

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ



## **The Securities and Exchange Commission of Pakistan**

was established under the Securities and Exchange Commission of Pakistan Act, 1997 for beneficial regulation of the capital market and superintendence and control of corporate entities. Over time, its mandate has been expanded to include supervision and regulation of insurance companies and non-banking finance companies. Consequently, the Commission is now an integrated corporate and non-banking financial sector supervisor/regulator.

This report has been prepared in pursuance of Section 25 of the Securities and Exchange Commission of Pakistan Act, 1997 for the purpose of reporting the activities and performance of the Securities and Exchange Commission of Pakistan during the period 1 July 2003 to 30 June 2004.

# Abbreviations and Acronyms

|                     |  |
|---------------------|--|
| ADB                 | Asian Development Bank                                       |
| ADR                 | Alternate Dispute Resolution                                 |
| AGM                 | Annual General Meeting                                       |
| ALICO               | American Life Insurance Company (Pakistan) Limited           |
| AML                 | Anti-money Laundering  |
| APG                 | Asia/Pacific Group   |
| CA                  | Chartered Accountant   |
| CBR                 | Central Board of Revenue                                     |
| CDC                 | Central Depository Company of Pakistan Limited               |
| CDS                 | Central Depository System                                    |
| CEES                | Companies Easy Exit Scheme                                   |
| CEO                 | Chief Executive Officer                                      |
| CFT                 | Countering the Financing of Terrorism                        |
| CLA                 | Corporate Law Authority                                      |
| CLD                 | Company Law Division   |
| CMA                 | Cost and Management Accountant                               |
| CNIC                | Computerized National Identity Card                          |
| COI                 | Certificate of Investment                                    |
| Cost Audit Rules    | Companies (Audit of Cost Accounts) Rules, 1998               |
| COT                 | Carry-over Transactions                                      |
| CRO                 | Company Registration Office                                  |
| CS                  | Chairman's Secretariat                                       |
| CSR                 | Corporate Social Responsibility                              |
| Deposit Rules       | Companies (Invitation and Acceptance of Deposit) Rules, 1987 |
| DFI                 | Development Finance Institution                              |
| EFU                 | EFU Life Assurance Limited                                   |
| EMC                 | Emerging Markets Committee                                   |
| FMGP                | Financial (non-bank) Markets and Governance Program          |
| FSAP                | Financial Sector Assessment Program                          |
| FY                  | Financial Year   |
| GATS                | General Agreement on Trade in Services                       |
| GNP                 | Gross National Product                                       |
| HBFC                | House Building Finance Corporation                           |
| IAIS                | International Association of Insurance Supervisors           |
| IAS                 | International Accounting Standard                            |
| ICAP                | Institute of Chartered Accountants of Pakistan               |
| ID                  | Insurance Department   |
| IFIC Bank Limited   | International Finance Investment and Commerce Bank Limited   |
| IMF                 | International Monetary Fund                                  |
| INPRS               | International Network of Pension Regulators and Supervisors  |
| Insurance Ordinance | Insurance Ordinance, 2000                                    |
| IOSCO               | International Organization of Securities Commissions         |
| IPO                 | Initial Public Offer   |
| ISE                 | Islamabad Stock Exchange                                     |
| IT                  | Information Technology                                       |
| ITSP                | Information Technology Strategy Plan                         |
| JEIS                | Junior Executives Induction Scheme                           |
| KSE                 | Karachi Stock Exchange                                       |
| KSE-100 Index       | Karachi Stock Exchange 100 Shares Index                      |
| KYC                 | Know-Your-Customer   |
| LAN                 | Local Area Network   |
| LSE                 | Lahore Stock Exchange  |
| LUMS                | Lahore University of Management Sciences                     |
| MAP                 | Modaraba Association of Pakistan                             |
| METRO               | Metropolitan Life Assurance Company of Pakistan Limited      |
| MIS                 | Management Information System                                |
| MLM                 | Multi-level Marketing  |

