

April 2019

PICG ADVISORY UPDATE - 22



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. Regulations/ Rules issued				
i	SECP	SRO 485 (I)/2019	Apr 23, 2019	Draft Listed Companies (Code of Corporate Governance) Regulations 2017
ii	SECP	SRO 486 (I) 2019	Apr 23, 2019	Draft Listed Companies (Buy-Back of Shares) Regulations, 2019
2. Amendments				
i	SBP	BPRD Circular Letter No. 06 of 2019	Apr 22, 2019	Amendments to Prudential Regulations G-1
3. Others				
i	SBP	BPRD Circular Letter No. 08 of 2019	April 30, 2019	Extension of implementation date of IFRS 16 - Leases
ii	SECP	Press release	April 23, 2019	SECP Reforms: Ease of Doing Business, Investor Protection, Market Development & Transparency
iii	SECP	Press release	April 12 & 19, 2019	SECP explains AML/CFT reporting requirements + Frequently Asked Questions (FAQs) on AML/CFT- 1st Version + Frequently Asked Questions (FAQs) on AML/CFT- 2nd Version

International

Topic	Links
OECD report on 'Thriving in a Digital World'	OECD Skills Outlook 2019
IFC's Report on the Assessment of Myanmar Companies	Myanmar Corporate Governance Scorecard 2018

“It is clear that good corporate governance makes good sense. The name of the game for a company in the 21st Century will be conform while it performs.”

- Mervyn King

(Chairman: King Report)

B. Synopsis of changes

Pakistan

1. Regulations/ Rules issued

a. Draft Listed Companies (Code of Corporate Governance) Regulations, 2019

SECP has proposed further amendments to the Listed Companies (Code of Corporate Governance) Regulations, 2017, based on recommendations received from SECP's Policy Board. The code was last amended a few months ago via SRO 1475(1)/2018 dated December 5, 2018.

Significant amendments proposed to be made to the Code are as follows:

i. Application, basis & mandatory provisions of Draft Code:

The regulations shall apply to “public listed companies (‘listed company’) based on “**comply or explain approach**” **except the requirements for which it is explicitly stated as “mandatory”** and it shall be the responsibility of boards to use this approach wisely and of investors to assess differing company approaches thoughtfully.

In this regard, **mandatory provisions** in the draft pertain to the following:

- i. No person shall be a director of a listed company, including as an alternate director, of more than 7 listed companies simultaneously. (Previously, the limit was 5 listed companies and ‘listed subsidiaries of a listed holding company’ were excluded from the said limit, whereas the current draft does not mention anything about listed subsidiaries).
- ii. Each listed company shall have at least 2 or 1/3rd members of the board, whichever is higher, as independent directors. In this regard, a listed company shall explain the reasons, in its directors report, if any fraction contained in such 1/3rd number is not rounded off as one.
- iii. The independent director shall submit his consent to act as director, along with declaration to the company that he qualifies the criteria of independence notified under the Act.
- iv. The board of directors shall have at least 1 female director when it is next reconstituted after the effective date of these Regulations.
- v. Executive directors, including the chief executive officer, shall not be more than 1/3rd of its board of directors. Again, a listed company shall explain the reasons, in its directors report, if any fraction contained in such 1/3rd number is not rounded off as one.
- vi. The audit committee shall be constituted by board of directors keeping in view the requirements stated in the regulations.
- vii. There shall be a human resource and remuneration committee of at least of 3 members comprising a majority of non-executive directors of whom at least 1 member shall be an independent director. (Note: although the word ‘mandatory’ has not been used in this clause, it is a mandatory requirement as per the statement of compliance given in the regulations)
- viii. No company shall appoint as external auditors, a firm of auditors, which has not been given a satisfactory rating under the Quality Control Review program of the Institute of Chartered Accountants of Pakistan (ICAP) and registered with Audit Oversight Board of Pakistan under section 361 of Securities and Exchange Commission of Pakistan Act, 1997. Further, no company is to appoint

as external auditors, a firm of auditors which or a partner of which is non-compliant with the International Federation of Accountants' (IFAC) Guidelines on Code of Ethics, as adopted by ICAP.

