

**Country Review: Islamic Republic of Pakistan**  
**IOSCO Objectives and Principles of Securities**  
**Regulation**  
**Detailed Assessment of Implementation**



**OICU-IOSCO**

**THE BOARD**  
**OF THE**  
**INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS**

**FR13/2015**

**JULY 2015**

Copies of publications are available from:  
The International Organization of Securities Commissions website [www.iosco.org](http://www.iosco.org)

© *International Organization of Securities Commissions 2015. All rights reserved. Brief excerpts may be reproduced or translated provided the source is stated.*

## Contents

Glossary .....	1
I. Summary .....	4
II. Introduction.....	5
III. Information and methodology used for the assessment.....	5
IV. Institutional and regulatory structure .....	7
V. Overview of the capital markets .....	9
Capital Market Infrastructure.....	10
Market Intermediaries .....	11
Corporate Debt Market .....	13
Collective Investment Schemes .....	15
Recent major capital market reforms .....	16
Market/Product Development .....	19
Future planned reforms .....	21
VI. Principle-by-principle assessment of implementation: main findings and recommendations for action.....	24
Table 1: Summary Implementation of the IOSCO Principles – Main Findings .....	26
Table 2: Recommended Action Plan to Improve Implementation of the IOSCO Principles.....	36
VII. The response of the Authorities .....	40
VIII. Detailed Assessment .....	43
Table 3. Detailed Assessment of Implementation of the IOSCO Principles .....	43

## GLOSSARY

Accounting Standards Committee	ASC
Anti-Money Laundering Act 2010	AML Act
Assessment Committee	AC
Asset Management Company	AMC
Assets Under Management	AUM
Audit Oversight Board of Pakistan	AOBP
Balloters Transfer Agents and Underwriter Rules, 2001	BTU Rules 2001
Bonds Automated Trading System	BATS
Broker and Agents	Broker Rules 2001
Capital Gains Tax	CGT
Central Counterparty	CCP
Central Depository Company of Pakistan Limited	CDC
Central Depositories Act, 1997	CDC Act
Central Depository Companies (Establishment and Regulation) Rules, 1996	CDC Rules 1996
Central Depository System	CDS
Chartered Accountants Ordinance 1961	CAO 1961
Chartered Accountant Bye-Laws 1983	CA Bye Laws 1983
Collective Investment Scheme	CIS
Clearing House Protection Fund Trust	CHPFT
Clearing Houses (Registration and Regulations) Rules, 2005	Clearing Houses Rules 2005
Code of Corporate Governance	CCG
Code of Corporate Governance 2012	Code 2012
Commodity Exchange and Futures Contracts Rules, 2005	Commodity Exchange Rules 2005
Companies Ordinance 1984	Ordinance 84
Credit Rating Agency	CRA
Credit Rating Companies Rules, 1995	CRC Rules
The Code of Conduct for Credit Rating Companies/Agencies (directives dated 13 January 2014 issued under rule 7 of the CRC Rules)	CRA-Code of Conduct
Customer Due Diligence	CDD
Default Management Committee	DMC
Default Management Regulations	DMR
Exchange Traded Funds	ETFs

Federal Board of Revenue	FBR
Federal Government	FG
Financial Sector Assessment Program	FSAP
Institute of Capital Markets	ICM
Institute of Chartered Accountants Pakistan	ICAP
International Accounting Standards	IAS
International Federation of Accountants	IFAC
International Financial Reporting Standards	IFRS
International Organization of Securities Commissions	IOSCO
International Standards on Auditing	ISA
Islamabad Stock Exchange	ISE
Karachi Stock Exchange	KSE
Karachi Interbank Offer Rate	KIBOR
Know Your Customer	KYC
Lahore Stock Exchange	LSE
Listed Companies (Substantial Acquisition of Voting Shares and Takeovers) Ordinance 2002	Takeovers Ordinance
Listed Companies (Substantial Acquisition of Voting Shares and Take-Overs) Regulations, 2008	Takeover Regulations
Listing Regulations of the exchange	LR
Market Surveillance Suite	MSS
Memorandum of Understanding	MoU
Ministry of Finance	MoF
Multilateral Memorandum of Understanding	MMoU
Mutual Funds Association of Pakistan	MUFAP
National Clearing and Settlement System	NCSS
National Clearing Company of Pakistan Limited	NCCPL
National Clearing Company of Pakistan Ltd Regulations 2012	NCCPL Regulations
National Database and Registration Authority	NADRA
National Identity Card	NIC
Net-Asset Value	NAV
Net Capital Balance	NCB
Non-Bank Finance Companies	NBFCs
Non-Bank Finance Companies and Notified Entities Regulations 2008	NBFC Regulations 2008
Non-Bank Finance Companies Rules 2003	NBFC Rules 2003
Over the Counter	OTC
Pakistan Mercantile Exchange Limited	PMEX

Professional Standards and Technical Advisory Committee	PS&TAC
Qualified Institutional Buyer	QIB
Quality Assurance Board	QAB
Quality Control Review	QCR
Risk Management Regulations	RMR
Securities and Exchange Commission of Pakistan	SECP
Securities and Exchange Commission of Pakistan Act 1997	SECP Act
Securities and Exchange Ordinance 1969	Ordinance 1969
Securities and Exchange Rules 1971	Rules 1971
Securities Investor Protection Corporation	SIPC
Self-Regulatory Organization	SRO
Small and Medium Enterprises	SME
Specialized Companies Division	SCD
State Bank of Pakistan	SBP
Stock Exchanges (Corporatization, Demutualization and Integration) Act, 2012	Demutualization Act
Stock Exchanges (Corporatization, Demutualization and Integration) Regulations, 2012	Demutualization Regulations
Term Finance Certificates	TFC
Trading Right Entitlement Certificate	TREC
Unique Identification Number	UIN
Value at Risk	VaR

## I. SUMMARY

Pakistan has made significant improvements in the structure and practice of regulation since the 2004 Financial Sector Assessment Program (FSAP) report and this is reflected in this assessment. Challenges remain however. At the same time the expectations IOSCO has of its member organizations has also increased, most notably since the Global Financial Crisis. The required scope of regulation is now broader, and the issue of effectiveness and of the outcomes achieved are more important features of any assessment of implementation of IOSCO's Objectives and Principles. In terms of scope, the SECP has yet to adopt effective measures that meet the demands of new Principles to identify and mitigate systemic risk, to regulate hedge funds and to mitigate the risks to investors from conflicts of interest in the work of research analysts employed by brokers, while the jurisdiction has yet to create an oversight body for the accounting and auditors that is independent of that audit profession and acts solely in the public interest.

These challenges notwithstanding, the SECP has broad and comprehensive powers of investigation surveillance and enforcement. The operation of the civil court system is not conducive to the rapid resolution of appeals against SECP decisions and the criminal justice system does not appear to be sufficiently supportive, both of which hamper the SECP's effectiveness; there is no provision for prison sentences for insider trading for example. Bank secrecy appears to remain a problem despite the SECP becoming a full signatory to the IOSCO MMoU.

Regulation of issuers is extensive and the interests of minority shareholders appear to be reasonably well safeguarded although disclosure of materially significant information has not kept pace with improvements elsewhere. This is to some extent, recognized in the LR and the Code 2012 forming part of the LR. However, although compliance with the LR is mandatory for listed companies, it is not clear to what extent compliance with Code 2012 is followed by issuers.

Accounting and auditing standards are generally high but, as noted above, Pakistan has not kept pace with international developments whereby auditors and accounting standards are now subject to oversight by a body which acts exclusively in the public interest. The industry remains in the control of the accounting profession.

In the collective investment scheme sector, although supervision of managers appears sufficient, the lack of supervision of scheme distributors by either the SECP or an SRO is a potential vulnerability as was, until very recently, the lack of an inspection regime for trustees, given the reliance SECP and investors places on trustees meeting their responsibilities diligently.

The licensing and supervision of market intermediaries is subject to resource constraints which impact on the frequency with which brokers are subject to on-site inspections and this is compounded by the lack of an effective process of risk based supervision and initial and ongoing licensing requirement that properly reflect the recent move from individual stock exchange membership to corporate membership following demutualization of the exchanges.

Significant vulnerabilities in regulation governing the segregation of client money by brokers, which have been the source of investor losses in the past, are just beginning to be addressed but may need more intensive intervention by the SECP.

Many of these deficiencies and vulnerabilities have been identified by the SECP prior to this assessment and an extensive program of legislative and regulatory improvement is currently underway. This assessment strongly endorses that program, as it understands it, but also makes a significant number of additional recommendations for action for the consideration of the SECP and Federal Government (FG).

## **II. INTRODUCTION**

This assessment is the first to be undertaken as a result of decisions taken as part of IOSCO's 2010 Strategic Direction Review. This recommended that an Assessment Committee (AC) be established to organize and structure a program to assess implementation of IOSCO Principles and Standards across the IOSCO membership. It also provided guidance on how the assessment program might be structured. One of the AC's responsibilities is to design and conduct a program of Country Reviews. The AC's core responsibilities are to review self-assessments prepared by IOSCO member jurisdictions of their implementation of IOSCO Principles using the IOSCO assessment methodology. Specifically, the AC reviews will:

- Evaluate the status of compliance of IOSCO Principles by the jurisdiction;
- Identify gaps in the implementation of IOSCO Principles; and
- Recommend, through a road map, how issues of significance and materiality to IOSCO Principles identified by the review might be addressed.

The reviews are to be carried out by Review Teams comprised of current, practicing regulators from member organizations.

The Review Team wishes to thank the staff of the SECP for the collaborative and professional approach they brought to the review process and the large volume of work they completed in preparing the self-assessment and responding to the numerous and, in many cases, complex questions the Review Team raised. Particular thanks go to Khalida Habib and her group for organizing and coordinating the process efficiently and with grace and good humor. The AC would also like to thank the five member organizations who volunteered staff members to form the Review Team and others who provided support.

## **III. INFORMATION AND METHODOLOGY USED FOR THE ASSESSMENT**

This first assessment was carried out by a Review Team of six regulators nominated by member organizations from developed and emerging markets and a member of the IOSCO secretariat who collectively brought a broad range of current knowledge and practical expertise to the task. They were Raluca Tircoci-Craciun (IOSCO Secretariat), Mark McGinness (Dubai FSA), Majeed Abduljabbar (Saudi Arabia CMA), Laurent van Burik (Luxemburg CSSF), Selcan Olca (Turkey CMB) and Marian Kljakovic (Australia ASIC). The Review Team leader was Richard Britton, an independent consultant who



has worked on numerous FSAPs. Financial support to conduct the project was received from the Pakistani authorities.

The primary source document for the Review Team's assessment was a self-assessment prepared by a task force set up by the SECP, comprising members from all operational departments relevant to the regulation of securities markets. The assessment structure followed the methodology developed by IOSCO and used by the IMF and World Bank when conducting assessments under the FSAP. That is, the SECP provided answers to a series of Key Questions under each Principle, the purpose of which is to identify potential gaps, inconsistencies, weaknesses, and areas where further powers may be necessary, and as a basis for framing priorities for enhancements or reforms to existing laws, rules and procedures. According to the SECP, the main sources of information it used in undertaking the self-assessment were relevant legislation and practices regarding the regulation of securities and investments, the regulatory and surveillance arrangements adopted by SECP, and system and procedures adopted by firms in complying with the legislation and other public or non-public documents. The methodology used was a combination of desk research, questionnaires to various stakeholders, reports and Pakistan's 2004 FSAP assessment. The first draft of the self-assessment was delivered to IOSCO in November 2013.

Throughout the course of 2014 the Review Team developed a better and deeper understanding of the regulatory framework and operational capabilities of the SECP via a process of written questions and answers supported by documentary evidence such as copies of the laws, regulations, guidance etc. In January 2015 a three day meeting was held between the Review Team and representatives of the SECP. A conference call was held with two Commissioners and meetings were also held with representatives of the stock exchanges, the clearing company and the central depository and two brokers. Discussions were frank and open and provided significant additional information and clarifications to assist the Review Team in its final deliberations.

The Review Team followed the approach laid down by IOSCO which requires that the assessment be based on the current situation. Envisaged changes should not be used as a reason to alter the assessment of implementation and therefore should not be reflected in the assessment grade given to a Principle. The Review Team has however commented on current and planned initiatives that, if fully and effectively implemented, will lead to enhanced grades.

The Review Team was also conscious of the IOSCO requirement to not only look at the legal and regulatory framework in place, but also at how it has been implemented in practice. This involves making judgments on supervisory practices and determinations on whether they are sufficiently effective. Among other exercises, such a judgment involves a review of the inspection programs for different types of supervised entities, the cycle, scope and quality of inspections as well as assessing how the SECP follows up on findings, including by using enforcement actions.

## IV. INSTITUTIONAL AND REGULATORY STRUCTURE

### Institutional Structure

Pakistan's financial sector is divided along institutional lines and is regulated by two regulators: the SECP and the SBP. SECP governs the regulation of the entire non-bank financial sector, including the capital markets, corporate sector and insurance; and the SBP, Pakistan's central bank, is mandated to regulate the banking sector including banks, development financial institutions and microfinance institutions under statutes namely, the State Bank of Pakistan Act 1956 and the Banking Companies Ordinance, 1962. SECP also regulates company matters (within the framework of Ordinance 84) for all the banks, and also investor protection (within the framework for listed companies) where a bank is listed on a stock exchange.

The SECP was constituted on January 1, 1999 in pursuance of the SECP Act. It is an independent statutory regulatory authority for the superintendence and control of corporate entities, administration of the corporate laws and the beneficial regulation of the capital market. SECP's mandate also includes regulation of non-bank finance companies (NBFCs). These include mutual funds, investment banks, leasing companies, housing finance, discount houses, private pensions, real estate investment trusts and private equity and venture capital funds, modarabas (closed ended funds operating on the basis of Islamic Shariah principles), insurance companies, credit rating companies and professional accounting bodies.

SECP is responsible for the supervision of both securities and derivatives markets. In particular, it has responsibility for the supervision of primary securities markets (issuance); secondary markets (for both securities and derivatives); the disclosure obligations of issuers; the provision of investment services by market intermediaries; and collective investment schemes (mutual funds and investment companies). The authorization of all intermediaries, as well as the authorization of all market infrastructure providers (exchanges, the central clearing company and depository) is also the responsibility of the SECP. The SECP is also responsible for the oversight of various external service providers to the corporate and financial sector, including chartered accountants, credit rating agencies, corporate secretaries, brokers, surveyors etc.

Broadly speaking entities and business activities falling under the SECP's regulatory mandate can be categorized into four sectors:

- Corporate sector (includes corporate registry and enforcement of listed companies obligations)
- Capital market
- Insurance sector
- Non-bank finance companies

The regulatory duties and functions of the SECP under the SECP Act can be categorized into 5 broad areas:

- Registration & Licensing

- Supervision
- Enforcement
- Market development
- Legislation – Power to make Rules and Regulations

In addition, the competition authority, the Competition Commission of Pakistan, has broad responsibility for anti-trust issues, including in the financial sector.

## **Legal Environment**

Pakistan has a multifaceted legal regime for securities markets set out in statutes approved by the Parliament, rules approved by the FG, regulations made by the SECP and the stock exchanges with prior SECP approval including among others the listing regulations. The primary legal framework for regulation of securities markets administered by SECP encompasses the following:

- Securities and Exchange Ordinance, 1969 (the Ordinance 1969)
- Companies Ordinance, 1984 (the Ordinance 84)
- Central Depositories Act, 1997 (the CDC Act)
- Securities and Exchange Commission of Pakistan Act, 1997 (the SECP Act),
- Listed Companies (Substantial Acquisition of Voting Shares and Takeovers) Ordinance, 2002 (the Takeovers Ordinance)
- Stock Exchanges (Corporatization, Demutualization and Integration) Act, 2012 (the Demutualization Act)

## **Regulatory Structure**

### ***Regulator***

The SECP Act institutionalized certain policy decisions relating to the constitution and structure, power, and functions of the SECP, thereby giving it administrative authority and financial independence in carrying out its regulatory and statutory responsibilities. It can be categorized as an umbrella law giving SECP the power to administer all other laws which pertain to specified activities.

### ***Self-Regulatory Organizations (SROs)***

The framework in Pakistan comprehensively covers the functioning of SROs, from establishment to processes. The General Regulations issued by the stock and mercantile exchange provide duties and responsibilities of members of the exchange. The CDC Act and National Clearing Company of Pakistan Limited (NCCPL) regulations lay out the modalities of the system and duties of participants. Further, risk management requirements and operation of trading terminals are amongst other things also covered in regulations framed under the Ordinance 1969.

### ***Issuer Companies***

Ordinance 84 is the primary corporate law that sets out the framework for the establishment and governance of companies i.e. structure of the legal entity; requirements for framing and amending constitutive documents; role and responsibilities of the board

of director and management; financial disclosure, approval, recording and disclosure of related party transactions; issuance and recording of share capital; defining statutory positions within a company i.e. chairman, director, CEO, CFO and company secretary; and procedures to be followed for shareholder approval, reporting of shareholdings, etc. The Ordinance 84 also provides for enforcement power with respect to inquiry or investigation into the affairs of a company along with penal provisions.

### ***Capital Markets***

The Ordinance 1969 is the primary law for the capital market; it not only lays down the structure of the market i.e. condition for registration of exchanges, brokers and their roles, responsibilities, reporting requirements, etc., but also provides the framework for investor protection, prevention of fraud and insider trading, listing of securities on exchanges and penal provisions in case of violation. All regulations of the exchanges including LR are approved by the SECP under this law.

### ***Listing regulations***

These are framed under the Ordinance 1969 and provide for listing of companies on the exchanges. In addition to establishing listing requirements these lay down trading requirements for directors, CEOs and other statutory employees and for reporting of trading to the exchanges. In addition to trading requirement these regulations make it mandatory for a listed company to make all announcements of material information including financials and corporate affairs immediately at the stock exchange before making the announcement through any other medium.

### ***Non-Bank Finance Companies***

The regulatory framework for Collective Investment Schemes (CIS) consists of the Ordinance 84, NBFCs (Establishment and Regulation) Rules 2003, and NBFCs and Notified Entities Regulations 2008.

### ***Brokers***

The Ordinance 1969, as the primary law lays down the role and responsibilities of brokers, which is further supported by various rules made under the SECP Act and Ordinance 1969, such as the Broker and Agents Registration Rules 2001 (Broker Rules 2001), which also lay down the code of conduct to be followed by brokers.

## **V. OVERVIEW OF THE CAPITAL MARKETS**

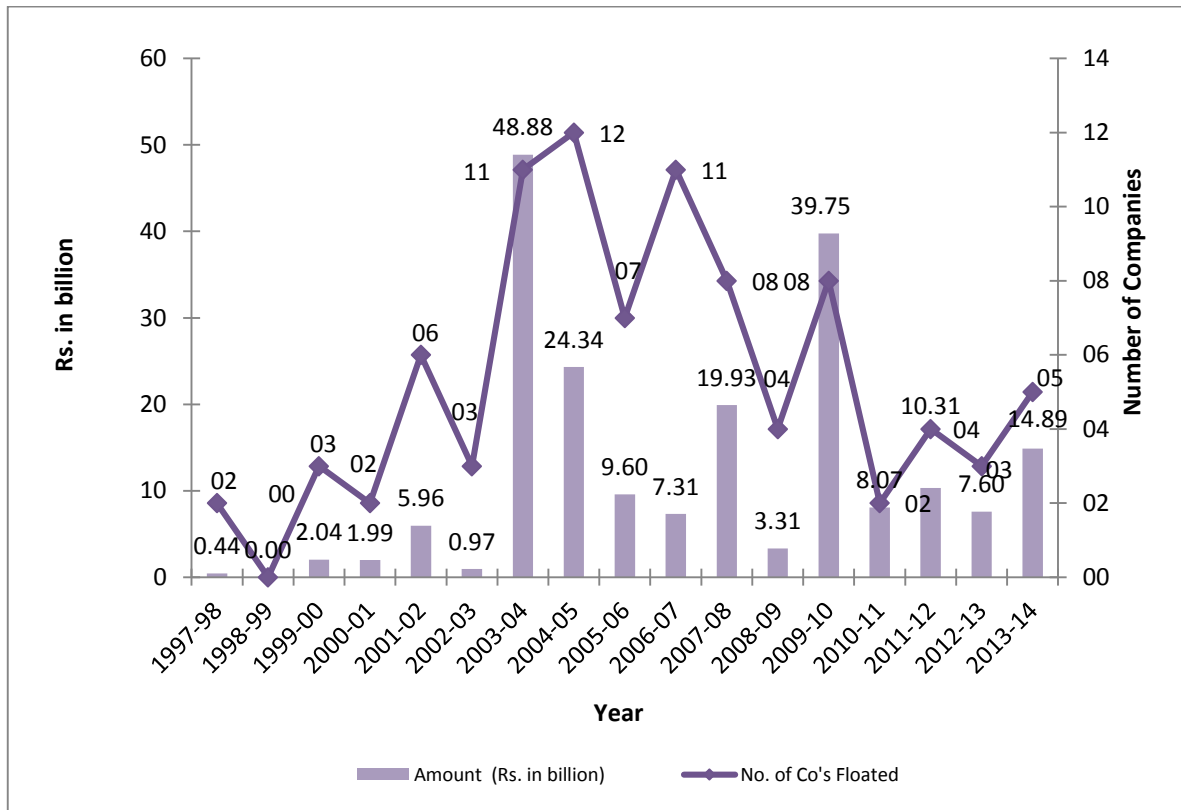
The major Pakistani capital market institutions include the three stock exchanges: Karachi Stock Exchange (KSE), Lahore Stock Exchange (LSE), Islamabad Stock Exchange (ISE); the central and geographically neutral clearing house – National Clearing Company of Pakistan Limited (NCCPL); the Central Depository Company of Pakistan Limited (CDC); and the Pakistan Mercantile Exchange Limited (PMEX).

The SECP as the apex regulator of the Pakistani capital markets is entrusted with the regulation of the overall capital market and the SROs mentioned above. These SROs have responsibility for the authorization of their members, and for the supervision of their obligations under relevant rules and regulations.

## Capital Market Infrastructure

### Stock Exchanges

KSE as the oldest and biggest stock exchange is the leading contributor to the equity market of Pakistan, contributing around 80% of the trading activity in the market. The KSE-100 index which began 2014 at 21,005.69 points reached 29,652.53 points by close of trading on June 30, 2014, i.e., an increase of almost 41% since the start of the year. Average daily turnover increased to 215.52 million shares by June 30, 2014, i.e., an increase of 7.38% over 2013. A total of 557 companies with total paid up capital of PKR 1,160,340.93 million were listed on the KSE. Market capitalization stood at PKR 7,022,692.26 million as at June 30, 2014, which reflected a 35% increase over 2013. Foreign investment in the stock market exhibited net inflow of approximately PKR 26,128.13 million during the year to June 2014, which reflects a decrease of 55% over the previous year.



**Number of equity issues to public FY1998-2014**

The LSE-25 index reflected an upward trend during last one year starting from a level of 4,803 points, reaching a high of 5,612.83 on June 30, 2014.

As of June 30, 2014, a total of 270 securities with total listed capital of PKR 897 billion were listed at the ISE. The ISE-10 index closed at 4,572 points on June 30, 2014. Almost all companies that are listed on ISE are also listed on KSE or LSE.

### ***Central Depository Company of Pakistan Limited (CDC)***

CDC was registered with the SECP as a depository under the Central Depositories (Establishment and Regulation) Rules, 1996 (CDC Rules 1996) to manage and operate the Central Depository System (CDS) as the custodian of book entry securities. CDS is an electronic book entry system for recording and transferring securities so that securities do not physically change hands and the transfer from one client account to another takes place electronically.

### ***National Clearing Company of Pakistan Limited (NCCPL)***

The clearing and settlement services are being provided by the NCCPL which acts as a central and geographically neutral clearing house for book entry securities for all three stock exchanges. The NCCPL uses the National Clearing and Settlement System (NCSS) launched on December 24, 2001.

### ***Pakistan Mercantile Exchange Limited (PMEX)***

PMEX is Pakistan's first fully automated demutualized commodity exchange which commenced operations on May 11, 2007. PMEX is a technology driven on-line commodity futures exchange and employs modern risk management techniques based on Value-at-Risk. The PMEX product portfolio is being continuously renewed to cater for the hedging and trading needs of various investor groups.

PMEX introduced the concept of a Central Counter Party (CCP) to Pakistan. The CCP operates on the basis of novation, whereby PMEX's clearinghouse becomes the seller to all buyers and the buyer to all sellers. Along with the introduction of the CCP model, PMEX also offers Direct Market Access facilities. PMEX presently offers a variety of futures contracts in the commodities of Gold, Silver, Rice, Palm Oil, Crude Oil, Wheat, Cotton, Sugar and Karachi Interbank Offer Rate (KIBOR).

## **Market Intermediaries**

### ***Brokers and Agents***

Ordinance 1969 defines a broker as follows: "broker means any person engaged in the business of effecting transactions in securities for the account of others". The Ordinance 1969, as the primary law lays down the role and responsibilities of brokers, which is further supported by various rules made under the SECP Act and Ordinance 1969, such as the Broker Rules 2001, which also lay down the code of conduct to be followed by brokers. As of June 2014, the total number of brokerage houses registered with the SECP stands at 252: comprising KSE 129 (51%); LSE 77 (31%); and ISE 46 (18%). The statistics with respect to certificates granted to agents, stock exchange wise as of 30 June, 2014 are 204, 58, and 11 for the KSE, LSE and ISE respectively. Agents registered with KSE comprise 75% of the total 273 agents in Pakistan.

Brokers are registered under the Broker Rules 2001 and allowed to trade on behalf of clients. Each agent is also registered with the SECP under the Broker Rules 2001 as an authorized representative of a particular broker. Brokers can have agents who can solicit clients for the broker and earn commission thereon. An agent can undertake his activities after registering with the SECP as an agent. Brokers are not permitted to undertake investment advisory services under the Broker Rules 2001. Brokers can handle client money directly or through its appointed agent, however, there is no specific license for this activity.

Following demutualization stock exchanges natural persons can no longer acquire a stock exchange brokerage license. All natural persons operating as brokers at the time of commencement of the Demutualization Act i.e. May 7, 2012 were required to convert into corporate trading right entitlement certificate (TREC) holders and become registered as corporate brokers by May 7, 2013 i.e. within one year of the enactment of the Demutualization Act. However, natural persons who were not registered as brokers at the time of commencement of the Demutualization Act were required to convert to corporate form and register as brokers by August 26, 2014. Becoming a TREC Holder is a pre-requisite for becoming a broker.

### ***Underwriters***

Ordinance 1969 defines an underwriter as follows: “underwriter includes a person who has made a contract with an issuer to subscribe and pay in cash for those securities as are not fully subscribed by the public or a person who has initially bought the securities from an issuer for the purpose of selling such securities by means of a public offer.”

Under the existing Ballotter, Transfer Agents and Underwriter Rules, 2001 (BTU Rules 2001) the eligibility criteria have been prescribed for the Ballotter, Transfer Agents and Underwriter. However they are not required to be licensed under the said BTU Rules 2001. SECP notes that a review of the BTU Rules 2001 is in process and the draft new rules contain a requirement for the registration of underwriters and Ballotter and Transfer Agents.

### ***Investment Advisors (Non-Bank Finance Company)***

Investment advisors are treated as non-bank finance companies (NBFC). According to the Ordinance 1969, “investment advisor” includes a person who is, for compensation, engaged in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities, but does not include:

- (i) a bank;
- (ii) any lawyer, accountant, engineer or teacher whose performance of such services is solely incidental to the practice of his profession;
- (iii) any broker, jobber, member or associate whose performance of such services is solely incidental to the conduct of his business as a broker, jobber, member or associate and who receives no separate compensation therefor;
- (iv) the publisher of any newspaper, news magazine, or other publication of general and regular circulation; or
- (v) the Investment Corporation of Pakistan.

Investment Advisors can provide simple advice and portfolio management services (jointly known as investment advisory services). Investment advisors cannot carry on brokerage. They can deal on behalf of clients however, they cannot execute trades on the exchange. Investment advisors cannot hold the assets of the clients in custody however, they can manage the assets (including cash) under authority from the customer.

***CIS Distributors***

CIS distributors are not licensed or supervised by the SECP and are required only to be registered with the Mutual Funds Association of Pakistan (MUFAP) which is a trade body. They are required to be registered with MUFAP as Service Providers.

***Credit Rating Companies***

There are two credit rating agencies operating in Pakistan, namely the Pakistan Credit Rating Agency and the Japan Credit Rating-Vital Information Services.

***Banks***

There are 36 scheduled banks and 8 Development Finance Institutions in Pakistan which are regulated by the SBP.

***Insurance Companies***

There are 50 insurance companies including 5 takaful (offering Shariah based products), 3 state owned and 42 conventional insurance companies.

**Life and non-life insurance companies**

<b>Detail</b>	<b>LIFE-Sep 30,2013</b>	<b>NON LIFE-Sep 30,2013</b>
<b>Takaful</b>	<b>3</b>	<b>2</b>
<b>State Owned</b>	<b>1</b>	<b>2</b>
<b>Conventional</b>	<b>5</b>	<b>37</b>

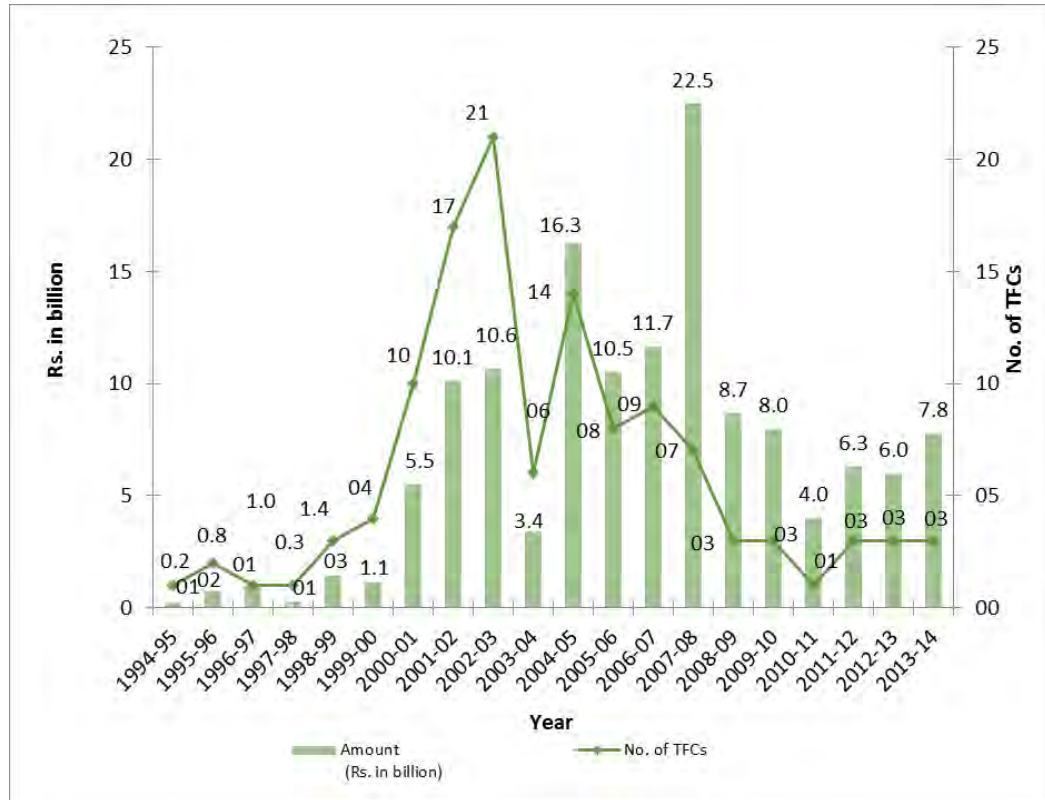
**Corporate Debt Market**

The debt market is a market for trading debt instruments such as Term Finance Certificates (TFC), Bonds, T-Bills, Commercial Paper, Participation Term Certificate, Corporate and Federal Bonds etc. The bond market in Pakistan covers debt and debt like securities issued by the FG, statutory corporations and corporate entities. The market is regulated under the Governing Bonds Automated Trading Regulations and the Governing Government Debt Securities Market Regulations introduced in 2014; however, it is still at a very nascent stage. The SECP has identified the development of a vibrant debt market as one of its key focus areas. Total debt issues in Pakistan have raised approximately US\$ 10.5 billion while outstanding debt issues remain at US\$ 6 billion.



Furthermore, an OTC market also exists in Pakistan which is regulated under the stock exchanges regulations governing OTC markets.

