PICG Advisory Update-3

December 2016- January 2017

A. Summary Table

Pakistan

Sr #	Body	Reference	Date	Topic / Update link
1	SECP	Press Release	Dec 3, 2016	Companies to maintain functional websites
2	SECP	SRO 1165(I)/2016	Dec 22, 2016	Amendments in Insurance Companies (Sound and Prudent Management) Regulations, 2012
3	SBP	BPRD Circular Letter No.38	Dec 26, 2016	Identity documents of Directors authorized to open bank accounts- AML/CFT Regulations
4	SBP	BPRD Circular No.15 of 2016	Dec 28, 2016	Revised Instructions on Independent Directors of Banks/ DFI's
5	SECP	Press Release	Dec 28, 2016	Draft Insurance Bill 2016-eliciting public comments
6	SBP	BPRD Circular No. 1 of 2017	Jan 25, 2017	Revised Guidelines on Remuneration Practices
7	SECP	Direction No. 4 of 2017	Jan 27, 2017	Authentication of statutory returns
8	SECP	Press Release	Feb 6, 2017	NA approves Companies Bill 2016
9	PICG	-	-	Task Force to review Code of Corporate Governance

International

Topic	Links
Developments in Corporate Governance and Stewardship 2016 – (FRC Report Jan 2017)	Developments in Corporate Governance and Stewardship 2016
World Development Report 2017- Governance and The Law - (World Bank Group Report)	World Development Report 2017

B. Synopsis of changes

Pakistan

1. **Companies to maintain functional websites without fail- Public Companies (Listed and unlisted)**
   Websites are effective tools for dissemination of material information to the public. In this regard, SECP had issued notification dated July 10, 2014, requiring all public companies to maintain functional websites and also prescribed the relevant content to be displayed (such as matters pertaining to profile, governance, media, election of directors, investor information and relations). Thereafter, to facilitate understanding and implementation, the SECP issued guidelines, notifications and a circular, however, despite these efforts, many companies have yet to adhere to the directives in letter and spirit. Further, it has been noted that some companies are omitting or partially disclosing information regarding their board of directors, financial statements and investor complaint mechanism. This practice defeats the very purpose of timely, accessible and legible disclosure of information.

   Consequently, to ensure compliance, the SECP has been issuing clarification letters and initiating proceedings against defaulting companies, with 26 show-cause notices and 11 orders having been issued since July 2016. The focus of all the directives of SECP since 2014, is not just confined to display of information, rather companies should use their websites for synergizing with investors and the SECP urges clarity, accessibility, facilitation and uniformity in the information disclosed and public companies are therefore encouraged to comply with the same. All other companies are also encouraged to maintain functional websites.

2. **Amendments in Insurance Companies (Sound and Prudent Management) Regulations, 2012**
   In order to promote good corporate governance, which helps to protect the interest of all stakeholders, the Fit and Proper criteria is prescribed and implemented by regulators globally in the financial sector. Likewise, in order to support the insurance sector in Pakistan in meeting the challenges of globalization and to avoid maladministration, insurance companies must be run by competent persons with adequate know-how of the insurance business.

   Considering this fact, in January 2012 the SECP had devised the criteria for CEOs/principal officers and directors, and also for the relevant key officers of insurance companies via the issuance of the 'Insurance Companies (Sound and Prudent Management) Regulations, 2012'. After further review and taking into consideration changes in governance requirements over the years, the SECP has now made various amendments to the abovementioned Regulations via the issuance of an SRO in December 2016.

   The main changes made are as follows:
   - The Regulations shall now also be applicable on "Consultants, Advisors, Executive Directors or others" who are not members of the Board but are charged with the functions of decision-making and formulation of policies of an insurer – as these have been included under "Key Officers" for the purpose of applicability of these Regulations.
   - An affidavit in the form of Annexure C to the Regulations is now required to be submitted by the proposed Director/ CEO/ Principal Officer, along with their application for approval of appointment by SECP, in order to assume charge of office. This affidavit is a required undertaking by the Director/ CEO/ Principal Officer to ensure their "Fitness and Propriety" for the respective role. [Note: Annex A

(consisting of basic information and bio-data) and Annex B (affidavit on the eligibility of the person and correctness of information) remain the same as before].

- Various matters pertaining to fitness and propriety, as included in the affidavit (Annex C), have also been incorporated in the relevant clauses within the Regulations.

3. Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Regulations

A clarification was issued by SBP regarding Annexure-I to the AML/CFT Regulations which requires banks/DFIs to obtain photocopies of identity documents of all directors and persons authorized to open and operate accounts while establishing banking relationships with Limited Companies/ Corporations.

The clarification has stated that the condition of obtaining photocopies of such documents of directors of Limited Companies/Corporations **is relaxed in case of Government/Semi Government entities**, where banks/DFIs should obtain photocopies of identity documents of **only those directors** and persons who are authorized to open and operate the account. For the other directors, however, banks/DFIs shall validate identity information including CNIC from certified copies of 'Form-A/Form-B' and 'Form 29' and verify their particulars through NADRA Verisys.

4. Revised Instructions on Independent Directors - Banks/DFI's

SBP has amended the definition of "Independent Director" given in the Prudential Regulations and brought it in line with the definition provided in the Code of Corporate Governance as follows:

> "Independent Director means a Director who is not connected or does not have any other relationship, whether pecuniary or otherwise, with the bank/DFI, its associated companies, subsidiaries, holding company or Directors."

In this regard, the 'test of independence' (ie. whether such person can reasonably be perceived as being able to exercise independent business judgment without being subservient to any form of conflict of interest) should be applied.

To further clarify, new clauses have also been added to the list of persons who would not be considered as 'independent', such as a person who:

- is a close relative of the bank/DFI's promoters, Directors or major shareholders[1]
- holds cross-directorships or has significant links with other Directors through involvement in other companies or bodies.
- has served on the Board for more than three consecutive terms from the date of his first appointment (provided that such person shall be deemed "Independent Director" after lapse of one term).
- is nominated by the creditors of the bank/DFI or is in service of Pakistan or any statutory body or any body or institution owned or controlled by the Government

Also, the "cooling off term" of a person who has been an employee of the bank/DFI, any of its subsidiaries or holding company, has been reduced from 5years to 3years before they would be considered independent.

This definition is applicable with immediate effect for new appointments. By March 31, 2018, at least 1/3rd of the board shall comprise of Independent Directors in line with the revised instructions. However, existing Independent Directors may continue till March 31, 2018 or expiry of their terms whichever is earlier.

[1] Close relative means spouse(s), lineal ascendants and descendants and siblings.

SBP further encouraged the enhanced role of Independent Directors in different committees/sub-committees of the Board of Directors of the banks/DFIs and recommends holding of a separate meeting of the Independent Directors at least once in a year.

5. **Insurance Sector in Pakistan – Eliciting Public Comments on the Draft Insurance Bill, 2016**

The SECP approved the draft of the proposed Insurance Bill, 2016 for eliciting public comments on December 27, 2016. Prior to this the SECP held consultative roundtables in Karachi, Islamabad and Lahore in October 2016 that were attended by insurance companies, insurance brokers, associations of insurance surveyors, Pakistan Societies of Actuaries and the Institute of Chartered Accountants of Pakistan.

The draft Bill aims to provide a regulatory environment that encourages market development, strengthens regulatory framework- ensuring alignment with the Insurance Core Principles (ICP) of the International Association of Insurance Supervisors (IAIS), address entity specific and systemic risks by a phased shift towards Risk Based Supervision (RBS) and Risk Based Capital (RBC) Regime and to address the regulatory gaps in existing law.

SECP is striving to improve the overall governance framework of Insurance Companies in Pakistan which is evident from efforts towards the approval of the draft Bill, recent issuance of the Code of Corporate Governance for Insurers, 2016, meetings being held with various stakeholders including pre-audit meetings with statutory external auditors of listed insurance companies, and recent amendments in the Insurance Companies (Sound and Prudent Management) Regulations, 2012 (mentioned above).

6. **Revised Guidelines and Disclosures on Governance and Remuneration Practices**

SBP had developed and issued 'Guidelines on Remuneration Practices' via BPRD Circular No. 02 of 2016 in March 2016 to provide banks/DFIs with recommended policy measures and disclosures on their compensation practices to align them with risks and responsibilities and international standards. In this regard, feedback was received by SBP from the banking industry on the basis of which revisions have been made to certain paras of the guidelines/disclosures and the implementation timeframe.

Consequent to this revision, Banks/DFIs shall now be required to:

- prepare a comprehensive, transparent and fair remuneration policy and Framework setting mechanism latest by 31.12.2017 in a phased manner[2], and
- disclose the remuneration related matters on annual basis effective from 31.12.2018.

