Feb 2019

PICG ADVISORY UPDATE -20

Pakistan Institute of Corporate Governance

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.	**Directive**			
i	SECP	SRO 245 (I)/2019	Feb 22, 2019	Anti Money Laundering - Reporting for Regulated Persons
2.	**Circular**			
i	SECP	Circular No 3 of 2019	Feb 25, 2019	Temporary Relaxation/Exemption on Appointment of Female Director on Boards for Listed Companies
3.	**Guidelines**			
i	SECP	Guideline	Feb 12, 2019	Frequently Asked Questions (FAQs) on Ultimate Beneficial Ownership
4.	**Others**			
i	SECP	Press release	Mar 11, 2019	Pakistan Report on Observance of Standards and Codes (ROSC) on Corporate Governance
ii	SECP	SRO 229 (I)/2019	Feb 14, 2019	SECP defers applicability of IFRS 9

International

Topic	Links
OECD's report on insights into the state of digital transformation	Measuring the Digital Transformation
OECD's report on Social Institutions and Gender Index (SIGI)- Transforming Challenges into Opportunities	SIGI 2019 Global Report
ASX Corporate Governance Council's Principles and Recommendations- Australia	Corporate Governance Principles and Recommendations- Australia

"Gender equality is more than a goal in itself. It is a precondition for meeting the challenge of reducing poverty, promoting sustainable development and building good governance"

- Kofi Annan

B. Synopsis of changes

Pakistan

1. Directive

a. Anti Money Laundering - Reporting for Regulated Persons

In order to combat Anti Money Laundering (AML), the Securities and Exchange Commission of Pakistan (SECP) issued various regulations and guidelines such as:

- SECP (Anti Money Laundering and Countering Financing of Terrorism) Regulations, 2018 in June 2018 upon recommendation of Financial Monitoring Unit requiring all Regulated Persons(RP's)[1] to:
  - conduct self-risk assessment,
  - have appropriate mechanisms to provide the risk assessment information to the SECP, and
  - ensure implementation of targeted financial sanctions under the United Nations Security Council Resolutions, adopted by the Government of Pakistan, and
  - refrain from forming business relationship with proscribed persons and entities under the Anti Terrorism Act, 1997 and related matters.

- Guidelines for implementation of AML /CFT framework as contained in the Regulations in September, 2018 for assistance and guidance of RP's. The Guidelines supplement the Regulations and the AML/CFT regime by clarifying and explaining the general requirements of the AML Law to help RP's in applying AML/CFT measures, developing an effective AML/CFT risk assessment and compliance framework suitable/compatible to their business, and in particular, in detecting and reporting suspicious activities. The Guidelines also contain four (4) detailed Annexures which provide:
  - guidance for preparing AML/CFT Risk Assessment;
  - AML/CFT Compliance Assessment Checklist;
  - ML/TF warning signs/ red flags; and
  - proliferation financing warning signs/red alerts.

With regard to the above, the SECP has now directed Regulated Persons to comply with the following reporting requirements and submit information in the manner prescribed below to the respective supervisory departments of the Commission:

Requirement	Report by	Details
i. Annual "risk assessment" and "control/ compliance assessment" framework	30th June each year	a) Risk Assessment Framework: – RP's to submit annual risk assessment report that covers the process adopted for risk identification. – Risk assessment methodology to cover risk emanating from customers, products, geography and delivery channels, elaborate risk tolerance level and assess residual risk after implementation of mitigation measures. – Template given in Annex 1 to the Guidelines may be used for reference, but RP's may choose their own risk assessment

[1] "Regulated Person" for the purposes of these regulations means securities brokers, futures brokers, Insurers, Takaful Operators, NBFCs and Modarabas".