### Number of TFCs (Debt Instruments) floated FY1995-2014



### Historical market data for TFCs

	Listed TFCs		Privately Placed TFCs				Sukuk		Commercial Paper				Total Debt Issues	
			Unlisted		Listed				Unlisted		OTC			
	No. of issues	PKR Bln	No. of issues	PKR Bln	No. of Issues	PKR Bln	No. of issues	PKR Bln	No. of issues	PKR Bln	No of issues	PKR Bln	No. of issues	PKR Bln
<b>Total Raised (June 30th 2013)</b>	119	128.1	79	328.9	6	11	76	625.9	32	14.98	1	1	313	1110
<b>Total Outstanding (June 30th 2013)</b>	31	54.52	36	59.09	6	10.08	45	511.8	-	0	0	0	118	635.5

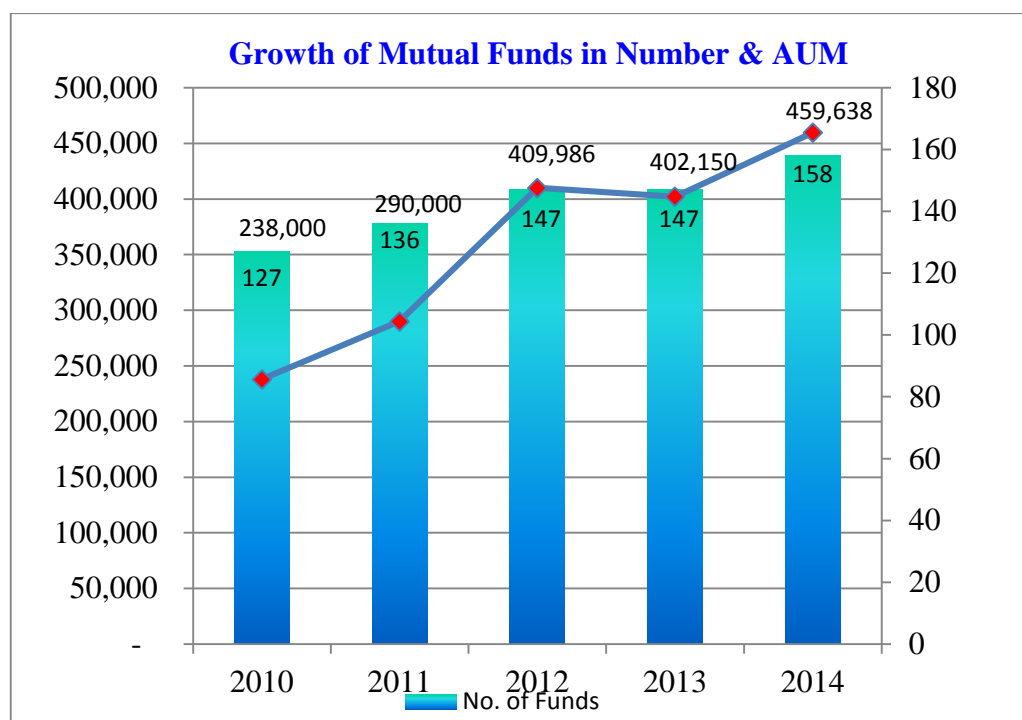
## Collective Investment Schemes

The Non-Banking Financial (NBF) Sector under SECP ambit has been divided into two clusters; i.e. Non-Banking Finance Services categorized as Cluster One and Fund Management Services categorized as Cluster Two.

Asset management services, being part of cluster two activities, comprises mutual funds, pension funds and investment advisory services. This business model is based on a two-tier system whereby the asset management company (AMC) i.e. fund manager and the fund being managed by it, are two separate entities.

- A mutual fund is set up either in the form of an investment company or a trust: The investment company is established as a public limited company and the AMC manages its assets and appoints a custodian/trustee for safe custody of assets of the investment company.
- A trust is established through a trust deed and, a principal document for the formation and management of the mutual fund is executed between the AMC and the trustee. The AMC manages the assets of the mutual fund in the interests of the unit holder whereas the custodian/trustee provides safe custody of the assets of the mutual fund.

The investment in a mutual fund is solicited through an offering document which is a published document containing information on the mutual fund and invites the public to purchase its units or certificates.



The asset size of the mutual fund industry grew by PKR57.48 billion and stood at PKR460 billion as of June 30, 2014 compared to PKR402 billion as of June 30, 2013, representing a growth of 12% during the period ending June 30, 2014. The asset allocation of the industry shows that equity funds (both conventional and Shariah compliant) dominated the assets under management (AUM) of the industry with the largest share of the mutual fund industry at 34.74%. Money market funds (both conventional and Shariah compliant) held the second largest market share at 29.31%, followed by Income funds (both conventional and Shariah compliant) with market share of 24%. Moreover, the total number of funds has reached the level of 158 during the period as compared to 147 on June 30, 2013.

Portfolio management industry in Pakistan is steadily growing with the rise in AUM. This is evident in the expanding asset base of the portfolio management industry, where discretionary/non-discretionary portfolios of the industry showed an annual growth of 28% due to large inflows of PKR14 billion and stood at PKR72 billion on June 30, 2014.

### **Recent major capital market reforms**

As set out in the following paragraphs, Pakistan's securities markets have undergone very significant reforms in recent years. These reforms fall under two broad headings, which are sometimes interrelated:

- changes brought about by major changes in policy which have had an impact on the structure of the securities markets;
- changes flowing from the development of new products and activities.

### ***Risk Management***

#### Unique Identification Number (UIN)

In order to increase market transparency and improve surveillance capacity, the UIN System is in place at pre-trade level at the stock exchanges. The UIN System establishes a traceable link between the executed trade and the investor at the stock exchange. The UIN system has significantly enhanced risk management at client level by improving the surveillance and monitoring capacity of the SECP and the stock exchanges.

#### Risk Management Regime

In order to mitigate systemic risk in the stock market and in line with international best practices, a risk management regime including a VaR based margining system, netting regime, position limits, mark-to-market loss collection, special margins and valuation of securities (haircuts regime) has been introduced at the exchanges. In order to further strengthen this risk management regime, the SECP, through various regulatory amendments has improved the criteria for selection of margin eligible securities based on impact cost and highest daily turnover, implemented scrip-wise circuit breakers and introduced concentration margins replacing special margins in the deliverable and cash settled futures market, along with introducing liquidity margins in the ready market.

Whereas special margins become applicable for all market participants in the Stock Index Futures Market in case of excessive price movement, concentration margins are targeted at those investors generating the largest risk in the market due to excessive accumulation/concentration. Furthermore, a Client Level Margining System has been introduced whereby all margin requirements of each UIN are met from respective UIN-wise securities /cash deposits; thus essentially shifting the focus of the system from broker-level to client-level.

#### Pre-Trade Margin Verification System

A pre-trade margin verification system is in place that ensures broker do not exceed their capital adequacy limits and deposit requirements. The system is pre-emptive as it checks at the time of placing an order whether the concerned member is within his capital adequacy limit and has sufficient margin deposits for the execution of trades in the market.

#### ***Governance and Transparency***

##### Code of Corporate Governance 2012 (Code 2012)

The Code of Corporate Governance (CCG) was initially adopted in March 2002 and became part of the listing regulations of the stock exchanges. To keep pace with constantly evolving corporate and financial sectors and governance benchmarks, the CCG was reviewed in consultation with stakeholders, and a new Code 2012 was introduced for the listed companies. Code 2012 incorporates international best practices and standards and introduces more stringent requirements to ensure transparency and good governance in companies with public stakes.

##### Implementation of AML/CFT Regime

In the wake of increasing focus by the international community on achieving a financial system that efficiently counters the risks of money laundering and terrorist financing, amendments were approved to the General Regulations of the Stock Exchanges to make it mandatory for the broker to comply with the guidelines issued in respect of the Anti-Money Laundering/Combating the Financing of Terrorism regime. The guidelines have been prepared in light of the recommendations of the Financial Action Task Force and other international and local best practices relating to customer identification, customer profiling, ongoing due diligence, risk assessment, and enhanced due diligence requirements relating to politically exposed persons and staff training/ screening etc. Further, to assist implementation of the said regime, all transactions in securities markets above PKR 25,000 are required to be undertaken through crossed banking instruments only.

##### Standardization of CDC Sub-Account Opening Forms

To ensure adequate protection of the rights and obligations of the sub-account holder as well as the broker, a standardized CDC sub-account opening form has been introduced which restricts any general purpose authority to be given by clients to brokers.

##### Blank selling

Blank selling has been banned and replaced by regulated short selling.

### Segregation of Client's Assets from Broker's Assets

In order to correct a serious deficiency in the regulation of segregation of client money by brokers, through which investors have lost money, NCCPL has recently started offering a facility which will enable investors to keep their cash with NCCPL instead of brokers and settle their trades directly from the security/ cash accounts maintained with NCCPL. This will eliminate the risk of misappropriation of cash for investors who choose to use the facility. It is not mandatory.

### Surveillance and Monitoring System

SECP has electronic market monitoring and surveillance software, the Market Surveillance Suite, equipped with sophisticated tools, which facilitates the monitoring of trading activity and includes an "alerts" module. With the help of this software, multi-segment and multi-exchange monitoring of the stock market is possible. This software has greatly augmented the SECP's ability to detect market abuse and assisted in bringing more transparency and fairness into the market. Trading activity on PMEX is monitored electronically by PMEX, which reports to the SECP.

### Mandatory reporting of Off-Market Transactions

Reporting of off-market transactions has been made mandatory. The Exchanges have developed an automated interface to facilitate same day reporting of off-market transactions. KSE has recently introduced the Negotiated Deal Reporting System whereby reporting of off-market transactions for both debt and equity market segments is being done on a real-time basis.

### Fit and Proper Criteria for directors on the Boards of the stock and commodity exchanges, the CDC and NCCPL

The SECP has implemented Fit & Proper Criteria for directors on the Boards of the stock and commodity exchanges, the CDC and NCCPL. The criteria have been devised to ensure that the boards of directors of organizations that serve as the cornerstone of the Pakistani securities markets are comprised of professionals who satisfy the highest standards of integrity and honesty, promote business ethics, and inculcate practices of good corporate governance.

### ***Revamping of Capital Gains Tax (CGT)***

With the aim of facilitating the Government's objective of bringing the income of securities market investor within the tax ambit, the CGT regime was revamped to address the practical issues and encourage activity in the securities market. Accordingly, the amendments were made in the Income Tax Ordinance giving effect to the revised CGT regime whereby the NCCPL has been appointed as an intermediary entity to compute, determine, collect and deposit the CGT on securities transaction using an automated and efficient mechanism.

## **Market/Product Development**

### ***Futures Market***

In order to provide investors with basic hedging instruments, financing options and increased investment alternatives, 30 day single stock Deliverable Futures Contracts and 90, 30 and 7 day single stock Cash-Settled Futures Contracts are available for trading. Additionally Stock Index Futures Contracts based on the KSE 30 Index and sectoral indices for oil and gas sectors and the banking sector are available at the KSE. These tradable indices provide an opportunity for investors to hedge price volatility risk associated with the underlying sectors in their investment portfolios.

### ***Development of the Debt Market***

Various measures have been introduced for the development of a vibrant and robust debt capital market. To provide transparent and efficient price discovery through an automated trading platform for debt market securities at the stock exchanges, a Bonds Automated Trading System (BATS) was introduced in 2009 at the KSE and similar automated trading systems were introduced at the LSE and ISE in 2009 and early 2010 respectively. The systems were revamped in 2011 along the lines of the Bloomberg-based E-Bond with various system enhancements aimed at facilitating the price discovery process of debt instruments and price negotiation between the market participants in line with international standards.

Further, to facilitate investor trading in listed TFCs at different exchanges, a regulatory framework was introduced for facilitating inter-exchange trades in listed TFCs and a broker-to-broker functionality was introduced in BATS which enables brokers to settle their inter-exchange trades directly with the NCCPL, resulting in greater efficiency and transparency in the trading and settlement process. Also, for efficient price discovery and transparency purposes, a centralized platform has been developed at the NCCPL for mandatory reporting of trades executed in unlisted TFCs and the same is also being reported to the market on a real time basis through the BATS interface.

To accelerate growth of the debt market, in January 2014 a system for trading and settlement of Government Debt Securities was launched at the stock exchanges with the combined efforts of the FG, SBP, SECP, KSE, CDC and NCCPL. However, this segment is yet to gain activity.

### ***Over-The-Counter (OTC) market***

The OTC market is operated by stock exchanges under the Governing Over the Counter (OTC) Market Regulations 2010 whereby the securities are formally listed at an exchange and traded at the trading platform of the stock exchange. The OTC Regulations allow the listing of both equity and debt securities. Only qualified institutional buyers (QIBs) can participate in trading of debt securities on the OTC market. The debt securities must be first privately placed with the QIBs and then listed at the stock exchange for trading. In the case of shares, the OTC regulations enable those companies with minimum capital of

PKR 10 million and minimum public offering size of PKR 5 million to obtain listing at the stock exchange. The regulations require mandatory appointment of a market maker and compliance with a special Code of Corporate Governance. Whereas only QIBs can participate in trading of debt securities on the OTC, there is provision for the public to trade in OTC equity securities, however, to date only debt securities and no equity securities have been listed under the OTC Regulations. Accordingly, there was a need was for a dedicated framework for listing of equity securities of Small and Medium Enterprise (SME) companies that has been provided with comparatively relaxed requirements such as optional market making and exemption from the Code of Corporate Governance. This is the framework now in place.

### ***Automation of Transfer of Securities into CDS against Trades / Transactions Settled through NCSS***

For establishing adequate levels of authentication and control and preventing chances of misuse in procedures governing the movements of book-entry securities in the CDS, an automated clearing and settlement process has been implemented whereby securities now move directly from the sellers sub-account or house account to the buyers sub-account or house account at the CDC. Such straight-through-processing in the settlement mechanism does not involve any manual intervention and provides for a fair and transparent settlement system.

### ***Introduction of Leverage Products (Margin Financing & Margin Trading) and the Securities Lending and Borrowing Mechanisms***

In response to the dearth of liquidity and non-availability of any financing mechanism in the Pakistani capital market, the Securities (Leveraged Markets and Pledging) Rules, 2011 were promulgated in line with international best practices after exhaustive consultation with stakeholders. These Rules provide a broad regulatory framework for margin financing, margin trading, securities lending and borrowing, and pledging of clients' securities. The Rules also introduce disclosure requirements with risk containment measures to secure greater transparency and provide avenues for meeting the financing needs of capital markets and providing retail investors with an easy access to financing against shares.

### ***Introduction of Exchange-Traded Funds***

To provide more investment alternatives in the market, the SECP has approved the launch of Exchange Traded Funds (ETFs). ETFs will allow investment in diversified portfolios of securities tracking a benchmark index providing investor trading flexibility; and overall portfolio diversification and transparency. ETFs will publish underlying holdings on a daily basis.

### ***Introduction of Index-based Option Contracts***

To add depth to the market and to allow investors to leverage positions for large diversified portfolios, regulations have been approved for launching Index-based Option Contracts at the KSE in line with international best practices.

## ***Demutualization***

The stock exchanges in Pakistan were successfully incorporated and demutualized in 2012 following promulgation of the Demutualization Act. Demutualization is intended to address the conflicts prevalent in the earlier mutualized structure of the stock exchanges by segregation of commercial and regulatory functions and separation of ownership and trading rights. In addition to bringing enhanced governance and transparency at the stock exchanges, demutualization will facilitate the exchanges in attracting global strategic investors and increase the depth of primary and secondary markets.

Post demutualization, each member/initial shareholder of the stock exchanges has been allotted shares and a TREC in lieu of the membership card. The concept of base minimum capital was introduced which is required to be deposited and maintained at all times by each TREC holder with the respective stock exchanges. The base minimum capital is available for utilization as collateral in the event of default by the relevant TREC holder/forfeiture of TREC in the demutualized regime.

## **Future planned reforms**

### ***Revamping the Legal Framework***

SECP, recognizing the critical need for an updated regulatory and supervisory framework to provide financial stability and a conducive business environment, has initiated a legal reform process. The following major draft laws are in the process of approval.

#### **Draft SECP (Amendment) Bill**

The Bill is being drafted in light of international best practices and IOSCO recommendations. It will amend the existing SECP Act, remedy current regulatory deficiencies, and be used to provide a unified and comprehensive structure for regulation of all sectors within the jurisdiction of the SECP regarding enforcement, fit and proper compliance, and product development. The draft Bill provides the SECP with enhanced statutory power and strengthens the regulatory framework for the overall role of the SECP in view of its increased mandate. The draft Bill is being reviewed between the SECP and the Ministry of Finance.

#### **Futures Trading Bill**

To facilitate the transfer of risk among economic agents by providing mechanisms to enhance liquidity and facilitate price discovery in future markets, the Futures Trading Act has been drafted based on international best practices to allow fair, transparent and efficient futures markets and to enable a sound foundation for the development of futures markets in Pakistan. The Bill was submitted to the Ministry of Finance on January 6, 2015.



### Draft Securities Bill, 2014

For effective regulation of securities markets and to safeguard investor rights, SECP, after detailed consultation with key stakeholders has drafted the Securities Act to replace the Ordinance 1969, to enhance the supervisory and enforcement power of the SECP to curb insider trading, market manipulation and money laundering in the capital markets. The draft Act provides a framework for improved regulation and supervision of the securities market and provides better regulatory cover for areas presently not catered for sufficiently in the Ordinance 1969. The draft Bill has been approved by the Senate Standing Committee and is awaiting promulgation by the Parliament.

### Corporate Law

SECP has restarted work on drafting a new corporate law for which the Corporate Law Review Commission has been reconstituted. Once approved by the Parliament it would replace the Ordinance 84.

### *Securities market*

The SECP's future roadmap, envisages the introduction of further structural and regulatory reforms for the development of equity, derivative, debt and commodities markets, and undertaking measures for improving governance, risk management, efficiency and transparency in capital market operations

### Post-demutualization

The SECP, in collaboration with the stock exchanges, introduced consequential reforms. The stock exchanges are in the process of bringing in strategic investor(s) to benefit from their expertise and technological assistance, and at the same time bringing foreign investment, and broadening the investor base. Simultaneously, efforts will be made for listing the stock exchanges and offering their shares to the general public.

### Establishment of a CCP

In line with international best practices, efforts are being made to enable NCCPL to function as a CCP to provide protection for investors and to resolve pending settlements in case of defaults.

### Commodities Markets development

For developing the country's commodity market, the SECP is working to bring agri-based commodity futures to the market for price discovery and provision of hedging against price risk. An expert team has been identified to work in this area.

### SME Board

In order to provide alternate source of financing for SMEs, the SECP is working in coordination with stakeholders to implement a framework for establishment of an SME Board at the stock exchanges.

### Development of the Islamic Capital Market

To maintain the momentum of development of the Islamic capital market in the country, SECP has recently established an independent Islamic Finance Department to introduce a comprehensive Shariah regulatory framework for the stakeholders of the Islamic capital market in line with best international practices, standards and guidelines issued by the recognized international Islamic financial standard setting bodies. Focus is on the following key areas for the promotion and development of the Islamic Capital market:

1. Provide an enabling regulatory environment;
2. Introduce Shariah Governance and Compliance Mechanism;
3. Create awareness and capacity building;
4. Product and Market Development”

### Strengthening the Debt Market

To accelerate growth of the debt market, in January 2014 a system for trading and settlement of Government Debt Securities was launched at the stock exchanges with the combined efforts of the FG, SBP, SECP, KSE, CDC and NCCPL. Efforts are being made for integration of the National Savings Scheme instruments into the mainstream capital market to enable wider retail participation and increasing the savings ratio in the country.

### Development of New Products and Systems

The future SECP agenda includes listing and trading of call warrants on stock exchanges, stock options, and cross listings of foreign and domestic indices at Pakistani and foreign stock exchanges to boost activity in the index futures market. Further, avenues are being explored for introducing the latest risk management techniques including introduction of the Standardized Portfolio Analysis of Risk margining regime in the derivative markets.

For investors in the commodities segment, the SECP is pursuing with PMEX the launch of agri-based futures contract at PMEX. The SECP is also engaged in dialogue with SBP to expedite the launch of currency futures contracts at PMEX. Further, work is underway for introducing warehousing receipts which will be made available for trading on PMEX.

### Centralized Know Your Client Organization

To facilitate the securities market investor, NCCPL will act as a Centralized Know Your Customer (KYC) Organization to maintain investors' records in line with international best practices pertaining to KYC and Customer Due Diligence (CDD) policies. The KYC records will be available for access by all market intermediaries removing the duplication in the KYC process at various intermediaries;

### Registration Regime

SECP has initiated a process of amendments in the Broker Rules 2001 for revamping the broker' registration regime by bringing in fit and proper criteria, and separating trading and clearing functions by introducing different classes of broker such as a trading broker and a clearing participant.

### Establishment of a SIPC

A Securities Investor Protection Corporation (SIPC) will be established to protect investors' interests in the event of default of their broker through pooling of funds to compensate investors. SIPCs exist in many jurisdictions through specialized legislation that enables SIPCs to have recourse to the assets of a defaulting brokerage house in favor of clients.

### **Collective Investment Schemes**

SECP has carried out an exhaustive review of the business model and current regime of mutual funds. Considering global best practices as well as the interests of all stakeholders, the following measures for the sustainable growth of the mutual fund sector are under implementation:

- Charging distribution expense to funds as a percentage of net assets and making it mandatory for AMCs to establish their own distribution network.
- Distribution of mutual funds units through the stock exchanges.
- Reduction in annual regulatory fees provided more than 50% of a fund's net assets are held by retail clients.
- Improving the skill set of key personnel by setting out the minimum standards for 'Fit and Proper criteria'.
- Introduction of a Code of Conduct for fund managers.

## **VI. PRINCIPLE-BY-PRINCIPLE ASSESSMENT OF IMPLEMENTATION: MAIN FINDINGS AND RECOMMENDATIONS FOR ACTION**

The purpose of the assessment is primarily to ascertain whether the legal and regulatory securities markets requirements of the country and the operations of the securities regulatory authorities in implementing and enforcing these requirements in practice meet the standards set out in the IOSCO Principles. The assessment is to be a means of identifying potential gaps, inconsistencies, weaknesses and areas where further powers and/or better implementation of the existing framework may be necessary and used as a basis for establishing priorities for improvements to the current regulatory scheme. The assessment of the country's observance of each individual Principle is made by assigning to it one of the following assessment categories: fully implemented, broadly implemented, partly implemented, not implemented and not applicable. The IOSCO assessment methodology provides a set of assessment criteria to be met in respect of each Principle to achieve the designated benchmarks. The methodology recognizes that the means of implementation may vary depending on the domestic context, structure, and stage of development of the country's capital market and acknowledges that regulatory authorities may implement the Principles in many different ways.

- A Principle is considered fully implemented when all assessment criteria specified for that Principle are generally met without any significant deficiencies.

- A Principle is considered broadly implemented when the exceptions to meeting the assessment criteria specified for that Principle are limited to those specified under the broadly implemented benchmark for that Principle and do not substantially affect the overall adequacy of the regulation that the Principle is intended to address.
- A Principle is considered partly implemented when the assessment criteria specified under the partly implemented benchmark for that Principle are generally met without any significant deficiencies.
- A Principle is considered not implemented when major shortcomings (as specified in the not implemented benchmark for that Principle) are found in adhering to the assessment criteria specified for that Principle.
- A Principle is considered not applicable when it does not apply because of the nature of the country's securities market and relevant structural, legal and institutional considerations.

**Table 1: Summary Implementation of the IOSCO Principles – Main Findings**

Principle	Grade	Findings
Principle 1. The responsibilities of the Regulator should be clear and objectively stated	FI	SECP responsibilities are clear and objectively stated. SECP has discretion to interpret its own authority and the interpretative process is transparent.
Principle 2. The Regulator should be operationally independent and accountable in the exercise of its functions and power	NI	There is no clear evidence that the SECP does not operate in practice as an independent agency free from political or commercial interests. However, the current structure does not provide sufficient assurance that it is adequately ring-fenced from political interests. Two measures proposed by the Review Team (a Code of Conduct for Policy Board members and the Chair of the Board to be chosen from the private sector members) are under active consideration. Subject to the terms of the Code of Conduct, in the view of the Review Team, adoption of these two measures could result in a Partly Implemented rating which would be consistent with many recent assessments. SECP is self-funded.
Principle 3. The Regulator should have adequate power, proper resources and the capacity to perform its functions and exercise its power	FI	SECP seems to have sufficient capacity to perform its functions and exercise its powers. Recent initiatives in investor education and an enhanced staff training program from 2015 appear to have remedied previously identified deficiencies in these areas. Findings as to the allocation of resources to on-site supervision are highlighted in Principles 12, 31 and 33.
Principle 4. The Regulator should adopt clear and consistent regulatory processes.	FI	SECP has clear and consistent regulatory processes. It has the capacity to interpret legislative provisions during the consultation process and holds regular roundtables with industry participants.
Principle 5. The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.	FI	There are clear conduct rules applicable to SECP staff. Deficiencies in applying the rules on confidentiality to ex-employees/retirees have recently been corrected and greater attention is now being paid to monitoring of professional standards.
Principle 6. The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.	NI	SECP lacks a process to monitor, mitigate and manage systemic risk. At the time of the assessment, amendments have been proposed for the SECP Act with regard to the powers and functions of SECP which, if passed, will enable SECP to identify and address systemic risk factors.
Principle 7. The Regulator should have or contribute to a process to review the	FI	SECP identifies and addresses risks through reviewing the regulatory framework on an ongoing basis. This can be initiated by market feedback,

perimeter of regulation regularly.		onsite-offsite monitoring etc. A Coordination Committee has been established to review the effectiveness of the regulatory perimeters and a Task Force is working to identify and manage risks posed to the financial sector due to evolving products and conglomeration.
Principle 8. The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.	BI	Conflicts of interest are identified and evaluated by SECP in the process of supervision of regulated entities. The applicable legal framework prohibits regulated entities from undertaking various activities and requires them to establish policies and procedures for internal control which properly address conflicts of interest. However, treatment of misalignment of incentives in intermediaries is not clearly articulated in the SECP rules and will be addressed in the draft Securities Bill which at the time of the assessment had been approved by the Senate Standing Committee and was awaiting promulgation by the Parliament. Further, appropriate amendments have been made in NBFC Rules that are in public consultation.
Principle 9. Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising power and delegated responsibilities.	BI	The SECP has in place measures and procedures for oversight of the eligibility requirements of SRO's. Regulation making powers have been delegated to the SROs which are to be reviewed by the SECP prior to approval. Cooperation between the SECP and SROs is an on-going process; however, no formal guidelines for cooperation have been established. Furthermore, SECP at present does not conduct annual assessments on compliance with its obligations as a licensee as well as any onsite inspections of the SROs. However, weekly meetings are currently in place. The SECP has proposed to initiate a Systems Audit process using an external auditor but it is not clear whether the scope and the expertise of the auditor will sufficiently replicate those of the SECP were it to carry out the inspection itself. See also Principle 33.
Principle 10. The Regulator should have comprehensive inspection, investigation and surveillance power	FI	The SECP has broad inspection, investigation and surveillance powers.
Principle 11. The Regulator should have comprehensive enforcement power.	FI	The SECP has comprehensive powers to investigate and take action against anyone who breaches the laws it administers.
Principle 12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement power and implementation of an effective compliance program.	PI	At the time of assessment, the SECP did not employ a risk-based assessment and lacks an intensive or structured on-site inspection program. The majority of firms could expect to be inspected only once every ten years. On 1 March 2015, SECP approved Manuals to implement procedures for off-site surveillance and monitoring and on-site

		inspections based on risk based criteria which should address this deficiency. But the major impediment to effective compliance is congestion and delay in the Courts, particularly in the handling of appeals from SECP decisions which can take years to conclude.
Principle 13. The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.	FI	The SECP has the ability and capacity to share information and cooperate with other authorities in Pakistan and internationally. The SECP can share confidential information with any other foreign regulatory authority.
Principle 14. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.	FI	The SECP is a signatory to the IOSCO MMOU, and has bilateral MOUs with 12 of its international counterparts. It has bilateral MOUs with the SBP, Federal Board of Revenue (FBR), Employees Old Age Benefits Institution and the Karachi Centre for Dispute Resolution.
Principle 15. The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their power.	PI	The SECP became a signatory to the IOSCO MMOU on 10 March 2011. Central Bank approval is required to obtain bank records. The protocol in place between the SECP and the Central Bank to obtain and share bank records with foreign regulators has proved to be defective and approval pursuant to an MMoU request has not been forthcoming. Legislation (a proposed s.42C of the SECP Act) to allow the SECP to obtain and share bank records without Central Bank approval is before Parliament.
Principle 16. There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investor's decisions.	PI	<p>Current offering documents provide potential investors with a level of comfort through the way risks are presented that may in reality give an untrue depiction of the actual risks associated with the offer. Additionally, current regulations have a requirement that issuers are to present prospectuses to potential investors in English only, which may be problematic due to English not being the most widely spoken language in Pakistan.</p> <p>Renounceable rights issues do not require a full prospectus.</p> <p>Under earlier regulations issuers were allowed to advertise the offering with information that is not present in the offering document. SECP has recently (March 4th 2015) amended the Guidelines for issue of prospectus explicitly restricting any advertisement containing material that is not part of the approved prospectus”.</p>
Principle 17. Holder of securities in a company should be treated in a fair and equitable manner.	PI	Takeover and most other regulations are extensive. Time limits for disclosure of substantial shareholdings (and changes) are too long to be useful. Time limits for disclosure to the company

		of holdings by directors and senior managers (and changes) as set out in the Code 2012 have recently been substantially reduced and are part of the LR of the KSE. Compliance is mandatory.
Principle 18. Accounting standards used by issuer to prepare financial statements should be of a high and internationally acceptable quality.	BI	The accounting standards applicable in Pakistan are in practice consistent with IFRS. However, standard setting and the interpretation process of audit standards is effectively with the Institute of Chartered Accounts Pakistan (ICAP) which is not and cannot be seen as acting in the public interest.
Principle 19. Auditor should be subject to adequate levels of oversight.	NI	Although there is a framework for and effective exercise of oversight of those performing audit services and of the quality and the implementation of auditing, independence and ethical standards in Pakistan, the regime is effectively under exclusive control of ICAP, which cannot be seen as acting in the public interest and which is not independent from the audit/accounting profession.
Principle 20. Auditor should be independent of the issuing entity that they audit.	BI	Constraints on auditor and audit firms in relation to independence are spelled out in rules applicable to auditors as well as in those applicable to audited entities. Obligations on all auditors regarding the establishment and maintenance of internal systems, governance arrangements and processes for monitoring, identifying and addressing threats to independence could be more explicit.
Principle 21. Audit standards should be of a high and internationally acceptable quality.	BI	As with its accounting standards, Pakistan has adopted auditing standards based on International Standards of Auditing. But as is the case in relation to accounting standards, the mechanism for setting and interpretation of and ensuring compliance with auditing standards is effectively under the control of ICAP, which cannot be seen as acting in the public interest.
Principle 22. Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.	FI	Although there is only a limited number of CRAs operating in Pakistan (i.e. 2 CRAs at the time of writing) Pakistan has made efforts to effectively and comprehensively implement the IOSCO requirements in relation to CRAs, and has recently introduced a CRA Code of Conduct. The first on-site inspections are scheduled to commence in the last week of May 2015.
Principle 23. Other entities that offer investor analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.	NI	There are currently no rules applicable to and related to the oversight of research report providers. Efforts have been made since 2013 to regulate and oversee such professionals, and to put in place a specific regulatory and oversight framework for research analysts, Those efforts should be continued so to ensure the proposed regime is effectively adopted and implemented.



