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PICG ADVISORY UPDATE-27



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 1163 (I)/2019	Sep 25, 2019	Listed Companies (Code of Corporate Governance) Regulations, 2019
ii	SECP	Press release- Policy Board	Sep 17, 2019	SECP Policy Board Approves Amendments to ETF & Other Regulations
2. Orders				
i	SECP	SRO 1048 (I)/2019	Sep 11, 2019	The companies (Submission of Information regarding Income Tax Return) General Order, 2019
3. Others				
i	SECP	Press release- Policy Board	Sep 28, 2019	Creation of Adjudication Division in SECP
ii	SECP	Press release	Sep 23, 2019	Revision in tariff structures of NCCPL & CDC for capital market development

International

Topic	Links
OECD Report on Strengthening Trust in Business	OECD Business and Finance Outlook 2019
OECD and ADB Report on government resources, processes and outcomes in ASEAN member countries	Government at a Glance Southeast Asia 2019
KMPG Report on Environmental, Social, and Governance (ESG) Issues of selected companies	The ESG journey: Lessons from the boardroom and C-suite

“Ethics is knowing the difference between what you have the right to do and what is right to do”

- Potter Stewart
(Former Associate Justice of the Supreme Court of the United States)

B. Synopsis of changes

Pakistan

1. Regulations/ Rules issued

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

The Securities and Exchange Commission of Pakistan issued the new “Listed Companies (Code of Corporate Governance) Regulations, 2019 (‘Regulations’), on September 25, 2019, which was formulated based on recommendations received from SECP’s Policy Board. The new Regulations supersede the 2017 Code, which was last amended in December 2018.

The new Code 2019 represents a new era of corporate governance reporting, whereby the board of directors of listed companies shall use the “comply or explain approach”, except for provisions where compliance is explicitly stated as “mandatory”. It shall be the responsibility of the board to use this approach wisely and of investors to assess differing company approaches thoughtfully.

The “comply or explain approach” means:

“discretion of a company with respect to non-mandatory provisions of these Regulations either to comply or provide appropriate explanation as to any impediment in its compliance in the compliance report along with the financial statements.”

Mandatory provisions are to be strictly complied with by the company and any non-compliance is punishable with a penalty which 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 as provided for under sub-section (2) of section 512 of the Companies Act, 2017.

Manadatory regulations are as follows:

Regulations	Details
3. Directorship limits.	No person shall be elected or nominated or hold office as a director of a listed company including as an alternate director of more than 7 listed companies simultaneously: Provided that the said limit on directorship shall be effective when the Board shall be reconstituted not later than expiry of its current term. (The previous limit was 5 listed companies and did not include ‘listed subsidiaries of a listed holding company’. However, as per the current regulations, listed subsidiaries shall also be taken into account while calculating the number of companies)
6. Independent Director	6(1) Each listed company shall have at least 2 or 1/3 rd members of the Board, whichever is higher, as independent directors. (In this regard, a listed company shall explain the reasons, in the compliance report, if any fraction contained in such 1/3 rd number which is <u>not</u> rounded up as 1). 6(3) 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 and such declaration shall be submitted to chairman of the Board at the first meeting which is held after election of directors as well as on an event of any change affecting his independence.