|                         |  |
|-------------------------|--|
| Modaraba Ordinance      | Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980 |
| Modaraba Rules          | Modaraba Companies and Modaraba Rules, 1981                              |
| MoU                     | Memorandum of Understanding  |
| MSF                     | MetroBank Pakistan Sovereign Fund  |
| NAB                     | National Accountability Bureau   |
| NAV                     | Net Asset Value  |
| NBFC                    | Non-banking Finance Company  |
| NBFCD                   | Non-banking Finance Companies Department                                 |
| NBFC Rules              | Non-banking Finance Companies (Establishment and Regulation) Rules, 2003 |
| NBFI                    | Non-banking Financial Institution  |
| NBP                     | National Bank of Pakistan  |
| NCCPL                   | National Clearing Company of Pakistan Limited                            |
| NCEL                    | National Commodity Exchange Limited                                      |
| NDLC                    | National Development Leasing Corporation                                 |
| NICL                    | National Insurance Company Limited                                       |
| NJLI                    | New Jubilee Life Insurance Company Limited                               |
| NOC                     | No Objection Certificate   |
| OGDCL                   | Oil and Gas Development Company Limited                                  |
| OTC                     | Over-the-Counter   |
| PD                      | Policy Department  |
| PIA                     | Pakistan International Airlines Corporation                              |
| PICIC                   | Pakistan Industrial Credit and Investment Corporation                    |
| Policy Board            | Securities and Exchange Policy Board                                     |
| PRCL                    | Pakistan Reinsurance Company Limited                                     |
| PSD                     | Professional Services Department   |
| PSPD                    | Professional Services and Policy Division                                |
| QCR                     | Quality Control Review   |
| RIA                     | Regulatory Impact Assessment   |
| SBP                     | State Bank of Pakistan   |
| SCD                     | Specialized Companies Division   |
| SLIC                    | State Life Insurance Corporation of Pakistan                             |
| SMC                     | Single Member Company  |
| SMD                     | Securities Market Division   |
| SME                     | Small and Medium Enterprise  |
| SOE                     | State-owned Enterprise   |
| SPV                     | Special Purpose Vehicle  |
| SRO                     | Self-regulatory Organization   |
| SSD                     | Support Services Division  |
| SSGCL                   | Sui Southern Gas Company Limited   |
| TA                      | Technical Assistance   |
| TFC                     | Term Finance Certificate   |
| The Commission          | The Securities and Exchange Commission of Pakistan                       |
| The Companies Ordinance | The Companies Ordinance, 1984  |
| The Constitution        | The Constitution of the Islamic Republic of Pakistan, 1973               |
| The SECP Act            | The Securities and Exchange Commission of Pakistan Act, 1997             |
| ToR                     | Terms of Reference   |
| UK                      | United Kingdom   |
| UNDP                    | United Nations Development Program                                       |
| UNODC                   | United Nations Office on Drugs and Crime                                 |
| USA                     | United States of America   |
| UTP                     | Unit Trust of Pakistan   |
| VPS                     | Voluntary Pension System   |
| WAN                     | Wide Area Network  |
| WG3                     | Working Group-3  |
| WTO                     | World Trade Organization   |

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## Vision

The development of modern and efficient corporate sector and capital market, based on sound regulatory principles, that provide impetus for high economic growth and foster social harmony in the country.

## Mission

To develop a fair, efficient and transparent regulatory framework, based on international legal standards and best practices, for the protection of investors and mitigation of systemic risk aimed at fostering growth of a robust corporate sector and broad based capital market in Pakistan.

## Strategy

To develop an efficient and dynamic regulatory body that fosters principles of good governance in the corporate sector, ensures proper risk management procedures in the capital market, and protects investors through responsive policy measures and effective enforcement practices.

# Chairman's Report

I am pleased to present the annual report of the Securities and Exchange Commission of Pakistan (the Commission) covering the year 1 July 2003 to 30 June 2004. During the year under review, sustained efforts were made to implement the reform measures identified at the outset of the year. The Commission developed a diagnostic approach towards solving the various issues in the financial sector and intends to develop a medium-term strategy for the regulation and development of corporate and financial (non-banking) sectors.



## Market Development

Regulatory mechanisms of the Commission supplemented the milestones achieved by the capital market during the year as the Karachi Stock Exchange 100 Shares Index touched an all time high of 5,620 on 19 April 2004. Market capitalization of the Karachi Stock Exchange nearly doubled during the year, reaching US\$ 24.3 billion as at the close of the year from US\$ 13.05 billion as at the close of last year.

Activity in the primary market signified the depth added to the capital market. There were eleven equity issues during the year, compared to three in the last year. All, except one, were oversubscribed. The Commission continued to take proactive measures to curtail systemic risk in the capital market and, in this regard, introduced the Margin Trading Rules, 2004. Moreover, a road map for the phase-out of Carry-over Transactions (COT) was also announced in consultation with the stock exchanges; accordingly, COT would be replaced by margin financing and futures trading by June 2005.

To strengthen and develop the financial sector, the Commission continued to encourage mergers for improving the capital base of non-banking finance companies (NBFCs). It also granted licenses to new NBFCs to undertake various forms of business, as laid down in the Companies Ordinance, 1984. New products were also introduced in the insurance sector as the Commission introduced takaful business in the country and constituted a task force to prepare necessary rules in this regard. Pursuant to its recently expanded mandate to regulate private pension schemes in the country, the Commission designed a scheme of voluntary pension system and is presently finalizing the rules for the purpose.