<p>Principle 24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.</p>	<p>PI</p>	<p>Current regulations do not have any specific articles that require best execution. Furthermore, the regulations do not currently have any restrictions on churning. Furthermore, the licensing and supervision of CIS distributors is conducted by MUFAP which is a trade association and not an SRO subject to SECP oversight.</p>
<p>Principle 25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.</p>	<p>BI</p>	<p>The current regulatory regime has been effective in providing for rules governing the legal form and structure of CISs and the segregation and protection of client assets. Although Trustees play a major role in the CIS business and are required under the current regulations to oversee the activities of AMCs they have not been subject to inspection by SECP. There are two trustees and one is dominant. SECP has recently begun an on-site inspection program. Subject to a judgment of the scope and intensity of the inspection process, an upgrade may be merited in due course.</p>
<p>Principle 26. Regulation should require disclosure, as set forth under the principles for issuer, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.</p>	<p>FI</p>	<p>Enhanced timeliness of the dissemination of audit annual reports would serve to provide investors with more timely and therefore useful information and thereby a higher level of protection.</p>
<p>Principle 27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.</p>	<p>FI</p>	<p>The NBFC Regulations 2008 provide detailed procedures for calculating the NAV of CIS assets including for unlisted and illiquid securities. Suspension of redemption can only be provided in exceptional circumstances and the SECP is empowered to terminate suspensions in the interests of unit holders.</p>
<p>Principle 28. Regulation should ensure that hedge funds and/or hedge funds managers/advisor are subject to appropriate oversight.</p>	<p>NI</p>	<p>The current regulations do not cover any issues pertaining to the licensing and monitoring of hedge funds although investment by foreign domiciled hedge funds in the securities market is subject to regulation via foreign exchange restrictions. SECP is finalizing "Private Funds Regulation" which are subject to public consultation. The draft regulations cover the registration of private funds domiciled in Pakistan (including hedge funds).</p> <p>The scale of any marketing of foreign hedge funds without authorization or registration is currently unknown.</p>
<p>Principle 29. Regulation should provide for minimum entry standards for market intermediaries.</p>	<p>PI</p>	<p>Minimum entry standards are in place for market intermediaries although SECP requirements focus on brokers as natural persons and are not sufficient to deal with the licensing of corporate entities. KSE requirements are further developed in this</p>

		<p>regard as are those of CDC and NCCPL.</p> <p>There is no single data base in Pakistan for criminal record checks.</p> <p>Considering that broker registrations are renewed every year, the number of SECP staff dealing with the applications and registrations raises concerns in terms of workload and effectiveness. In addition, SECP and the exchanges do not conduct any on-site visits to a brokerage company at initial registration or licensing.</p> <p>While there are eligibility criteria in the regulation of underwriters, they are not licensed and they are assessed by the SECP only when engaged in an IPO.</p> <p>Regarding the deficiencies, SECP has stated that it will enhance brokers' registration rules by December, 2015 and the Underwriter Rules and the Credit Rating Rules by June 2015.</p>
<p>Principle 30. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.</p>	<p>PI</p>	<p>There are initial and ongoing capital requirements for brokers and investment advisors. However, the net capital calculation of exchange members is limited to accounting for current assets and current liabilities and does not give sufficient weight to the full range of risks to which exchange members may be exposed, in terms of quantum and type. Capital adequacy procedures and exposure limits imposed by the stock exchanges allow a broker to absorb some losses. For the investment advisor, only absolute minimum equity requirements exist rather than any risk based capital requirements. There is no capital requirement for underwriters.</p> <p>Reporting of compliance with the capital requirements is limited in content and frequency, particularly as regards reporting to SECP.</p>
<p>Principle 31. Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters</p>	<p>PI</p>	<p>The limitations in the licensing regime described in Principle 29 are carried over into the supervision regime for licensees.</p> <p>There are no explicit requirements (eg) for:</p> <ul style="list-style-type: none"> <li>• appropriate management, organizational structure, and outsourced activities;</li> <li>• the requirement for adequate internal controls (except the new KSE regulation, which applies only to KSE members);</li> <li>• responsibilities of senior management;</li> <li>• segregation of key duties and functions;</li> <li>• objective evaluation of a broker's internal controls through an internal audit function;</li> </ul> <p>or</p> <ul style="list-style-type: none"> <li>• an efficient and effective mechanism within a broker to address investor complaints internally.</li> </ul>

		<p>While there are some protection measures for the assets of the clients, with regard to the money of the clients, the account at the bank is in the name of the broker, with the client's segregation maintained as a book entry in the back office of the respective broker. In the event of a broker's insolvency client funds are not protected from claims of other creditors. NCCPL has recently started offering a facility which will enable investors to keep their cash with NCCPL instead of brokers and settle their trades directly from the security/ cash accounts maintained with NCCPL. This appears to eliminate the risk of misappropriation of cash for investors who choose to use the facility. It is not mandatory for brokers to use it.</p> <p>SECP does not have a specific supervision program. The regulatory capacity regarding supervision (on-site and off-site) needs to be enhanced.</p> <p>SECP is planning to employ a system called "Global/Joint Inspection" which is being developed with a view to eliminating the duplication and inefficiency created due to separate inspections conducted by each SRO. This plan aims to have a full coverage for broker inspection by end May 2015. The plan should provide a more effective and efficient supervision and inspection regime, however its application in practice will require assessment.</p>
<p>Principle 32. There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investor and to contain systemic risk.</p>	<p>PI</p>	<p>The default management regulations of all three stock exchanges and PEMEX set out procedures in case of a settlement default of a broker, including restraining conduct and dealing with the assets and liabilities of the defaulter. On the other hand, there is no specific plan or scenario analysis in order to deal with failures other than settlement default or failures of large conglomerates. In the case of the financial insolvency of a broker, neither the Broker Rules 2001 nor the courts protect client money from other creditors.</p> <p>SECP and the exchanges have the authority to restrain conduct and take necessary steps in order to protect investors, in case of a default of the broker. Further, there are additional measures such as Insurance Schemes and Guarantee Funds to minimize the loss in case of a default.</p> <p>With regard to early warnings, SECP interprets early warnings signals of a possible default through System Audit Reports, investor complaints, net capital balance certificates, CDC inspections, delivery defaults etc.</p> <p>However, enhanced off-site periodic reporting is essential in order to be preventive and take necessary action before a possible default. SECP</p>

		does not receive off-site periodic reports other than the net capital balance (NCB) reports. Further, the NCB reporting period and the coverage of the report do not give sufficient information regarding the financial risks that the intermediary carries.
Principle 33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.	BI	<p>The SECP has the powers it needs in law to oversee exchanges.</p> <p>The SECP does not carry out on-site inspections of exchanges. It has by letter of 25 February 2015 directed exchanges to conduct a Systems Audit process using an independent audit/consultancy firm with excellent repute and having significant expertise in capital market related operations. It is not yet clear whether the scope and the expertise of the auditor will sufficiently replicate those of the SECP were it to carry out the inspection itself, so that this will achieve the required outcome. See also Principle 9.</p> <p>There are two particular areas where oversight could be improved. Firstly, the SECP does not have a system in place to review the fairness of the trade matching or execution algorithm of automated exchanges for fairness. This may become more of an issue as automated trading becomes more prevalent. Secondly, the arrangements for segregation of client funds held by exchange members only involve a back-office separation, meaning that the funds will not necessarily be protected from the broker's creditors. See also Principle 31.</p>
Principle 34. There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.	BI	<p>The SECP provides electronic surveillance of day-to-day trading and monitors exchanges' compliance with their responsibilities.</p> <p>The monitoring of intermediaries' conduct (through examinations of their business operations) raises some issues. There does not appear to be sufficiently vigorous and risk-based monitoring, combined with sufficient on-site inspections. There is heavy reliance on regular system audits by chartered accountants, who may lack the specialised expertise to fully assess a broker's operations. Systems audits are focused on ensuring there has been compliance with relevant legal requirements and are not a substitute for a fuller overview of participants' behaviour.</p>
Principle 35. Regulation should promote transparency of trading.	FI	The system functions effectively to provide transparency, both pre-trade and post-trade. While there is no legislative authority for transparency, this could be invoked if needed.
Principle 36. Regulation should be designed to detect and deter	BI	The law prohibiting market misconduct is appropriate and covers the abuses required by this

<p>manipulation and other unfair trading practices.</p>		<p>Principle.</p> <p>The Ordinance 1969 provides for penalties for particular offences that are in some cases inadequate. While the catch-all s.22 of the Ordinance 1969 to some extent closes this gap, providing for penalties of 50 million rupees, it does not provide for prison terms. However, the lack of imprisonment for insider trading is being addressed through the draft Securities Bill, which is in the process of getting approval from Parliament.</p> <p>The deterrent effect of the penalties regime may be blunted by the ability to delay cases for long periods through legal challenges; the lack of actions resulting in prison sentences; and the relatively light penalties imposed, given the large potential profits from market misconduct. These matters are largely beyond the SECP's control.</p> <p>There are weaknesses in the monitoring of the conduct of market intermediaries participating in the market place. The SECP and exchanges are working together to strengthen such monitoring.</p>
<p>Principle 37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.</p>	<p>BI</p>	<p>Regulation aims to ensure the proper management of large exposures through a series of limits. An automated mechanism prevents trading activity beyond the prescribed limits.</p> <p>The SECP has by letter of 25 February 2015 directed exchanges to conduct a Systems Audit process using an independent audit/consultancy firm with excellent repute and having significant expertise in capital market related operations. It is not yet clear whether the scope and the expertise of the auditor will sufficiently replicate those of the SECP were it to carry out the inspection itself, so that this will achieve the required outcome. See also Principle 33.</p> <p>This may not be sufficient in all cases, e.g. underwriting of new issues. Provisions have been inserted in the draft Securities Bill which may resolve the issue. The proposed new rules require the underwriters to ascertain, before entering into an underwriting agreement, that the regulatory requirements relating to the exposure limits on investment in securities are not breached. The proposed new rules restrict the quantum of the underwriting to a maximum of five times of the equity of the underwriter.</p> <p>The exchanges and the SECP have adequate access to information to be able to monitor exposure levels, and adequate powers to demand more information where needed and to intervene where necessary.</p> <p>While the SECP has adequate arrangements to share information with exchanges, there are no</p>

		<p>formal arrangements for information sharing among the exchanges in order to better manage risk. It would be desirable to address this and strengthen such information-sharing, both in regard to the monitoring of large exposures and in order to minimise the effects of a market disruption.</p> <p>The exchanges have appropriate and publicly available arrangements to deal with default risk and isolate the problems of a failing firm.</p> <p>The practice of short selling is subject to adequate controls, designed to minimise risks to stability.</p>
<p>Principle 38. Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.</p>	<p>Not Assessed</p>	
<p><b>Fully Implemented (FI), Broadly Implemented (BI), Partly Implemented (PI), Not Implemented (NI), Not Applicable (NA)</b></p>		

**Table 2: Recommended Action Plan to Improve Implementation of the IOSCO Principles**

Principle	Recommended Action
1	With regard to CIS sales through Bank Branches, draft amendments to be proposed in NBFC Rules and regulations for licensing of CIS distributors by SECP.
2	<p>The SECP and the FG should pursue current initiatives as a matter of priority:</p> <ul style="list-style-type: none"> <li>• either the chairman of the SECP or a private sector member of the Policy Board would be appointed as Chair of the Policy Board to increase the distance between the Policy Board and the FG;</li> <li>• implementation of a (published) code of conduct for adherence by Policy Board members specifying their role and responsibilities.</li> </ul> <p>The second initiative will also have an impact on Principle 5. Overall, an uprating from Not Implemented to Partly Implemented is likely to be the most that can be attained maintaining the current structure. This would be consistent with a clear majority of recent assessments carried out under the FSAP.</p>
4	SECP should implement its policy for disclosure of enforcement actions.
6	SECP's plan for systemic risk mitigation and amendments of the SECP Act should be accelerated.
8	Current legislative proposals and their translation into SECP rules should be pursued as a priority. Treatment of misalignment of incentives should be clearly articulated in the SECP rules.
9	<ul style="list-style-type: none"> <li>• The SECP should consider whether its proposal to initiate a Systems Audit process for exchanges using an external auditor will sufficiently replicate the knowledge and expertise the SECP staff would bring to the process were it to carry out the inspection itself. See also Principle 33.</li> <li>• SROs should be required to improve cooperation with each other, especially with respect to investigating any violation or compliance of applicable laws.</li> </ul>
12	<ul style="list-style-type: none"> <li>• SECP should develop and implement an annual inspection plan (supplemented and informed by an off-site program) against which the effectiveness of the enforcement activity can be assessed.</li> <li>• The SECP's "Global/Joint Inspection" system, which aims to have full coverage for brokers should be accorded priority and implemented.</li> <li>• The FG should address chronic delays in the Courts. It might consider establishing a specialist financial court.</li> </ul>
15	<ul style="list-style-type: none"> <li>• Legislation (draft Section 42C of the SECP Act) proposed by the SECP to allow it to obtain and share bank records without Central Bank approval should be passed.</li> <li>• The SECP should clarify the terms of its MoU with the Central Bank.</li> </ul>
16	<ul style="list-style-type: none"> <li>• The implementing regulations should be amended in regards the disclosure of material information.</li> <li>• The implementing regulations should be amended to reflect a separation between the disclosure of risks section and any proposed mitigating factors.</li> <li>• SECP should consider removing the exemption from the requirement to publish a</li> </ul>

Principle	Recommended Action
	<p>prospectus from renounceable rights issues (rights that can be sold on to the public).</p> <ul style="list-style-type: none"> <li>• Clause 6 of the Guidelines should be amended as to make it mandatory to publish any prospectus to the public in Urdu as well as in English.</li> </ul>
17	<ul style="list-style-type: none"> <li>• SECP should obtain changes to the time limits for public disclosure of substantial shareholdings (and changes) to a maximum of 2 days in order for the information to be timely, useful to the public and to be consistent with international good practice. SECP should examine its powers to disenfranchise shares where it is unable to establish the identity of the beneficial owners, to satisfy itself that these are sufficient. See also Principle 37.</li> </ul>
18	<ul style="list-style-type: none"> <li>• The FG should, as also recommended under Principle 19 and Principle 21, urgently establish a non-industry controlled audit and accounting profession oversight body such as the contemplated Audit Oversight Board of Pakistan (AOBP) so to ensure adequate independence and oversight in the public interest. Review of the rating of the principle will then need to be assessed at a later stage once the AOBP regime is finalized, adopted and effectively implemented.</li> <li>• As recommended in Principle 16, the exemption from the obligation to publish a full prospectus, with full audited financial statements, when a company issues renounceable rights, should be reconsidered.</li> </ul>
19	Principle 18, first recommendation, is equally applicable to Principle 19.
20	The FG and SECP should implement regulations to impose more explicit provisions applicable to all auditors regarding the establishment and maintenance of internal systems, governance arrangements and processes for monitoring, identifying and addressing threats to independence.
21	Principle 18, first recommendation is equally applicable to Principle 21.
22	SECP should, on an annual basis, assess and monitor, including by on-site inspections, compliance with the CRA Code of Conduct dated 13 January 2014 by any CRA operating in Pakistan. (Note that the first on-site inspections of both CRAs are scheduled to take place at the end of May 2015).
23	The Commission should ensure that the proposed Research Analysts Regulations are put in place and subsequently effectively implemented. The rating of Principle 23 can then be re-assessed.
24	<ul style="list-style-type: none"> <li>• The Government should amend the licensing and supervisory regime for CIS distributors; this should be done either by the SECP or by a fully functioning SRO subject to SECP oversight.</li> <li>• Establish requirement for best execution.</li> <li>• Establish requirement that restrict churning.</li> </ul>
26	SECP should consider enhancing the timeliness of the dissemination of audited annual reports which would serve to better protect the interests of investors and better reflect international standards.
27	Although current regulations seem to meet international standards, the SECP should have a continuous program that assesses, through bench marking international best practice, developments in asset valuation and redemption practices on a periodic basis.
28	<ul style="list-style-type: none"> <li>• SECP should seek to ensure that its draft “Private Funds Regulation” is finalised and implemented as a matter of priority, having regard to the IOSCO standards.</li> <li>• The regulations should also deal with the legal and illegal marketing of foreign</li> </ul>



Principle	Recommended Action
	<p>hedge funds in Pakistan including matters such as registration, approval of overseas jurisdictions and penalties for breach.</p>
29	<ul style="list-style-type: none"> <li>• Regulation regarding registration and ongoing requirements of market intermediaries should be better organised, updated and should provide more clear and detailed requirements (especially for brokerage companies) as a priority. This includes organizational structures, risk management systems, supervisory systems, written policies and procedures, internal controls, criteria for major shareholder etc.</li> <li>• A single data base in Pakistan for criminal record checks is essential for the assessment of the registration requirements.</li> <li>• As a matter of procedure, on-site visits to brokerage companies at the initial registration are important in terms of assessment of the application and verification of some of the information that the company has provided, such as, location of the firm, internal organisation, staff, technical infrastructure, resources etc. This should be considered by the SECP.</li> <li>• Considering that the registration of brokers are renewed every year, the limited number of the SECP staff dealing with the applications and registrations raises concerns. SECP should consider enhancing the capacity of the relevant department in order to have a more effective assessment of the applications.</li> <li>• As planned by the SECP, the certification requirement of CIS sales staff could be extended to investment advisors, critical staff at the brokerage company (such as analysts), and underwriter to complement the professionalism in the market.</li> </ul>
30	<ul style="list-style-type: none"> <li>• As a priority, SECP is recommended to consider revising capital requirement rules in order to reflect the risks that the intermediaries undertake. These should include credit risk, liquidity risk, operational risk, risks arising from outside the intermediary etc.</li> <li>• The revised system is recommended to cover: <ul style="list-style-type: none"> <li>- a detailed and more comprehensive structure of the capital adequacy report; and</li> <li>- more frequent reporting to the SECP.</li> </ul> </li> </ul>
31	<ul style="list-style-type: none"> <li>• SECP should examine the new NCCPL facility for segregating client funds from a legal perspective to satisfy itself that clients' funds are sufficiently remote from the bankruptcy of the client's broker. If the new NCCPL facility for segregating client funds proves effective legally and practically the SECP should, as a high priority, make its use by brokers mandatory.</li> <li>• The regulation should explicitly cover at least the requirement for appropriate management and organizational structure (for brokers), requirement for adequate internal controls (for brokers and underwriters), the requirement for the management of a market intermediary to bear primary responsibility, segregation of key duties and functions (brokers).</li> <li>• SECP should consider improving its supervision function. More frequent on-site inspections could be complemented by on-going surveillance tools to be developed, such as periodic reporting in critical areas.</li> <li>• Rules regarding organizational, managerial, supervisory structure of the brokerage companies should be further revised in parallel with the new system after demutualization of the Exchanges. (See also Principle 29).</li> <li>• A requirement for brokers to be subject to an objective evaluation of their internal controls through an internal audit function would incentivize better market conduct.</li> <li>• SECP should consider having a requirement for underwriters and NBFCs/investment advisors to be subject to an objective, periodic evaluation of their internal controls and risk management processes.</li> <li>• A guideline for addressing the conflicts of interest by market participants (as planned by the SECP) could be helpful for the market participants to address this</li> </ul>

Principle	Recommended Action
	<p>issue.</p> <ul style="list-style-type: none"> <li>• SECP should consider requiring market intermediaries to provide for an efficient and effective mechanism to address investor complaints internally.</li> <li>• SECP should consider a requirement for intermediaries to provide a client with statements of account, at least annually.</li> </ul>
32	<ul style="list-style-type: none"> <li>• Specific plans should be developed in order to deal with failures other than settlement default or failures of large conglomerates.</li> <li>• Ongoing surveillance tools (including periodic reporting in some critical areas), and improved capital adequacy reporting (including an obligation to report when a broker's capital declines to within a SECP defined percentage (e.g. 120%) of its minimum capital requirement should be developed. These will serve as early warning signal of a potential default.</li> </ul>
33	<ul style="list-style-type: none"> <li>• Given the current responsibilities the exchanges have for supervising their members, the urgent need to secure effective segregation of client funds referred to in Principle 31 must cover exchange members as well as other licensees.</li> <li>• The SECP should consider whether its proposal to initiate a Systems Audit process for exchanges using an external auditor will sufficiently replicate the knowledge and expertise the SECP staff would bring to the process were it to carry out the inspection itself. See also Principle 9.</li> <li>• The SECP should consider whether it needs to develop a system to review the fairness of the trade matching or execution algorithm of automated exchanges for fairness. This may become more of an issue as automated trading becomes more prevalent.</li> </ul>
34	<ul style="list-style-type: none"> <li>• The SECP is developing an Action Plan which includes measures to enhance the monitoring of intermediaries' conduct. This is an important initiative and should be pursued vigorously.</li> <li>• The SECP should move towards more robust and risk-based monitoring, combined with more on-site inspections. Monitoring should be more proactive, not just in detecting breaches but working to identify risks and respond appropriately. See also Principle 31.</li> </ul>
36	<ul style="list-style-type: none"> <li>• Given the lack of actions resulting in prison sentences, the possibility of delaying the enforcement of penalties and the large potential profits from market misconduct, it would be appropriate to consider reviewing the penalties to see whether they are still appropriate and how they could be given a stronger deterrent effect. It might be that, without changing the penalties, the Commission could exercise its power to impose higher penalties.</li> <li>• It would be appropriate to review other penalties as well, to ensure they remain internally consistent and appropriate. The Corporate Law Review Commission is looking into this but, as a wide-ranging review of penalties, it will take some time to be completed.</li> </ul>
37	<ul style="list-style-type: none"> <li>• The SECP should encourage the exchanges and the NCCPL to consider entering into more extensive, and possibly more formal, agreements among themselves to share information on a more regular basis, particularly on large exposures, for risk management purposes.</li> <li>• The SROs should also be encouraged to consider developing a process for consulting with each other in order to minimise the adverse effects of market disruptions.</li> <li>• The recommendation on beneficial ownership in Principle 17 is relevant here.</li> </ul>

## **Priority recommended actions**

The Review Team has identified the following recommended actions as having priority.

- Current legislative proposals and their translation into SECP rules should be pursued (Principle 8).
- The SECP’s “Global/Joint Inspection” system, which aims to have full coverage for brokers should be implemented.
- SECP should seek to ensure that its draft “Private Funds Regulation” is finalised and implemented. (Principle 28).
- Regulation regarding registration and ongoing requirements of market intermediaries should be better organised and updated (Principle 29).
- SECP should consider revising capital requirement rules in order to reflect the risks that the intermediaries undertake (Principle 30).
- Clear and secure segregation of client assets held by intermediaries should be achieved (Principle 31).

## **VII. THE RESPONSE OF THE AUTHORITIES**

The SECP welcome the opportunity of being the first jurisdiction to be assessed by the IOSCO AC under its Country Review program as part of IOSCO’s 2010 Strategic Direction Review. The assessment provided us with an opportunity to comprehensively review our regulatory and supervisory framework for securities regulation through our self-assessments and to engage in constructive dialogue with Review Team on further enhancements to the framework.

The SECP appreciate the IOSCO’s view that Pakistan has made significant improvements in the structure and practice of regulation since the 2004 FSAP report. The assessment contains some useful observations and recommendations which could help further improvements on the areas that have been identified to enhance regulation of securities markets in Pakistan. SECP broadly agree with the findings of the Report. Regarding certain deficiencies in the area of conduct regulation and supervision (Principles 6, 12, 15, 16, 19, 29, 31) as well as in the area of financial market infrastructure regulation (Principles 9, 33, 34, 37) we would like to highlight – as is also stated in the report – that there are ongoing legislative projects that were initiated prior to the AC review which aim at reshaping the regulatory architecture to be in line with international principles. The Securities Bill 2015 has recently been promulgated addressing certain observations raised in the assessment report. SECP is committed to continue the process.

The SECP also wish to recall that the evaluation is more demanding and more oriented towards the quality and outcomes of supervision. Pakistan being an emerging market jurisdiction which proactively volunteered for the peer review under the IOSCO AC Country Review program, the raising of bar for assessing the effectiveness of implementation status through more rigorous IOSCO standards works adversely in certain cases for us. SECP however, broadly consider that the assessment is tough but fair.

The SECP appreciate the significant time and effort the Review Team dedicated to complete the assessment, as well as their thoroughness and professionalism in assessing our system against the IOSCO Principles. SECP while remaining committed to develop and implement reform initiatives consistent with IOSCO standards, will carefully consider the findings and recommendations from this Review and give due consideration to their adoption where appropriate. We would also like to take this opportunity to comment on some specific recommendations are set out in the ensuing paragraphs.

### **Operational Independence of the Regulators (Principle 2)**

The SECP notes the assessors' finding that there is no clear evidence that the SECP does not operate in practice as an independent agency free from political or commercial interests. The SECP would like to reiterate its stance on the observation that the current structure does not provide sufficient assurance that it is adequately ring-fenced from political interests. The structure and role of Policy Board reflects the Government's ultimate responsibility to formulate financial policies and regulate and supervise financial markets as enshrined in the core laws.

Policy Board is therefore, a policy making body which has no role in day-to-day operational matters of the SECP. This structure and role of Policy Board provide ample safeguards against any interference that affects day-to-day decision making, and given these qualifications, the SECP consider that the Policy Board should not be seen as having the potential for interference in the day-to-day operations of the regulators. There had been no instance where SECP's operational independence was compromised. SECP reiterates the fact that it has operational autonomy in the exercise of its powers and functions. The unlikely possibility of inappropriate intervention does not, in fact, impair SECP's operational independence or its ability to discharge its functions

Adoption of two measures proposed by the Review Team (a Code of Conduct for Policy Board members and the Chair of the Board to be chosen from the private sector members) would result in a Partly Implemented rating only. However, the assessment is silent on implementation of measures to attain Fully Implemented status.

### **Disclosure to Investors (Principle 16)**

The assessment recommends SECP to consider amending the implementing regulations to reflect a separation between the disclosure of risks section and any proposed mitigating factors. SECP during March 2015 amended the Guidelines on "Issue of Prospectus" so as to address downplaying the risk factors by removing the provision, previously part of guidelines, regarding disclosure of risk mitigation factor. Further, regarding the recommendation for mandatory publication of prospectus in Urdu, SECP notes that the entire legal and regulatory framework and all applicable documentation including the financial statements are in English which is the official language in Pakistan and is generally comprehensible by the investing population. As such, the investor outreach for listing issuers is not as strong as an issue considering the general understanding and common usage of English language in Pakistan. Notwithstanding the foregoing, the SECP will study the recommendations and, if appropriate, fine-tune the requirements applicable to publication of prospectus.

### **Risk based capital requirements for investment advisor (Principle 30)**

The assessment observes existence of only absolute minimum equity requirements rather than any risk based capital requirements for investment advisor, it is to note that in Pakistan, the investment advisory business is a non-fund based activity under the prevailing law. The investment advisors which carry on the business of portfolio management deal for clients, however, the custody of assets is in the name of investor/client therefore there is no risk posed to clients' assets.

### **Future Road Map**

The SECP has already committed to reporting on a six-month basis (in December 2015 and June 2016) to the AC to update on implementation of Review recommendations. The SECP is of the view that based on these updates, post 2016 there should be a review by the AC to gauge effectiveness of implemented recommendations and adjust ratings where material progress has been made. This would help the SECP to appropriately exhibit our progress on implementation of recommendations and graduation towards more compliant ratings.

## VIII. DETAILED ASSESSMENT

**Table 3: Detailed Assessment of Implementation of the IOSCO Principles**

<b>Principles Relating to the Regulator</b>	
<b>Principle 1.</b> The responsibilities of the regulator should be clear and objectively stated.	
Description	<p>In Pakistan, the financial sector is regulated by two regulators, the State Bank of Pakistan (SBP) oversee the banking sector while the SECP governs the regulation of the entire non-bank financial sector. The responsibilities of both financial sector regulators are distinctly separate. SBP regulates the banking sector under the statutes namely; State Bank of Pakistan Act 1956 and Banking Companies Ordinance, 1962 while SECP regulates company matters (within the framework of Companies Ordinance 1984 (Ordinance 84)) for all the banks and also investor protection (within the framework for listed companies) where a bank is listed on a stock exchange. The securities markets are primarily within the jurisdiction of the SECP and SBP, apart from Government Debt Securities (T-bills) has no role to play in this regard. If a bank decides to trade in listed securities, a subsidiary of a bank will have to hold a trading rights entitlement certificate (TREC) which would bring it under the regulations of the SECP. However, banks can transact themselves in Government securities which are not formally listed but made available for trading purposes through the stock exchanges.</p> <p>The SECP is the sole authority for the regulation of securities and derivative markets in Pakistan. SECP was set up in pursuance of the Securities and Exchange Commission of Pakistan Act, 1997 (SECP Act) as an integrated regulator, responsible for the beneficial regulation of the capital markets including issuers, intermediaries, mutual funds, exchanges, securities depositories and clearing houses, and superintendence of corporate entities including the entities that carry out non-bank financial services, private pensions and insurance companies.</p> <p>The SECP is responsible for regulating and supervising the securities and derivatives markets to ensure that they are fair, efficient and orderly and that the interests of investors are adequately protected. The supervision includes registration, supervision and surveillance and the imposition of enforcement actions.</p> <p>Specifically, the SECP Act clearly defines, and transparently sets out, the SECP's responsibilities in s.20 (1) of the Act giving it all such powers as may be necessary to perform its duties and functions under the Act. S.20 (4) of SECP Act, clearly defines, the primary responsibilities of SECP towards the securities market as follows:</p> <ul style="list-style-type: none"> <li>• regulating the issue of securities including forward and future contracts;</li> <li>• regulating the business of stock exchanges, commodity exchanges and any other securities and derivatives markets;</li> <li>• supervising and monitoring the activities of any central depository and stock exchange clearing house;</li> <li>• registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with the securities markets in any manner;</li> <li>• proposing regulations for the registration and regulating the working of CIS, including unit trust schemes;</li> <li>• promoting and regulating SROs including securities industry and related organizations such as stock exchanges and associations of mutual funds, leasing companies and other NBFCs;</li> <li>• prohibiting fraudulent and unfair trade practices relating to securities markets;</li> </ul>

	<ul style="list-style-type: none"> <li>• promoting investors' education and training of intermediaries of securities markets;</li> <li>• hearing and deciding investor complaints against persons involved in brokerage business for violations of securities laws, rules, regulations, directives, codes, etc.;</li> <li>• conducting investigations in respect of matters related to the SECP Act and the Ordinance 84 and in particular for the purpose of investigating insider trading in securities and initiating action against the offenders;</li> <li>• regulating professionals who provide services within the financial services market;</li> <li>• calling for information from and undertaking inspections, conducting inquiries and audits of the stock exchanges and intermediaries and SROs in the securities market;</li> <li>• considering and suggesting reforms of the law relating to companies and bodies corporate, securities markets, including changes to the constitution, rules and regulations of companies and bodies corporate, stock exchanges or clearing houses;</li> <li>• encouraging the organized development of the capital market and the corporate sector in Pakistan.</li> </ul> <p>The SECP has extensive powers under the Ordinance 84. These include the power to: approve a prospectus (s.57); approve the issue of securities outside Pakistan (s.62A); and grant a license to carry on business as an NBFC and incorporate an NBFC (s.282C). SECP's authority with regard to the regulation of securities markets has been clearly and transparently provided in the Ordinance 1969, Ordinance 84 and SECP Act. The Ordinance 1969 gives SECP authority to; take enforcement action for carrying out the functions of an exchange without registration (s.3) or without being eligible (s.4); cancel/suspend the registration of an exchange (s.7), to direct a stock exchange to delist a security (s.9); suspend trading of any security (s9(7)); initiate action against insider trading (s.15E), initiate action against fraudulent acts (s.17); initiate action against false statements (s.18), issue prohibitory orders to the market participants (s.20); initiate inquiry (s.21), impose penalty where the regulatee refuses or fails to comply with order of SECP (s.22); and file prosecution in the court of law on the basis of the inquiry (s.25).</p> <p>The Ordinance 84 authorizes SECP to issue directions to NBFCs (s.282D); remove from office any chairman or director or chief executive or other officer of an NBFC (s.282E); supersede the board of directors of an NBFC (s.282F); require an NBFC to furnish information (s.282G); enquire into or inspect the affairs of an NBFC (s.282I); and to cancel any license of an NBFC (s.282J).</p> <p>Regulation 38(a) of the NBFC Regulations 2008 requires an Asset Management Company (AMC) to be responsible for managing the assets of the CIS in the interest of the unit, certificate or shareholders in good faith and to the best of its ability and without gaining any undue advantage for itself or any of its related parties including connected persons and group companies or its officers. While working as the distributor of CIS, the bank is under principal/agent relationship with the CIS operator. As per regulation 38(c), the CIS operator is responsible for the acts and omissions of all persons to whom it may delegate any of its functions as manager as if they were its own acts and omissions. In case of any incident in which a bank is not fulfilling the CIS investor interest, SECP can take action against the CIS operator for misconduct of the distributor bank. In case of any violation of law particularly from the perspective of protection of investors, SECP can cancel the license of the CIS operator and/or impose fine up to PKR 50 million. MUFAP is the representative body of CIS operators while distributors work as agents of these CIS Operators. The distribution function is the responsibility of the CIS operator and for this purpose the CIS operator is regulated by the SECP. In case the CIS operator delegates this function to a distributor, then there is an additional requirement that such distributors shall be registered with MUFAP. The CIS operator is responsible for all acts and omissions of its distributors.</p> <p>SECP's discretion to interpret its authority is set out in the laws it administers, and discretions relating to the application of the legislation can be exercised only if permitted by</p>
--	--

	<p>the law. The interpretive process is transparent. All SECP guidelines, decisions and directives must be in writing. All policy decisions and directives must be published in the Gazette (s.22 of SECP Act). While adjudicating the rights of any person, the opportunity of a hearing is provided, reasons for decision is given and orders are placed on the SECP website.</p> <p>The SECP provides guidance to regulated entities in the form of information on its website, including details for the authorization of intermediaries and operators of CIS and guidance on compliance and legal issues.</p> <p>Further, while making rules and regulation, SECP is required to publish the draft in the official Gazette for eliciting public opinion within a period of not less than thirty days from the date of publication (s.39(2) and s.40(2) of SECP Act, s.506 and s.506A of Ordinance 84. SECP's interpretive authority is at all times under the review and check of the courts. A person aggrieved by SECP's interpretation can file a writ with the High Court.</p> <p>SECP also acts as appellate forum for hearing the appeals against the orders of the SECP passed by one Commissioner or officer of the SECP (SECP Act, s.33).</p>
Assessment	Fully Implemented
Comments	<p>SECP responsibilities are clear and objectively stated. SECP has discretion to interpret its own authority and the interpretative process is transparent. At the time of the assessment, draft amendments are being sought with regard to CIS sales through bank branches for the NBFC Rules and regulations for licensing of CIS distributors by SECP. See Principle 24.</p> <p><i>SECP has adopted a transparent policy for the publication of its circulars, directives and guidelines, including any relief instrument given.</i></p>
<b>Principle 2.</b>	The regulator should be operationally independent and accountable in the exercise of its functions and power
Description	<p>The conduct of SECP's day to day functions, such as corporate submissions approvals, licensing reviews and recommendations, monitoring and surveillance of markets and intermediaries, prudential oversight and inspections are all determined by the Commission through established procedures. It can take enforcement action and file prosecutions without seeking the approval from the FG.</p> <p>Ss.39 and 40 of the SECP Act gives the SECP the power to make rules and regulations. The FG is nevertheless, responsible for the performance of the following essential tasks (excluding any operational matters):</p> <ul style="list-style-type: none"> <li>• enactment of appropriate rules of law about the establishment and constitution of SECP and about the regulation of markets and institutions;</li> <li>• to appoint commissioners and Policy Board (Board) members;</li> <li>• to receive and consider SECP's recommendations on the laws and rules which it administers.</li> </ul> <p>SECP is a collegiate body, made up of commissioners not less than five in number, with collective responsibility. In terms of s.5 of SECP Act, the FG appoints the commissioners including the chairman who is the chief executive of the Commission. The position of commissioner is tenure based. Each commissioner is appointed for a term of three years and can be re-appointed for another term of three years. The majority of the commissioners are from the private sector and are persons known for their integrity, expertise, experience and eminence in a relevant field, including the securities market, law, accountancy, economics, finance, insurance, and industry and help bring wider vision and independence of judgment to the operations of the SECP.</p> <p>The preamble of the SECP Act sets out the role of the SECP as "the beneficial regulation of</p>



the capital markets and the superintendence and control of the corporate sector”, and ancillary matters. This signify the SECP’s objectives, which encompass supervision, enforcement, and development of the sectors identified in the SECP Act, whether in consequence of the SECP Act itself or through the other laws it has been charged with the administration of, including the Ordinance 1969 and the Ordinance 84.

To meet above objectives, the SECP Act provides certain powers and functions which are laid down in s.20. Broadly speaking, under sss.20(4) and 20(5) these functions cover:

- identifying and recommending policy decisions to the Policy Board;
- proposing regulations for the execution of the SECP’s functions to the Policy Board;
- registering and/or licensing Regulated Sector entities where required by law;
- regulating the capital market and its participants, the NBFC sector and its participants, and the corporate sector (“regulated sectors”) generally;
- granting approvals as and where required by law;
- ensuring compliance with the relevant laws by the regulated sectors;
- supervising and monitoring the activities of the regulated sectors;
- identifying regulatory violations, whether civil or criminal, and proceeding accordingly;
- promoting the organized development of the regulated sectors;
- considering and suggesting legal reforms in respect of the regulated sectors; and
- promoting investor awareness and education.

SECP Policy Board is a policy making advisory body that comprises nine members, appointed by the FG, five of whom are ex-officio from the public sector (one being the Chairman SECP) while four are from private sector and are well known for their integrity, expertise and experience in relevant areas (s.12 of SECP Act).

The main objective of the Policy Board is to provide guidance to the SECP in matters relating to its functions and to formulate policies in consultation with the SECP. Pursuant to s.21 of the SECP Act, the Board has been entrusted to:

- when so asked to do and after consultation with the SECP, advise the FG on all matters that fall within the regulatory ambit of the SECP;
- consider and approve, with or without modification, any regulations with respect to the implementation of policy decisions, proposed to be made by the SECP;
- consider and approve, with or without modification, the SECP’s budget for each financial year;
- express its opinion in writing on any policy matter referred to it by the FG or the SECP;
- oversee the performance of the SECP to the extent that the purposes of the SECP Act are achieved;
- exercise all such powers and perform all such functions as are conferred or assigned to it under the SECP Act;
- specify fees, penalties and other charges chargeable by the SECP for carrying out the purposes of the SECP Act.