- ix. No company shall appoint its external auditors to provide services in addition to audit except in accordance with the regulations and shall require the auditors to observe applicable IFAC guidelines.
- x. Further, no company shall appoint a person as an external auditor or a person involved in the audit of a company who is a close relative (spouse, parents, dependents and non-dependent children) of the CEO, CFO, head of internal audit, company secretary or a director of the company.
- xi. Every company shall require the external auditors to furnish a management letter to its board of directors within 45 days of the date of audit report.
- xii. All listed companies in the financial sector shall change their external auditors every 5 years: Provided that all inter related companies/ institutions, engaged in the business of providing financial services shall appoint the same firm of auditors to conduct the audit of their accounts. [Note: Financial sector, for this purpose, means banks, non-banking financial companies (NBFC's), modarabas and insurance or takaful insurance companies].
- xiii. All listed companies other than those in the financial sector shall, at the minimum, rotate the engagement partner after every 5 years: Provided that in case the audit firm is a sole proprietorship then after completion of 5 years such audit firm shall be changed
- xiv. The quarterly unaudited financial statements of companies shall be published and circulated along with directors' review on the affairs of the company, with information as required in the regulation. (Note: this is a mandatory requirement as per the statement of compliance given in the regulations)
- xv. All companies shall publish and circulate the 'Compliance Statement', reviewed and certified by statutory auditors, along with their annual reports to set out the status of compliance with the regulations. The said statement shall be specific and supported by necessary explanation by the company and the statutory auditors shall highlight any non compliance in their review report.
- xvi. Whoever fails or refuses to comply with, or contravenes any of the mandatory requirements of the regulations shall be punishable with penalty as provided under sub-section (2) of section 512 of the Companies Act 2017 (ie. penalty may extend to Rs 5 million and, where the 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).

Note: SECP may relax requirements of mandatory provisions on application of a company, subject to such conditions as it may deem fit.

II. Training requirements:

Training requirements for Directors and Executives have been changed to "encouraged" in the current draft, as opposed to being a mandatory requirement. Further, dates by which director's need to obtain the requisite certification has been extended by 1 year.

III. Provisions added to Code in 2018 removed:

A number of provisions that had been introduced to the Code in December 2018, have now been removed from the current draft, including:

- i. Regulation stating that the board of directors are responsible for adoption and monitoring the effectiveness of corporate governance practices of the company.

- ii. Adequate policy, systems and controls are in place for communication and disclosure with stakeholders and queries of shareholders/ investors and complaints.
- iii. Clause requiring formal mechanism for selecting, compensating, monitoring and replacing senior executives and overseeing succession planning and the remuneration of key executive and board to be aligned with the long term interests of the company and its shareholders.
- iv. Clauses included in the “remuneration of directors” portion, stating that directors remuneration is to be decided after giving due consideration to performance evaluation + an independent consultant may be engaged to recommend an appropriate level of remuneration for consideration of the board, have been removed.
- v. Exemptions from directors training requirement based on certain defined post-qualification experience.
- vi. “Remuneration policy” for non-executive directors including independent directors changed back to policy on “permissible fee” for such directors.
- vii. HR Committee shall take into consideration that such remuneration is commensurate with the performance of the company and evaluation of board and management.

IV. Other proposed deletions:

Other clauses proposed to be deleted in the draft Code, include:

- i. Clause requiring notices, agenda and relevant material to be circulated at least 7 days prior to meetings.
- ii. Conflict of interest clause stating that quorum shall not be deemed to be present unless at least 2 independent directors are present when such matter is being considered by the board for the first time.

With regard to the proposed amendments, SECP has stated that the purpose is to facilitate listed companies to decide for themselves whether a certain requirement is appropriate for its operations and leaves it to the stakeholders to consider whether the company has given a cogent explanation for not fulfilling it.

b. Draft Listed Companies (Buy-Back of Shares) Regulations, 2019.

The SECP has issued draft regulations for buyback of shares of companies, proposed to repeal the Listed Companies (Buy-Back of Shares) Regulations, 2016. The regulations shall apply to the buy-back of shares of companies listed on the securities exchange - in pursuance of section 88 of the Companies Act, 2017).

The draft regulations provide the criteria and conditions for eligibility to purchase, such as the requirement that the company is listed on the securities exchange for a period of not less than 3 years; the general meeting in which the special resolution is to be passed shall not be held more than 30 days from the date of the meeting of the board of directors in which the purchase is recommended; and the purchasing company shall make a public announcement on the next working day of passing of the special resolution.

The regulations also lay out the obligations and restrictions of the purchase process such as: the requirement to communicate the decision of the board of directors regarding recommendation of the purchase to both the Commission and the Securities Exchange, simultaneously, on the day the decision is made; submit an undertaking duly signed by all the directors, including the CEO, stating that the public

announcement has been approved by them + the information given therein is true and accurate + the directors - both individually and collectively - accept full responsibility for the accuracy of the information given and confirm that no facts have been concealed; the purchasing company shall not apply for voluntary delisting or voluntary winding up within a period of 12 months of the close of the purchase period; in the case of purchase through tender offer, the purchase price shall be the price as recommended by the board of directors and approved by the members through special resolution (which shall not be less than 30 days weighted average price of the shares); and in the case of purchase through securities exchange, the purchase price shall not be more than 5 % above the weighted average market price of the share of the purchasing company for the last 90 days immediately prior to the date on which the shares are purchased, etc.