		methodology that best suits or represents their business, in light of the AML Act, 2010 and the Regulations. – Risk assessment report to be reviewed and approved by the Board and shall be signed by the CEO/ Company Secretary. b) Compliance Assessment Checklist: – RP's to submit annual compliance assessment checklist to demonstrate adequacy and effectiveness of AML/CFT compliance framework in light of the Regulations – May use checklist provided in Annex 2 to the Guidelines.
ii. Six monthly information/ data + Annual risk assessment and compliance check list	• 30th June each year • 31st Dec each year	a) Extracts of the discussion / deliberations on Know Your Customer (KYC) / AML / CFT by board and/or management committees; b) Number of new customer accounts opened during the period according to risk categorizations i.e. high, medium and low; c) Total number of foreign and domestic politically exposed persons (PEP) and their total value of investments/deposits/financing etc. during the period; d) Details of all the accounts which were refused to be opened during the period; e) Documentation of any activity for which a Suspicious Transaction Reports (STR) was considered but not filed along with rationale, during the period; f) Copies of reports/mechanism to identify unusual transactions warranting further review; g) Number of suspicious transaction and currency transaction reports submitted to Financial Monitoring Unit, during the period; h) Detail of complaints received on account of KYC / AML, including its status i.e. in process/ resolved / closed, during the period; i) Details of trainings conducted on AML/CFT of staff, during the period; j) Record of transferring customers from one risk category to another, during the six month period.
iii. Compliance report on statutory regulatory orders	Within 3days of receiving the same	– Issued by the Ministry of Foreign Affairs on United Nations Security Council Resolutions, and intimation from National Counter Terrorism Authority/Ministry of Interior – Regarding updates in list of proscribed persons under the Anti-Terrorism Act, 1997 – To be submitted by authorized officer of the Regulated Person.

Anyone who is in contravention with the above or submits false information shall be liable to penalty under section 40A of the SECP Act, 1997, which may extend to Rs 10 million + a further penalty which may extend to Rs 1 lakh for every day after the first during which such contravention continues.

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2. Circulars

a. Temporary Relaxation/Exemption on Appointment of Female Director on Boards – Listed Companies

The SECP has granted listed companies a temporary relaxation/exemption from Regulation 7 of the Listed Companies (Code of Corporate Governance) Regulations, 2017. The said Regulation requires that the board of listed companies shall have at least one female director when:

- it is next reconstituted not later than expiry of its current term OR
- within the next one year from the effective date of these regulations,

whichever is later.

The regulations were notified vide S.R.O. 1216(I)/2017 dated November 22, 2017, to come into effect on January 1, 2018. However, as a result of applications from listed companies where the board of the company was reconstituted immediately after the commencement of the regulations but before the expiry of one year from the effective date of the regulations, the SECP has allowed all such listed companies to appoint a female director on their respective boards either:

- on the date of next election of board of directors OR
- on occurrence of a casual vacancy before the date of next election of directors.

3. Guidelines

a. Ultimate Beneficial Ownership – FAQs

The SECP has issued Frequently Asked Questions (FAQs) to provide guidance to companies to better understand the requirements and methods of maintaining Ultimate Beneficial Ownership (UBO) information. The FAQs state that the requirement to maintain UBO information is aimed at determining the true owners of a company as information about the actual (ultimate) owners and shareholders is the most significant information for a large number of stakeholders of a company such as creditors, tax authorities, corporate registry, major suppliers, major customers, financial institutions, etc.

The FAQs also state that UBO information is necessary to detect and prevent tax evasion, corruption, money laundering, terrorist financing, and other illicit behavior involving one or more companies. Public trust in companies and markets largely depends on the existence of an accurate disclosure regime that provides transparency in the beneficial ownership and control structures of companies.

Various details have been provided through the FAQs to clarify areas of ambiguity, including:

- How would you differentiate between direct or indirect ownership or control?
- Which companies are required to comply with the provisions of Circular no. 16 of 2018 read with Circular no. 20 of 2018?
- What is the mechanism for obtaining UBO information by a company, having legal person(s) as its members, from ultimate beneficial owners?
- How would you differentiate between beneficial ownership and legal ownership?
- How the regulatory requirements for maintenance of register of members required under section 452 of the Companies Act, 2017 differs from the register of ultimate beneficial owners?
- What is the role and purpose of Financial Action Task Force?
- What are the requirements for provision of UBO information to regulatory authorities? Etc.

4. Others

a. Applicability of IFRS 9 - Deferred

The SECP has deferred the effective date for applicability of the International Financial Reporting Standard (IFRS) 9 “Financial Instruments” for all companies required to prepare their financial statements in accordance with the requirements of IFRS.

The SECP had notified IFRS 9 via SRO 1007(I)/2017, dated October 4, 2017, replacing the International Accounting Standard (IAS) 39 “Financial Instruments: Recognition and Measurement” with effect from reporting periods starting July 1, 2018. However, after being approached by a number of companies regarding the non-availability of relevant data/estimates, increased complexity of the new impairment model, time constraint for finalization of financial statements for the period ending on December 31, 2018, and peculiar circumstances of various companies facing the issue of circular debt, the SECP decided to defer the date based on the recommendation of the Institute of Chartered Accountants of Pakistan.