Apart from above, all policy decisions, including any change in previously established policy, in respect of all and any matters within the jurisdiction of the SECP shall be made only by the Board. The Board may make policy decisions suo moto or adopt such policy recommendations of the SECP, with or without modification, as the Board may deem fit in its discretion.

Relationship between Policy Board and the SECP is that of a policy maker and the executor of policy. The Policy Board is the policy making body while the SECP performs its functions within the policy parameters defined by the Board to achieve the objectives of the

SECP.

FG appoints Commissioners within the SECP; however, s.5 (2) of the SECP Act requires that a majority of the Commissioners shall always be private sector individuals. This subsection provides for the circumstances where a person who while holding position in FG may be appointed as Commissioner.

However, the position of a Commissioner is a full time job that requires operational independence and in practice no Commissioner can hold a dual position in the FG. Recent FG advertisements for the position of Commissioner mention that the candidate if selected will have to resign from his position held in government, semi government and autonomous bodies.

Further, SECP Act does not provide any list of the positions which a Commissioner can hold. However, in terms of s.16(a) a Commissioner is required to disclose any situation of conflict of interest in an issue which the SECP is about to discuss or take a decision on.

In terms of accountability, the SECP is accountable to the Parliament and is required by law to submit within 120 days of the end of each financial year, its annual report, and its audited statement of accounts to the FG to be tabled to Parliament. Accountability before the FG is determined through the authority of the FG to appoint and remove the Commissioners and the Policy Board members who are accountable to the FG for their performance.

In order to ensure its autonomous status and to make available to it, the requisite financial resources, the SECP was allowed to establish a Fund in terms of s.23 of the SECP Act, to be administered and controlled by the SECP.

The Fund consists of grants of money and sums borrowed or raised by the SECP for the purposes of meeting any of its obligations or discharging any of its duties, taxes, fees, penalties or other charges levied under the SECP Act, Ordinance 84, Ordinance 1969, and under any other law being administered by the SECP; and all other sums or property which may in any manner become payable to or vested in the SECP in respect of any matter incidental to the exercise of its functions and powers (s.23 of SECP Act).

The fee and charges levied by the SECP under the laws administered by it become part of the SECP Fund. SECP is a self-funded organization and generates revenue from the registration of companies, licensing of regulated entities like NBFCs, CIS, brokers, credit rating companies, etc., transaction and other fee on securities market, annual monitoring fee for various market intermediaries, and fee charged for approvals and other processing functions. This ensures a stable and continuous source of funding and adequate financial resources for the SECP to exercise its powers and responsibilities in supervising the markets and to stay in touch with international best practices.

The penalties imposed on violations of the provisions of the laws however are deposited with the FG treasury. Due to a recent amendment any surplus of revenue after meeting expenses from 2013 onward would go to federal consolidated fund.

The SECP keeps proper accounts and prepares annual financial statements that are audited by auditors, appointed by the SECP with the approval of the FG, who is an independent firm of chartered accountants.

The auditors makes a report to the FG upon the SECP's annual accounts, and give opinions on whether the balance sheet is full and fair, containing all necessary particulars and exhibits a true and correct view of the affairs of the SECP and, in case they have called for any explanation or information from the SECP, whether it has been given and whether it is satisfactory (s.25 of the SECP Act).

As the reports are audited by independent auditors approved by the FG, the reports cannot be challenged. The FG can further, if it deems fit, also require the accounts of the SECP for any financial year to be audited by the Auditor General of Pakistan. The audited accounts are then published in the official gazette and laid before both houses of Parliament.

Further, members of the FG form part of the SECP Policy Board. The Board can intervene

	<p>and reduce or re-allocate the SECP budget only at the time of budget approval. Once approved the budgets cannot be affected.</p> <p>The SECP releases its annual report which includes details of its resources and uses and its activities over the financial year, to the public and simultaneously, sends a copy of its report to the FG which causes it to be published in the official gazette. The annual report and the financial statements are also placed on SECP's website and are available for general public information.</p>
Assessment	Not Implemented
Comments	<p>IOSCO Principle 2 states that the regulator should be operationally independent and accountable in the exercise of its powers and functions. The methodology by which the Principle is to be assessed requires positive answers to the questions:</p> <ol style="list-style-type: none"> <li>1. Does the securities regulator have the ability to operate on a day-to-day basis without <ol style="list-style-type: none"> <li>a. external political interference?</li> <li>b. interference from commercial or other sectoral interests?</li> </ol> </li> </ol> <p>Furthermore IOSCO has defined "interference" as a "formal or informal level and method of contact that affects day-to-day decision making and is unsusceptible to review or scrutiny." The IOSCO methodology does not require evidence of improper conduct. Nor has it taken a view on the circumstances in which political involvement in policy formulation, fee setting, budgets etc. might improperly influence decision making by a regulator, or at least give the public the perception that this is so. This is because, by its nature, such interference is difficult to establish and more difficult to prove. In practice therefore this Principle has been assessed on the basis that it is directed at identifying vulnerabilities inherent in structures and processes and not at the efficacy of day to day decision making.</p> <p>The Review Team was not exposed to any evidence that the SECP does not operate in practice as an independent agency free from political or commercial interests. However, the current structure does not provide sufficient assurance that it is adequately ring-fenced from political interests. Maintaining therefore the current structure will not ensure that the SECP is operationally independent from political interference as required by this Principle.</p> <p>SECP has advised that it, and the FG, are considering possible options proposed by the Review Team:</p> <ol style="list-style-type: none"> <li>a. Either the chairman of the SECP or a private sector member of the Policy Board would be appointed as Chair of the Policy Board to distance, to a greater degree than that present, the decisions taken by the Policy Board.</li> <li>b. Implementation of a (published) code of conduct for adherence by Policy Board members specifying their role and responsibilities.</li> </ol> <p>In the assessors' view these options provide clear benefits (subject to the terms of the code of conduct). Option (b) will also have an impact on Principle 5. Overall, an upgrading from Not Implemented to Partly Implemented is likely to be the most that can be attained maintaining the current structure. This would be consistent with a clear majority of recent assessments carried out under the FSAP.</p>
<b>Principle 3.</b>	The regulator should have adequate power, proper resources and the capacity to perform its functions and exercise its power
Description	<p>The SECP has extensive and wide ranging powers.</p> <p>Under the SECP Act, SECP may conduct investigations of any matter which is an offence under the SECP Act. It may also undertake inspections; require the production of books,</p>

registers and documents; and has power of entry including power of forcible entry. Further, it may require “any person acquainted with the facts and circumstances of the case” to appear before it; and to prosecute offences.

Under the Ordinance 1969, the powers of SECP include :

- to register any stock exchange (s.5);
- to register any securities broker or brokers agent (s.5A);
- to suspend or cancel the registration of a stock exchange or any member, supersede the governing body or suspend or remove a director, officer or member from his office or membership (s.7);
- to direct a stock exchange to list a security (ss.9 and 10);
- to require a listed company to comply with a listing condition or requirement (s.9);
- to direct a stock exchange to delist a security, on application by the issuer where the exchange has refused to delist (s.9);
- to approve regulations of a stock exchange, generally and relating to the transfer of property in securities (ss.34 and 31);
- to direct a stock exchange to make, amend or rescind a regulation (s.34);
- to register central depository companies (s.32);
- to register credit rating companies (s.32B).

SECP also has power to intervene in insider trading matters involving insiders as defined; may direct a person to abstain from doing an act which contravenes the law and impose fines for non-compliance. It may undertake enquiries, enter into premises, and seize documents, availing itself of the type of powers available to the courts in the conduct of proceedings.

SECP may also “by notification in the official Gazette, exempt any person or class of persons or any security or class of securities or any transaction or class of transactions from the operation of all or any of the provisions” of the Ordinance 1969.

Under the Ordinance 84, the SECP has extensive powers which include to:

- require any person to produce any documents or information for the purposes of any proceeding or inquiry (s.12(4)) ;
- approve a prospectus (s.57);
- approve the issue of securities outside Pakistan (s.62A);
- specify the minimum amount of shares or debentures to be allotted pursuant to a prospectus (s.67);
- prescribe the maximum rate of commission to be paid by a subscriber on the issue of shares (s.82);
- sanction the issue of shares at a discount (s.84);
- extend the time for holding the AGM in the case of listed companies (s.158);
- approve a company loan or guarantee to a director (s.195);
- recover gains made by directors, officers and principal shareholders in prescribed transactions in the company’s equity securities (s.224) ;
- extend the period for laying the annual accounts before a listed company in AGM (s.233);
- to direct a change in financial year of holding companies and their subsidiaries (s.238);
- call for additional statements of accounts from companies (s.246);
- appoint auditors in certain cases (ss.252 and 254);
- investigate the affairs of a company (ss.) ;
- prosecute a company or person who appears as a consequence of an investigation to have been guilty of an offence (ss.270 and 271);

	<ul style="list-style-type: none"> <li>• appoint an administrator, on the application of creditors having “interest equivalent in amount to not less than sixty per cent of the paid up capital” (s.295);</li> <li>• make application to the Court for winding up a company (s.309);</li> <li>• recommend a panel of persons to the Court for appointment as official liquidator (s.321);</li> <li>• direct a company or any officer to comply with any provision of the Ordinance (s.472);</li> <li>• impose a fine for offences, other than those for which imprisonment is provided for in the law, or for failure to comply with a Commission directive (s.476). (There is a right of appeal against an SECP decision to impose such a fine to FG. Appeal to the Court is expressly excluded);</li> <li>• exercise the same powers in relation to the conduct of enquiries and proceedings as are held by the Court (s.478);</li> <li>• apply the amount of a fine towards the payment of costs, rewarding a person who has provided information and payment to an aggrieved party (s.483);</li> <li>• give prior approval to the incorporation of an NBFC (s.282C);</li> <li>• grant a license to carry on business as an NBFC (s.282C);</li> <li>• prescribe the minimum paid up capital of each form of NBFC business (s.282C);</li> <li>• issue directions to NBFCs generally or to any one NBFC (s.282D);</li> <li>• by order, remove from office any chairman or director or chief executive or other officer of an NBFC (s.282E);</li> <li>• by order, supersede the board of directors of an NBFC (s.282F);</li> <li>• require an NBFC to furnish information (s.282G);</li> <li>• order the special audit of an NBFC –SECP is required to monitor the general financial condition of an NBFC (s.282H);</li> <li>• enquire into or inspect the affairs of an NBFC (s.282I);</li> <li>• cancel any license of an NBFC (s.282J);</li> <li>• impose a fine on an NBFC or its officers for non-compliance with a provision of the SECP Act (s.282 J);</li> <li>• impose the fine for any offence other than an offence for which the fine may be imposed in addition to a term of imprisonment (s.282M)</li> </ul> <p>The SECP observes that it has sufficient resources at its disposal in order to attract and retain qualified and able work force. In order to monitor, regulate and develop the securities market the SECP has a team comprising of qualified lawyers (LLB, LLM, BVC), Financial Analysts, Accountants (qualified CFA, CA, CPA, ACCA). SECP ensures that its staff receives adequate training and personal development opportunities in a scientific and measured manner for maximum value addition.</p> <p>The FG had placed a ban on hiring in June 2013, due to which there has been a significant decrease in the number of hiring’s as compared to 2012. However, the ban was lifted on 28 October 2014.</p> <p>The SECP enjoys full discretion in setting the number of staff limits for performing its responsibilities. This is made part of the HR budget that is implemented after approval of the policy board. However, if the FG restricts hiring which is applicable on all autonomous bodies besides the semi-autonomous and government bodies, SECP has to observe such restriction.</p> <p>An annual Training Needs Assessment plan is conducted by the HR department of the SECP. Based on the needs identified during the exercise the budget for training is finalized and made part of the SECP budget for approval. Both local and foreign trainings are thereafter identified for which suitable candidates are nominated.</p> <p>Cognizant of the need for investor education and awareness in Pakistan, and to fulfil its regulatory obligations, SECP has developed a comprehensive three years Investors’ Education Program (Program) which is part of its wider goal towards protecting investors</p>
--	--

	<p>more adequately, spreading awareness and literacy across Pakistan for the betterment of not just individuals but the economy as a whole, and for building and sustaining an adequate savings culture in the country.</p> <p>The scope of the Program spreads over the corporate sector, the insurance sector, stock exchanges &amp; stock brokers and NBF sector including, investment banks, asset management companies, unit trusts and private pensions.</p>
Assessment	Fully Implemented
Comments	SECP seem to have sufficient capacity to perform its functions and exercise its powers. Recent initiatives in investor education and an enhanced staff training program from 2015 appear to have remedied previously identified deficiencies in these areas. Findings as to the allocation of resources to on-site supervision are highlighted in Principles 12, 31 and 33.
<b>Principle 4.</b> The regulator should adopt clear and consistent regulatory processes.	
Description	<p>SECP participates in the development of new statute law, in rules and regulations made under the law, and in regulations made by the self-regulatory agencies, in particular, the exchanges. All FG Rules and SECP Regulations made under the SECP Act are subject to a statutory process of prior consultation with the public and must be published.</p> <p>The SECP strives to develop efficient capital markets and a transparent regulatory framework based on consultative rule and policy making processes. The SECP lays considerable emphasis on market development while administering and enforcing various corporate and securities laws and follows a thorough consultation process. Stakeholder comments are also requested by the SECP prior to finalization of any new regulation or product.</p> <p>SECP also follows broad based consultation procedures which involve sharing the draft legislation with those who may be affected by the law or the policy that may include exchanges, associations of stakeholders such as MUFAP and the Insurance Association of Pakistan amongst others. The SECP also constitutes committees which include members from the SECP, exchanges, members of exchanges and executives of different organizations for proposing/drafting different policies, rules and regulations such as “Proposed reforms to Pakistan’s Debt Capital Markets” and “Non-Bank Financial Sector Reforms”.</p> <p>Any regulations, directives, guidelines or circulars issued by the SECP for its regulatees are also disseminated to the respective market participants. To clarify the SECP’s interpretation or point of view, if need arises, clarifications/ explanations are also issued. Any feedback received from the market stakeholders is given due consideration and the rationale for the issuance of any regulatory actions taken by the SECP is also provided along with the respective regulation, directive, etc. Any change in rules, regulations, directives, guidelines, etc. is also placed on the bulletin board of SECP’s official website and the media coverage is also provided giving due rationale for the change made in the policy.</p> <p>The costs and benefits, as perceived by the regulator in terms of efficient market conditions, investor protection, free and fair trading, risk mitigation, etc., are taken into account by the SECP for the introduction of any new policy.</p> <p>Ensuring that the consultation process takes place is obligatory for the SECP. While responding to comments is not obligatory for the SECP, it nonetheless invariably holds roundtables with various industry representatives to respond to their queries during the process. Further, the SECP has developed a Web Consultation Forum within its website where the general public can post comments on any draft rules, regulations or concept papers placed by the SECP, which are usually responded to by the staff of the SECP. The Forum can be accessed at the following link (<a href="http://forum.secp.gov.pk/forum.php">http://forum.secp.gov.pk/forum.php</a>).</p> <p>To ensure procedural fairness, the law also provide for the procedure to be followed while</p>

	<p>dealing with the SECP. The SECP is also required to give reasons in writing for its decisions that affect the rights or interests of others.</p> <p>The criteria for granting, denying and revoking any license is laid out in the regulatory framework. Any decision regarding denying and revocation of a license is subject to the opportunity of hearing for the concerned person and may be challenged before the Appellate Bench of the SECP. It may also be noted that the aforementioned statutes are public documents and are easily accessible on the SECP's website.</p> <p>The SECP is able to protect the confidentiality of its investigation reports and information in its possession. S.35(3) of the SECP Act requires that the SECP take all reasonable measures to protect from unauthorized use or disclosure, information given to it in confidence. S.35(1) of the SECP Act also restricts Policy Board Members, Commissioners or employees from disclosing information acquired in the course of their duty while the provision for permitted disclosure of the same is dealt with under s.36 of the SECP Act. Under the said sections of the SECP Act the SECP is bound to maintain confidentiality of information and is only permitted selective disclosure of such information for cases that either pertains to investor protection, the interest of the market or for performing the functions of the SECP.</p> <p>The Ordinance 1969 also imposes confidentiality requirements, by prohibiting the communication or disclosure of any information obtained or accessed in the course of the performance of any functions without the permission of the SECP (s.19).</p> <p>SECP has a standardized "Regulatory and Enforcement Actions Disclosure Policy which is currently being reviewed to make it part of a broader media policy of the SECP. In general, the policy sets out SECP's approach towards public disclosure of regulatory and enforcement actions including market development measures, ongoing and concluded inquiry or investigation. The Policy also highlights circumstances as to when such disclosure should be permitted.</p> <p>For disclosure of regulatory actions including; amendments/draft of new legal framework, new licensing; product development and amendments, investor facilitation activities and other achievements of the SECP, the Policy requires disclosure through print and electronic media as well as by making web placement on a prompt basis.</p> <p>For disclosure of Enforcement Actions, the Policy entail different disclosure parameters at different stages of enforcement action such as at commencement, during and conclusion of inquiry/investigation, issuance of show cause notices and disclosure of enforcement orders; depending upon the circumstances and with a view to maintain public confidence. Policy also requires the public disclosure of enforcement actions, the determination of "Significant Enforcement Actions" underpinned by the following criteria;</p> <ul style="list-style-type: none"> <li>• Price sensitive information</li> <li>• Information which protects investors and is in the public interest at large</li> <li>• Information that maintains accountability and targets regulatory deterrence</li> <li>• Information which minimizes widespread misconduct or reduces systemic risk in the capital market.</li> </ul> <p>Further, the Policy sets the parameters for public disclosure of criminal proceedings and rulings on the appeals filed before the Appellate Bench of the SECP.</p>
Assessment	Fully Implemented
Comments	SECP has clear and consistent regulatory processes. SECP has the capacity to interpret legislative provisions during the consultation process. SECP holds regular roundtables with industry participants. SECP should implement its policy for disclosure of enforcement actions.

<b>Principle 5.</b> The staff of the regulator should observe the highest professional standards, including appropriate standards of confidentiality.	
Description	<p>The SECP Act, s.16 and 17 provide detailed guidance to avoid conflict of interest. Whereas a Commissioner or a Member of the Policy Board having any interest in any matter to be discussed or decided by the SECP or the Policy Board or a committee shall, prior to any discussion of the matter, disclose in writing, respectively, to the SECP, the Policy Board or a committee, as the case may be, the fact of his interest and the nature thereof. Further, an SECP employee, Member of the Policy Board or Commissioner shall not, except to perform official duties, make a record of or disclose to any person any information acquired for the purposes of work other than in the performance of official duties. Any person who contravenes the disclosure of interests (s.16) and confidentiality requirements (s.35) of the SECP Act is liable on conviction to a fine or to imprisonment or both.</p> <p>All SECP employees are expected to abide by the Service Manual and HR Handbook in place which highlight that the staff of the regulator cannot be involved in any activities which may be considered to create conflicts of interest such as disclosure of confidential documents amongst others. The procedures also entail detailed guidance pertaining to requirements for an employee for investment and sale of listed shares and IPOs of securities. As per the instruction all employees are required to obtain prior permission from the Commissioner of their Division before making any investment in shares and sale of shares. The permission required shall be applicable to all investments in the name of the employee or investments made on behalf of dependent children, spouse or parents. In case of misconduct disciplinary action will be taken against the employee.</p> <p>Under clause 5 of Chapter 12 of the SECP's HR Handbook, 2007, all officers are required to submit copies of the following declaration / statement / documents by the 31st December of each year to the Secretary to the SECP, in a sealed envelope:-</p> <ul style="list-style-type: none"> <li>• Income Tax Returns</li> <li>• Wealth Statement (using the same format as prescribed by the FBR for the purpose)</li> <li>• CDC Account Statement (for those employees who hold shares)</li> </ul> <p>A declaration is also required to be filed if any investment is made on behalf of any of the dependent family members of the officer. The documents are submitted by all employees to the Secretary to the SECP's office for record keeping and maintenance in the employees file.</p> <p>The internal audit function at the SECP also acts as an independent appraisal of various operations and system of control within the SECP to determine whether policies and procedures are followed.</p> <p>As per Chapter 11A of the HR Handbook, when there is reason to believe that violation of professional conduct has taken place, the SECP may initiate proceedings against any employee of the SECP. An inquiry officer or committee is then formed to look in to the matter. The employee against whom an inquiry has been initiated may be suspended where it is deemed necessary. The inquiry committee begins its fact finding analysis and can call upon the accused for questioning. An inquiry report is then formulated which provides details of the case and evidence collected. If any issues are found, a disciplinary notice is sent to the accused and a disciplinary hearing takes place where the accused can respond to the charges. When an accused is found liable to disciplinary proceedings, minor actions, such as, holding back salary or recovering the loss from the accused can be imposed, or major actions, such as demotion or dismissal can be levied on the accused. The accused thereafter has the right to appeal to the appellate bench of the SECP and thereafter can also appeal to the Court. In the past, the process described above has been used when required.</p>
Assessment	Fully Implemented



Comments	There are clear conduct rules applicable to SECP staff. Recent changes to the rules now apply to employment after the SECP, on retirement etc. A new HR Manual will shortly be presented to the Policy Board for approval covering the monitoring of professional standards for investment in shares and declaration of assets.
<b>Principle 6.</b> The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.	
Description	<p>Monitoring, mitigating and managing systemic risk is at present not a responsibility explicitly included in SECP’s existing legislative mandate. Systemic risk has been made part of the regulatory objectives in the new draft SECP Act which is pending promulgation. It may be noted that SECP, through its various measures and reforms that focus on better governance, enhanced transparency and improved risk management does however contribute to processes which monitor, mitigate and manage the systemic risk.</p> <p>In order to identify and tackle systemic risks or risks posed by significantly important financial and non-financial institutions across sectors, SECP has entered into a protocol for information sharing with the Central Bank of Pakistan (SBP). Both regulators have established mechanism of regular information sharing through a MoU on important issues that affect the overall financial sector and the economy.</p> <p>Further, to develop expertise for risk measurement and analysis across sectors, SECP and SBP have established a Task Force for appropriate supervision of conglomerates having direct or indirect holdings or influence on financial sector through shareholdings as well as large exposures. These essentially involve banks, Development Financial Institutions, , NBFCs, insurance companies, brokerage houses, large corporate entities and other financial institutions. The Task Force is working to develop a framework to provide an overarching supervisory control over the major stakeholders within the financial services sector.</p> <p>The SECP has also entered in to a MoU on information sharing and coordination with the FBR to effectively carry out the respective statutory responsibilities and maintain the highest level of oversight quality, while minimizing duplication of efforts.</p> <p>A proposal to create a Council of Financial Regulators involving the MoF, SBP, FBR and the SECP has also been tabled. The council aims to provide a forum for open dialogue and discussion to look at the developmental aspects, systemic risk as well as policy and structural issues impacting Pakistani financial markets. In addition, the creation of a risk management wing which focuses on systemic risk assessment is also envisaged.</p> <p>The SECP is in the process of adding monitoring of systemic risk as part of its legal mandate and internal processes. At the time of the assessment, amendments are proposed for the SECP Act with regard to the powers and functions of the SECP. A new provision is proposed for the SECP to identify and address the systemic risk factors.</p>
Assessment	Not Implemented
Comments	<p>Lack of a regulatory process to monitor, mitigate and manage systemic risk. At the time of the assessment, amendments are proposed for the SECP Act with regard to the powers and functions of the SECP. A new provision is proposed for the SECP to identify and address the systemic risk factors. SECP plan for systemic risk mitigation and amendments of the SECP Act should be therefore accelerated.</p> <p>IMF/IOSCO have recently made the following update to the assessment process of which the SECP should be aware as it develops its work in this area. They state: “The first assessments of Principles 6 and 7 conducted by the IMF after the introduction of the new Assessment Methodology focused on three high level issues in assessing the existence of a process to identify systemic risk or to review the perimeter of regulation, which is required pursuant to Key Question 1 of the respective Principles: (i) whether the arrangements in</p>

	<p>place allow for a holistic (across products, entities, and markets) view of risk; (ii) whether they allow for a periodic reassessment of risk; and (iii) whether they allow for proper follow-up (actions). The experience gained since has enabled an enhancement of the assessment criteria, for example, by looking at the type of data and analysis that the authorities use to identify such risks, and the degree to which the processes implemented allow for proper accountability. This is in line with the recommendations included in the recent report of the Assessment Committee of IOSCO”.</p>
<p><b>Principle 7.</b> The Regulator should have or contribute to a process to review the perimeter of regulation regularly.</p>	
<p>Description</p>	<p>The SECP identifies and addresses risks through reviewing the regulatory framework on an on-going basis that can be initiated by market feedback, complaints or on-site or off-site monitoring. The process entails initiation of concept papers and forwarding to the relevant ministry or Parliament whichever is the case for legislative changes. The review also entails consultation of stakeholders, formulation of committees and roundtable discussions. Public consultation is also a mandatory part of review process. In addition to that, the market participants also submit their proposals to review the regulatory perimeter which are reviewed by the SECP.</p> <p>Externally the SECP has institutionalized the information sharing mechanisms with the SBP and the FBR. SBP and SECP have established a Coordination Committee since 2003 and regular Coordination Committee Meetings are being held to review the effectiveness of the regulatory perimeters and to identify any risk posed to the financial sector due to evolving markets.</p> <p><b>SECP/SBP MoU</b></p> <p>Clause 4.1 (information to be shared)</p> <ul style="list-style-type: none"> <li>• Details of relevant examination reports, inquiry and investigation reports and other examination data and material available to the parties</li> <li>• Information regarding the financial markets, including the securities financing markets, to assess the conditions in such markets, that may materially affect the operations or financial condition of their respective regulatees</li> <li>• Such information as may be required to set supervisory and regulatory requirements, guidelines or rules in areas like the capital, liquidity and funding positions and resources, risk management systems and controls of the regulated entities</li> </ul> <p>Clause 7</p> <ul style="list-style-type: none"> <li>• Each party will inform the other about any major relevant policy changes and will discuss with the other, in advance, any policy changes which are likely to have a bearing on the regulatory responsibilities of the other</li> <li>• Parties will do their utmost to ensure they have unanimity of views on major policy issues concerning the sectors/areas under their respective jurisdictions when making any representation to the Government.</li> </ul> <p>Clause 9</p> <ul style="list-style-type: none"> <li>• The parties will where deemed necessary, form committees and task forces for the purpose of the MoU</li> <li>• Representatives from both parties will meet regularly to coordinate efforts to undertake policy dialogue for uniformity in regulatory approach</li> </ul> <p>Clause 10</p> <ul style="list-style-type: none"> <li>• The parties will meet regularly to identify, discuss and share information regarding regulatory and supervisory issues related to the conglomerates, large</li> </ul>

	<p>financial and non-financial groups, including information on the structure of financial conglomerates, financial condition, risk management systems, internal controls and capital, liquidity, funding resources, investments in companies within the same group, intra-group exposures and group-wide exposures as well as other regulatory and supervisory issues of mutual interest</p> <ul style="list-style-type: none"> <li>• Each party will provide to each other, on an on-going basis to the extent requested, information and analysis regarding the financial condition, risk management systems, internal controls and capital liquidity, funding resources of any of its regulatees. This shall not restrict the parties from providing any information that is deemed relevant, even though it may not be requested.</li> </ul> <p><b>SECP/FBR MoU</b></p> <p>Clause 7</p> <ul style="list-style-type: none"> <li>• Each party will inform the other about any major relevant policy changes and will discuss with the other in advance of any policy changes which are likely to have a bearing on the regulatory responsibilities of the other</li> <li>• Parties will use their utmost efforts to ensure they have unanimity of views on major policy issues concerning the sectors/areas under their respective jurisdictions while making any representation to the FG</li> <li>• Parties will hold consultation on fiscal policy measures and proposals pertaining to the Non-Bank Financial Sector and corporate sector with a view to encouraging documentation of the economy, promotion of long-term saving culture and corporatization</li> </ul> <p>Clause 9</p> <p>Representatives from both parties will meet regularly to coordinate efforts through this platform to undertake policy dialogue for achieving unanimity in the regulatory approach for sectors under their respective regulatory purview.</p> <p>Furthermore, a Financial Sector Development Task Force was created between the SECP and SBP to study the impediments towards achieving an inclusive financial sector and to recommend a medium term development strategy for the financial sector. As mentioned earlier, a proposal for the establishment of a Council of Financial Regulators has also been tabled.</p> <p>In the same manner the SECP regularly meets with the FBR to consider the impacts of fiscal and taxation policies on the sectors under the SECP's regulatory ambit and to amend such policies in light of emerging risks and developments in the markets.</p> <p>Effective coordination has also been established with the Financial Monitoring Unit, the regulator of the Anti-Money Laundering Act 2010 (AML Act), for implementation of the AML National Strategy in the financial sector.</p> <p>The SECP Policy Board, which is responsible for all policy decisions pertaining to the SECP's regulatory ambit, is also involved with various FG officials and an official from the SBP. This helps in aligning policies on all fronts in light of existing, evolving and new markets, market processes and market participants.</p> <p>The SECP either on its own initiative or at the request of market participants can also review its past policy decisions in view of changing circumstances. After a review of the regulatory perimeter, if the need arises, the SECP, after consultation with all stakeholders, either amends relevant rules and regulations or issues a circular, direction or guideline in light of developments in existing, evolving and new markets, market processes, financial products and market participants and for addressing emerging risks.</p>
Assessment	Fully Implemented

Comments	SECP identifies and addresses risks through reviewing the regulatory framework on an ongoing basis. This can be initiated by market feedback, onsite-offsite monitoring etc. A Coordination Committee has been established to review effectiveness of the regulatory perimeters and to identify risks posed to financial sector due to evolving markets.
<b>Principle 8.</b> The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.	
Description	<p>Supervisory programs in place for the on-going supervision of regulated entities including securities intermediaries, CIS operators and CRAs, and auditors are a key mechanism to identify, evaluate and, when necessary, take regulatory actions including; amendments in the regulatory framework, or issuance of notifications/ circulars/ directives/ guidelines etc., to address potential and actual conflicts of interest regarding issuers and regulated entities.</p> <p>The current regulatory framework has put in place mechanisms to mitigate and prevent conflicts of interest in regulated entities by restricting regulated entities from undertaking certain activities or through disclosure to investors and the regulator.</p> <ul style="list-style-type: none"> <li>• CIS Operators. To address conflict of interest, CIS operators (AMC) are prohibited from undertaking businesses involving equity proprietary trading, brokerage business, corporate advisory or other form of investment banking activity and to manage private equity and venture capital funds (r. 5(2) and r.5(4) of NBFC Rules 2003).</li> <li>• Auditors and Auditing Services. No issuer can appoint an auditor who is also engaged by the issuer as a consultant or advisor or to provide any accounting, auditing, HR, legal or actuarial services (LR of the stock exchange).</li> <li>• Credit Rating Agencies (CRAs). The Code of Conduct for CRAs issued by SECP obligates the CRAs to make various disclosures to mitigate the conflicts of interest between a CRA and the issuer they rate.</li> <li>• Brokers. The Code of Conduct for Brokers specified under the Broker Rules 2001 address areas of conflicts of interest which may arise between the broker and his client. The regulations of the stock exchanges also contain specific arrangements for misaligned incentives.</li> <li>• Capital Market Infrastructure. To address conflicts of interest, SECP revamped the investor account structure at the central depository by segregating clients' assets from the brokers. Now the client assets cannot be operated/changed by the broker without prior approval.</li> <li>• Stock Exchanges. Recent corporatization and demutualization of the stock exchanges in Pakistan has segregated ownership and trading rights as well as commercial and regulatory functions</li> <li>• Issuer. A Lead Manager and a Book Runner cannot be an associated company or an associated undertaking of the Issue/Offeror. The issuer is further restricted from advancing loans to its directors without approval of the SECP. The CEO of the issuer company cannot engage in a competing business and disclosure of director's interests is mandated under the law.</li> </ul> <p>SECP is in the process of prescribing "Guidelines For Dealing With Conflicts of Interest in Securities Market" which will adequately focus on adoption of clear and concise policies; adequate disclosures; information barriers; effective procedures; remuneration to commensurate the activities; maintaining record of activities; specific prohibitions, etc.</p> <p>The laws, the Ordinance 84, the Takeover Ordinance and the LR, provide necessary prohibitions and disclosures to avoid issuers' potential misalignment of incentives.</p> <p>The SECP seeks to identify potential misalignment of incentives through the review that it does of issuers' reporting obligations. When issues of concern arise, the SECP seeks to address them mainly through enhanced disclosure or put in place restriction from</p>

undertaking certain activities.

Revision of the CCG in 2012 was the outcome of an SECP review of requirements to address issuers' potential conflict of interest and misalignment of incentives. The following amendments were implemented in Stock Exchange Listing Regulations-Code of Corporate Governance, to address misalignment of incentives through enhanced disclosure and prohibitions:

- The Chairman and CEO shall not be the same person, unless specifically provided for in any other law.
- The Chairman shall be elected from amongst the non-executive directors of the listed company.
- The appointment, remuneration and terms and conditions of employment of the CFO, CS and the Head of Internal Audit of listed companies shall be determined by the Board. The removal will also be by the Board for the CS and CFO.
- A formal and transparent procedure is to be followed for setting remuneration of directors and disclosure of aggregate remuneration in the annual report.
- The Chairman of the Audit Committee shall be an independent director, who shall not be the chairman of the board. Audit Committee shall comprise of non-executive directors.
- The secretary of the Audit Committee shall either be the Company Secretary or Head of Internal Audit. However, the CFO shall not be appointed as the secretary to the Audit Committee.
- Human Resources and Remuneration Committees have been introduced.