7 Female Directors	The Board shall have at least 1 female director when it is reconstituted after the expiry of its current term.
8. Executive Director	The executive directors, including the chief executive officer, shall not be more than 1/3 rd of the Board. (In this regard, a listed company shall explain the reasons, in compliance report, any fraction contained in such 1/3 rd number <i>which is rounded up as 1</i>).
27 Audit Committee	<p>(1) The audit committee shall be constituted by the board of directors keeping in view the requirements stated in the regulations.</p> <p>(2) Requirements for holding meetings of audit committee.</p> <p>(3) Board of every company shall determine the terms of reference of the audit committee.</p> <p>(4) Board shall provide adequate resources and authority to enable the audit committee to carry out its responsibilities effectively and the terms of reference of the audit committee shall be explicitly documented and include matters given in the Regulations</p> <p>(5) Secretary of audit committee shall circulate minutes of meetings of the audit committee to all members, directors, head of internal audit and where required to chief financial officer prior to the next meeting of the Board: Provided that where this is not practicable, the chairman of the audit committee shall communicate a synopsis of the proceedings to the Board and the minutes shall be circulated along with the minutes of the meeting of the Board.</p>
32. External Auditor	<p>(1) No company shall appoint an 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 and registered with Audit Oversight Board of Pakistan under section 36I of the SECP Act, 1997.</p> <p>(2) No company shall appoint as external auditors, a firm of auditors which, or a partner of which, is non-compliant with the International Federation of Accountants' Guidelines on Code of Ethics, as adopted by the Institute of Chartered Accountants of Pakistan.</p> <p>(3) The Board of a company shall recommend appointment of external auditors for a year and its remuneration, as suggested by the audit committee and such recommendations shall be included in the Directors' Report and in case a recommendation for appointment of an auditor is other than the retiring auditor, the reasons for the same shall be included in the Directors' Report.</p> <p>(4) 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 International Federation of Accountants guidelines in this regard.</p> <p>(5) The company shall ensure that the auditors do not perform management functions or make management decisions, responsibility for which remains with the Board and management of the company.</p>

	<p>(6) 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 chief executive officer, the chief financial officer, the head of internal audit, the company secretary or a director of the company.</p> <p>(7) Every company requires the external auditors to furnish a management letter to its Board within 45 days of the date of audit report: Provided that any matter deemed significant by the external auditor shall be communicated in writing to the Board prior to the approval of the audited accounts by the Board.</p>
33. Rotation of auditors	<p>(1) All listed companies in the financial sector shall change their external auditors every 5 years: Provided that all inter related companies/ institutions, engaged in business of providing financial services shall appoint the same firm of auditors to conduct the audit of their accounts.</p> <p>(Note: Financial sector, for this purpose, means banks, NBFC's, modarabas and insurance or takaful insurance companies).</p> <p>(2) 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.</p>
36. Compliance Statement and Auditor Review	<p>(1) The company shall publish and circulate a statement, as given under Annexure A of the Regulations, along with their annual reports to set out the status of their compliance with the Regulations and the said statement shall be specific and supported by necessary explanations.</p> <p>(2) The company shall ensure that the statement of compliance is reviewed and certified by statutory auditors as per relevant Regulations specified by Commission.</p> <p>(3) The statutory auditors of company shall highlight any non-compliance with the Regulations in their review report.</p>

Note: Where the Commission is satisfied that it is not practicable to comply with any of the mandatory requirements, it may, for reasons to be recorded in writing, on the application by the company, *extend the time for compliance* of the same, subject to such conditions as it may deem fit.

With respect to the 'non-mandatory' provisions, listed companies shall now decide for themselves whether a certain requirement is appropriate for its operations and stakeholders shall consider whether the company has given a cogent explanation for not fulfilling such provisions.

b. SECP Policy Board Approves Amendments to ETF & Other Regulations

The SECP Policy Board approved amendments to the following regulations:

- i. The Exchange Traded Funds (ETFs) Regulations: in order to facilitate launch of ETFs, fund managers have been given flexibility to appoint separate intermediaries for performing the functions of market maker and authorized participant. This shall enable fund managers for onboarding market makers easily with an aim to reduce cumbersome requirements and decrease the cost of doing business.

- ii. Futures Brokers (Licensing & Operations) Regulations, 2018: amended to provide relaxation in education requirement of CEO, elimination of the requirement of NCB, deletion of the requirement of wealth statement, and reduction in frequency of reports by Compliance Officer.
- iii. Securities Brokers (Licensing & Operations) Regulations 2016: extension in timeline for complying with financial resource requirements till December 2019, and deletion of requirement to submit certificate of commencement of business.
- iv. CDC Regulations : Reforms in CDC Regulatory Framework for ease of doing business by direct credit of securities in the CDS, issued by way of right issue of public unlisted and private companies; relaxation in appointment of independent Transfer Agent by private and single member companies.