Companies shall now ensure applicability of IFRS 9 for reporting period/year ending on or after June 30, 2019, with an allowance for earlier adoption for companies that wish to do so.

b. Pakistan Report on Observance of Standards and Codes (ROSC) on Corporate Governance

Pakistan’s enhanced implementation of corporate governance principles, as recognized by the World Bank, was lauded at the launch event of the “Pakistan Report on Observance of Standards and Codes (ROSC)” on Corporate Governance. The ROSC is a component of global efforts to strengthen the international financial architecture and aims at promoting greater financial stability, both domestically and internationally, through the development, dissemination, adoption, and implementation of international standards and codes.

The ROSC corporate governance initiative is administered by the World Bank that assesses the degree to which a country observes the G20/OECD Principles of Corporate Governance (OECD Principles)- the international reference point for good corporate governance; and develop a series of recommendations to reduce or close identified gaps.

Pakistan ROSC’s highlights recent improvements in corporate governance regulation, makes policy recommendations, and provides investors with a benchmark against which to measure corporate governance in Pakistan. The report focuses on the governance of large and listed companies, but includes a special section on the governance of public sector companies. The report stated that the corporate governance framework for listed companies has improved in recent years as the government has enhanced the legal and policy framework, and key institutions have grown in sophistication and maturity, however, much more can be done to address corporate governance in Public Sector Companies.

ROSC corporate governance initiative assessed compliance in five areas including: the commitment of the public and private sectors to reform; shareholder rights; disclosure and transparency; boards of directors and public sector companies.

The report noted that the government took many important steps to improve the regulation of corporate governance reform in Pakistan, including the updates to the Companies Act, the issuance of the Listed Companies (Code of Corporate Governance) Regulations (“LCR”) and updates to the Public Sector Companies (Corporate Governance) Rules 2013. The Pakistan Institute of Corporate Governance was mentioned as playing a leading role in building the awareness of the need for improved corporate governance. It was stated that PICG, which was created in 2005, now provides a variety of services including directors training programs, directors orientation programs, board evaluation and other advisory services.

Possible future changes recommended in the report to the LCR are as follows:

- Increase the number of independent directors required on key committees, to at least a majority.
- Explicitly require boards to establish an investor relations function in each company.
- Require companies and boards to develop explicit board nomination and elections policies.
- Explicitly require remuneration policy to be aligned to both short and long term performance of the company, and to the board evaluation process.
- Explicitly refer to setting performance objectives and key performance indicators.
- Explicitly refer to the board's role in overseeing corporate governance practices.
- Explicitly require boards to oversee disclosure and communication.
- Clarify the role for the HR committee (and the Chairman) in the board nomination and elections procedures.
- Require companies to develop (and disclose) committee charters (or mandates).
- Explicitly describe key roles and responsibilities of a board chairman to complement the relevant provisions of the Companies Act
- Require more specific disclosures about current and prospective board members, including length of service as a board member, tenure on various committees, primary employment, and the number of other seats held.
- Require companies to provide professional advice at the expense of the company to the board and require the company to disclose the use of paid advisors by the board.

"Fighting corruption is not just good governance. It's self-defense. It's patriotism"

- Joe Biden

International

a. Measuring the Digital Transformation[2]

OECD's report "Measuring the Digital Transformation: A Roadmap for the Future" provides new insights into the state of the digital transformation by mapping indicators across a range of areas – from education and innovation, to trade, economic and social outcomes – against current digital policy issues. The report identifies gaps in the current measurement framework, assesses progress made towards filling these gaps and sets-out a forward-looking measurement roadmap. The goal is to provide evidence on which to base more robust policies for growth and well-being in the digital era.

The report does not aim to "rank" countries, instead, its objective is to provide policy makers and analysts with key indicators for each of the dimensions of the "Going Digital" integrated policy framework to give analysts, stakeholders and policy makers deeper insights into how their economies are performing along those dimensions.

The roadmap states nine actions that, if implemented, would substantially advance the capacity of countries to monitor the digital transformation and its impacts. The first four actions are directed towards building the next generation of data and indicators capable of dealing with the challenges of the digital transformation:

i. make the digital economy visible in economic statistics,
ii. understand the economic impacts of the digital transformation,
iii. measure well-being in the digital age, and
iv. design new and interdisciplinary approaches to data collection.