The regulatory framework provides for several measures to address conflicts of interest arising in different scenarios and to avoid misalignment of incentives. S.3.2 of the Rule Book of KSE requires directors of KSE to adequately disclose any conflict of interest in respect of any agenda item of a board meeting and to refrain from participating in a board meeting in connection with such matter. Further, s.4.13 of the Rule Book requires a broker to disclose conflict of interest in respect of any research report issued. The Code of Conduct for Trading by Employees of Brokerage House as provided in the Rule Book of KSE requires the employees of a brokerage house to avoid conflict of interest while giving advice to a customer and while trading. In addition, Rule 7 of the Securities and Exchange Rules, 1971 (Rules 1971) require brokers to refrain from any proprietary trading activity which may adversely affect the interest of clients. Similar requirements are also provided in the Chapter 7 of the Rule Book. Further clause 7.4 of the Rule Book provides requirements relating to conflict of interest.

The SECP's regular review of the disclosure requirements as well as on-site and off-site inspection program serves this purpose. The SECP require regulated entities and issuers to provide disclosures along with annual financial statements and other periodic filings. Conflicts of interest form part of the SECP's inspection. Compliance with the regulatory framework by the brokers is checked during the System Audit of brokers and through on-site inspections by SECP. Further, SECP closely reviews the conduct of board of stock exchanges and their management to prevent any conflicts of interest. Recently SECP required explanation from a member of the Regulatory Affairs Committee of KSE concerning his alleged association with a broker and due to his appearance as a legal counsel of that broker in a disciplinary hearing conducted by SECP.

#### **Proposed legislative and regulatory enhancements**

Amendments covering misalignment of incentives for intermediaries i.e., brokers, and underwriters are incorporated in the draft Securities Bill which has been approved by the Senate Standing Committee and is awaiting promulgation by the Parliament. Appropriate amendments for CIS are to be covered in draft NBFC Regulations and for brokers in the new Brokers Rules. Regulations would assign the board of an intermediary to put in place mechanisms to avoid, manage and disclose misalignment of incentives through its compensation policies which may be structured with remuneration aligned to long term product performance. The SECP or the SROs would assess implementation of such policies

	through their on-site inspections.
Assessment	Broadly Implemented
Comments	Conflicts of interest are identified and evaluated by SECP in the process of supervision of regulated entities. The applicable legal framework prohibits regulated entities from undertaking various activities and requires them to establish policies and procedures for internal control which properly address conflicts of interest. However, treatment of misalignment of incentives is not yet clearly articulated in the SECP rules.
<b>Principle for Self-Regulation</b>	
<b>Principle 9.</b> Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.	
Description	<p>The three demutualized Stock Exchanges (KSE, LSE and ISE), the PMEX, the CDC and the NCCPL acting as SROs establish rules of eligibility for individuals or firms who participate in significant securities activity in terms of securities trading, clearing, settlement and transfer of title systems.</p> <p>The SROs are mandated to discharge functions and responsibilities entrusted to them under the memorandum and articles of association subject to the statutory powers of the SECP under the Ordinance 1969, and the relevant laws and regulations made thereunder. The responsibilities of the SRO exchanges include: administering the stock exchange rules and regulations including those relating to the qualification for membership, admission, suspension and expulsion of members; members' exposure and compliance with the code of conduct; administering the LR for the listing of issuers and securities, the offer of securities by the listed companies including the transfer of securities; periodic reporting and timely reporting of material information as it arises; applicability of the Code 2012; and the delisting of issuers and securities.</p> <p>The SROs (exchanges, CDC and NCCPL) regulations outline the requirements and procedures for conducting trading activities and participating in the business of securities transactions. The SROs in addition to monitoring trading activities have the authority to make, amend or rescind their regulations subject to prior approval of the SECP.</p> <p>The stock exchanges have statutory obligations to regulate the participants that use their markets and facilities, monitor their behavior and have the power to impose meaningful sanctions on them. Following corporatization and demutualization of the stock exchanges, the Memorandum and Articles of Association of the stock exchanges impose specific conditions on TREC holders, clearing persons and any other related person to ensure compliance with the regulations of the stock exchanges; Similarly, the PMEX general regulations ensure compliance of all such affairs at the commodity exchange.</p> <p>Respective regulations of CDC and NCCPL also specify the rules of trading, business conduct and qualification requirements for individuals and firms registered with them. Apart from the overall mandatory nature of the regulations of these entities, the regulations stipulate agreements to be signed by the CDS/NCSS participants with the CDC/NCCPL respectively.</p> <p>Registration is granted to the SROs after the SECP is satisfied with their ability to perform their functions in accordance with the law. Prior to the grant of licenses for registration to the SROs, in terms of ss.4 and 5 of the Ordinance 1969, s.4 of the CDC Rules 1996 and s.4 of the Clearing Houses Rules 2005 require SROs to demonstrate that they have the capacity to perform their functions defined under the laws and the ability to enforce compliance by</p>

their members and associated persons subject to those laws, regulations and rules.

The SECP is authorized under s.20 (k) of the SECP, Act 1997 to call for information, undertake inspections, and conduct inquiries and audits of the stock exchanges and SROs in the securities market. However, in practice such inspections do not take place.

A stock exchange may not change its rules without the approval of the SECP. A stock exchange must maintain books of accounts and documents to disclose a true and fair picture of its state of affairs at any point in time. It must report monthly on this to the SECP. Under s.6(2) of the Ordinance 1969, every exchange is required to submit annual and periodic reports to the SECP, as prescribed, relating to its affairs; Ss.9 and 10 of the Rules 1971 detail the periodic reports that are required to be filed.

No broker may deal on the exchange unless registered by the SECP. Every member must maintain books of account and other documents to disclose a true, accurate and up-to date position of the business (Rules 7 and 8 of the Rules 1971).

CDC Rules 1996 require the CDC to conduct a comprehensive annual review of the CDS and provide a copy of the audit certificate to the SECP. Similarly, the NCCPL Regulations also require that the NCCPL conduct a detailed annual review of its NCSS through an independent firm and submit the review report to the SECP.

SECP reviews the SROs rules and regulations to ensure that they have sufficient powers and where it feels any amendment is required, the SROs are directed to make, amend or rescind any regulation.

Appropriate sanctions under the regulatory framework can be taken by SROs for any non-compliance to the rules or regulations in place.

SECP does not conduct on-site inspection of stock exchanges. However, SECP has several checks and balances in place to ensure close monitoring and supervision of stock exchanges. SECP conducts weekly meetings with the MD and Chief Regulatory Officer (CRO) of stock exchanges wherein matters relating to regulatory compliance and measures for investor protection are discussed. SECP also closely reviews all minutes of the board meetings and the Regulatory Affairs Committee meetings and follow up is made with stock exchanges in case of any problem areas identified. In addition, Inter-exchange coordination committee meetings are also conducted on a frequent basis with the MDs, CROs and director of stock exchanges wherein decisions are taken to continuously introduce reforms in the market and the performance of exchanges against ongoing reform measures is reviewed.

SECP has also implemented a system of off-site reporting by the KSE on a monthly and quarterly basis wherein information relating to the compliance by KSE with respect to the roles and responsibilities assigned under the law is collected and analyzed.

The System Audit reports concerning the regulatory audit of brokers by chartered accountant firms are also obtained from stock exchanges whereby the exceptions identified by the auditors and the resultant enforcement action by the stock exchanges are analyzed.

Due to the above measures SECP is in a position to immediately identify and take corrective action regarding any lapse by a stock exchange in complying with the regulatory framework. Accordingly SECP imposed penalties on the KSE, its managing director and deputy managing director vide its orders dated May 23, 2014 as a result of a failure in taking timely and appropriate action in respect of non-compliance identified in the System Audit Report of a broker.

SECP also instructed NCCPL to initiate a comprehensive regulatory audit which was conducted by one of the big 3 chartered accountant firms in 2014 and which checked controls of NCCPL on compliance with regulations, adequacy of safeguards over data confidentiality, access controls, disaster recovery policies efficiency of internal audit function etc.

SECP has also instructed KSE to submit terms of reference for a regulatory compliance

	<p>audit which will be conducted at least once in 2 years by one of the big 3 audit firms.</p> <p>The regulatory compliance audit will aim to check following areas:</p> <ul style="list-style-type: none"> <li>• compliance with regulations by the stock exchanges;</li> <li>• adherence to risk management framework and policies;</li> <li>• internal controls and measures to ensure confidentiality of data;</li> <li>• adherence with a policy to address conflict of interest;</li> <li>• compliance with the fit and proper criteria by the directors and committee members of stock exchange.</li> </ul>
Assessment	Broadly Implemented
Comments	<p>The SECP has in place measures and procedures for oversight of the eligibility requirements of SRO's. Regulation making powers have been delegated to the SROs which are to be reviewed by the SECP prior to approval. Cooperation between the SECP and SROs is an on-going process; however, no formal guidelines for cooperation have been established. Furthermore, SECP at present does not conduct annual assessments on compliance with its obligations as a licensee as well as any onsite inspections of the SROs. However, weekly meetings are currently in place.</p> <p>The SECP has proposed to initiate a Systems Audit process using an external auditor but it is not clear whether the scope and the expertise of the auditor will sufficiently replicate those of the SECP were it to carry out the inspection itself. See also Principle 33.</p>
<b>Principles for the Enforcement of Securities Regulation</b>	
<b>Principle 10.</b> The regulator should have comprehensive inspection, investigation and surveillance power	
Description	<p>The SECP has extensive inspection, investigation and surveillance powers pursuant to the SECP Act, the Ordinance 1969, the Ordinance 84 and under the Takeovers Ordinance.</p> <p>The mandate of the SECP includes powers to :</p> <ul style="list-style-type: none"> <li>• inspect a regulated entity without giving prior notice;</li> <li>• conduct onsite inspections of regulated entities;</li> <li>• obtain books and records and request data or information from regulated entities on a routine basis or in response to a particular inquiry;</li> <li>• conduct or supervise surveillance of trading activity on its authorized exchanges and regulated trading platforms;</li> <li>• access the identity of customers of regulated entities.</li> </ul> <p>Regulated entities in Pakistan are required to</p> <ul style="list-style-type: none"> <li>• maintain records concerning client identity;</li> <li>• maintain records that permit tracing of funds and securities in and out of brokerage and bank accounts related to securities transactions.</li> </ul> <p>The exchanges, brokers, companies, banks, CDC and NCCPL are all required to maintain records that allow tracing of funds. These records under the law can be obtained by the SECP. Where the SECP outsources inspections or other regulatory functions, the results are submitted to the SECP for review and the SECP has full access to the information obtained by a third party. Obligations of confidentiality under s.35 of the SECP Act are equally applicable to a third party.</p>
Assessment	Fully Implemented



Comments	The SECP has comprehensive powers and can access the necessary information from regulated entities and from third parties.
<b>Principle 11.</b> The regulator should have comprehensive enforcement power	
Description	<p>The SECP has a comprehensive range of enforcement and investigative powers.</p> <p><b>Investigative powers</b></p> <p>The SECP uses the powers under s.20 and s.29 of the SECP Act to carry out investigations into possible breaches of legislation that may result in administrative or criminal sanctions. The SECP regulates all entities operating in insurance, capital markets and NBFC sectors by issuing licenses, supervising their businesses, and taking enforcement actions where it considers necessary. The SECP can investigate, where appropriate, the affairs of a company under s.265 of the Ordinance 84.</p> <p><b>Enforcement Powers</b></p> <p>S.20(4) of the SECP Act provides SECP with enforcement powers and the power to monitor compliance with statutory requirements (both legal and operational), financial and non-financial disclosures, examination of audited accounts, off-site monitoring of regulated entities, on-site inspection of regulated entities, conducting investigations, surveillance of trading activity at stock exchanges, etc. In addition, the SECP Act and other statutes empower the SECP to issue directives, circulars and guidelines with fines being imposed for non-compliance.</p> <p>In general the powers of the SECP include the ability:</p> <p><i>Under the Ordinance 1969:</i></p> <ul style="list-style-type: none"> <li>• to suspend or cancel the registration of a stock exchange or any member, supersede the governing body or suspend or remove a director, officer or member from his office or membership (s.7);</li> <li>• to require a listed company to comply with a listing condition or requirement (s.9);</li> <li>• to suspend the trading of any listed security (s.9);</li> <li>• to direct a person to abstain from doing an act which in the opinion of SECP contravenes the law or to do an act where the failure to do so would breach the law (s.20);</li> <li>• to impose administrative fines on those who are subject to the law for non-compliance;</li> <li>• to undertake enquiries, enter into premises, seize documents, availing itself of the types of powers which are available to the court in the conduct of proceedings;</li> <li>• to prosecute an offence, where breaches constitute a criminal offence.</li> </ul> <p><i>Under the Ordinance 84:</i></p> <ul style="list-style-type: none"> <li>• to call for additional statements of accounts from companies (s.246);</li> <li>• to appoint auditors in certain cases (s.252 and s.254);</li> <li>• to investigate the affairs of a company (s.263 and s.265);</li> <li>• to prosecute a company or person who appears as a consequence of an investigation to have been guilty of an offence (s.270 and s.271);</li> <li>• to appoint an administrator, on the application of creditors having “interest equivalent in amount to not less than sixty per cent of the paid up capital” (s.295);</li> <li>• to make application to the Court for winding-up a company (s.309);</li> <li>• to direct a company or any officer to comply with any provision of Ordinance 84 (s.472);</li> </ul>

- to impose a fine for offences, other than those for which imprisonment is provided for in the law, or for failure to comply with a SECP directive (s.476);
- to issue directions to NBFCs generally or to any one NBFC (s.282D);
- by order, to remove from office any chairman or director or chief executive or other officer of an NBFC (s.282E);
- by order, to supersede the board of directors of an NBFC (s.282F);
- to require an NBFC to furnish information (s.282G);
- to order a special audit of an NBFC – the SECP is required to monitor the general financial condition of an NBFC (s.282H);
- to cancel any license of an NBFC (s.282J);
- to impose a fine on an NBFC or its officers for non-compliance with a provision of the Act (s.282 J);
- to impose the fine for any offence other than an offence for which the fine may be imposed in addition to a term of imprisonment (s.282M).

*Under the CDC Act*

- carry out investigations, call for information, and take cognizance of any offence;
- call for information and appoint any person as inspector to investigate the affairs of the CDC or of any participant (s.27).

*Recourse Measures for shareholders and investors*

Private rights of action are available to shareholders and investors to seek compensation or other remedies for losses resulting from misconduct by regulated entities. In addition to approaching the SECP to seek remedy for misconduct relating to the securities laws, an injured party can also approach the Courts or other government law enforcement agencies like National Accountability Bureau and Federal Investigation Agency to seek remedy under their respective laws.

Appeals can also be filed with the appellate bench of the SECP. Orders issued by the appellate bench can be appealed to a court.

*Ability to reconstruct all securities and derivatives transactions*

The SECP has the ability to obtain the necessary information from regulated entities – such as stock exchanges, intermediaries and SROs (s.20(7) SECP Act; Companies; NBFCs and the modarabas; CDC; and any un-regulated person for the purposes of an SECP proceeding or inquiry.

The SECP also has the power to call upon a company, any of its present or past directors, officers or auditors to furnish such information or explanation, or document, within such time not being less than fourteen days as specified. S.27 of the CDC Act empowers the SECP to call for information from the central depository or any participant which is a company or a corporation to which the Ordinance 84 applies. The SECP is empowered under s.20(7) of the SECP Act to require anyone to furnish such information and documents in their possession relating to any matter as may be necessary for the purposes of a proceeding or enquiry.

The SECP is therefore, empowered under its primary laws namely; the SECP Act, the Ordinance 1969, the CDC Act and the Ordinance 84 to obtain bank and brokerage account information and contemporaneous records, including records of all funds and assets transferred into and out of bank and brokerage accounts relating to securities transactions either directly from the broker member and the bank or from the stock exchange.

*Identifying securities and derivatives transactions*

Under the Ordinance 1969, the SECP has been given the power to inspect the book of accounts and other documents of any exchange. As for record keeping requirements, each stock exchange is required to keep a daily record of quotations and transactions on the stock

	<p>exchange showing the time at which each transaction took place and the record of transactions with the bank (rule 7(2)(d), (e) and 7(3) of the Rules, 1971).</p> <p>Under Rules 1971, every stock exchange member is required to maintain records including a register of all orders to buy or sell securities that a member receives. The register is required to record the name and address of the person who placed the order; the name and number of the securities to be bought or sold; the nature of the transaction; and the limitation (if any) of the price of the securities or the period for which the order is valid.</p> <p>The stock exchange member executing a customer order is to transmit to the customer a confirmation, which includes the following information pursuant to rule 4(4) of the Rules 1971: the date on which the order is executed; the name and number of securities; the nature of the transaction; the price; the commission (if the member is acting as a broker); whether the order is executed for the member's own account or from the market.</p> <p>The SECP is empowered to inspect the books and records required to be maintained by a member of a stock exchange (rule 5 Stock Exchange Members (Inspection of Books and Record) Rules). It is obligatory for the stock exchange member, who is being inspected, to produce such books of accounts, record computer-data in possession of the member or any other person and other documents under his custody or control with information relating to transaction in securities market within such time as may be required by the SECP.</p> <p>It is mandatory for stock exchange members to report all off market transactions in all the listed securities to the stock exchange. In the case of listed securities, the CDC does not allow the movement of those shares unless evidence is provided that the off market transaction has been reported to the stock exchange by the concerned members. Chapter 9 of CDC Rules 1996 provides for the nature of underlying securities transactions based on which free delivery of book entry securities is allowed and regulation 9.1.1(h) specifically allows for free delivery of book entry securities, if evidenced that the underlying securities transaction is an off market transaction. This reporting includes the volume of transaction, the price, the counter parties, and details of the stock sold.</p> <p>Stock exchange members are also under a requirement to use a unique client code number for each client (regulation 9.7 National Clearing Company of Pakistan Limited Regulations, 2003). This code establishes a traceable link between the executed trade and the client and enables the SECP to identify the individual client who dealt in a securities transaction.</p> <p>Intermediaries who are not stock exchange members cannot transact off-market without a brokerage company who will report the transaction to the stock exchange.</p> <p><i>Beneficial Ownership Information</i></p> <p>The corporate sector in Pakistan, including publicly listed companies, non-listed companies, private companies, single member companies, not for profit companies, guarantee companies and foreign companies fall within the regulatory ambit of the SECP. As a general rule, under Pakistani company law, the beneficial owner is taken to be the legal owner. Exceptions to this general rule exist for listed companies and for securities held through the central depository. In both these cases the SECP can obtain beneficial ownership information through market disclosure obligations, from records kept by the central depository or through the use of its information gathering powers.</p> <p>For entities that are not regulated by the SECP (such as partnerships and trusts) the SECP can use the information gathering powers under s.20(7) of the SECP Act to gather this information. In fact, s.20(7) empowers the SECP to require anyone to furnish such information and documents in their possession relating to any matter as may be necessary for the purposes of a proceeding or enquiry.</p> <p><i>Ability to take Statements and Testimony</i></p> <p>The SECP is able to take a voluntary statement from any person in terms of s.32(3) of the SECP Act. The SECP is also able to compel any person acquainted with the facts and circumstances of the case to appear before an SECP investigator. Such a person shall be</p>
--	--

	<p>examined orally and any statement made during the examination can be reduced to writing under s.32 of the SECP Act. During the examination a person is bound to answer all questions relating to the case as put to him by the investigating officer. The SECP can also apply pecuniary and criminal penalties under s.32(5) of the SECP Act to encourage compliance with requests for the provision of information and documents. This conduct is an offence and the person shall be liable on conviction to a fine up to 100,000 rupees or imprisonment for a term not exceeding one year, or both.</p>
Assessment	Fully Implemented
Comments	The SECP has comprehensive enforcement powers under the country's legal framework. For issues concerning beneficial ownership see Principles 17 and 37.
<p><b>Principle 12.</b> The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.</p>	
Description	<p><b>Inspection and Surveillance</b></p> <p><i>On-site Inspections</i></p> <p>The SECP has various internal departments which conduct inspections of regulated entities. These departments also carry out investigations of conduct that may indicate violations for which a criminal or administrative penalty may be imposed. Inspections are conducted on a routine or periodic basis in accordance with an annual inspection plan, on the basis of which enforcement actions are taken. During surveillance and inspection of the members of the exchanges the SECP checks the compliance of applicable rules and regulations by the members/brokers including the conduct of business, accuracy of calculation of capital adequacy, disclosure and segregation of clients' assets.</p> <p>Furthermore, the SECP can initiate inspection on the basis of a complaint or intelligence received regarding a regulated entity. The SECP has initiated inspections based on investor's complaints, tips, and complaints from other sources.</p> <p>Surveillance of the stock exchanges and trading systems is carried out via an automated software system called the "Market Surveillance Suite" (MSS). The MSS is a combination of different modules that includes an Alerts Module, which at the end of each day generates alerts based on pre-set parameters defined in the system relating to any unusual activity in the trading at the stock exchanges. SECP has also required the exchanges to establish their own surveillance wings to monitor trading activities at the respective exchanges. All the three stock exchanges have their own surveillance wings which monitor the trading activities of investors at their respective exchanges.</p> <p>Mechanisms have been established to detect and deter issues relating to:</p> <ul style="list-style-type: none"> <li>• Market or price manipulation or any fraudulent practices (ss.17a-e, Ordinance 1969)</li> <li>• Insider Trading (ss.15A-E, Ordinance 1969)</li> </ul> <p><b>Compliance</b></p> <p>The SECP ensures that the exchanges have their own surveillance system and procedures to monitor the activities at the respective exchanges. In terms of SECP's Circular 34 of 2009 every broker is required to appoint from amongst its employees, an officer, who is responsible for ensuring effective implementation and compliance with the regulatory framework. Further, NBFC Rules 2003 and NBFC Regulations 2008 make it mandatory for CIS operators to have compliance officer(s) and internal audit function.</p>

*On-site inspection of brokers*

Sr. No	Inspection Period	Type	Number of Brokers
1	July 2011 - June 2012	Regular	9
2	July 2012 - June 2013	Regular	27
3	July 2013 - June 2014	Regular	18

*Orders Issued*

2009-2014		
Sr. No	Category	Number of Orders
1	Blank Sales	18
2	Deleted Orders	1
3	Non - Compliance to Code of Code of Conduct of Brokers Registration Rules	14
4	Insider Trading	31
5	Violation of Listing Regulations	9
6	Violation of Section 22 of the Securities and Exchange Ordinance, 1969	3
7	Wash Trades	12
8	Price Manipulation	1
	<b><u>TOTAL</u></b>	<b><u>89</u></b>

*Criminal Complaints*

Sr. No	Criminal Complaints Filed in Court for Price Manipulation	Filed in
1	Azgard Nine Limited	April-13
2	Chenab Limited	Nov-13

*Actions for Insider Trading*

Insider Trading	
Year	# of Orders
2011	3
2012	13
2013	5
2014	1
<b>TOTAL</b>	<b>22</b>

	<i>Inspection of non-bank finance companies</i>		
	<b>Sector</b>	<b>Number of firms inspected</b>	<b>Type of Inspection</b>
	Asset Management Companies ((Managing 69 mutual funds and 4 pension funds))	11	Regular
	Modarabas	1	Regular
	Leasing Companies	1	Regular
	Investment banks	2	Regular
Assessment	Partly Implemented		
Comments	<p><b>On-site Inspections</b></p> <p>Lack of risk-based assessments along with the need to establish and operate an intensive and structured on-site inspection program have contributed to the rating. The annual inspection plans are created on an ad-hoc basis from department to department. As the table above indicates on-site inspections are insufficiently frequent. In the last three years only 54 out of 255 brokers (21%) have been inspected. Some regulated entities may be inspected only once in ten years. The risk to investors is significant. SECP should have an enhanced annual inspection plan (supplemented and informed by an off-site program) duly approved by the SECP against which effectiveness of the enforcement activity can be assessed.</p> <p>As noted in the Comments to Principle 31, the SECP’s “Global/Joint Inspection” system, for which a committee was formed in late 2014, will be developed with a view to eliminating the duplication and inefficiency created due to separate inspections conducted by each SRO. This plan aims to have full coverage for brokers and should be accorded priority and implemented.</p> <p><b>The Courts</b></p> <p>While the regulatory framework provides sufficient and wide-ranging powers to ensure enforcement of securities laws and the SECP can take a combination of measures from enforcement orders and warnings to fines, suspension, and even criminal charges, the biggest obstacle to an effective enforcement regime is a chronic delay in the Courts’ system.</p> <p>Defendants make full use of the country’s appellate process, which is their right, but this leads to investigators appearing regularly and repeatedly before the Courts on procedural issues and the cases going unresolved for as long as eight years. These problems are beyond the control of the SECP but the authorities might consider establishing a financial court which can give proper attention to cases concerning markets matters.</p> <p><b>The effectiveness of the Enforcement Program needs to be enhanced</b></p> <p>As noted in Principle 36, the law prohibiting market misconduct is appropriate and covers the areas it needs to. The Ordinance 1969 provides for penalties for particular offences that are in some cases inadequate. While the catch-all s.22 of the Ordinance 1969 to some extent closes this gap, providing for penalties of 50 million rupees, it does not provide for prison terms. For insider trading, the available penalties should include imprisonment. The criminalization of insider trading, currently sought by the SECP, will address this.</p> <p>The deterrent effect of the penalties regime may be blunted by the ability of defendants to delay cases for long periods through legal challenges; the lack of actions resulting in prison sentences; and the relatively light penalties imposed, given the large potential profits from market misconduct. The ability to levy a penalty of three times the profits made in some</p>		

	<p>circumstances is a mitigating factor.</p> <p>There are weaknesses in the monitoring of the conduct of market intermediaries participating in the market place. The SECP and the exchanges are working together to strengthen such monitoring.</p> <p>As noted in Principle 34, the monitoring of intermediaries' conduct (through examinations of their business operations) raises some issues. There does not appear to be sufficiently vigorous and risk-based monitoring, combined with sufficient on-site inspections. There is heavy reliance on regular Systems audits by chartered accountants, who may lack the specialised expertise to fully assess a broker's operations. Systems audits are focused on ensuring there has been compliance with relevant legal requirements and are not a substitute for a fuller overview of participants' behaviour.</p> <p>In the judgment of the assessors, while SECP and the exchanges take action when they are aware of non-compliance in the market, there is a risk that they might not be aware, because early warning systems such as adequate off-site periodic reporting, effective on-site inspection program, and a risk-based capital adequacy system are not in place. (See in addition Principles 29-32).</p>
<b>Principles for Cooperation in Regulation</b>	
<b>Principle 13.</b> The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.	
Description	<p><b>Domestic Counterparts</b></p> <p>The SECP can provide to domestic regulators and authorities information on any matter in its hands concerning regulated entities without any external approvals. Information sharing mechanisms are in place in the form of MoUs.</p> <p>The SECP Act empowers the SECP to share and disclose information in its possession with domestic counterparts. Disclosure of information can occur under s.35(6)(b) of the SECP Act, where the Chairman is satisfied that particular information will enable or assist the FG, or an agency of the FG, to perform a function, or exercise a power, conferred by a law in force, the disclosure of such information will be taken to be for authorized use; further under s.35(7) keeping in view the confidential nature of any information being provided, the Chairman may impose conditions to be complied with.</p> <p>To facilitate cooperation and the exchange of information between financial market regulators, the SECP has signed MoUs on cooperation and exchange of information with the SBP and FBR. SECP is also a member of the National Executive Committee and the General Committee constituted under the AML Act with the SBP and collaborates with all the state authorities engaged in money laundering law enforcement.</p> <p><b>International Counterparts</b></p> <p>As a signatory to the IOSCO MMoU (signed on 10 March 2011), the SECP satisfied the requirements of IOSCO's Screening Group. The SECP also has bilateral cooperation arrangements with several foreign counterparts for sharing enforcement-related information in its possession on a multilateral, bilateral, and on an ad hoc basis. Information sharing with foreign counterparts is subject to maintaining safeguards for protecting the confidentiality of information under s.35(11) of the SECP Act.</p>
Assessment	Fully Implemented
Comments	This Principle concerns the sharing of public and non-public information with other regulators (as distinct from the ability to obtain information, not already in the possession of the SECP, on behalf of another regulator). Assessment by IOSCO's Screening Group

	determined that the SECP has the authority to share public and non-public information with its domestic and foreign counterparts
<b>Principle 14.</b> Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.	
Description	<p>There is no explicit provision that authorises the SECP to enter into information sharing agreements with domestic authorities, but such authority is implicit in the power to cooperate conferred by s.35 (6) of the SECP Act read with s.20. Through these provisions the SECP has the implied power to enter into information sharing agreements with other domestic authorities. The Commission policy is that bilateral MoUs will only be entered into where a need exists: for the purposes of regulatory cooperation, to assist cross-investment, or where there are trade ties.</p> <p>Domestically, the SECP has entered into a MoU with the SBP to obtain access to bank records. It also has a MoU with the FBR, and another with the Karachi Centre for Dispute Resolution for cooperation in respect of encouraging mediation for settlement of disputes. The SECP does not have a MoU with the SROs. It considered that the duty to report and to share information is sufficiently enshrined in the law. For similar reasons – as a legal obligation to report exists - there is no MoU with the Financial Intelligence Unit (although the SECP Chair is a member of the AML National Executive Council), nor with the criminal enforcement agencies. Negotiations are currently taking place for MoUs with the Competition Commission and the Federal Board of Revenue.</p> <p>Internationally, the SECP has signed 12 bilateral memoranda of understanding (MOUs) with foreign securities authorities including; UAE, Oman, Jordan, Morocco, Turkey, China, Iran, India, Maldives, Australia, Bhutan and Sri Lanka.</p> <p>At a multilateral level, SECP is a signatory to the IOSCO MMOU, a multilateral MOU among South Asian Securities Regulators, and MoUs with 21 European Securities Regulatory Authorities for information sharing related to the supervision of Alternative Investment Fund Managers. The SECP also provides information to foreign regulators on an ad-hoc basis. All information provided to the SECP by foreign authorities must be kept confidential by SECP under s.35 of the SECP Act.</p>
Assessment	Fully Implemented
Comments	<p>The SECP is, an IOSCO MMoU signatory (although the difficulties it has encountered with the SBP are relevant to Principle 15). The SECP appears to have few formal information-sharing mechanisms in place with other domestic regulators. Where there are requirements under the Law for domestic authorities to report and share information – for example the SROs, the criminal authorities and the AML authority - a bilateral MoU may not be necessary. A number of domestic MoUs are currently being discussed. However, there will be instances – as yet untested – where the cooperation and assistance of these authorities are necessary to fulfill a request under the IOSCO MMoU and some sort of mechanism may be required.</p> <p>Given the difficulties with the only request so far received under the IOSCO MMoU, the bilateral MoU between the SECP and the SBP may need greater clarity.</p>
<b>Principle 15.</b> The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers	
Description	Relevant information, in the SECP’s possession, can be shared with a foreign authority under the IOSCO MMoU, any other relevant agreement or on a case-by-case basis. For example, the SECP has shared regulatory (as opposed to investigative) information with the



	<p>Dubai Financial Services Authority on a Pakistani licensee, in the absence of a bilateral MoU.</p> <p>Powers vested in the SECP under the regulatory framework can be used in the same manner to assist foreign regulators (s.35(6)(c) of the SECP Act). There is no requirement for the SECP to have an independent interest in order to provide assistance to a foreign regulator, if the subject of the request constitutes a breach of the securities laws of the requesting foreign authority. The SECP however, has no power to obtain court orders on behalf of other regulators. (This is not yet a requirement under the IOSCO MMoU but it will be a feature of the enhanced MMoU).</p> <p>The SBP currently retains the power to release bank records and the SECP needs to obtain the State Bank’s consent to release and share them with foreign regulators.</p>
Assessment	Partly Implemented
Comments	<p>SECP can use its powers of inquiry, inspection and investigation at the request of and for the purposes of a foreign counterpart.</p> <p>Despite the fact that an arrangement was agreed with the Central Bank, to the satisfaction of IOSCO’s MMoU Screening Group, this understanding has not proved to work in practice. In the one request (made in April-May 2014) for bank records under the MMoU, the Central Bank has not been able to release the information to the SECP.</p> <p>A change in the SECP Act has been necessary to address the obstacle. A draft provision, s.42C, still to go before Parliament, has been drafted and proposes to give the SECP itself the authority to obtain and share bank records with foreign counterparts.</p> <p>This amendment should give the SECP the authority it requires and is actively seeking. Greater experience in cooperation is recommended and closer collaboration with the Central Bank is essential if this Principle is to be satisfied.</p>
<b>Principles for Issuers</b>	
<b>Principle 16.</b> There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investor’s decisions.	
Description	<p><b>Public Offerings</b></p> <p>Company Ordinance 84 at s.2(30) defines a public company as a company which is not a private company. A private company (s.2(28)) is defined as a company which:</p> <ul style="list-style-type: none"> <li>(i) restricts the right to transfer its shares, if any;</li> <li>(ii) limits the number of its members to fifty not including persons who are in the employment of the company; and</li> <li>(iii) prohibits any invitation to the public to subscribe for the shares, if any, or debentures of the company.</li> </ul> <p>A listed company is a company or a body corporate or other body whose securities are listed.</p> <p>S.2.(29) defines a prospectus as “any document described or issued as prospectus, and includes any notice, circular, advertisement, or other communication, inviting offers from the public for the subscription or purchase of any shares in, or debentures of, a body corporate, or inviting deposits from the public, other than deposits invited by a banking company or a financial institution approved by the Federal Government, whether described as prospectus or otherwise.”</p> <p>S.53(5) says “no-one shall issue any form of application for shares in or debentures of a</p>

*company, unless the form is accompanied by a prospectus which complies with the requirements of this section.” This requirement does not apply to renounceable rights issues (i.e., rights which can be sold on to the public) s.53 (8).*

The Ordinance 1969, Ordinance 84 and related rules, regulations and guidelines set out a detailed and comprehensive disclosure and reporting regime for issuer and offerors whose securities are offered to the public in Pakistan. The regime includes requirements for:

- a prospectus (or offer for sale document, in case of divestment) for public offerings of both equity and debt issues;
- annual reports;
- quarterly reports; and
- material event disclosures (“immediate reports”).