Further, the Policy Board also approved the Pakistan Stock Exchange (PSX) as the sole frontline regulator. The PSX may draw upon the assistance of the National Clearing Company of Pakistan Limited (NCCPL) and Central Depository Company (CDC) to outsource the compliance function of PSX, to the extent of supervision or conducting any investigation, inspection or enquiry and monitoring compliance of securities brokers.

2. Orders

a. Companies (Submission of Information regarding Income Tax Return) General Order, 2019

In order to ensure income tax return filing by companies, the SECP issued the Companies (Submission of Information regarding Income Tax Return) General Order, 2019 whereby it is compulsory for the corporate sector to submit compliance certificate regarding its status of compliance with the requirements of return under Income Tax Ordinance, 2001. The Order is applicable for the financial year ended/ending on or after June 30, 2019, for the following companies:

Sr. No	Company	Filing Requirement
1	A Single Member Company or a Private Company having paid up capital of not more than Rs 3m where there is no change of particulars in the last annual return filed with the registrar and is not required to file annual return.	Compliance Certificate as per Schedule II within time specified in Section 130 of the Companies Act, 2017
2	A company (other than a company mentioned at Serial No. 1 above) where there is no change of particulars in the last annual return filed with the registrar and is not required to file annual return.	Compliance Certificate as per Schedule II of the Order shall be filed along with Form C (Annual return of companies in case there is no change of particulars since last annual return filed with the registrar)
3	Companies required to file annual return i.e. where there is change of particulars in the last annual return filed with the registrar.	Compliance Certificate as per Schedule II of the Order shall be filed along with; Form A (Annual return of company having share capital) - OR - Form B (Annual return of company not having share capital)

The compliance certificate is to be signed by the Chief Executive Officer of the company or by the person duly authorized by the company to sign the annual return. Any contravention of the requirements of this order shall be an offence liable to penalty as provided under sub-section (2) of section 238 of the Companies Act, 2017 (ie. Level 3 of the standard scale).

Note:

On review, SECP's Policy Board considered the above Order to be ultra vires and beyond the jurisdiction of the SECP and has directed the Commission to take steps for its withdrawal after taking legal advice.

3. Others

a. Creation of Adjudication Division in SECP

The SECP Policy Board has approved the setting up of a centralized adjudication division in the Commission to function as a quasi-judicial arm of the Commission. The division is to be entrusted the responsibility for adjudication work pertaining to all regulated entities and persons, as opposed to the existing practice of adjudication being carried out separately by various departments/divisions within the Commission.

The centralization of adjudication is expected to:

- enhance the effectiveness of the Commission,
- ensure fair and consistent decisions, and
- minimize any seeping risk of arbitrariness in the discharge of its judicial function.

b. Revision in tariff structures of NCCPL & CDC for capital market development

With a view to foster capital market development and broaden investor base, the SECP has approved the reduction of tariff structures of the National Clearing Company of Pakistan Limited (NCCPL) and Central Depository Company of Pakistan Limited (CDC). The reduction in regulatory charges is expected to minimize investor related costs in different segments of equity and debt market and make it a more competitive investment avenue.

The SECP had advised the CDC and NCCPL to rationalize their respective tariff structures in line with international best practices, and, consequently, the board of directors of both companies issued SROs, announcing significant reduction in their tariff structures to pass on maximum benefit to shareholders and encourage investments.

As per revised tariff structures, the sub-account maintenance fee of sub-account holders maintaining Investor Accounts with CDC has been waived off to encourage investors to open sub accounts with CDC for prudent and safe custody of their investments. Likewise, tariff for annual fee of redeemable securities has been reduced by almost 70% to support the corporate debt market. In addition, the SECP has advised CDC to reduce ceiling on fresh issuance fee for issuers to Rs35 million from Rs50 million.