Five further actions target specific areas identified as requiring attention:

v. transformative technologies,
vi. data and data flows,
vii. skills in the digital era,
viii. trust in online environments, and
ix. governments' digital strengths.

b. Social Institutions and Gender Index[3]

The OECD Social Institutions and Gender Index (SIGI) series analyses how formal and informal laws, social norms and practices discriminate on the basis of gender and helps governments and development practitioners identify policies and programmes to tackle this discrimination. The SIGI series proposes gender-transformative actions at the international, regional and national levels. It identifies the underlying drivers of gender inequality and proposes whole-of-society entry points to build more inclusive societies and opportunities for all.

The report states that placing women and men on an equal footing in every walk of political, economic and social life – gender equality – is not only a moral imperative, but also an economic one and estimates the cost to the global economy as a result of gender-based discrimination in social institutions to be USD 6 trillion (7.5% of the global GDP). Decision makers have agreed on a new global compact: Agenda 2030. It puts gender equality and social norms at the core of sustainable and inclusive development.

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[2] OECD (2019), Measuring the Digital Transformation: A Roadmap for the Future, OECD Publishing, Paris, https://doi.org/10.1787/9789264311992-en.

[3] OECD (2019), *SIGI 2019 Global Report: Transforming Challenges into Opportunities*, Social Institutions and Gender Index, OECD Publishing, Paris, https://doi.org/10.1787/bc56d212-en.

The SIGI 2019 Global Report provides an overview of the main outcomes of the SIGI in relation to women and the family, their physical integrity, access to productive and financial resources and their civic rights. Building on these outcomes, the report provides a set of policy recommendations to enhance governments' efforts to deliver their gender-equality commitments through a three-pronged approach:

- starting with legal reforms and transformative gender policies,
- enforcing laws through community mobilisation and empowerment, and
- learning about the efficiency of policy through monitoring.

c. Corporate Governance Principles and Recommendations- Australia

The Australian Securities Exchange's - ASX Corporate Governance Council ("Council") has issued the 4th edition of the Corporate Governance Principles and Recommendations ("Principles and Recommendations"). The 1st set of principles was introduced in 2003, followed by 2nd and 3rd editions published in 2007 and 2014, respectively.

These Principles and Recommendations set out recommended corporate governance practices for entities listed on the ASX that, in the Council's view, are likely to achieve good governance outcomes and meet the reasonable expectations of most investors in most situations. However, taking into consideration the fact that different entities may legitimately adopt different governance practices, based on a range of factors, including their size, complexity, history and corporate culture, the Principles and Recommendations are not mandatory and do not seek to prescribe the corporate governance practices that a listed entity must adopt. Further, the Principles and Recommendations are specifically directed at, and only intended to apply to ASX listed entities, however, other bodies may also find them helpful in formulating their governance rules or practices.

Under the Principles and Recommendations, if the board of a listed entity considers that a Council recommendation is not appropriate to its particular circumstances, it is entitled not to adopt it. If it does so, however, it must explain why it has not adopted the recommendation – the **"if not, why not"** approach. This approach ensures that the market receives an appropriate level of information about the entity's governance arrangements so that investors and other stakeholders may have a meaningful dialogue with the board and management on governance matters and can factor the information provided into their decision on whether or not to invest in the entity and how to vote on particular resolutions.

CORPORATE GOVERNANCE ASSESSMENT

PICG offers Corporate Governance Assessment (CGA) services to help identify and analyze both corporate governance risks and opportunities in organizations. It enables companies to monitor and improve corporate governance structures, policies and processes that in turn improve the firm's valuation. Review and audit of existing procedures as well as a review of company bylaws are an integral part of this service.

Areas covered in the CGA include:

- Commitment to Corporate Governance
- Board Structure and Functioning
- Control Environment
- Disclosure and Transparency
- Shareholder Practices

Each assessment is tailored to address the unique challenges faced by companies with different ownership structures and is carried out by PICG and IFC's highly skilled representatives. The results of the assessment and a recommended plan for implementing change, along with prioritization and milestones, are conveyed in a detailed report.

Benefits

Access to lower cost of capital

Enhancement of reputation

Improvement in operational efficiency

Effective management of stakeholder issues and concerns

Effective performance measurement

Accountability

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Pakistan Institute of Corporate Governance (PICG) is the market leader for improving corporate governance culture, promoting best practices and providing a platform to companies to acquire the requisite training and certification that is pivotal for their growth.

Conduct your company's Corporate Governance assessment:

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