The information prescribed for inclusion in the prospectus is quite extensive and includes:

- the offer of securities;
- the securities and capital of the issuer;
- the use of the proceeds from the offered securities;
- description of the issuer (financial and other) and its promoter;
- the issuer’s subsidiaries and associated companies;
- the issuer’s principal shareholder and senior corporate officers;
- financial statements;
- additional details, including; an accountant’s opinion on the audited financial statements; expenses and commissions relating to the offer; and any allocation of securities made for noncash consideration;
- justification for an offer of securities at a premium;
- Information relating to the book building process, where the issue/offer of shares are through a book building process; and
- Information relating to the asset backed process, where the issue of debt securities is through an asset backed securitization process.

Guidelines for preparation of a prospectus which specify contents to be disclosed in the prospectus and guidelines for issuance of TFCs have also been prescribed by the SECP.

To ensure timely disclosure, under s.53(2) of the Ordinance 84, a prospectus or an advertisement of a prospectus is required to be published in newspapers not less than seven days and not more than thirty days before the date of subscription.

#### **Annual and Periodic Reports**

The Ordinance 84 contains the core rules of law about financial and other reporting by companies and the power of SECP as the regulator. The Ordinance 84 includes provisions about:

- the keeping of accounts;
- financial statements;
- consolidated financial statements;
- financial year;
- filing of balance sheets;
- quarterly accounts of listed companies;
- SECP power to require submission of additional statements;
- appointment and remuneration of auditors;
- qualification and disqualification of an auditor;
- power and duties of auditors;
- directors’ report.

All companies must prepare and distribute audited annual financial statements to shareholders and file them with SECP. The directors' annual report must be attached to the financial statements. All listed companies must also distribute quarterly financial statements to shareholder and file with SECP. The AGM of a company must be held within 4 months from the close of the financial year. The annual report and audited financial statements must be distributed and available in good time for the AGM, effectively within three months of balance date. Quarterly statements must be prepared and distributed within one month of the end of the quarter.

The annual financial statements comprise balance sheet, profit and loss account, statement of changes in equity, cash flow statement and statement of accounting policies and explanatory notes. They are to be accompanied by the auditor's report and, in the case of listed companies, the directors' statement of compliance with Code 2012. The financial statements are to give a true and fair view of the financial position, performance and cash flows and to comply with international accounting standards as notified in the official Gazette by SECP. The information to be contained in the balance sheet and the profit and loss account is specified in Schedules to the Ordinance 84.

The Ordinance 84 contains provisions about the shareholdings and other interests of director, principal officers and others. SECP considers directors' dealings in the company's shares to be a matter of immediate material interest to shareholders but as described in Principle 17 there are deficiencies as regards the immediacy of disclosure.

SECP maintains an active monitoring program with a view to ensuring that companies, particularly listed companies, distribute their quarterly and annual financial statements and hold their annual general meetings on time.

#### **Shareholder Meetings**

Under s.160(1)(B), s.172(1) and s.173(1) and (4) of the Ordinance 84 the issuer company is required to :

- maintain records of general meetings and director meetings;
- timely circulate minutes of meetings to directors (14 days);
- timely circulate all special resolutions (15 days) and to file these with the registrar once authenticated by the chief executive or secretary of the company;
- disclose any special business which is transacted at a general meeting, stating all material facts including interests of director, approval of documents within the meeting and reporting of the time and place where the documents can be inspected.

#### **Material Information**

Listing rules of the stock exchanges concerning events material to the price or value of securities include the following;

- Regulation 16(1) requires that every listed company and issuer of a listed security will keep the exchange informed of all decisions of its board of director relating to cash dividends, bonus issues, rights issues or any other entitlement or corporate actions and any other price sensitive information in the manner notified by the exchange from time to time; information must be communicated to the exchange prior to its release to any other person or print/electronic media in the manner prescribed in the correspondence manual.
- Regulation 16(2) imposes a condition that, whenever a listed company becomes aware or is made aware of any rumor or report containing material information that is likely to affect the market price of its listed securities or trading volume the company must clarify/confirm or deny the rumor or false information and submit the facts in writing to the stock exchange, within one day of such publication/broadcast.
- Regulation 16(5) requires announcement of dividends and all other entitlements to

	<p>be sent to the exchange no later than 14 days prior to commencement of the book closure.</p> <ul style="list-style-type: none"> <li>• Regulation 17 prescribes requirements regarding timely provision of quarterly and annual financial results to the exchange.</li> <li>• Regulation 18(2) further stipulates that a listed company will send copies of all notices and resolutions to the exchange prior to their publication and dispatch to the shareholder; and also file with the exchange certified copies of all resolutions after they have been adopted.</li> <li>• Regulation 22 requires the listed company to immediately inform the SECP about the impact of a corporate action concerning any change in authorized, issued or paid-up capital through the issue of bonus shares, right shares or refund of capital, etc.</li> </ul> <p><b>Accountability</b></p> <p>Under clause 30A of Part 1, s.2 of the Second Schedule to the Ordinance 84, it is mandatory that the CEO and CFO of the company certify that the prospectus constitutes a full true and plain disclosure of all material facts relating to the securities offered by the prospectus.</p> <p>S.66 and s.492 of the Ordinance 84 also provide penal provisions for misleading or misrepresentation of information.</p> <p>The Market Surveillance Wing of the SECP and the exchanges also review the announcements made by listed companies in order to ensure that the companies' announcements are accurate, timely and contain sufficient information as required under the applicable rules and regulations. Moreover, certification is provided by the auditor on audited accounts included in the prospectus and other supporting documents provided by the company</p> <p>To ensure that experts are liable for their content, s.59 of the Ordinance 84 provides for civil liability for misstatements in the prospectus, and s.60 of the Ordinance 84 provides for criminal liability for every person who signed or authorized the issue of a prospectus with respect to any untrue statement or misstatement.</p> <p>Moreover, in case of failure to exercise due diligence in the gathering and provision of information in the prospectus a person can also be made liable for penalties under s.66 and s.492 of the Ordinance 84.</p> <p><b>Cross border matters</b></p> <p>At present there are no public offerings or listings by foreign companies in Pakistan. Public offerings or listings by foreign issuers are only allowed for foreign companies having a place of business and must be offered under a prospectus which the CEO and the CFO of the company certify constitutes a full, true and plain disclosure of all material facts relating to the securities offered by the prospectus.</p>
Assessment	Partly Implemented
Comments	<p>The downgrade arises from several factors.</p> <p>It is not consistent with the general obligation under the law that offers to the public must be accompanied by a prospectus that renounceable rights issues (i.e., rights that have value and can be sold on to the public) can be made with only a very limited content circular for documentation.</p> <p>The implementing regulations should be amended in regards to the disclosure of material information, to reflect immediate dissemination of price sensitive information to the general public. Currently, under s.15D(1) of the Ordinance 1969 and regulation 16(1) and 16(2) of the implementing regulations the immediate publication of price sensitive information is not required.</p>

	<p>Currently, the implementing regulations allow management of a company making an offer to the public the use of possible mitigating factors in the risk section of the offering document. This approach works to weaken the importance of the risks section of the offering document, and may actually give potential investors a level of comfort that in reality might not exist. Thus, amendments should require a clear separation between the disclosure of risks section and any possible mitigating factors section proposed by the management of the firm.</p> <p>Clause 6 of the Guidelines should be amended to make it mandatory to publish any prospectus to the public in Urdu as well as in English. It is worth noting that the SECP view is that the use of Urdu for prospectuses would be difficult due to cost concerns and lack of interest from current investors. While, this may be true in the short term, the introduction of prospectuses in Urdu would be essential to broaden the potential investor base within Pakistan that is currently limited to the English speaking part of the population which is minuscule when compared to the size of the population.</p> <p>The assessor understands that SECP is working on amendments to the Listing Regulations to address the concerns that have been highlighted. We would recommend that these initiatives should be pursued with high priority.</p>
--	---

**Principle 17.** Holder of securities in a company should be treated in a fair and equitable manner.

Description	<p><b>Rights of Shareholder</b></p> <p>Equitable treatment of shareholder is ensured through voting rights provided in s.160 of the Ordinance 84. The Ordinance 84 covers various aspects of voting including elections, corporate changes, notice of meetings and decisions, proxy voting and receipt of corporate benefits and includes the following:</p> <ul style="list-style-type: none"> <li>• members holding not less than one-tenth of the voting power may apply to SECP for an investigation of the company’s affairs;</li> <li>• SECP may apply to the Court for orders relating to the management of the company;</li> <li>• members holding not less than 20% of the issued share capital or creditors having an interest equivalent to not less than 20% of the paid up capital of the company may apply to the Court under provisions relating to Prevention of Oppression and Mismanagement.</li> </ul> <p><b>Control</b></p> <p>The ownership of several listed companies is highly concentrated and there are significant cross-shareholdings. The Takeovers Ordinance is the primary law that protects shareholder interests and provides for fair and equal treatment for all shareholders, as well as a transparent and efficient system for substantial acquisition of voting shares and take-overs of listed companies, and establishes additional disclosure and takeover related requirements with respect to listed companies.</p> <p>The key provisions of this Ordinance are:</p> <ul style="list-style-type: none"> <li>• a person who acquires more than 10 percent of the voting shares of a listed company must disclose this to the exchange and the company;</li> <li>• no person may acquire more than 25 percent of the voting shares or control of a listed company unless the person makes a public offer in accordance with the Ordinance;</li> <li>• no person who has acquired more than 25 percent but less than 51 percent of the voting shares or control of a listed company may acquire additional shares or control unless by public offer in accordance with the Ordinance.</li> </ul> <p>For any takeover bid, shareholders are provided with sufficient time and information to consider the proposal and make a decision. Furthermore, information on any person with</p>
-------------	--

	<p>substantial shareholdings of voting securities is disclosed within the offering documents, as and when the threshold for substantial holdings is reached.</p> <p>The legal infrastructure is sufficient to allow proper enforcement and ensure compliance with the areas covered in the law. Appropriate penalties, including recovery of unfair gains, have been prescribed for non-compliance with requirements pertaining to beneficial ownership. As regards misstatements or concealment of facts under the public offering and listing particulars documents, enforcement provisions can extend to imposition of fines and in some cases, initiation of criminal proceedings. Moreover, for requirements under the LR, the stock exchanges can initiate action and impose penalties.</p> <p>The Ordinance 84 along with the Takeovers Ordinance define control and the obligations of substantial shareholders to disclose both direct and indirect shareholdings. Due to the time limits for disclosure in the Ordinance 84 the public may not get this information until 30 or 15 days after the transaction. S.4(2) of the Takeovers Ordinance has recently been strengthened through recent amendments to the Code 2012 (incorporated in the LR) to include a requirement that directors, the CEO and executives have to disclose, to the relevant stock exchange for public dissemination, any trading in the shares of the company of which they are a director, the CEO or an executive. The disclosure requirement extends to any share trading by their spouse.</p> <p>The Takeover Regulations require immediate disclosure by the acquirer and the target company, to the shareholders of the target company, wherever there is any intention/likelihood of acquisition/change of control of a listed company. Such information is immediately released by the stock exchanges for public dissemination. Furthermore, any person intending to acquire voting shares of the target company which will attract the provisions of s.5 (&gt; 25%) or s.6 (consolidation of shareholding by a person who already holds &gt;25% but &lt; 51%) is required by the Takeovers Regulations to make public announcement of his/her intention through publication in both an English and an Urdu language newspaper. Such a public announcement of intention is required before an acquirer:</p> <ul style="list-style-type: none"> <li>(a) enters into negotiations for a share purchase agreement;</li> <li>(b) in the case of a company, passes a board resolution;</li> <li>(c) starts raising funds; or</li> <li>(d) commences a due diligence process to evaluate the share price of the target company or assesses the viability of the acquisition, whether through a consultant or otherwise.</li> </ul> <p>A copy of the public announcement must be submitted to the SECP at least two working days prior to issuance.</p> <p>S.11 of the Takeovers Ordinance also requires that public announcements, any other advertisements, circulars brochures, publicity materials or offer letters issued in respect of, or in relation to, the acquisition of voting shares shall not contain any misleading information.</p> <p>In the case of takeover, the minimum price to be offered to the shareholders of a company by an acquirer has been prescribed under the Takeover Regulations.</p> <p><b>Pricing mechanism in case of schemes of arrangement</b></p> <p>The Court, before passing any order on a scheme of arrangement, is required by law to invite and consider comments on the merger petition, from the registrar of companies (SECP). SECP submits its observations, if any, on a scheme of arrangement to the Court through the registrar of companies (SECP) to ensure the rights of minority shareholders are protected. Moreover, every scheme of arrangement is examined initially at the time of approval by the shareholders to ensure that all material information has been disclosed to the shareholders; thus allowing them to make an informed decision.</p> <p><b>Pricing Mechanism for buy back of shares</b></p> <p>In the case of a buyback of shares, procedures for the determination of the minimum</p>
--	--

purchase price have been prescribed in the listing regulations of the stock exchanges. Under the listing regulations, while the final minimum purchase price is fixed by the stock exchange, the minimum purchase price proposed by the sponsors shall be the highest of the benchmark price based on any of the following:

- (a) Current Market Price as of the date the stock exchange receives the sponsors/majority security holder' intimation regarding their intention to buy back;
- (b) Average Market Price (Annualized);
- (c) Intrinsic value per share (estimated net realizable value of assets of the company);
- (d) Earnings Multiplier approach (for profitable companies);
- (e) The maximum price at which the sponsors had purchased these shares from the open market in the preceding one year.

The following guidelines have been provided in the LR s.30-A Takeover Regulations regarding determination of intrinsic value per share, fair value using the earning multiplier approach and the average market price:

#### **Intrinsic value per share**

The intrinsic value per share will be determined on the basis of a revaluation of assets, carried out by a professional evaluator approved by the Pakistan Banks' Association; that is any Investment Bank or valuer having relevant expertise and duly certified by the auditor as falling in Category 'A' or 'B' of the SBP list. The revaluation of assets carried out by the evaluator shall not be older than six months from the date of receipt of buy-back application. The intrinsic value may also include any other factor in addition to tangible and intangible assets of the company, which may be considered appropriate by the stock exchange, while fixing the price of shares.

#### **Earning Multiplier approach (for profitable companies)**

A profitable company is a company that has declared an after tax profit for the three years preceding the date of the application for voluntary de-listing as reported in its annual audited accounts.

Fair value = Estimated Earnings \* P/E ratio

Estimated earnings should be arrived at using the weighted average earning per share of the last three years audited accounts. For this purpose, the higher of, weights of 45%, 35% and 20% assigned to the preceding three years respectively or latest earning per share should be used.

The P/E ratio to be used may be of the date the stock exchange receives the application for buy back. According to the regulation this approach is based on the concept that a stock's current price is the product of its actual earnings per share and the P/E ratio. The P/E ratio is calculated by dividing the current price by the actual earnings per share.

To determine the value of stock, both the earnings and the P/E ratio will have to be estimated. Price may be determined as a multiple of the P/E ratio of the related sector as on the date of application for the voluntary buy-back of shares. Earnings per share may be based on the latest audited accounts of the companies in that sector or a weighted average earning per share of last 3 years of those companies

#### **Average Market Price**

Daily closing price of the three years, preceding the date the stock exchange receives the intimation of a company's intention to buyback, should be used to calculate the Average Market Price.

#### **Cross border matters**

At present there are no public offerings or listings by foreign companies in Pakistan. See Principle 16.

Assessment	Partly implemented
Comments	Although the processes being followed in Pakistan to help assure that the holder of securities are treated in a fair and equitable manner generally seem to meet international best practice and are extensive and clearly defined, the time limits for disclosure of substantial shareholdings (and changes) results in the downgrade. Recognizing the difficulty in establishing beneficial ownership when there is a deliberate attempt to obscure this information, SECP should examine its powers to disenfranchise shares where it is unable to establish the identity of the beneficial owners to satisfy itself that these are sufficient. See also Principle 37.
<b>Principle 18.</b> Accounting standards used by issuer to prepare financial statements should be of a high and internationally acceptable quality.	
Description	<p><b>Legal position</b></p> <p>There is a requirement under Ordinance 84 for public offering documents to include audited financial statements in relation to an issuer whose securities are going to be listed (abridged financial statements for the last 5 years). S.53(5) of the Ordinance 84 further states that <i>“No one shall issue any form of application for shares in or debentures of a company, unless the form is accompanied by a prospectus which complies with the requirements of this section: Provided that this sub-section shall not apply if it is shown that the form of application was issued either (i) in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to the shares or debentures; or (ii) in relation to shares or debentures which were not offered to the public.”</i> The assessors understanding is that all public offerings must be listed.</p> <p>There is a specific exemption from the obligation to file a prospectus in the case of rights issues (whether non- renounceable or renounceable) (s.53(8)). Renounceable rights can be sold on to the general public. The Circular which must accompany a rights issue, (addressed to current shareholders), contains only very limited information.</p> <p>Otherwise, financial statements are prepared in accordance with a comprehensive body of accounting standards, which follow IFRS, given the mandatory application of IFRS in Pakistan for listed companies and their subsidiaries: All IFRS, apart from IFRS-1 (First-time Adoption of IFRS) are currently adopted in Pakistan.</p> <p>S.234 of the Ordinance 84 requires that every balance sheet of a company should give a true and fair view of the state of affairs of the company as of the end of its financial year, and every profit and loss account must give a true and fair view of the profit and loss of the company for the financial year. In terms of these provisions, balance sheet, profit and loss account, statement of cash flows and statement of changes in equity are necessary parts of the financial statements to be prepared by the listed companies. The statements must be “audited by the auditor of the company” (s.233). They must be distributed to shareholders, filed with SECP and are subject to review. Audited financial information also appear in a company’s prospectus and other offer documents (for listed securities), periodic and annual reports. The Code 2012 also prescribes several provisions pertaining to high quality financial statements. The accounts are required to be compiled in accordance with the Fourth Schedule to the Ordinance 84 which prescribes mandatory application of IFRS for listed companies and their subsidiaries (balance sheet and profit and loss account) as notified and adopted by SECP from time to time. S.234 of the Ordinance 84 further provides that the financial statements need to be compliant with IFRS. The Fourth Schedule to the Ordinance 84 further explicitly requires that listed companies and their subsidiaries must use IFRS.</p> <p>Interim financial statements are prepared in line with IAS 34, ‘Interim Financial Reporting’ by the listed companies. The minimum components specified for an interim financial report are: (IAS 34.8) (a) a condensed balance sheet (statement of financial position); (b) a condensed statement of comprehensive income, presented as either; (i) a condensed single</p>



statement; or (ii) a condensed separate income statement and condensed statement of comprehensive income; (c) a condensed statement of changes in equity; (d) a condensed statement of cash flows; and (e) selected explanatory notes. Moreover, if a complete set of financial statements is published in the interim report, those financial statements should be in full compliance with IFRS (IAS 34.9).

If the financial statements are condensed, they should include, at a minimum, each of the headings and sub-totals included in the most recent annual financial statements and the explanatory notes required by IAS 34, 'Interim Financial Reporting'. Additional line-items or notes should be included if their omission would make the interim financial information misleading. S.245 of the Ordinance 84 requires the publication and circulation of quarterly unaudited financial statements along with a director's report as required by ss.(1) and (2) of s.241.

Further, clause xvi(d) of the Code 2012 provides that the directors of listed companies should annex statements along with the directors' reports stating that IFRS as applicable in Pakistan have been followed in the preparation of financial statements, and any departure has been adequately disclosed and explained.

### **Responsibility for accounting standards**

The regulation and oversight of the auditing and accounting profession is the responsibility of ICAP, which is a statutory body established under the CAO 1961, that operates under the CA Bye Laws 1983. ICAP is in charge of:

- setting standards for accounting and auditing standards in consultation with SECP, as well as any interpretation needed;
- administering the registration and licensing of auditors;
- quality control and overseeing the quality of audits; and
- Investigations into auditor behaviour.

It is also the body responsible for adopting and recommending accounting standards for notification by the SECP.

ICAP is governed by a Council comprising 19 members; 15 members of the Council are elected by ICAP members and 4 council members are nominated by the FG. Current nominees of the Government are Chairman SECP, Deputy Auditor General of Pakistan, Secretary Planning and Development (formerly Chairman FBR) and Secretary Finance. The duties of carrying out the provisions of the CAO 1961 are vested in the Council, and the Council may make Bye-laws for the purpose of carrying out the objects of the CAO 1961. In addition to administration of examinations, and the practice of the chartered accountancy profession in Pakistan, the Council is responsible for appointing from amongst its members standing committees, including executive, examination, and investigation committees, responsible for their respective areas of oversight.

Adoption of an IFRS or IAS involves the following steps :

1. Initially, the IFRS/IAS is considered by the Accounting Standards Committee (ASC) of ICAP, which identifies any issues that may arise on adoption;
2. The ASC refers the matter to the Professional Standards and Technical Advisory Committee (PS&TAC) of ICAP and then to the Council of ICAP;
3. The PS&TAC, after considering the local environment, determines how the adoption and implementation can be facilitated, e.g. the length of the transition period and whether the issue requires amendments in local regulations;
4. If the identified issues necessitate amendments in the local regulations then the matter is referred to the SECP and/or the SBP through the Coordination Committees of ICAP and SECP/SBP;
5. After the satisfactory resolution of issues the PS&TAC and the Council reconsider the matter of adoption; and
6. By decision of the Council, the ICAP recommends the adoption to the SECP (and to the

	<p>SBP in the case of banks and other financial institutions) for notification in the Official Gazette. The decision to adopt rests with the SECP and SBP.</p> <p>SECP also issues Special Regulatory Orders that prescribe the mandatory application of IFRS, each of which is issued under the authority of s.234(3) of the Ordinance 84.</p> <p><b>Surveillance and sanctions</b></p> <p>Monitoring for compliance with the applicable accounting standards is split between ICAP and SECP.</p> <p>SECP performs off-site monitoring of financial statements (both annual and interim) by a team of 35 professionals. SECP's enforcement power involve monitoring compliance with statutory filing requirements (both legal and operational), financial and non-financial disclosures including compliance with accounting standards, examination of audited accounts, off-site monitoring of regulated entities, on-site inspection of regulated entities, conducting investigations, etc. Based on the findings, the SECP may initiate civil or criminal proceedings. In case of the former, SECP is both adjudicator and first level appeal authority. In addition, the SECP Act and other statutes empower the SECP to issue directives, circulars and guidelines. Any violation of these is liable to the imposition of a fine.</p> <p>SECP ensures that identified deviations of financial statements from the required standards are rectified in the subsequent set of financial statements, in accordance with the provisions laid down in the IFRS as applicable in Pakistan. Considering the materiality and pervasiveness of the impact of the deviation, different types of enforcement actions may be taken.</p> <p><b>Cross border issues</b></p> <p>Foreign companies are required to have a place of business in Pakistan before they offer their securities to the public. Further, under s.461 of the Ordinance 84, foreign companies looking to offer securities within Pakistan would need to get approval from the SECP. Foreign Companies have to comply with all the requirements of public offerings or listings in a similar manner to local companies. Under s.234 (3) of the Ordinance 84, all companies have to follow such International Accounting Standards and other standards with regards to the accounts and preparation of the balance-sheet and profit and loss account as are applicable within Pakistan.</p>
Assessment	Broadly Implemented
Comments	<p>Accounting standards used by issuers are generally of a high and international acceptable quality and subject to overview. This being said, SECP's role in the adoption of accounting standards is limited to the publication of standards adopted by ICAP, a self-regulatory body of the accounting/audit profession, with insufficient cooperation with, or oversight by the SECP or any other body acting in the public interest.</p> <p>In order for Pakistan to move from Broadly Implemented to Fully Implemented, ICAP's role should be taken over by another body (such as, for example, the Audit Oversight Board Pakistan – see also comments in relation to Principle 19), which will adequately meet the requirements of public interest/independence as required under the IOSCO Principles and Methodology.</p> <p>As commented in Principle 16, the exemption from the issue of a prospectus, with full audited financial statements, for renounceable rights, should be reconsidered.</p>
<b>Principle 19.</b> Auditor should be subject to adequate levels of oversight.	
Description	In Pakistan, the licensing and oversight of the audit profession is centralised with and under the responsibility of the ICAP. Under the current framework, oversight of the auditing

profession in Pakistan is self-regulated by ICAP.

### **Quality and Implementation of auditing and auditing standards**

In Pakistan, the relevant legal and regulatory framework for overseeing the quality and implementation of the auditing profession includes the following:

- The CAO 1961 and CA Bye Laws 1983, both administered by ICAP;
- The Ordinance 84 administered by SECP ;and
- Code 2012 enforced through the Stock Exchange LR

#### *ICAP*

The regulation and oversight of the auditing and accounting profession is the responsibility of the ICAP, which is a statutory body established under the CAO 1961 that operates under the CA Bye Laws 1983. ICAP is in charge of:

- setting standards for accounting and auditing standards in consultation with SECP, as well as any interpretation needed;
- administering the registration and licensing of auditor;
- quality control and overseeing the quality of auditor; and
- Investigations into auditor conduct.

#### *The Ordinance 84*

S.254 of the Ordinance 84 provides that a person shall not be qualified for appointment as an auditor: (a) in the case of a public company or a private company which is subsidiary of a public company unless he is a chartered accountant within the meaning of the CAO 1961; and (b) in the case of a private company having paid up capital of three million rupees or more unless he is a chartered accountant within the meaning of the CAO 1961. In addition, auditors must meet certain minimum requirements before being licensed to perform audits.

Pursuant to Article 109 Chapter IX of the CA Bye Laws 1983, a person shall not be eligible for enrolment as member of ICAP unless the person has:

1. passed all the prescribed examinations of ICAP or has been granted exemption from such examinations; or
2. passed the examinations of accounting bodies outside Pakistan and obtained training that is recognized as equivalent to the examinations and training prescribed by the bye-laws.

In addition if a person referred to sub-clause (1) and (2) wishes to start practicing as a chartered accountant or a management accountant, he must have received at least two years of approved training. Under the CAO 1961, Chapter II article 6, no member of ICAP shall be entitled to practice as an auditor of a public company unless he has obtained a certificate of practice from the council.

The audit of a company should be carried out in conformity with the provisions laid down in s.255 of the Ordinance 84. The Ordinance 84 defines the responsibilities and duties of the external auditor with respect to the examination of the books and records, and reports to be issued.

S.260 of the Ordinance 84 prescribes penalties that may be imposed by the SECP on the external auditor for not reporting, “untrue statements or other material facts”, that would prevent an auditor from giving an unqualified opinion.

#### *Code of Corporate Governance 2012 (Code 2012)*

Code 2012 provides guidance for ensuring quality and performance of external audits. Further, the Code 2012 provides under clause (xxxiii), that no listed company shall appoint as external auditor, a firm of auditors that has not received a satisfactory rating under the Quality Control Review (QCR) program of ICAP; and in addition under clause (xxxiv), no

listed company shall appoint as external auditor, a firm of auditors that is non-compliant with the International Federation of Accountants (IFAC) guidelines on Code of Ethics, as adopted by ICAP.

#### *Ethical Standards and Quality Control Environment for the Auditing Profession*

The regulatory framework for compliance with ethical standards and the development of a quality control environment for the auditing profession is supported by ICAP, which has adopted the “Code of Ethics” of the International Ethics Standards Board for Accountants and accordingly revised its ‘Code of Ethics for Chartered Accountants’ (the Ethics Code) to bring it in line with the IFAC Code of Ethics. The Ethics Code establishes a conceptual framework for all chartered accountants to ensure compliance with the five fundamental principles of professional ethics, namely; integrity; objectivity; professional competence and due care; confidentiality; and professional behaviour. Under the framework, all chartered accountants are required to identify threats to these fundamental principles and take all possible measures to ensure that the principles are not compromised. The framework applies to all chartered accountants, whether in practice or not. The Ethics Code applies to all members, students, affiliates, employees of member firms and, where applicable, member firms, in all of their professional and business activities, whether remunerated or voluntary. The Ethics Code has been issued as a “Directive of the Council” and any violation of the provisions of the Ethics Code falls under Part 4 Schedule 1 of the CAO 1961.

Non-compliance with the Ethics Code is referred to the ICAP Council for disciplinary action and the Council may order the establishment of an investigation committee. It may be noted the Council and investigation committee will be deemed to have the power of a civil court under the Code of Civil Procedure, 1908.

#### *Accreditation and Oversight*

The responsibility for the regulation and oversight of the auditing and accounting profession in Pakistan is self-regulated by ICAP, whose membership is authorized by statute to conduct audits of listed and economically significant non-listed companies. All laws and bye-laws of the ICAP are subject to approval by the MoF.

Administering the registration and licensing of auditors (accreditation) is performed by ICAP through its Quality Assurance Board (QAB), which issues quality ratings to audit firms. Listed and economically significant companies are required to appoint as their auditor a firm which has been given a satisfactory quality rating by the QAB of ICAP. Moreover, SBP and SECP also maintain a panel of auditors for certain sectors e.g. Banks, Insurance, Modarabas and firms in these sectors are required to appoint auditors only from those panels. Under the CAO 1961, Chapter II article 6, no member of the ICAP shall be entitled to practice as an auditor of a public company unless he has obtained a certificate of practice from the ICAP Council.

ICAP regulates the quality control environment of the auditing profession through a QCR program implemented by the QAB. The QAB monitors the quality of audit work undertaken by its members. The QAB is responsible for establishing:

- policies and procedures for the QCR program to ensure that firms conduct audits in accordance with professional standards adopted by ICAP ; and
- appropriate quality assurance guidelines for audit practice considered essential for the practice of auditing, that are in compliance with the requirements of ‘Statement of Membership Obligation (SMO)-1’ on Quality Assurance issued by the IFAC.

Oversight is accomplished through a QCR program implemented by the QAB, whose members are appointed by the council through a nomination process. The primary objective of the review is to monitor compliance by audit firms with appropriate levels of professional standards in the performance of the audit function, and also to provide guidance to practitioners and to assist them in improving their standards. The QAB performs its responsibilities in accordance with the framework of the QCR independently of the council. The QAB is funded by ICAP and comprises 14 members, including the chairman who is

appointed by the Council and is neither a practicing member nor from the sitting Council. The QAB is assisted by a Quality Assurance Department of ICAP and its responsibilities and functions are to:

- Carry out QCR of the firms every two and a half years, or earlier if directed by the QAB, under a defined QCR program, and monitor the QCR program to ensure its adequate and effective implementation.
- Arrange training programs and workshops for continuing professional development to improve the quality standards of audits.
- Perform a periodic review of the QCR program (including policies, procedures and processes etc.) to ensure that it remains up-to-date and is in line with the relevant standards and guidelines issued by the IFAC.
- Set policies for the QCR program and ensure that they are as relevant as possible to all types and sizes of practices, and decide on all matters relating to QCR, in the public interest and in the interest of the profession.

During the period July 1, 2011 to June 30, 2013 a total of 94 QCR reports were presented to the QAB and in the case of 16 firms the Board decided to carry out an early review, that is, after one year instead of the periodic 2 ½ years.

#### **Audit Oversight Board – Future Plans**

The SECP is in the process of establishing an audit oversight board – the Audit Oversight Board of Pakistan (AOBP). The AOBP will be charged with the responsibility of accreditation of independent external auditors and determining their eligibility to be appointed as auditors of listed and economically significant companies, as defined in the Ordinance 84.