## Governance Measures

The Commission diligently pursued its objective of improving the governance of capital market and corporate sector. During the year, the Commission constituted an Expert Committee, comprising of national and international experts, to formulate a comprehensive plan for demutualization and integration of stock exchanges. For the furtherance of corporate governance, the Commission initiated the process of setting up an Institute of Corporate Governance in Pakistan in collaboration with major stakeholders. The Institute, which is now at the final stages of establishment, shall provide training and development in corporate governance as well as cater for indigenous research. In all, it will provide an enabling environment for effective implementation of the Code of Corporate Governance.

## Institutional Developments

During the year, the Securities and Exchange Policy Board (Policy Board) was reactivated and brought to its full strength of nine members. The Policy Board provides advice to the Federal Government relating to the securities market, insurance industry and corporate sector as well as oversees the performance of the Commission. Meetings of the Policy Board were held every quarter during the year to achieve these purposes.

In order to strengthen the policy making function at the Commission as well as to ensure the independence of professional services provided to the financial sector under its purview, the Commission underwent internal restructuring and established a new Division, namely, Professional Services and Policy Division. The Division recommends policy guidelines for the consideration of the Commission and the Policy Board, based on international best practices and local circumstances. One of the key responsibilities assigned to the Division is to regulate and promote the development of professional bodies and self-regulatory organizations. The Division also provides legal support to the Commission.

Efficient and timely resolution of investor complaints was rigorously pursued so as to achieve the Commission's primary objective of protection of investor interests. An enabling environment within the Commission is being engendered for this purpose and well-defined, transparent procedures have been developed. Capacity building of the Commission also remained a continuous feature of development. A number of skilled professionals were inducted during the year and placed in various Divisions of the Commission. Capacity building in terms of information technology (IT) enhancement was also undertaken during the year.

## Operational Overview

During the year under review, public facilitation was enhanced to ensure growth of the corporate sector. The incorporation fee was reduced and a number of guides were published to educate the public. The Companies Easy Exit Scheme was re-launched to provide another opportunity to dormant companies to get their names struck off the register of companies. On the enforcement side, the Commission undertook targeted actions to discourage unauthorized inter-corporate financing, non-payment of dividends, irregularities relating to employees' provident fund accounts and other contraventions of statutory provisions.

In the securities market area, the Commission initiated on-site inspection of books and records of several brokers. Furthermore, the National Clearing Company of Pakistan Limited has improved efficiency of the settlement process and operationalization of the National Commodity Exchange is in the offing.

In order to strengthen the non-banking finance sector and introduce a uniform set of regulations, prudential regulations were introduced for NBFCs while prudential regulations for modarabas were revised. Accounting regulations and accounting formats for life insurance companies were also reviewed while their illustrative returns were capped at 8 percent.

The Commission maintained a regular review of operational matters of professional bodies of accountants and credit rating agencies. Amendments were proposed in various laws administered by the Commission and guidelines on certain regulatory matters were drafted. The Fourth Schedule to the Companies Ordinance, 1984 was also revised to improve the reporting framework of listed companies.

Within the Commission, the Internal Audit, Human Resource, Finance, Administration and IT functions were strengthened to provide efficient services to the Commission. The Commission also liaised with various multilateral organizations and relevant capital market and non-banking financial sector related projects were initiated/extended during the year with their assistance.

## International Activities

To attain harmonization of policies internationally, the Commission deems it expedient to contribute to the actual standard setting process. This is ensured through active participation in international fora and standard setting bodies. During the year under review, the Commission was honored to be re-elected to chair the Working Group-3 (WG3) of Emerging Markets Committee (EMC) of the International Organization of Securities Commissions (IOSCO). As chair of the WG3, the Commission presented a draft report on 'Cross-border Activities of Financial Intermediaries in Emerging Markets' at IOSCO's Annual Conference in Amman, Jordan this year. The report covers the issue of cross-border trading at three levels – international experience, prevalent regulatory practices in EMC member countries and recommendations for emerging markets.

Subsequent to the close of the year, the Commission obtained membership of the International Organization of Pension Supervisors in consideration of its mandate to regulate voluntary pension schemes in Pakistan. The Commission also joined the International Association of Insurance Supervisors (IAIS) to coordinate with counterpart regulatory authorities in the area of insurance; its membership is subject to approval in the forthcoming annual meeting of IAIS.

During the year under review, joint Mission of the World Bank and the International Monetary Fund visited the Commission in connection with Financial Sector Assessment Program. The Mission carried out detailed assessments of compliance with IOSCO's thirty principles of securities regulation as well as in areas of insurance and NBFCs. While finding the Commission compliant to a large extent with IOSCO's principles, the Mission highlighted that the securities market has gained from the recent reforms introduced by the Commission but may still be vulnerable to risk owing to speculative trading and highly leveraged position. Detailed recommendations were also made in this regard, which are being used in developing a blue print for securities market reforms.

