhere in the company.

Stakeholder Relationships and Engagement - Directors should foster effective stakeholder relationships aligned to the company's purpose. The board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions.

² The Wates Principles were drawn up by a coalition established by the FRC and chaired by James Wates, who heads a large UK private construction company

There is no obligation on companies to adopt these principles but the intention is that the Wates Principles provide an approach to corporate governance that offers sufficient flexibility for a diverse range of companies without being too prescriptive. A company which chooses to adopt the Wates Principles should follow them using an “apply and explain” approach in a way that is most appropriate for their particular organisation. Boards should be able to explain, in their own words, how they have addressed each of the principles in their governance practices.

Large companies will also have to provide greater detail than before about how they engaged with employees and will also have to explain for the first time how they have engaged with suppliers, customers and others in a business relationship with the company.

The principles come into force on 1 January 2019, at the same time as the new UK Corporate Governance Code. Companies will have to provide a supporting statement explaining how corporate governance policies and processes operate to achieve the desired outcome for each principle.

b. Corporate Governance Outlook 2019

The Corporate Governance Outlook 2019, an Equilar publication, co-authored by Hogan Lovells (an international law firm) and Donnelley Financial Solutions (a risk and compliance solutions company) to provide context and insight on public companies’ approaches to governance issues and communications with shareholders through proxy statements and other channels.

Proxy statements and shareholder voting results for Equilar 500³ companies from 2014 to 2018 were analyzed to examine corporate governance and executive compensation disclosure in proxy filings. The report reviews the recent trends in governance and disclosure practices and provides a look ahead as to what may come in 2019 with respect to shareholder engagement, CEO Pay Ratio, Say on Pay, board evaluation, mandatory retirement ages for directors, and other corporate governance trends.

According to the report, proxy disclosures are likely to follow three major trends which are receiving intensifying focus from investors. These trends are primarily driven by investor engagement and input, as opposed to new regulatory requirements:

- **Intensifying focus on gender and other aspects of diversity in the boardroom:** This topic extends beyond the current snapshot of board composition, and includes ongoing processes and practices that will shape the evolution of a board. Investors are increasingly becoming more proactive, and companies are becoming more transparent on several issues including: how a board’s skill set meets the company’s current and foreseeable strategic needs, structure and results of a board’s evaluation and recruitment processes, board oversight of a growing array of risks, and board governance over ESG matters.
- **Correlation between executive compensation and company strategy:** Investor interest has evolved past ensuring an alignment of pay outcomes with performance. Today, investors are encouraging companies to communicate how its pay program supports the business strategy, and, if that strategy is evolving, how the pay program (vehicles, metrics, weightings, etc) is evolving concurrently.
- **Closing the information gap on ESG/CSR issues:** Investors are seeking quantitative, decision-useful information about what is relevant and material to any particular company, in order to make key decisions. Currently, an information gap between what companies are disclosing and what investors are seeking exists.

³ The Equilar 500 is an index composed of the largest companies by revenue trading on one of the major U.S. stock exchanges—NYSE, Nasdaq or NYSE American (formerly AMEX)—adjusted to approximate the industry sector mix of similar large-cap indices.

The most critical function of the Board of Directors relates to their financial stewardship that underpins the success of any company. In order to enable the directors to discharge their functions and fulfill their statutory obligations, it is essential that all members of the Board are familiar with financial concepts, are able to analyze financial aspects of reports, understand financial performance, review and approve investment decisions. To promote better governance by increasing financial awareness in Directors and Senior Managers, who do not have a financial background, PICG is pleased to organize a workshop Finance for non-Finance Directors & Senior Managers.

Training investment: Rs. 30,000/-
Discounted price for PICG members: Rs. 25,000/-

Prices are exclusive of any taxes that may be levied on this or other services. PICG reserves the right to recover all or part of these.

Participants of this workshop will be better able to:

- Understand the accounting environment & basic accounting assumptions
- Review the financial statements, its components and financial relationships
- Assess business performance in terms of liquidity and profitability
- Discuss current local regulatory requirements and international best practices
- Assess and approve investment decisions
- Understand Company valuations and business acquisitions

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FINANCE FOR NON FINANCE DIRECTORS AND MANAGERS

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