Once the draft is approved, it shall take effect immediately.

2. Amendments

State Bank of Pakistan : Amendments to Prudential Regulations G-1

The State Bank of Pakistan (SBP) has amended Section-C of the Prudential Regulations G-1 pertaining to "Management" as was previously notified vide BPRD Circular Letter No. 12 dated April 24, 2009.

Para C-3 of the abovementioned section stated that the Chairman of the Board of Directors may, if deemed necessary, appoint one advisor to advise and facilitate him/her in discharge of his/her duties/responsibilities subject to certain conditions of appointment.

SBP has now decided to replace the said Para C-3 as follows:

"The Chairman/Board shall not appoint an 'Advisor' in any capacity. Accordingly, all Banks/DFIs are advised to ensure appropriate skill mix of the Board keeping in view the overall risk profile of the institution."

Hence, SBP has advised all banks/DFIs to ensure compliance within 6 months of the date of issuance of the circular letter, following which any non-compliance shall attract punitive action under the relevant provisions of the Banking Companies Ordinance, 1962.

"Ethics in business is extremely important; your reputation is all you have in life."

- Sir Freddie Laker

3. Others

a. Extension of implementation date of IFRS 16 - Leases

In view of difficulties being faced by various financial institutions in the implementation of International Financial Reporting Standard on Leases (i.e. IFRS 16 on the banking industry), the SBP has decided to extend the implementation date of IFRS 16 for banks/DFIs/MFBs in Pakistan from January 1, 2019 to June 30, 2019.

Consequently, banks/DFIs/MFBs have been advised to review their internal systems and procedures to prepare themselves for implementation of the said standard within the revised timeline, other than those banks/DFIs/MFBs that have already adopted IFRS 16 and may prepare their financial statements in accordance therewith.

b. SECP Reforms: Ease of Doing Business, Investor Protection, Market Development & Transparency

As a result of the implementation of the broad-based reform agenda for Pakistan's capital market, the SECP has made various efforts to focus on facilitating the ease of doing business, investor protection, market development and enhancing transparency. As per a press release of the SECP, the major reforms introduced so far include:

- Simplification of licensing regime for securities brokers with minimal submission requirements;
- Increase in the number of securities acceptable against margin requirements to enable wider spectrum of possible collaterals to be furnished to the clearing house;
- Modification of base minimum capital requirements to allow brokers to pledge PSX shares held by directors/sponsors of brokerage house, including shares recently released by the central depository;
- Measures for effective contingency planning of securities brokers have been introduced with required system developments at PSX to allow continuous access to the trading system by a broker in case of broker-specific disaster;
- Previously applicable restrictions impairing execution of certain genuine Negotiated Deal Market (NDM) transaction have been removed;
- Profit sharing arrangements on client balances stand simplified with profit on clients' unutilized balances with brokers to be shared based on principles of disclosure and mutual understanding;
- Requirement for limited assurance report has been discontinued and consolidated inspection mechanism is being introduced, which will do away with multiple audits and inspections of securities brokers being conducted by PSX, CDC, NCCPL and SECP;
- The advertisement process for securities brokers has been simplified;
- Issuers have been allowed to electronically submit accounts and other information/documents to PSX;
- CDC tariff structure for debt market securities has been drastically reduced.

Further, a centralized Know Your Customer(KYC) organization is in process providing a 'one-pager' KYC form to eliminate the process of KYC while opening multiple accounts with brokers/mutual funds. Efforts are also being made to bring in more transparency in the market through automated biometric and mobile number verification.

Furthermore, the limit allowed to foreign investors in PSX shares has been increased from 10% to 20% thereby opening up the stock market to foreign investment.

As per SECP, the purpose of the above reforms is to encourage growth and enhance liquidity in the market while facilitating the brokerage industry through removal of any excessive regulatory requirements based on international standards and best practices.

c. SECP explains AML/CFT reporting requirements

The SECP has issued a number of regulatory requirement pertaining to Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT). In this regard, SECP has clarified that it has rescinded the reporting requirements prescribed vide:

- Circular 8 of 2017 - Compliance Report on AML Directive for Insurers
- Circular 9 of 2017 - Reporting by Non-Bank Finance Companies (NBFCs)
- Circular 10 of 2017 - Reporting by Securities Brokers
- Direction 1 of 2017 - Reporting by Modaraba Companies & Modarabas

The above AML/CFT reporting requirements have been replaced by the reporting framework prescribed under SECP's S.R.O. 245 (I)/2019 dated February 22, 2019, which lays down a comprehensive reporting mechanism in line with the FATF Recommendations and SECP AML/CFT Regulations, 2018.