Banks/ DFIs are advised to ensure compliance with the revised Guidelines in letter and spirit; strictly adhere to the timeframe; and provide a quarterly report (duly approved by the Board Remuneration Committee) on the activities undertaken to achieve the corresponding milestones. The first such report shall be submitted for the quarter ending 31st March, 2017.

The guidelines specify the areas that the Board shall be responsible for under Section 1 "Governance and Remuneration Policy". It states that the Board:

- should ensure that a fair, transparent and competitive remuneration mechanism is developed and put in place encouraging the culture of 'pay for performance'.

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[2] Phase/Activity wise implementation schedule is given as Annexure-II to the Revised Guidelines on Remuneration Practices.

- may directly approve the compensation and benefits of CEO and other key executives (based on specific criteria which will be recorded in writing with justifications, and be in line with the overall compensation policy).
- should constitute a Human Resource and Remuneration Committee (keeping in view the complexity, large banks can also form separate committees for 'Human Resource Management' and 'Remuneration' functions).

Accordingly, Boards should ensure that an institution-wide policy on remuneration is developed and implemented keeping in mind that the guidelines provide the minimum benchmark towards better remuneration practices which in turn enhance the overall corporate governance culture.

The guidelines are applicable to Banks (applied to members of the Board, Key Executives and other senior level employees). DFI's may appropriately comply in accordance with their size, nature of business and complexities of operations. Foreign banks operating in Pakistan in branch mode are not required to follow the guidelines (however, they will be required to provide confirmation to SBP that FSB and BIS guidelines[3] on remuneration practices or similar local standards are being following by their Board and Head offices in their respective home jurisdictions)

7. Authentication of Statutory Returns filed by the Companies

Companies are required to file various statutory returns with the office of the registrar concerned, however, many instances have been observed where such returns are authenticated by different directors/officers of the company, contrary to the authorized signatory specified in the relevant statutory return, which has led to discrepancies, disputes and litigation.

In order to ensure transparency and sanctity of information, all companies are directed to ensure that returns filed with the Commission and Company Registration Offices (CROs) shall be authenticated by an Officer (as defined under the Companies Ordinance 1984) who shall also be **duly authorized through a resolution of the board of directors in writing**. Copy of such resolution shall be provided along with the return filed on the letterhead of the company and the resolution so provided shall not be older than one year on the date of filing of return.

It will be effective in respect of filings made on or after March 1, 2017. All companies (except as stated above) are required to ensure meticulous compliance with this direction, failing which statutory returns filed by them shall not be accepted by the respective CROs. (It will not be applicable upon filing of returns notifying information relating to resignation of directors, chief executive, secretary or other responsible officers of the company; and on single member private limited companies.)

8. Companies Bill 2017

The National Assembly (NA) approved the Companies Bill, 2017 on February 6, 2017, based on a review of the recommendations received from the subcommittee of the Standing Committee of the NA. Henceforth, if approved by the Senate and assented to by the President, it will become law.

The proposed new law aims at being more facilitative by recommending various business measures to aid the ease of doing business and investor facilitation on the one hand, and providing for stringent enforcement powers, anti-fraud measures, etc., on the other.

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[3] Refer Financial Stability Board(FSB)- http://www.fsb.org/ & Bank for International Settlements- https://www.bis.org/

Proposed provisions mentioned include:

- ease in incorporation of new companies and less filing requirements;
- companies with a paid-up capital up to Rs 3million are not required to file return if there is no change in the particulars;
- concept of inactive company has been introduced (this will provide flexibility to owners to keep companies alive with no compliance requirements during the inactive period);
- companies with a paid-up capital up to Rs1 million are not required to get the financial statements audited; concept of decision by circular resolution has been introduced for ease of operations;
- alternative dispute resolution mechanism has been provided in the law (this will assist companies to resolve matters in lesser time without having to pay hefty legal fees); and
- amalgamation and merger has been eased by allowing the amalgamation of wholly owned subsidiaries in holding company without formal approval.

Further, the new Ordinance encourages the use of technology and electronic mediums of transferring information to all relevant stakeholders.

9. PICG Task Force on review of Code of Corporate Governance

The Board of Directors of PICG had appointed a task force under the Chairmanship of Mr Ebrahim Sidat to review the Code of Corporate Governance 2012 and make recommendations aimed at further improving the standard of Governance.

The task force recommendations were presented to the Board of PICG which, while appreciating the role of the task force, approved the recommendations. These will now be submitted to SECP for consideration.

International

1. **FRC Report- Developments in Corporate Governance and Stewardship**

   The Financial Reporting Council (FRC) is UK's independent regulator that sets UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work and also monitors and takes action to promote the quality of corporate reporting.