Proposed composition of the AOBP is as follows:

- Four members shall be nominated by the SECP;
- Four members shall be nominated by the ICAP; and
- One member shall be nominated by the SBP

The functions of the AOBP are to include:

- conduct an Engagement Quality Review of the audit working papers of an audit firm or arrange for the conduct of such a review as it deems appropriate for the purposes of awarding or withdrawing quality ratings of audit firms;
- conduct or arrange for a review of the firm's system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with the International Standards on Quality Control – 1 as applicable in Pakistan;
- maintain and publish a list of firms with satisfactory "Quality Ratings" on its website;
- monitor QCR Program and to ensure its adequate and effective implementation;
- guide auditors in improving their quality of service and adherence to the various statutory and other regulatory requirements;
- establish policies for the QR Program and ensure that these are as relevant as possible to all audit firms and decide on all matters relating to QR in the public interest;
- carry out a comprehensive review of the operations and an evaluation of the adequacy of resources available for the QR Program;
- prepare and make available to the public, an annual report summarizing the results of the quality assurance review system, and its audited financial statements;
- invite experts for seeking technical assistance or opinion on any matter or issue that the AOBP may consider relevant for the purpose of assessing the quality of work and services rendered by the auditor; and
- develop any other policies and procedures which may be required for smooth and

	full functioning of the AOBP to achieve its objectives.
Assessment	Not Implemented
Comments	<p>Although SECP has certain sanctioning power under s.260 of the Ordinance 84 in relation to non-compliance with provisions of the Ordinance 84 by auditors, the accreditation and oversight mechanism of the audit profession in Pakistan as such is currently under the exclusive responsibility of ICAP, which is a self-regulated professional body which is not acting, and cannot be seen to be acting in the public interest. Principle 19 is therefore Not Implemented, although rules and procedures for the licensing and the oversight of the audit profession do as such exist (under ICAP).</p> <p>As an immediate priority, Pakistan should ensure that progress is made in relation to the implementation of an auditor licensing and oversight mechanism which is performed under oversight of a body that acts in the public interest, as the current AOBP project seeks to achieve. It is understood that the AOBP is in the early stages of development and it is currently not possible to assess if the regime contemplated by the AOBP proposal (no draft of which could be disclosed to the assessor) will meet the requirements under Principle 19 in an adequate manner. According to information received and based on the discussion of the assessor with relevant stakeholder, there seems to be resistance from the auditing profession to hand over audit licensing and oversight power from ICAP to an independent and non-industry dominated oversight body such as contemplated by the AOBP initiative.</p>
<b>Principle 20.</b> Auditor should be independent of the issuing entity that they audit.	
Description	<p>The regulatory framework applicable to auditors in Pakistan is composed of various sources that set general standards for independence (the Ethics Code, Ordinance 84 and the LR of the exchanges, and other conflicts of interest issues. Those sources of audit terms are rules applicable to the audited entities (i.e. Ordinance 84, the Code 2012 – Code of Corporate Governance for listed companies which is since part of the LR as well as rules applicable to auditors under the oversight of ICAP (i.e., the Ethics Code).</p> <p><b>Framework for independence</b></p> <p>The main source regarding independence is the Ethics Code, which has been brought in-line with the requirements of the Code of Ethics of the International Ethics Standard Board, and Ordinance 84. Further requirements for listed entities come from the Code 2012 (Code of Corporate Governance, part of the LR) and the LR of the Stock Exchanges; together they establish principles aimed at ensuring external auditor independence, as well as specific prohibitions (incompatibilities). Enforcement of the Ethics Code is done by ICAP and other independence mechanisms are enforced by SECP and the Stock Exchanges respectively.</p> <p>The auditing standards applicable in Pakistan are consistent with International Standards on Auditing (ISA), the International Code of Ethics and the International Standard on Quality Control. Compliance with International Standard on Quality Control - ISQC 1 is mandatory for all firms conducting audits of financial statements of listed and public interest entities for accounting periods beginning on or after December 15, 2010.</p> <p>The Ethics Code is applicable to assurance engagements for assurance/audit reports. S.220 of the Ethics Code addresses ‘Conflicts of Interest’ and requires that a chartered accountant before accepting an engagement should:</p> <ul style="list-style-type: none"> <li>• Take all reasonable steps to identify circumstances that could pose a conflict of interest, and pose a threat to compliance with fundamental principles and objectivity</li> <li>• Evaluate the significance of any threats created by business interests, or relationships with a client or third party</li> <li>• Notify the client and all known relevant parties about the conflict of interest that may exist and obtain their respective consent to accept the engagement</li> </ul>

	<ul style="list-style-type: none"> <li>• Consider declining the engagement where a conflict of interest threatens one or more fundamental principles including objectivity, confidentiality, or professional behaviour and cannot be eliminated or reduced to an acceptable level</li> </ul> <p>Further, s.290 of the Ethics Code addresses the independence requirements for audit and review engagements and provides a conceptual framework approach to independence, as:</p> <ul style="list-style-type: none"> <li>• Members of audit teams, firms, and network firms shall be independent of audit clients</li> <li>• Independence comprises independence of mind and appearance</li> <li>• Members should identify threats to independence and apply safeguards for elimination or reduction to an acceptable level</li> <li>• Members should decline engagements where independence is compromised</li> </ul> <p>The Ethics Code ensures compliance with the five fundamental principles of professional ethics, namely, integrity, objectivity, professional competence and due care, confidentiality, and professional behaviour. Under s.100 of the Ethics Code, threats may be created by a broad range of relationships and circumstances that may affect compliance with the fundamental principles. To counter these threats, safeguards are available that can help eliminate threats or reduce them to an acceptable level. The Ethics Code requires that if safeguards cannot eliminate or reduce the threat to an acceptable level, the chartered accountant should decline or terminate the relevant engagement. Safeguards fall into two broad categories:</p> <p>(a) Safeguards created by the profession, legislation or regulation; and  (b) Safeguards in the work environment.</p> <p>Compliance with the Ethics Code is ensured through the QAB of ICAP through the conduct of QCR that includes both an engagement review and a review of the firm's system of quality control. During the review process the QAB assesses that auditors are independent, both in fact and appearance of the enterprises that they audit.</p> <p><i>Provisions coming from Ordinance 84</i></p> <p>Under s.255, ss(3), (3A), (4), of the Ordinance 84 an auditor cannot be a director or officer of the company, be a partner or employee of a director or officer, or be indebted to the company. The firm of external auditors, auditing a listed company, or any partner in the firm and their spouse and minor children are prohibited from holding, purchasing, selling, or taking any position in the shares of the listed company, or any of its associated companies or undertakings. In addition, for public issuer/listed companies an independent external auditor, in both fact and appearance of the entity being audited, is mandatory. S.252 to 257, of the Ordinance 84 contain mandatory provisions relating to appointment, qualification, power and duties of an auditor, the auditor' report, and signature on the report.</p> <p><i>Provisions coming from Code 2012 for listed companies</i></p> <p>In relation to listed companies the Code 2012 Clause (xxiv) provides that the board of directors of every listed company is required to establish an Audit Committee of at least three members including the chairman who are non-executive directors. The chairman of the committee must be an independent director, while at least one member of the audit committee must have financial skills, expertise and experience. The Audit Committee is mandated to oversee the process of selection and appointment of the external auditor.</p> <p>Code 2012, clause xxvii further restricts listed companies from appointing a person as an external auditor, who is a close relative, i.e., spouse, parents, dependents and non-dependent children of the CEO, the CFO, an internal auditor or a director of the listed company.</p> <p>Code 2012 clause (xxxvi): prohibits listed companies from appointing the auditor to provide services in addition to audit, except in accordance with the LR and requires them to ensure that the auditor does not perform management functions, or make management decisions, responsibility for which remains with the Board and management of the listed company.</p>
--	---

	<p>Furthermore, clause (xxxvii) establishes a requirement for all listed companies in the financial sector (banks, non-banking financial companies (NBFC's), modarabas and insurance/takaful companies) to change their external auditor every five years while listed companies other than those in the financial sector, at a minimum, are required to rotate the engagement partner after every five years.</p> <p><i>Provisions coming from the LR</i></p> <p>Clause 29-C of the LR prohibits listed companies from appointing or retaining any person as an auditor who:</p> <ul style="list-style-type: none"> <li>• is engaged by the company to provide services that are prohibited; or</li> <li>• is associated with the auditor, or has been, at any time during the preceding three months engaged, as a consultant or advisor or retained to provide any services that are prohibited.</li> </ul> <p>A person is considered associated with the auditor, if that person is a partner in a client firm, or is a director in a company, or holds or controls shares carrying more than twenty percent of the voting power.</p> <p>Prohibited services include:</p> <ul style="list-style-type: none"> <li>• preparing financial statements and providing accounting services;</li> <li>• financial information technology system design and implementation that is significant to the overall financial statements;</li> <li>• appraisal or valuation services for material items of financial statements;</li> <li>• acting as an Appointed Actuary;</li> <li>• actuarial advice and reviews in respect of provisioning, and loss assessments for an insurance entity;</li> <li>• internal audit services related to internal accounting controls, financial systems, or financial statements;</li> <li>• human resource services relating to: <ul style="list-style-type: none"> <li>○ executive recruitment;</li> <li>○ work performed (including secondment where management decision will be made on behalf of a listed audit client);</li> </ul> </li> <li>• legal Services;</li> <li>• management functions or decisions;</li> <li>• corporate finance services, advice or assistance which may involve independence threats such as promoting, dealing in or underwriting of shares of audit clients;</li> <li>• any exercise or assignment for estimation of the financial effect of a transaction or event where an auditor provides litigation support services;</li> <li>• share Registration Services (Transfer Agents) and;</li> <li>• any other service(s) which the ICAP Council with the prior approval of the SECP may determine to be a prohibited service.</li> </ul>
Assessment	Broadly Implemented
Comments	<p>The regime applicable to auditors in Pakistan appears to cover the main aspects in relation the independence of the auditor of the issuing entity that they audit. Given that a full-fledged regime, including specific provisions on a governance body overseeing the selection and appointment of the external auditor is not in place it is considered that this Principle is only Broadly Implemented. Also necessary are more explicit provisions applicable to all auditors regarding the establishment and maintenance of internal systems, governance arrangements and processes for monitoring, identifying and addressing threats to independence.</p>



<b>Principle 21.</b> Audit standards should be of a high and internationally acceptable quality.	
Description	<p>The legal and regulatory framework foresees principles of high quality for the audit/auditors. The regulatory framework requires that financial statements included in public offering and publicly available annual reports are audited in accordance with a comprehensive set of auditing standards. Auditors are required to provide a report under s.53(1) read with clause 28 of section 2 part 1 of the Second Schedule to Ordinance 84 for inclusion in the prospectus of public offerings. This report contains statements on profit &amp; loss and assets and liabilities of the company together with information on subsidiaries and dividend payouts. S.234(1) of the Ordinance 84 provides that every balance sheet, profit and loss account or income and expenditure account will give a true and fair view of the state of affairs of a company. In addition, under s.234(3), International Accounting Standards, and other standards as notified in the Official Gazette by the SECP are to be followed.</p> <p>All International Standards for Auditing (ISAs), issued by the International Auditing and Assurance Board of IFAC except ISA -600, Audits of Group Financial Statements (including the work of a component auditor) have been adopted by ICAP. Therefore, all publicly available annual reports are audited in accordance with a comprehensive set of ISAs and are in line with international best practice.</p> <p>ICAP does not issue any auditing standards of its own, accordingly all prevailing auditing standards are IFAC standards, which are of a high, and internationally acceptable quality.</p> <p>Further, as required by Code 2012, listed companies can only appoint an auditor having satisfactory QCR rating from ICAP. To receive a satisfactory rating auditing firms must comply with all ISAs adopted by ICAP.</p>
Assessment	Broadly Implemented
Comments	<p>Auditing standards are generally of high and international acceptable quality and subject to overview. This being said, SECP's role in the adoption of auditing principles is limited to the publication of standards adopted by ICAP, a self-regulatory body of the accounting/audit profession, with insufficient cooperation with, or oversight by the SECP or another body acting in the public interest.</p> <p>In order for Pakistan to move from Broadly Implemented to Fully Implemented, ICAP's role should be taken over by another body (such as, for example, the Audit Oversight Board Pakistan – see also comments in relation to Principle 19), which will adequately meet the requirements of public interest/independence as required under the IOSCO Principles and Methodology.</p>
<b>Principle 22.</b> Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.	
Description	<p><b>Legal position</b></p> <p>Credit Rating Companies (CRAs) are regulated under the following laws:</p> <ul style="list-style-type: none"> <li>• S.32B of the Securities and Exchange Ordinance, 1969 (the Ordinance 1969)</li> <li>• Credit Rating Companies Rules 1995 (the CRC Rules) issued under s.33 of the Ordinance 1969; and</li> <li>• The directives dated 13 January 2014 issued under rule 7 of the CRC Rules (The Code of Conduct for Credit Rating Companies/Agencies (CRA-Code of Conduct)).</li> </ul> <p>CRAs that carry on a business of providing credit ratings must be registered with the SECP</p>

irrespective of whether the ratings will be used for regulatory purposes (s.32B Ordinance 1969). At present, 2 credit rating agencies are operational in Pakistan.

The CRA-Code of Conduct has been developed taking specific account of the key issues/questions of Principle 22 of the IOSCO Methodology. The CRA-Code of Conduct in this context specifically addresses aspects such as quality and integrity of the rating process, monitoring and review of the rating, integrity of the rating process (e.g. Appointment of a compliance officer, whistle-blowing procedure and rating shopping) and independence and conflicts of interest, operational requirements, adoption of international standards, reporting, filing and disclosure through newspapers and web-sites as well as treatment of confidential information and the list of policies to be developed and disclosed by CRAs operating in Pakistan.

Furthermore, s.32B of the Ordinance 1969 applies and requires:

- Registration to act as credit rating company;
- CRA should be a company incorporated under the Ordinance 84.
- Registration shall be valid for a period of one year and shall be renewable on payment of fee as prescribed under the Rules;
- In the case of non-compliance with the provision of Ordinance 1969 or the CRC Rules, the registration of a CRA can be suspended for a specified period; or the registration can even be cancelled.

Only ratings issued by CRAs established in Pakistan and registered with SECP can be used for regulatory purposes.

Due March 2015, the two CRAs currently operating in Pakistan have been required to provide the SECP with a clause-wise compliance status report on the provisions of the CRA-Code and the CRC Rules ; this report is to be certified by the board of director of the CRA.

### **Registration**

Under the CRC Rules, a company proposing to commence business as a CRA is eligible for registration, provided that:

- the company is incorporated as a limited liability company under the Ordinance 84;
- the company has entered into a joint venture or technical collaboration arrangement with an internationally recognized credit rating institution for a period of not less than five years;
- no director, officer or employee of the company has been convicted of fraud or breach of trust or has been adjudicated as insolvent;
- the promoters of the company are persons of means and integrity and have special knowledge of matters with which the company may have to deal with as a CRA; and
- the chief executive of the company is not holding a similar position in any other company.

### **Supervision**

The CRC Rules provide extensive power to the SECP in obtaining information about a regulated CRA, that the SECP deems necessary for oversight. Under Rule 8(2) of the CRC Rules, a credit rating company must furnish to the SECP any documents, information or explanation relating to its affairs as the SECP may require in writing. Every CRA is required to submit to the SECP a report giving sector-wise details of the credit ratings notified during the year, ratings downgraded, fee structure and any other information as may be specified by the SECP. Further, the CRA-Code of Conduct issued by the SECP requires all CRAs to file a yearly report containing a clause-wise compliance status with the Code of Conduct. The SECP has the power to give direction to a CRA and can impose penalties and sanctions where the regulatory requirements are not being met.

	<p><b>Quality and Integrity</b></p> <p>The CRA-Code of Conduct provides several clauses which seek to ensure that the ratings provided are fair, up to date and based on an unbiased and thorough analysis of the information available. The CRA-Code of Conduct also provides for maintenance of records and adequate technical and human resource infrastructure to provide rating services.</p> <p><b>Conflicts of Interests and Independence</b></p> <p>Annual compliance reports of CRA-Code of Conduct submitted by CRAs are reviewed by the SECP along with credit ratings given to various companies to ensure that the CRAs are independent and free from political or economic pressures. The CRA-Code of Conduct obligates the CRAs to put in place a ratings committee and to make various disclosures to mitigate conflicts of interest between a CRA and the issuers they rate; the CRA-Code of Conduct prohibits a CRA from rating securities issued by it or an associated company or to provide advisory services. CRAs are also required to establish and implement policies and procedures to protect against potential conflicts of interest and disclose all possible sources of conflicts of interest, and create firewalls for restricting any information flow between the credit rating process and any other activity. The CRC Rules also provide various provisions which seek to ensure the credibility of personnel within the CRA.</p> <p><b>Transparency and Timeliness</b></p> <p>The CRA-Code of Conduct requires that CRAs will publicly disseminate all ratings assigned by them, whether solicited by their clients or unsolicited, through a press release in at least one English and one Urdu national daily newspaper, within two working days of the notification of such ratings. In cases where rating is unsolicited, the rating report must clearly state this fact and whether the rated entity was a part of this process, and also the source of information on which the rating is based. CRAs are also required to maintain a website on which relevant information from the last 3 years must be placed.</p> <p><b>Confidentiality</b></p> <p>Rule 10 of the CRC Rules requires that no director, officer or employee of the credit rating company will communicate information acquired by him for use in rating purposes to any other person except where required under the law. Such information includes information pertaining to the client, non-public information and information with respect to pending rating actions. Employees are required to sign a non-disclosure agreement that prohibits them from using their access to rating information for their own personal benefit.</p>
Assessment	Fully Implemented
Comments	<p>Although the CRA business is relatively limited and split over only two CRAs which have an approximately even market share, the regime applicable to those CRA has been brought in-line with international standards and more specifically by the introduction of the CRA-Code of Conduct on 13 January 2014. This CRA-Code of Conduct has been developed taking specific account of the key issues/questions of Principle 22 of the IOSCO Methodology. The first on-site inspections are scheduled to commence in the last week of May 2015.</p>
<p><b>Principle 23.</b> Other entities that offer investor analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.</p>	
Description	<p>Sell-side analysts are persons who offer investor analytical and evaluative services. The SECP under s.15E(4) of the Ordinance 1969, has the power to regulate sell-side analysts, however, so far regulations have been very limited and research analysts remain largely unmonitored. Only Securities Market Division/Circular 1 of 2008 related to the “Advice on Media Relating to Securities Markets” provides limited guidance in relation to studies on</p>

	<p>publicly traded companies by research analysts.</p> <p>Keeping the above in view, the SECP staff drafted Research Analyst Regulations, 2015 which are now awaiting approval by the SECP. The draft regulations primarily contain:</p> <ul style="list-style-type: none"> <li>• licensing requirement for the research analysts;</li> <li>• procedure for obtaining the license;</li> <li>• disclosures to be included in the research report by the research analysts;</li> <li>• definitions of covered persons and the blackout period;</li> <li>• restrictions/prohibitions on the research analysts and the covered persons on the personal investments and trading in the securities listed on the stock exchanges;</li> <li>• relationship with the companies being analyzed by the Research Analysts and compensation to them;</li> <li>• requirements in reference to the maintenance of the records;</li> <li>• disciplinary proceedings, including the procedure of cancellation of the license.</li> </ul> <p>Under the draft research analyst regulations, all companies and brokers who employ research analysts, must, beside other matters:</p> <ul style="list-style-type: none"> <li>• implement appropriate disciplinary sanctions for its research analysts in case of violations;</li> <li>• continuously monitor and audit the effectiveness of compliance procedures and keep the employees updated with any changes in these procedures;</li> <li>• monitor the personal trading activities of its research analysts; and</li> <li>• maintain records of internal audit findings.</li> </ul> <p>Furthermore, under the draft regulations, several internal procedures will need to be adopted for avoidance of conflicts of interest. All companies and brokers will in this context be required to:</p> <ul style="list-style-type: none"> <li>• develop and maintain a policy for managing and disclosing conflicts of interest that may impede a research analysts' ability to conduct independent research and make objective recommendations;</li> <li>• have supervisory procedures in place to ensure that the company, broker, research analyst and the covered person, comply with policy and procedures and all applicable laws and regulations;</li> <li>• ensure timely dissemination of the research report and its recommendation to the clients and the general public; and</li> <li>• have in place a mechanism to resolve any conflict of interest that may arise while conducting research activities, and their resolution in an equitable manner.</li> </ul> <p>The draft regulations also provide internal control mechanisms, such as implementation of chinese walls within the employer firm to prevent sharing of research information with employees in the non-research department including investment banking department.</p>
Assessment	Not Implemented
Comments	<p>Research Analysts Regulations, 2015 have been drafted by SECP staff and are awaiting approval from the SECP. It is expected that they will be adopted and published during the second quarter of 2015, after a 4 week consultation period with the industry.</p> <p>Based on the draft Research Analysts Regulations, 2015 shared with the Review Team, it appears that the proposed regulations will potentially address some of the key aspects applicable to this principle, with the exception of the requirements to have an overarching provision concerning integrity and ethical behaviour, and detailed requirements on disclosure of actual and potential conflicts of interest.</p> <p>On the basis of the above, Principle 23 is Not Implemented at this stage, but a subsequent</p>

	assessment of the Principle might lead to the conclusion that if the Research Analysts Regulations, 2015 are effectively adopted and implemented, the rating might change to partially or broadly implemented. Any rating of Fully Implemented would in addition require effective implementation and enforcement of the regime to be in place.
<b>Principles for Collective Investment Schemes</b>	
<b>Principle 24.</b> The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.	
Description	<p><b>Eligibility</b></p> <p><b><i>Distributors</i></b></p> <p>CIS distributors are only required to register with MUFAP. MUFAP is a trade association which has no legal power under the law to perform regulatory functions.</p> <p><b><i>Operators</i></b></p> <p>The regulatory framework under the SECP specifies detailed licensing and ongoing requirements for entities offering or planning to offer, asset management services. To be eligible for a license to operate and market a CIS, an applicant must ensure that its promoter and board of directors fulfill the “fit and proper” criteria specified by the SECP, which among other things, covers the requirements in terms of competence and capability, honesty, integrity and reputation, as well as financial soundness of the applicant. Further, a minimum equity requirement of PKR 200 million has to be maintained by an entity operating a CIS at all times. No units or certificates of a CIS can be offered to the public unless the scheme is registered as a Notified Entity with the SECP.</p> <p><b>Governance</b></p> <p>To assess compliance of the CIS operator with applicable standards and requirements, annual review/inspection of all CIS operators is undertaken by an officer of the SECP. The review /inspection process comprises of:</p> <ul style="list-style-type: none"> <li>• Offsite surveillance</li> <li>• Onsite surveillance</li> <li>• Enforcement</li> </ul> <p>Routine monitoring of a CIS is carried out through a review of comprehensive monthly financial reports, filed electronically through the Specialized Companies Returns System. SECP conducts a detailed off-site review on a quarterly basis. Under NBFC Regulations 2008 the CIS operator must file quarterly, half yearly and annual financial statements with the SECP. In the case of any breach or default, several actions can be initiated by the SECP under s.282D-K of the Ordinance 84. In addition, the SECP also has the power of cancelling registration of a CIS and transferring management rights under NBFC Regulations 2008 (Regulation 45 and 45A).</p> <p><b>Operational Conduct</b></p> <p>NBFC Regulations 2008, Regulation 37 prescribes operational conduct standards for a CIS managed by the CIS operator. Salient terms and conditions require a CIS operator to appoint a qualified individual as a fund manager who must not manage more than three CISs simultaneously; further the CIS operator must constitute an investment committee approved by its Board for appropriate and proper investment decision making.</p> <p>Specific responsibilities of the investment committee include to:</p> <ul style="list-style-type: none"> <li>• act with due care skill and diligence, ensuring that investment decisions are in compliance with the constitutive documents, rules and regulations of the SECP;</li> </ul>

	<ul style="list-style-type: none"> <li>• review the performance of the CIS on a regular and timely basis ensuring that a proper record of meetings and investment decisions is maintained; and</li> <li>• develop a criteria for appointing a diverse panel of brokers and monitor their performance.</li> </ul> <p>The regulatory framework specifically requires a CIS operator to manage the affairs of the CIS in the interest of investors without gaining any undue advantage for itself or any of its connected persons. Any transaction with connected persons is subject to prior written approval of the board of director of the CIS operator and trustee of the CIS and may only be carried out in accordance with the provisions of the constitutive document. Such transactions must also be disclosed in the annual report of the CIS. A CIS operator on behalf of the CIS is prohibited from investing in any security of a company in which any director or officer of the CIS operator owns more than 5% of total securities or directors and officers of the CIS operator collectively own more than 10% of those securities. In addition, a CIS operator on behalf of the CIS cannot take exposure of more than 10% of the assets of the CIS in listed group companies of the CIS operator. Further, prior approval of the board of director is needed for any transactions with connected persons.</p> <p>Under existing practices, only outsourcing of non-core functions and back office functions like compliance, internal audit and accounting is allowed. NBFC Regulations 2008, Regulation 38(c) makes the CIS operator responsible for the acts and omissions of all persons to whom it may delegate any of its functions.</p>
Assessment	Partly Implemented
Comments	<p>The downgrade results from several deficiencies. The absence of a statutory licensing regime for those who market schemes (distributors) is significant. A high priority therefore should be imposed on licensing and supervision of distributors directly by SECP or via an SRO with the appropriate mandate and subject to SECP oversight. The implementing regulation fails to address critical issues in regards to dealing AMCs, namely best execution requirements and restricting churning. There is no onsite inspection program for trustees despite the reliance the regulatory framework places on their fulfilling their responsibilities properly. SECP has initiated work to develop regulations covering some of these issues which should, in due course, lead to an assessment upgrade.</p>
<p><b>Principle 25.</b> The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.</p>	
Description	<p>The SECP is responsible for regulation, licensing and supervision of CIS and is responsible for ensuring that all form and structure requirements of the CIS are complied with. The NBFC Regulations 2008 prescribe minimum contents of the constitutive documents of the CIS and the AMC is required to provide disclosure including structure, role and responsibilities of the CIS operator and trustee, investment policy and restrictions, fees and charges, purchase and redemptions and associated risks in the constitutive document of the CIS. Further, the regulatory framework specifies roles and responsibilities of all the parties including AMC, trustee and board of director in NBFC Regulations 2008, Regulations (38), (41), (44) and (54) in order to protect the interest of the investor.</p> <p>For segregation of client’s assets, the assets of a CIS are required to be held separate from the operator and its manager. NBFC Regulations 39(1), (2) and (3) require that an AMC of an open and/or closed end fund must appoint a registered trustee (who must be independent of the CIS and subject to the approval of the SECP) before the scheme can be registered. All the assets and money are held in the name of the trustee/custodian and the trustee is independently responsible for safeguarding the interest of unit holders. The trustee is liable for losses caused by its willful acts or omissions or for those of its agents in relation to any custody of assets or investment forming part of the property of the open end or closed end scheme. The regulatory framework prevents a trustee from investing in open end schemes for which it acts as a trustee (Regulation 41(r) NBFC Regulations 2008). In addition,</p>

	<p>restrictions may be imposed on a trustee or result in suspension of registration where a trustee contravenes or fails to comply with any provision of the regulations or fails to fulfill its obligations under the Trust Deed or is not in compliance with conditions of registration or any directive, circular or order issued by the SECP.</p> <p>The SECP has extensive inspection, and investigation power under the Ordinance 84 (s.282I) and may order an inspection or inquiry into the affairs of an NBFC or any notified entity or any of its director, manager or other officer. Moreover, the SECP has a number of general administrative powers under the Ordinance 84 (s.282D-H) to ensure compliance with NBFC Regulations 2008 and constitutive documents of a CIS. Further, penal measures in the case of non-compliance are also provided in s.282J and 282K of the Ordinance 84.</p>
Assessment	Broadly implemented
Comments	The current regulatory regime has been effective in providing for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets. The SECP places a high reliance on the trustees function within the market. The SECP advised the assessor that it had started onsite inspections of trustees from March 2015; it is unclear what inspection process will be followed and the actual frequency of these visits. There are two trustees and one is dominant. Subject to a judgment of the scope and intensity of the new inspection process, an upgrade may be merited in due course.
<b>Principle 26.</b> Regulation should require disclosure, as set forth under the principles for issuer, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.	
Description	<p>The investment policy and description of the risks must be clearly and concisely stated in the constitutive document and in the prospectus or offering document for the sale of securities; investment restrictions must also be stated in the constitutive documents. In addition, the directors of the AMC are obliged to disclose any information which may be necessary for investor to make an informed decision.</p> <p>NBFC Regulations 2008 prescribes the contents of the constitutive documents. The prescribed matters to be disclosed include: date of document, constitution, investment objectives and restrictions, valuation and pricing, operator and principals, characteristics of units (including procedure for subscription and redemption), details of custodian, distribution policy, fees and charges, taxation, reports and accounts, statement about audit and appointment of auditor, warning to seek advice, warning that the price of units may go up or down, list of constitutive documents and a statement that the manager accepts responsibility for the accuracy of information as at the date of publication.</p> <p>The offering document and any other form of invitation to the public to invest in a CIS, including announcements, must be submitted to the SECP prior to their issue. The approval is valid for 60 days and the SECP may vary or withdraw the approval. It is an offence to make an untrue statement in an offering document or invitation to the public.</p> <p>Further, an AMC is responsible for preparing and circulating annual, semi-annual and quarterly reports to unit holders, SECP, trustee and the relevant stock exchange.</p> <p>Standard formats as provided under the NBFC Regulations 2008 are used for disclosure of offering documents and periodic reports. All material changes to the offering document must be made with the approval of the SECP and trustee after prior notice to unit holders.</p>
Assessment	Fully implemented
Comments	Enhanced timeliness of the dissemination of audit annual reports would serve to provide investor with more timely and therefore useful information and thereby a higher level of

	protection.
<b>Principle 27.</b> Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.	
Description	<p>The NBFC Regulations 2008, Regulation 66 provides detailed procedures for calculating the NAV of CIS assets. The following procedure is specified:</p> <ul style="list-style-type: none"> <li>• the valuation of a security listed on a stock exchange, local or foreign will be based on the last closing sales price as of the date of valuation or in the event of the exchange being closed, the closing price on the next preceding date; if no sale is reported for the valuation date then the security is to be valued at an average of the closing “asked and bid prices”;</li> <li>• an unlisted debt security and a debt security listed but not traded regularly on a stock exchange will be valued in the manner specified by the SECP; it may be noted that the methodology for valuation and provisioning criteria for debt securities held by CIS has been notified by the SECP in Circular 1 of 2009 dated January 06, 2009 and Circular 33 dated October 24, 2012;</li> <li>• an investment purchased and awaiting payment against delivery will be included for valuation purposes;</li> <li>• an investment sold but not delivered pending receipt of proceeds will be valued at the net sale price;</li> <li>• the value of any dividends, bonus shares or rights which may have been declared on securities in the portfolio but not received by the CIS as of the close of business on the valuation date will be included;</li> <li>• mark-up accrued on any mark-up-bearing security in the portfolio will be included as an asset of the CIS, if such accrued mark-up is not otherwise included in the valuation of the security;</li> <li>• any other income accrued up to the date on which computation was made shall also be included in the assets;</li> <li>• all liabilities, expenses and other charges due or accrued up to the date of computation which are chargeable under these Regulations and taxes will be deducted from the value of the assets;</li> <li>• the remuneration accrued up to the date of computation payable to the AMC for providing management and other services will be included as an expense;</li> <li>• a security not listed or quoted on a stock exchange, other than government securities or debt security, will be valued at investment price or its breakup value under last audited accounts, whichever is lower;</li> <li>• Government Securities not listed on a stock exchange and traded in the interbank market will be valued at the average rate quoted on a widely used electronic quotation system and such average rate will be based on the remaining tenor of the security; and</li> <li>• use of any such method of valuation of assets and liabilities as may be specified or modified by the SECP from time to time.</li> </ul> <p>For the purpose of valuing the fund’s property and pricing the CIS units, an AMC will not omit anything from the valuation process that could result in conflict of interest with existing or potential unit holders. Further, the AMC company is to take all reasonable steps and exercise due diligence in ensuring that assets of the CIS are correctly valued and priced in line with the provisions of the regulations and constitutive documents. The NAV must be calculated daily and also be reported in the annual report of the fund, and fund managers report, in accordance with accepted accounting standards.</p> <p>For pricing upon redemption or subscription of units, the offer and redemption prices are calculated on the basis of the net assets of the CIS, after subtraction for fees and charges, as disclosed in the offering document, divided by number of shares/units outstanding</p>



	<p>(Regulation 57, NBFC Regulations 2008).</p> <p><b>Suspension of redemption rights</b></p> <p>Under existing Regulation 57(8), suspension of redemption can only be provided in exceptional circumstances (for a maximum 15 days) having regard to the interests of unit holders.</p> <p>Further, the SECP is empowered to issue direction under s.282(D) of the Ordinance 84 to terminate suspension of redemption in the interest of the unit holders.</p>
Assessment	Fully implemented
Comments	Current regulatory requirements seem to meet international standards in regards to proper and disclosed basis for asset valuation as well as to pricing and redemption of units in a collective investment scheme.
<b>Principle 28.</b> Regulation should ensure that hedge funds and/or hedge funds managers/advisor are subject to appropriate oversight.	
Description	Hedge Funds or Hedge Fund Regulations do not exist in Pakistan. As regards foreign domiciled hedge funds, investment in the Pakistani Market can only be made by opening Special Convertible Rupee Accounts with any authorized dealer (banks) in Pakistan and the banks have to report every transaction related to such accounts to SBP. Furthermore, the National Clearing Company of Pakistan Limited also discloses “Foreign Investors Portfolio Investments” on its website. These reporting requirements ensure that all foreign investments in Pakistan are documented and monitored.
Assessment	Not implemented
Comments	<p>Pakistan, currently has no regulatory framework to deal with hedge fund activities. It is recommended that such regulations should be addressed in the near future. This can be done by adding regulations to allow the registration of hedge funds and appropriate penalties to deal with illegal marketing of foreign hedge funds within Pakistan. The scale of such activity is currently unknown.</p> <p>SECP has published, for consultation, a draft “Private Funds Regulation”. The assessor understands that the draft regulations (unseen) cover the registration of private funds domiciled in Pakistan (including hedge funds) and fund manager, standards for internal organization and operational conduct, supervision and enforcement etc. If these regulations in due course meet the requirements of Principle 28, and there is evidence of their effective enforcement, a significant upgrade will be appropriate.</p>
<b>Principles for Market Intermediaries</b>	
<b>Principle 29.</b> Regulation should provide for minimum entry standards for market intermediaries.	
Description	<p><b>Authorization requirements</b></p> <p><i>Broker and Agents</i></p> <p><u>Registration Requirement:</u></p> <p>S.5A of the Ordinance 1969 sets the requirement of registration for brokers. It states that no person can act as broker or agent to deal in the business of effecting transactions in securities unless he is registered with the SECP. Broker Rules 2001, Rule 3 covers the</p>

registration requirement for TREC (Trading Right Entitlement Certificate) holders. All existing TREC holders must be registered with the SECP as Brokers under the Broker Rules 2001. Further, for TREC holders of the mercantile exchange, Rule 9 and 10 of the Commodity Exchange Rules 2005 states that members can not engage in business without registration with the SECP. There is a standard application form in the regulation to be filled by the broker and submitted to the SECP. SECP issues a "certificate of registration". All brokers should apply both to the exchange and to the SECP for registration. After obtaining a TREC from the exchange, the holder has to register himself as a broker with the SECP in order to start trading.

Registration Criteria:

Capital: A company or a statutory corporation or a body corporate can become a TREC holder (and thereby a member) of a stock exchange if it has minimum issued and paid-up capital of PKR 20 million. For the mercantile exchange, the requirement is to provide a certificate for a net worth of PKR 20 million as specified under the General Regulations.

Further Eligibility Criteria: For the registration of a broker, the SECP processes the applications under the eligibility requirements laid down in Rule 4 of the Broker Rules 2001 and Rule 11 of the Commodity Exchange Rules 2005 respectively. With regard to stockbrokers, any person or corporate can become a TREC holder, subject to fulfilment of criteria laid down in the Rule 3 of the Rules 1971. Rule 3 covers requirements of knowledge and experience, financial soundness (including capital requirements) and ethical attitude. Additionally, s.16 of the Demutualization Act imposes certain pre-requisites on TREC holders applying for brokerage licenses after the date of demutualization. Similarly any person can become a TREC holder of the mercantile exchange subject to the fulfilment of criteria laid down in Commodity Exchange Rules 2005.

Rule 4 of the Broker Rules 2001 and Rule 11 of the Commodity Exchange Rules 2005 require an applicant to have:

- at least passed graduation or equivalent exams from any institute recognized by Government;
- not been convicted of an offence involving fraud or breach of trust;
- not been adjudicated as insolvent or has suspended payment or has compounded with his creditors;
- experience of not less than 5 years in business of buying and selling or dealing in securities;
- not been a partner of a brokerage firm or director of a brokerage company which has been convicted of an offence concerning brokerage;
- not defaulted in payment of dues at a clearing house;
- not defaulted in compliance with the provisions of the Ordinance 69, the SECP Act, and the rules and regulations made hereunder;
- not defaulted on settlement of an investor complaint where such complaint has been adjudicated by an exchange or a committee of an exchange or the SECP;
- complied with the directives of the SECP in respect of business conduct, dealings with clients and financial prudence.