This framework has strengthened reporting from regulated persons including; securities brokers, futures brokers, insurers, takaful operators, NBFCs and modarabas as previously required under the rescinded circulars. Regulated persons are required to submit annual risk and compliance assessment reports and 6-monthly information/data to the SECP to demonstrate adequacy and effectiveness of the AML/CFT compliance framework. Furthermore, compliance report on the UN Security Council resolutions is to be submitted within 3 days of receiving intimation from the SECP.

Further, the SECP has published the 1st and 2nd versions of 'SECP's Frequently Asked Questions (FAQs) on AML/CFT' to provide answers to various questions that surfaced during awareness sessions with the industry on AML/CFT Obligations under the SECP AML/CFT Regulations, 2018 and guidelines on the Regulations. The FAQs aim to facilitate SECP's regulated financial services industry and investors to comprehend and implement their obligations under the AML/CFT regime and meet regulatory expectations for anti-money laundering and sanctions compliance. It includes information on a range of topics, such as KYC, CDD, risk assessments, sanctions compliance, and more information about how to comply with AML/CFT standards issued by the Financial Action Task Force (FATF).

International

a. OECD Skills Outlook 2019¹

The OECD Skills Outlook 2019-*Thriving in a Digital World* report aims to understand how policies, and in particular those that affect skills development and use, can shape the outcomes of digital transformation and translate into more equally shared benefits among and within countries' populations. Drawing from results of the 'Survey of Adult Skills' [a product of the OECD Programme for the International Assessment of Adult Competencies (PIAAC)], the report identifies the gaps that digitalisation threatens to widen and the best ways to bridge those gaps – in the workplace, the classroom, at home, within countries and between countries.

The report identifies that economies and societies are undergoing digital transformations that bring both opportunities and challenges and countries' preparedness to seize the benefits of a digital world is largely dependent on the skills of their population. The report shows that by enabling people to acquire the necessary broad mix of skills, countries can ensure today's technological revolution improves lives for all.

To ensure people can benefit from new technologies and are not left behind requires a comprehensive and co-ordinated policy effort. This package of co-ordinated policies needs to simultaneously promote digitalisation (when this increases productivity and well-being), and otherwise cushion its negative impacts.

b. Myanmar Corporate Governance Scorecard 2018

The Myanmar Corporate Governance Scorecard 2018 assesses the performance of 24 companies in Myanmar on the basis of the Association of Southeast Asian Nations (ASEAN) Corporate Governance Scorecard – the regional benchmark used by capital markets across the ASEAN Economic Community and closely aligned with the revised G20/OECD Principles of Corporate Governance. The report is a result of the joint effort of the International Finance Corporation (IFC), a member of the World Bank Group, the Securities and Exchange Commission of Myanmar, the Yangon Stock Exchange and the Directorate of Company Investment and Company Administration (DICA).

In August 2018, two significant events contributed to reshaping corporate governance practices in the country:

- The implementation of the new Companies Law
- The Myanmar Sustainable Development Plan, which aims at steering government policies until 2030 to achieve “genuine, inclusive and transformational economic growth.”

The launch of the Myanmar's Institute of Directors in March 2018 was also an important milestone, with the Institute working with IFC to provide corporate governance training to foster the professional development of Myanmar company directors and senior executives.

The above developments present Myanmar companies with the opportunity to rethink and improve their governance practices in line with international best practices. Consequently, the scorecard evaluates the corporate governance practices of the largest Myanmar companies and generates a mean score to indicate the level of compliance with international benchmarks and provides concrete recommendations for improvements to close the gap with other ASEAN capital markets.

¹ OECD (2019), *OECD Skills Outlook 2019: Thriving in a Digital World*, OECD Publishing, Paris, <https://doi.org/10.1787/df80bc12-en>.

Corporate Governance Framework

Corporate Governance Frameworks serve as an effective tool that encompass the governance and oversight role of the Board and highlight the delineation of responsibilities and duties and provide the Board with a structured way to collaborate with management by focusing on the right issues. Good governance drives continuous improvement, thus enhancing stakeholder confidence in the leadership and the management of the company.

PICG, with its vast experience in the field of governance, is in a unique position to help organizations develop, update and enhance their Corporate Governance Frameworks (including Board Charters and Terms of Reference of their various Board Committees) in conformity with legal and regulatory requirements as well as with global best practices.

Each framework assignment is tailored to address the unique needs and regulatory requirements faced by organizations with different ownership structures in their related sectors.

Benefits of the framework:

- Helps boards gain a better understanding of their oversight role by consolidating various applicable regulations in a single document
- Provides the structure with which the Board assigns and coordinates roles and responsibilities to management
- Translates policies into practices, procedures, and job responsibilities within the entity
- Provides an organized structure for Board Committees clearly defining their roles and responsibilities within the ambit of relevant regulation.



If you would like PICG to develop a Corporate Governance Framework for you, please contact
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