## Bilateral Cooperation

As a step towards bilateral cooperation, the Commission signed a Memorandum of Understanding (MoU) with the Securities and Exchange Commission of Sri Lanka. The three stock exchanges of Pakistan also signed MoUs with the stock exchanges of Colombo and Chittagong. The MoUs set out a framework for mutual cooperation and sharing of information amongst these jurisdictions, which is in line with our objective of integrating Pakistan's capital market with global markets.

In order to ensure holistic regulation, the Commission has initiated coordination with other regulatory bodies within the country. Coordination with the State Bank of Pakistan (SBP) is being strengthened and quarterly coordination meetings are held regularly to discuss areas of mutual concern and to ensure that there are no regulatory gaps or overlaps. A MoU was signed with SBP to institutionalize mutual cooperation. The Commission is also in the process of forming a task force with the Central Board of Revenue (CBR) to study the tax structure for addressing the impediments to corporatization and growth of the corporate sector.

## Regulatory Challenges

The Commission enjoys different roles, ranging from supervisory to regulatory, in the various sectors under its purview. At the time of its establishment, the Commission was assigned the regulation of capital market and corporate sector. Subsequently, insurance and non-banking finance sectors as well as private pensions were also passed on to the Commission. While the idea of consolidated regulation is appreciable, the Commission's mandate – that has enlarged substantially but piece-meal – needs to be realigned and made consistent across all sectors. In terms of the securities market, the corporate sector as well as the NBFC sector, the Commission is the apex regulator; however, in the insurance sector, there is a need to strengthen the powers of the Commission to effectively enforce the rules and regulations and take timely remedial actions to protect the interests of policyholders. Cohesive regulation of the sectors under the Commission's purview cannot be achieved unless uniform regulatory powers are assigned to it for all sectors.

In the area of professional services for corporate and financial sectors, a regulatory gap seems to exist. Although the Federal Government has delegated its powers to the Commission for regulation of certain service providers in the industry, many are functioning without

any proper regulatory framework in place. Service providers have a key role to play in the development of corporate and financial sectors and unless they are given due recognition and regulated under one umbrella, it would be difficult to raise the standards of corporate service delivery and strengthen these sectors.

Despite the focused measures undertaken by the Commission to improve the regulatory framework, regulatory imbalance among various sectors proves to be a major hindrance to the uniform development of the financial (non-banking) sector. Sustained buoyancy in the financial sector cannot be achieved unless its various segments receive adequate attention and uniform regulation is set out for each.

In an attempt to address some of these issues, I have developed a blueprint for the regulation and development of corporate and financial (non-banking) sectors, which is laid out in the first chapter of this report. The blueprint is intended to assist the Commission in developing the proposed medium-term strategy for the purpose.

## Regulatory Policy

In order to overcome the regulatory imbalance, the Commission intends, with the help of the Policy Board, to develop an integrated and uniform regulatory policy focused on removing the gaps in regulation and providing an enabling environment for business growth and development. The regulatory policy will, *inter alia*, include the following:

- i. a framework for proactive and flexible regulation;
- ii. standards defining the structure and quality of information that regulatees should provide; and
- iii. harmonization between local requirements and international best practices.

In order to introduce cost-effective regulation in the country, the Commission also intends to restructure the legal and regulatory framework, including the introduction of regulatory impact assessment (RIA). The Commission takes due cognizance of the fact that the policies it adopts have far reaching effects on various segments of the economy. As the ultimate aim of any legal and regulatory framework is to provide impetus to economic development, it is important to scrutinize its impacts on the various facets of the economy. RIA will provide the Commission with the mechanism to evaluate the impact of its laws, rules and regulations and strengthen the design and implementation of regulatory strategies.

The Commission further intends to develop a corporate tax policy, in collaboration with CBR, to promote corporatization and encourage progressive development of corporates in the country.

## Acknowledgments

Before I conclude, I would like to thank the Policy Board members for their valuable guidance and support. I would also like to take this opportunity to commend the management and staff of the Commission for their hard work and dedication throughout the year. It has been through concerted and focused team effort that the Commission has achieved many more milestones this year. I value the contributions of all my colleagues and am grateful for their efforts to improve institutional services for all stakeholders. In particular, I would like to acknowledge and appreciate the valuable contribution of Mr. Zafar-ul-Haq Hijazi who retired as Commissioner during the year. Mr. Hijazi contributed immensely towards the reform process instituted by the Commission over his five-year tenure as Commissioner.

I would also like to extend my gratitude to Mr. Shamim Ahmad Khan, first Chairman of the Commission and the architect of its institutional reforms, for not only his valuable comments on the blueprint set out in chapter 1 of this report but also his dedicated support for the continuing process of reforms being followed by the Commission.

Last but not least, I would like to thank my staff and, in particular, the editorial team comprising Jaweria Ather, Sarah Parvez and Salman Khan for ensuring the quality of this report.