International

a. OECD Business and Finance Outlook 2019: Strengthening Trust in Business¹

The Organisation for Economic Co-operation and Development (OECD)'s Business and Finance Outlook is an annual publication that presents data and analysis on the trends, both positive and negative, that are shaping the world of business, finance and investment.

This 2019 report is the 5th edition which considers the importance of public trust in business and finance, offering a conceptual approach to understanding components of trust in finance, investment and business with respect to economic value, fairness and integrity of conduct, as well as alignment with societal values.

The Outlook provides an assessment of factors that:

- i. contributed to the deterioration of trust during the Global Financial Crisis;
- ii. reviews recent developments that could contribute to a renewed erosion of trust (eg. the abundant issuance of sovereign, corporate and bank debt, which has supported post-crisis growth- but has raised concern over potential risks of excessive debt as the credit cycle matures); and,
- iii. offers policy considerations to help strengthen public trust in business and finance.

According to the report, policy makers should step up their efforts to bolster public trust in finance to reduce the risks of toxicity, if economic growth and financial returns continue to fall. Strengthened public trust in business and finance is essential to encourage the productive investment and commerce that contribute to inclusive and sustainable economic growth.

The Outlook provides policy makers with concrete considerations for action in 5 areas:

- i. financial markets;
- ii. financial institutions—such as banks and pension funds;
- iii. company liability—that is, trust in companies to obey the law;
- iv. the level playing field, focusing on the rising importance of state-owned enterprises and their associated conduct risks; and
- v. online markets.

b. OECD: Government at a Glance - Southeast Asia 2019²

This is OECD's first edition of the 'Government at a Glance' series for the region. It provides the latest available data on public administrations in 10 ASEAN member countries: Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam. The report is the result of collaboration between the OECD and the Asian Development Bank (ADB) and offers internationally comparable data on government resources, processes and outcomes in specific sectors in South East Asia countries.

¹ OECD (2019), *OECD Business and Finance Outlook 2019: Strengthening Trust in Business*, OECD Publishing, Paris, <https://doi.org/10.1787/af784794-en>.

² OECD/ADB (2019), *Government at a Glance Southeast Asia 2019*, OECD Publishing, Paris, <https://doi.org/10.1787/9789264305915-en>.

According to the report, the starting point for improving public sector effectiveness is to accurately benchmark government activity and performance. The comparative analysis is intended to help policymakers, public managers and citizens assess the performance of governments in the region.

The 34 indicators in the report cover key aspects of public management, such as:

- i. public finance and economics,
- ii. public employment,
- iii. budget practices and procedures,
- iv. strategic human resources management,
- v. digital government,
- vi. open government and
- vii. citizen satisfaction with public services.

Data in the report has also been compared against the OECD average and that of the neighbouring OECD member countries, such as Australia, Korea, Japan and New Zealand, where possible.

c. KPMG Report - The ESG journey: Lessons from the boardroom and C-suite

KPMG has issued a report on the Environmental, Social, and Governance (ESG) journey of selected companies to help guide the boards of such companies in addressing ESG issues as part of their framework for boards - '*ESG, strategy and the long view*'. In this regard, KPMG's Board Leadership Center interviewed directors and officers of major corporations, including Morgan Stanley, Tyson Foods, Ford Motor, Microsoft, Mars, and Whirlpool, among others.

The report states that it is widely recognized that environmental, social, and governance (ESG) issues factor into corporate performance and can no longer be seen as "soft" reputational issues to be handled by public relations or marketing. Investors are increasingly aware that poor ESG practices may pose environmental, legal, and reputation risks that can damage the company and the bottom line, and that positive ESG practices can contribute to improved company performance.

According to the report, even for conscientious CEOs and boards, integrating ESG into corporate strategy was not easy. ESG often means different things to different people. Transforming it from an ancillary issue to a broad core competency requires significant, sustained effort, however, there is no single model for organizations to follow.

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