   The FRC published a report in January 2017 highlighting the quality of compliance with, and reporting against, the UK Corporate Governance and Stewardship Codes and includes findings on the quality of engagement between companies and shareholders and provides an indication to the market as to where the FRC would like to see changes in corporate governance behaviour and reporting. The FRC believes more focused reporting by boards on how they discharge their responsibilities is necessary and has asked for more oversight powers from the Government to help achieve this.

   The report indicates that compliance with the UK Corporate Governance Code remains high but where Boards choose not to follow provisions "too many explanations are of poor quality"- suggesting that some boards still need to do more than pay lip service to the needs of their shareholders and other stakeholders. The report also includes analysis of the 2016 AGM season which showed generally reduced support for 'remuneration resolutions' and concern about a lack of transparency in the link between executive pay and performance. Further, boards need to address succession planning and diversity, and be better informed about the link to strategy and business value.

   Theresa May, the British Prime Minister, while outlining her plans on leaving the EU at the recently concluded World Economic Forum in Davos, pledged that UK will be "delivering yet higher standards of Corporate Governance to help make UK the best place to invest of any major economy".

2. **The 2017 World Development Report - Governance and The Law[4]**

   World Development Report, published annually since 1978, is one of the key outputs of the World Bank's Development Economics unit and is a guide to the economic, social, and environmental state of the world today. Each year a specific aspect of development is analyzed and policy recommendations are made as a result thereof, which are used by a number of multilateral and bilateral international organizations, national governments, development institutions and other global thought leaders.

   The topic for the 2017 Report is "Governance and The Law". The 2017 Report urges developing countries and international development agencies to rethink their approach to governance, as a key to overcoming challenges related to security, growth, and equity. The Report further explains how good governance can mitigate, even overcome, power asymmetries to bring about more effective policy interventions that achieve sustainable improvements

   Moving beyond the traditional concerns about implementation, such as limited state capacity, the Report then highlights how individuals and groups with differing degrees of influence and power can negotiate the choice of policies, the distribution of resources, and the ways in which to change the rules themselves. As the Report shows, positive change is possible and policy making and policy implementation do not occur in a vacuum.

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[4] World Bank. 2017. World Development Report 2017: Governance and the Law. Washington, DC: World Bank. doi:10.1596/978-1-4648-0950-7. License: Creative Commons Attribution CC BY 3.0 IGO

The main messages of the Report are:

- Successful reforms are not just about “best practice.” To be effective, policies must guarantee credible commitment, support coordination, and promote cooperation.
- Power asymmetries can undermine policy effectiveness. The unequal distribution of power in the policy arena can lead to exclusion, capture, and clientelism.
- Change is possible. Elites, citizens, and international actors can promote change by shifting incentives, reshaping preferences and beliefs, and enhancing the contestability of the decision making process.
- Three guiding principles for rethinking governance for development are:
    - Think not only about the form of institutions, but also about their functions.
    - Think not only about capacity building, but also about power asymmetries.
    - Think not only about the rule of law, but also about the role of law

Global Trends in Corporate Governance expected in 2017

Global trends likely to be faced by public companies in 2017:

- Increasing expectations around the oversight role of the board, to include greater oversight of strategy and scenario planning, investor engagement, and executive succession planning.
- Continued focus on board refreshment and composition, with particular attention being paid to directors’ skill profiles, the currency of directors’ knowledge, director over boarding, diversity, and robust mechanisms for board refreshment that go beyond box-ticking exercises.
- Greater scrutiny of company plans for sustained value creation, as concerns increase that activist settlements and other market forces are causing short-term priorities to compromise long-term interests.
- Greater focus on Environmental, Social and Governance (ESG) issues, and in particular those related to climate change and sustainability, as industries beyond the extractive sector begin to feel investor pressure in this area.

- *Post on ‘The Harvard Law School Forum on Corporate Governance and Financial Regulation’ by Russell Reynolds Associates-Jan 2017*

Other news:

We are pleased to announce that the Detailed Analysis Report on the Survey on "Board Composition, Practices & Remuneration-2016", conducted by PICG's Research Team, is now available.

The survey was carried out to obtain direct feedback from companies in Pakistan regarding current practices within their organizations and the extent to which they are complying with the Code of Corporate Governance and its underlying principles.

Please refer contact information given below in case you would like to obtain a copy for yourself or for other members of your board (ie. a board pack)