The exams referred above are not professional exams. They are the exams for which equivalence has been granted by the Higher Education Commission as equivalent to graduation.

Under the Demutualization Regulation natural persons can no longer acquire a stock exchange brokerage license. Therefore, regarding the above conditions, in practice the SECP applies these requirements to the CEO or any one director of the board (not to shareholders). For PMEX brokers under s.11(3) of the Commodity Exchange Rules 2005 at least one director is required to comply with the said requirement.

Current registration (by the SECP) rules focus on brokers as natural persons and do not provide enough specific criteria (organizational requirements, risk management systems,

supervisory systems etc.) regarding brokerage companies. However, after demutualization, KSE revised its Rule Book. According to the new Rule Book, the eligibility criteria for obtaining a TREC includes minimum paid-up capital of PKR 50 million, fit and proper requirements for director, sponsors and substantial shareholder of the applicant. It also requires that no person can be eligible for a TREC if it “*fails to satisfy the Exchange that it has adequate staff, resources, risk management and internal control policies, procedures and systems available to effectively perform its obligations as a TRE Certificate Holder.*” (This regulation applies only to KSE members).

The eligibility criteria for a CDC participant require an applicant to fulfill the “Technical and Performance requirements”, which includes accounting, settlement and recording systems as are necessary for the purposes of the applicant’s existing and anticipated settlement operations, data processing capacity and operational capabilities to provide service. Additionally NCCPL Regulations provide the Technical and Performance requirements as a part of the eligibility criteria as a Clearing Member. SECP notes that, at the time of granting registration as broker, it checks the participant’s status at CDC and the Clearing Member status at NCCPL.

SECP renews the registrations every year. Rule 7(2) of the Broker Rules 2001 states that requirements of these rules as applicable to initial registration shall also apply for renewal of the registration.

#### *NBFC/Investment Advisor*

Investment advisors in Pakistan are required to obtain an investment advisory services license under Rule 5(2) of the NBFC Rules 2003 from the SECP. NBFC Rules 2003 and NBFC Regulations 2008 prescribe detailed criteria for honesty, integrity and competence of persons offering investment advisory services. As a capital requirement, any applicant wishing to undertake investment advisory services must maintain PKR 30 million in equity at all times.

Schedule IX to NBFC Regulations 2008 prescribes detailed eligibility requirements for the majority shareholder, directors, sponsors and key employees of the NBFC particularly in terms of honesty and integrity. The criterion covers the “integrity and track record, financial soundness, competence and capability and conflicts of interest” of the applicant. Schedule IX of NBFC Regulations 2008 has dedicated and detailed paragraphs for each of these criteria. In addition, competence requirements based on human and technical resources are required.

Circular 32 of 2009 specifies relevant requirements that cover record keeping, disclosure and conflicts of interest for investment advisors. It also contains detailed regulations on the minimum requirements for undertaking discretionary and non-discretionary portfolio management.

For verification of the applicant’s financial soundness, financial statements, wealth statements and income tax returns are filed with relevant authorities. The applicant must not be declared as a defaulter in repayment of a loan to a financial institution exceeding PKR 1 million and the latest Credit Information Bureau statistics should not show any default by the applicant towards a financial institution.

#### *Underwriter*

S.32C of the Ordinance 1969 provides for regulation of the business of underwriters. Detailed requirements as to the manner and procedure for their functions are provided under the Balloters Transfer Agents and Underwriter Rules, 2001 (“BTU Rules 2001”). S.32C is as follows: “Regulation of business of transfer agents, balloter and underwriter, etc.- (1) The business of transfer agents, balloter, underwriter, sub-underwriter, consultants to a public issue and other ancillary business relating to stock market shall be regulated in such manner and on payment of such fees and charges as may be prescribed”. Further, Rule 3 of the BTU Rules 2001 is as follows: “No person shall offer his service, or act as a balloter, transfer agent or an underwriter unless such person fulfils the eligibility conditions specified in rule 4. Therefore, under the existing BTU Rules 2001 the eligibility criteria has been

prescribed for the Ballotter, Transfer Agents and Underwriter, however they are not required to be licensed under the BTU Rules 2001. Rule 4 states that: “No person shall act as a balloter, transfer agent or underwriter unless such person fulfils the following conditions, namely:

- it is a company;
- it employs persons possessing managerial experience for discharging functions offered by it;
- it has on its pay roll a person who possesses a degree in law recognized by the Pakistan Bar Council, or who is a chartered accountant or a cost and: management accountant;
- it owns computer hardware and software, and employs persons who are expert in the operation of such hardware and software to discharge the service offered;
- its director and employees have not been convicted of an offence involving fraud or breach of trust;
- its director and employees have not been punished for an offence under the Ordinance 69, the SECP Act any rules made or directive issued thereunder; and
- its directors and employees remain in compliance with the conditions aforesaid or any other requirements notified by the Commission generally or in any particular case.”

These criteria are not very comprehensive and do not include a capital requirement. However, Rule 3(II)(iv), Rule 4(iii), Rule 9(iii) of the Companies (Issue of Capital) Rules, 1996 makes it mandatory that the underwriter should include at least two financial institutions, including commercial banks and investment banks in any underwriting. Those banks have separate minimum capital requirement under their respective regulatory frameworks. Further, in case of broker underwriter, minimum capital requirements are in their respective regulatory framework.

#### **Assessment of the Applications**

SECP has provided statistics regarding the broker and investment advisor applications they received for the last 5 years and the process in practice for dealing with the applications.

SECP further noted that compliance of the broker with existing laws, status of resolution of any pending investor complaints, and other requirements such as the appointment of a compliance officer etc. are checked by the SECP. Additionally, when checking compliance with applicable laws at the time of renewal of a license, system audit reports of the broker and any enquiry/investigation reports are also reviewed to assess the sufficiency of internal controls, procedures and policies of the applicant. On-site inspections by the Inspection wing along with the review of system audit reports are examined before renewing the certificate of registration of a broker. SECP and the Stock Exchanges do not do any on-site visits to the brokerage company at the initial registration or licensing, but they do interview the CEO of the company at the SECP and/or at the Stock Exchange.

There is no single data base in Pakistan for criminal record checks, therefore only the records of the SECP are checked for the assessment of the registration requirements.

Broker’ Registration and Investor Complaints Wing, under the Market Supervision and Registration Department is entrusted with registration of broker and agents and handling investor complaints. There are 5 employees working for this wing. As there are 283 brokerage firms (as of end 2014), and all the registrations are renewed every year, the number of the SECP staff dealing with the applications raises concerns in terms of workload and effectiveness.

#### **Public Accessibility of the Regulations and licensee information**

The laws and any changes therein are published in the official Gazette of Pakistan and are also readily available on the SECP website for public access. The existence of a license, its category and status, telephone number and address information regarding registered investment advisors, broker and agents are available on SECP and exchanges’ websites.

However, the registered broker and agents list on the SECP's web site is "as of 2012" and needs to be updated. Further, there is not enough information on the scope of permitted activities and the identity of senior management and names of other authorized individuals who act in the name of the intermediary.

#### **Authority of SECP**

Regarding brokers, Rule 5 of Broker Rules 2001 and Rule 12 of Commodity Exchange Rules 2005 authorize the SECP to refuse applications for certificates of registration. Rule 8 of the Broker Rules 2001, authorizes the SECP to suspend a registration. Rule 15 of the Commodity Exchange Rules 2005 authorizes the SECP to suspend the registration of a broker. SECP also has the power to refuse licensing of investment advisors if authorization requirements have not been met. Rule 5 and 6 of the NBFC Rules, 2003 allows SECP to suspend or apply a condition to a license. Rule 5(1) of the Broker Rules 2001 provides that "*The Commission, if it is satisfied that the applicant is eligible for registration as a broker, and that it shall be in the interest of the stock market to do so, may grant certificate of registration to the applicant*". In case of an underwriter which does not meet the eligibility requirements as mentioned under Rule 4 of the BTU Rules 2001 or does not meet the requirements as mentioned in Rule 3(II)(iv), Rule 4(iii), Rule 9(iii) of the Companies (Issue of Capital) Rules, 1996, the SECP may refuse to allow the underwriter to take part in the IPO.

#### **Ongoing Requirements**

##### *Brokers*

Brokers are required to remain in compliance at all times with the requirements of registration and to inform the SECP immediately when non-compliance with any of the terms and condition. Further, requirements of registration are also reviewed at the time of annual renewal of licenses.

Regarding the capital requirement, brokers are required to submit net capital balance as at June 30 and December 31 duly certified by a practicing chartered accountant. Further, every year at the time of applying for renewal of the certificate of registration, brokers must submit a net capital balance certified by a practicing chartered accountant.

SECP does not receive off-site periodic reports other than the NCB report.

##### *Investment Advisors*

As referred to above, investment advisors provide simple advice and/or portfolio management services. Investment advisors can deal on behalf of the client, however, they cannot execute trades on the exchange. All trades on the exchange are executed through market intermediaries providing brokerage services and an investment advisor cannot provide brokerage. Further, under Circular No. 32 of 2009 issued by SECP, investment advisors are not allowed to have custody of clients' assets. The NBFC Regulations 2008 and circular 32 of 2009 specifies relevant requirements that cover record keeping, disclosure and conflicts of interest for investment advisor as noted above. For the capital requirement, investment advisor are required to submit quarterly, half yearly and annual accounts to the SECP, as well as their monthly capital position statement. Moreover, the SECP also gathers monthly on-line data through off-site surveillance of investment advisor Form II of the NBFC Rules 2003 pertaining to licensing of investment advisors which requires that they must keep licensing requirements up to date by communicating changes within a period of fourteen days from any such change.

##### *Underwriters*

As noted above, the SECP does not license underwriters, and they are not required to update periodically relevant information although information may be available on company web sites as with investment advisor and broker.

Assessment	Partly Implemented
Comments	<p>Current registration (at the SECP) rules focus on brokers as natural persons and do not provide enough specific criteria (requirements for organizational structures, risk management systems, supervisory systems, written policies and procedures, internal controls etc.) regarding the brokerage companies. KSE Rules are further developed in this regard, however these rules only apply to the KSE TREC holders. CDC participation requirements and NCCPL membership requirements complement the technical requirements for brokers. However, rules regarding eligibility of brokerage companies should be further revised and developed in parallel with the new system after demutualization of the exchanges, where all the brokers are corporate entities.</p> <p>The lack of a single data base in Pakistan for criminal record checks is a system vulnerability. SECP checks only the records of the SECP for the assessment of the registration requirements.</p> <p>During the registration process (initial and renewal of the licenses) at the SECP, the fit and proper criteria are applied to the CEO or any one director of the board, however not to the shareholder. (Revised KSE Rule Book (2014) requires major shareholders to comply with the fit and proper requirements mentioned in the KSE Rule Book, however this is only a requirement for having a TREC at the KSE.)</p> <p>Considering that the registration of brokers are renewed every year, the limited number of the SECP staff dealing with the applications and registrations raises concerns in terms of workload and effectiveness. In addition, SECP and the exchanges do not conduct any on-site visits to a brokerage company at the initial registration or licensing stage. This is a weakness in terms of the assessment of the application and verification of some of the information that the company has provided, such as, location of the firm, internal organisation, staff, technical infrastructure, resources etc.</p> <p>While there are eligibility criteria in the regulation for the underwriter, they are not licensed and are assessed by the SECP only when there is an IPO application. Furthermore the regulation regarding underwriters is not very comprehensive and does not include any capital requirement.</p> <p>Regarding the deficiencies, SECP has provided that they will revamp broker' registration rules by December, 2015 and the Underwriter Rules and the Credit Rating Rules by June 2015.</p> <p>SECP notes that the Institute of Capital Markets (ICM) conducts mandatory certification for sale agents/distributor of CIS. As planned by the SECP, this requirement could be extended to investment advisor, critical staff at the brokerage company (such as analysts), and underwriters to complement the professionalism in the market.</p>
<p><b>Principle 30.</b> There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.</p>	
Description	<p><b>Initial and Ongoing Capital Requirement</b></p> <p>There are initial and ongoing capital requirements for brokers and investment advisors. However, the net capital calculation of TREC holder of exchanges is limited to accounting for current assets and current liabilities and does not give sufficient weight to the full range of risks to which exchange members are exposed. There is no capital requirement for underwriters although this is among the planned changes to the Underwriters Rules.</p> <p><i>Brokers</i></p> <p>A company or a statutory corporation or a body corporate can become a TREC holder of a stock exchange if it has minimum issued and paid-up capital of PKR 50 million. Further,</p>

regulatory requirements are provided in the Rules 1971, which require every Broker/Member/TREC holder to maintain a NCB as prescribed in Rule 3(b) of the Rules 1971 and calculated in accordance with the third schedule of the Rules 1971 and as prescribed by the board of directors of the stock exchanges. Under Rule 3 of the Rules 1971 a TREC holder must at all times maintain a NCB of an amount which in the case of:

- a stock exchange which in the previous calendar year had on the cash counter a turnover of securities exceeding 15 billion rupees is PKR 2.5 million;
- a stock exchange which in the previous calendar year had on the cash counter a turnover of securities exceeding 7.5 billion rupees but not exceeding fifteen billion rupees is PKR 1.5 million;
- a stock exchange which in the previous calendar year had on the cash counter a turnover of securities exceeding 7.5 billion rupees is PKR 0.75 million.

In addition, base minimum capital and capital adequacy procedures and exposure limits are provided in the Risk Management Rules (RMR) of the stock exchanges which set the maximum exposure that a TREC holder may not exceed. Under the respective RMR of the stock exchanges, a TREC holder can only take exposure (collectively in ready as well as futures market) up to 25 times its NCB. Base Minimum Capital is defined as follows: every broker is required to maintain a base minimum capital of the amount and in the form as calculated/prescribed in Schedule-1 annexed to the RMR of the exchanges. This amount is a sum of the notional value of TREC and the breakup value of 40% of the shares of the Exchange out of the total shares of the Exchange allotted to an initial shareholder. The Exchange determines and reviews this amount periodically and currently (2014) it is PKR 31.156 million for KSE, PKR 7.955 million for LSE, and PKR 17.133 million for ISE.

Under the General Regulations of the PMEX, the requirement is to provide a certificate for a net worth of PKR 20 million as specified under the General Regulations. Further, TREC holders have to comply with the minimum capital balance requirement as specified by the Board from time to time with the approval of the SECP; however, it must not be less than PKR 2.5 million.

In tabular form, the requirements are set out below:

ITEM	KSE	LSE	ISE	PMEX	COMMENTS
<b>NCB under Rules 1971</b> (PKR in million)	2.5	2.5	2.5	2.5	Minimum requirement given in the Rules 1971
<b>NCB under Exchange requirements</b> (PKR in million)	2.5	4	4	2.5	Rules 1971 requirement enhanced to PKR 4 million by LSE and ISE
<b>Net Worth</b> (PKR in million)	Nil	Nil	Nil	Universal: 20 Commodity Specific: 10	Eligibility requirement for becoming PMEX member
<b>Paid up Capital</b> (PKR in million)	50**	10	5	Nil	Eligibility requirement for becoming stock exchange TREC holder
<b>Base Minimum Capital</b> (PKR in million)	31.156	7.95 5	17	Nil	Required by stock exchanges as pre-requisite for trading and risk management purposes

\*All the above requirements are applicable simultaneously. \*\* KSE Amount was revised upwards from PKR 20 million to PKR 50 million at the time of incorporating this requirement as part of the KSE Rule Book.

There is no specific liquidity standard, however, as TREC holders are subject to the RMR of the exchanges, this places exposure limits on their trading positions. Exposure is defined as “at any point in time, security-wise and client-wise cumulative net unsettled amount of purchases and sales, of a Broker (including proprietary trades) under each Markets determined in accordance with these regulations.” TREC holders of the exchanges are required to deposit with the exchanges different types of margins based on their exposure.

When a broker increases exposure in the market, margin requirements become more stringent.

#### *Investment Advisors*

According to the NBFC Regulations 2008, minimum equity requirement for the provision of investment advisory services is PKR 30 million and an investment advisor has to maintain this equity requirement at all times.

### **Record Keeping, Periodic Reporting and Audit**

#### *Brokers*

Rule 8 of the Rules 1971 and Rule 22 of Commodity Exchange Rules 2005 require TREC holders of the exchanges to prepare and maintain books of account and other documents in a manner that will disclose the true, accurate and current position of their business.

SECP receives bi-annual Net Capital Balance reports. TREC holders of the stock exchange are required to report (not audited/certified) on a weekly basis that, at all times during the week they have had a net capital balance of not less than as specified and where the balance falls below the limit, they must inform the exchange of the same. SECP does not receive these reports but is in process of implementing the Financial Reporting System under which registered broker will be required to submit their financial data on a quarterly basis through an online system.

Under Regulation 2.2(b), (c) and (d) of the RMR of the exchanges, the TREC holder of the exchange must submit bi-annually a certificate from an auditor approved by the exchange by the due date, failing which a penalty will be imposed as provided in the Schedule 6 of the RMR.

TREC holders have to prepare and submit audited annual financial statements (mandatory audit requirement under Ordinance 84). In addition, Rule 5 of the Rules 1971 states that TREC holders must prepare once every year a balance sheet and a statement of income and expenditure. If an audit of a TREC holder is required by the SECP in the public interest, the audit will be carried out by a chartered accountant appointed by the SECP.

#### *Investment Advisors*

Rule 7 of the NBFC Rules 2003 requires investment advisors to maintain detailed books and accounts of its business from which minimum equity can be readily determined.

Investment advisors report their capital position to the regulator on a monthly basis which should reveal any shortfalls in a timely fashion. Moreover, the SECP also gathers monthly on-line data through off-site surveillance of investment advisors

Rule 7(1)(b) of NBFC Rules 2003 requires every NBFC to appoint an external auditor from the approved list of auditors circulated by the SECP. Within this context, the annual accounts are audited by the independent auditor. In addition, the auditor performs an interim review of half yearly accounts.

### **Regulatory Action**

On the basis of the capital requirement reports, the SECP can take appropriate action in case of non-compliance. The SECP can cancel or suspend the license of any intermediary that does not meet the minimum capital requirements. SECP can impose additional conditions on a licensee as and when required, including additional monitoring and reporting requirements.

With respect to the RMR of the Exchanges, a TREC holder can only take exposure (collectively in ready as well as futures market) up to 25 times of its net capital balance. In order to impose an additional check on the capital adequacy of brokers, the RMR of the stock exchanges require that if a broker fails to submit its NCB certificate within the required time (bi-annually), the exchange shall in addition to imposing a penalty, gradually



	<p>start reducing the NCB, thereby resulting in restrictions on the maximum allowable exposure limit of that broker, if necessary to zero.</p> <p><b>Risks arising from outside the Regulated Entity</b></p> <p>The regulatory framework does not address risks from outside the regulated entity, including from unlicensed affiliates and off-balance sheet affiliates.</p>
Assessment	Partly Implemented
Comments	<p>While there are initial and ongoing capital and other prudential requirements for brokers, the net capital of the broker is calculated based on accounting for current assets and current liabilities and does not give sufficient weight to the range of risks required to be accounted for under this Principle. The system allows for some protection against market risks, however it does not take into account other risks such as credit, liquidity and operational. On the other hand, although, capital market standards are not designed to give sufficient weight to the full range of risks to which a broker is exposed, the base minimum capital and capital adequacy procedures and exposure limits provided in the RMR of the stock exchanges enable a broker to absorb some losses. For investment advisors, only absolute minimum equity requirements exist rather than any risk based capital requirements such as a percentage of annual expenditure although it appears that investment advisors which carry on the business of portfolio management deal for clients.</p> <p>In addition, with regard to reporting, the structure of NCB reports is not very detailed and only covers a net (capital) number which is calculated as current assets minus current liabilities. Further, its reporting frequency (bi-annual) to the SECP is not sufficiently frequent. Regarding the deficiencies, SECP is committed to upgrading the Broker Registration Rules by December, 2015 and the Underwriter Rules and the Credit Rating Rules by June 2015.</p>
<p><b>Principle 31.</b> Market intermediaries should be required to establish an internal function that deliver compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters</p>	
Description	<p><b>Management and Supervision</b></p> <p><i>Brokers</i></p> <p>Broker Rules 2001, Rule 12 requires that brokers should abide by a code of conduct specified in the Third Schedule. This Schedule includes duties to investors, broker vis-a-vis broker responsibilities and broker vis-a-vis SECP and exchanges responsibilities.</p> <p>With regard to stockbrokers, any body corporate can become a TREC holder of a stock exchange, subject to fulfilment of criteria laid down in the Rule 3 of the Rules 1971. The Rule covers requirements of knowledge and experience, financial soundness (including capital requirements) and ethical attitude. Rule 4 of Broker Rules 2001 and Rule 11 of the Commodity Exchange Rules 2005 cover some fit and proper criteria which in practice apply to the CEO or any one board director. The Rules do not explicitly cover the requirement to have an appropriate management and organizational structure.</p> <p>As noted in Principle 29, the general requirements for registration were initially created for natural persons and they are not yet revised in order to cover corporate broker specific issues (such as organizational requirements, internal controls and policies etc.). On the other hand, KSE rules were revised in 2014 in order to cover corporate broker specific requirements. The eligibility criteria of a KSE TREC holder as set out in the KSE Rule Book stipulate that no person can be eligible for TREC if it <i>“fails to satisfy the Exchange that it has adequate staff, resources, risk management and internal control policies, procedures and systems available to effectively perform its obligations as a TRE Certificate</i></p>

*Holder*” (4.4.7(f)).

Broker members of exchanges under SECP Circular 34 of 2009 are required to nominate a compliance officer who will be responsible for ensuring effective implementation and compliance with the relevant regulatory framework. The circular does not explicitly require that management of a market intermediary should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct. Additionally, the regulatory framework does not specifically require that there be an effective mechanism of internal reporting to management.

Further, the regulatory framework does not specifically refer to outsourced activities.

#### *Investment Advisors*

Investment advisors must fulfil the fit and proper criteria specified under Schedule IX of NBFC Regulations 2008. The criteria applies to “Key Executives” of the NBFC, who are defined in the Schedule IX, and the promoter and the major shareholder(s) of the NBFC. The criteria cover the “*integrity and track record, financial soundness, competence and capability and conflict of interest*” of the applicant. Schedule IX of NBFC Regulations 2008 has dedicated and detailed paragraphs for each of these criteria.

#### *Underwriters*

BTU Rules, 2001, Rule 4 states conditions for underwriters. These conditions include that “*No person shall act as a balloter, transfer agent or underwriter unless such person fulfils the following conditions*”. These are:

- it is a company;
- it employs persons possessing managerial experience for discharging functions offered by it;
- it has on its pay roll a person who possesses a degree in law recognized by the Pakistan Bar Council, or who is a chartered accountant or a cost and: management accountant;
- it owns computer hardware and software, and employs persons who are expert in the operation of such hardware and software to discharge the service offered;
- its director and employees have not been convicted of an offence involving fraud or breach of trust;
- its director and employees have not been punished for an offence under the Ordinance 69, the SECP Act any rules made or directive issued thereunder; and
- its director and employees remain in compliance with the conditions aforesaid or any other requirements notified by the SECP generally or in any particular case.”

#### **Requirement for Internal Controls and its objective periodic evaluation**

The general rules related to brokers and underwriters do not explicitly mention the requirement for adequate internal controls. However, there are certain applications and actions that would require broker to have adequate internal controls. For example, the inspection manuals of the SECP require the inspection report to detail any weaknesses identified in the broker’s internal control systems, policies and procedures. Further, for KSE members, the new KSE Rule Book also requires that no person can be eligible for TREC if it “*Fails to satisfy Exchange that it has adequate staff, resources, risk management and internal control policies, procedures and systems available to effectively perform its obligations as a TRE Certificate Holder.*”

Furthermore, broker members of exchanges are subject to an evaluation by an external auditor of some aspects of their internal controls and risk management processes. This is done under the “Regulations Governing System Audit (Regulatory Compliance) of the Broker of the Exchanges (Broker System Audit) implemented by all exchanges. Selection of Broker/TREC holder for audit is done through a biannual balloting on January 31 and July 31 of each year. The objective is to audit all brokers in a two year ‘cycle’. The auditor is selected from a panel of independent auditors specified by the exchange. The scope of

the audit includes the minimum activities with respect to the system as specified in Schedule A of the Broker System Audit. The main topics of this Schedule are Client Level Compliance, Recording of Orders Placed Through Telephone, Details to be Printed on Broker's Correspondence and Contract Notes, Registration with the Commission, Branch Offices and Agents, Segregation of Clients' Assets, Trading by employees of the Broker, Illegal Financing, Internet Trading, Leveraged Trading, and General Obligations of the Broker. The auditor prepares a system audit report based on the findings of the audit and the report is submitted to the relevant exchange and the SECP. If the report identifies any non-compliance(s) the exchange may, after giving the broker an opportunity of being heard and considering the severity and materiality of the non-compliances, take appropriate enforcement action including issuing warnings, imposing fines, suspension of membership rights etc. The Exchange may by order, direct the broker to pay a fine for each instance of non-compliance, in addition to the specific penalty/enforcement action as provided in the relevant law, rules and regulations.

On the other hand, there is no requirement for a broker to be subject to an objective evaluation of its internal controls through an internal audit function.

With regard to investment advisors, Rule 7 of the NBFC Rules 2003 requires that the investment advisor will ensure that adequate internal controls and compliance arrangements are in place to ensure that it conducts its business diligently, effectively, honestly and fairly. There is no requirement for underwriters or investment advisors to be subject to an objective, periodic evaluation of their internal controls and risk management processes. However, SECP notes that the supervision department of SECP, during on-site inspection evaluates the internal control and risk management systems of market intermediaries regularly.

### **Organizational Requirements**

#### *Brokers*

With regard to the assessment of the compliance function, the SECP Inspection Manual covers the following: "*Inspector would employ maximum tests to find out weaknesses, whether minor or pervasive, in the Broker' internal control and compliance system.*" Further, the brokers' System Audit (by the exchanges) includes assessment of the compliance function with respect to activities/functions of the Broker/TREC holder as provided in Schedule A; some of the areas included in the scope of audit include client level compliance, segregation of Clients' Assets, Branch Offices & Agents, conflict of interest issues and handling of client orders. SECP is empowered to take steps (including cancellation or applying conditions to a license) when there is a deficiency in compliance with the regulations.

The regulatory system with regards to broker' internal organization covers the following:

- The Broker Rules 2001 and Commodity Exchange Rules 2005 under Rule 12 require brokers to abide by the code of conduct specified in the Third Schedule. This Schedule includes, duties to investor, broker vis-a-vis broker responsibilities and broker vis-a-vis SECP and exchanges responsibilities and covers requirements including treatment of all clients in a fair, honest and professional manner.
- The Code of Conduct for Brokers specified under the BTU Rules 2001 address areas of conflicts of interest which may arise between the broker and his client.
- In case of Direct Electronic Access there are controls in place that do not allow a trader to execute trades beyond the assigned credit limit.

However, there is no specific regulation for brokers governing segregation of key duties and functions, particularly those duties and functions which, when performed by the same individual, create conflicts of interest. The regulation addresses this issue only implicitly by requiring the broker to be duty bound towards its clients, the exchange, and other broker etc.

#### *Investment Advisors*

Circular No. 32 of 2009 provides detailed requirements for investor advisors, including

disclosure of information, conflict of interest, custody of asset, conduct of business, compliance with the regulatory framework etc. It requires an NBFC, to take care in all its dealings with the investor without gaining any advantage for itself, related parties, connected persons or employees which causes detriment to the investor. Under Schedule IX(d) of NBFC Regulations 2008, a Key Executive of an investment advisor shall not hold more than one functional area that gives rise to conflict of interest within the organization. Inspections are carried out by SECP to check various functions of NBFC's, including the compliance function. Offsite Surveillance wing of SCD conducts offsite examination of all NBFCs (19 in total\*) having licenses of investment advisory and asset management services on quarterly basis, each year. There are two NBFCs having license of only investment advisory services, whose offsite examination is conducted on semiannual basis, each year. Whereas, with regard to onsite inspections, information is given in the following table:

	<b>Year Ended</b>	<b>Year ended June 30, 2010</b>	<b>Year ended June 30, 2011</b>	<b>Year ended June 30, 2012</b>	<b>Year ended June 30, 2013</b>	<b>Year ended June 30, 2014</b>
	No. of Inspections (Holding license of Asset Management Services as well as Investment advisory services)	14	8	15	8	9
	No. of Inspections (Holding license of Investment advisory Services only)	-	-	1	-	-
	<b>Total Inspections</b>	<b>14</b>	<b>8</b>	<b>16</b>	<b>8</b>	<b>9</b>

With regard to offsite examination/review, an offsite review plan is prepared on an annual basis. High risk entities are reviewed quarterly while entities having low risk are reviewed semi-annually.”

Any deficiencies in the systems and procedures of an NBFC are identified by the inspection team and the NBFC is required to improve the systems through regular follow up.

**Protection of Clients**

*Customer' Assets*

*Brokers*

Regulation 41 (KSE and LSE) and Regulation 43 (ISE) of the General Regulations of exchanges require that clients' assets should be segregated from the broker's. For this purpose, brokers are required to maintain a separate bank account for all client monies. However, the bank account is in the name of the broker, with the client money segregation maintained only as book entries in the back office of the respective broker. This raises concerns regarding the safety of clients' money and the risk of misuse by brokers. It is also the case that creditors of a broker have the right to block this money through court proceedings. In cases of financial insolvency broker rules do not segregate client monies from that of the broker. In order to correct a serious deficiency in the regulation of segregation of client money by brokers, through which investors have lost money NCCPL has recently started offering a facility which will enable investors to keep their cash with NCCPL instead of brokers and settle their trades directly from the security/cash accounts maintained with NCCPL. This will eliminate the risk of misappropriation of cash for investors who choose to use the facility. It is not mandatory.

As regards client securities, a broker is required to keep a record of client positions as well as a separate sub account under its participant account in the CDS for each of his clients. The regulatory framework prohibits unauthorized movement of securities. Brokers cannot move assets unless there is a trade. Also, at the CDC there are optional accounts for customers to enable them to block unauthorized movement of their securities.

Under the requirements of the General Regulations of the PMEX, brokers must, at all times, segregate for each of their clients, all monies, securities and property received for trades on

commodity futures contracts, including for delivery obligations.

#### *Investment Advisors*

Under clause 2 of Circular 32 of 2009, all client assets (securities and cash) shall be registered in the name of the investor and the investment advisor shall not directly or indirectly hold or provide custody of assets of investors. Cash of the customer is maintained in the customer's own bank account or with the custodian of the customer.

#### **Investor Complaints**

The regulatory framework provides a mechanism for dealing with investor complaints at the exchange (Arbitration Committees) and the SECP level. However, regarding the broker, the regulation does not require market intermediaries to provide for an efficient and effective mechanism to address investor complaints internally. On the other hand, as a condition for issuance or renewal of a certificate of registration, a broker must give an undertaking that it is not in default of settlement of investor complaints, where such complaint has been adjudicated by the stock exchange or the SECP.

An investment adviser must establish and implement written policies and procedures to ensure that complaints from investors are handled in a timely and appropriate manner.

#### **Intermediary's conduct with clients**

##### *Identification and Verification of Client's Identity, KYC:*

Regulation 40A (KSE and LSE) and Regulation 48 (ISE) of the General Regulations of the stock exchanges require brokers to formulate and implement an effective KYC and CDD internal policy and framework in accordance with the guidelines issued by the exchange. The guidelines require that KYC and CDD internal policies should generally cover, customer identification, risk assessment of customer, circumstances where enhanced due diligence is required, on-going due diligence, circumstances where simplified due diligence can be adopted, compliance function, data retention, training and employee screening. Brokerage houses are required to register their clients with the Unique Identification Number (UIN) database maintained by the NCCPL which has its own internal mechanisms to confirm the identity of the client before registration. Regarding investment advisors, Regulation 9 of the NBFC Regulations 2008, requires investment advisor to determine the true identity of their customer before extending their services. It further requires establishment of effective procedures for obtaining identification from new customers.

##### *Clients' Information and Account Opening Agreement*

Regulation 40 of the General Regulations for stockbroker and Regulation 3.37 and 4.9 of the General Regulations for Commodity Broker, require that a broker enters into an agreement with the client before doing business, by using a Standardized Account Opening Form. The account opening form sets forth the terms and conditions which governs the relationship between clients and broker. Under Circular 32 of 2009, investment advisors are required to prepare, after due consultation with the investor, a written Investment Policy Statement. While devising the statement, the NBFC must undertake a risk and return assessment of the investor and thoroughly evaluate and understand the investor's investment objectives, investment constraints (including tolerance for risk, liquidity needs, time horizon, and financial, legal or regulatory constraints) and other unique needs and preferences. Investment advisors are required to execute a written Portfolio Management Agreement with the investor under Circular 32 of 2009 and as provided in the annexure to the Circular the agreement sets out in sufficient detail the rights, liabilities and obligations of each party including scope of services to be provided.

##### *Record Keeping*

Regarding brokers, Rule 7 and 8 of the Rules 1971 and Rule 22(2) of the Commodity Exchange Rules 2005 require members/TREC holders to maintain records for a period of five years. Further, KYC/CDD guidelines of the exchanges require that brokers should keep all customer records updated and have a policy of assessing any change in customer

profile on a regular basis; changes should be documented and sufficient information should be obtained regarding such changes. With regard to investment advisors, the NBFC Rules 2003 require intermediaries to keep proper records and books of accounts for at least 10 years. The books and records are to be maintained in prescribed formats whereby all relevant information relating to transactions can be traced.

#### *Providing Information to Investors*

The Code of Conduct as provided in the Third Schedule of the Broker Rules 2001 under “Business and Commission” requires that a broker must not furnish false or misleading quotations or give any other false or misleading advice or information to a client with a view to inducing him to do business in particular securities. There is no mandatory specific period for brokers to provide a client with statements of account. However the rules address the right of the investor to obtain a statement of account. With regard to brokers, information about fees/commissions to be charged is provided under the terms of the account opening form.

Under the requirements of Circular 32 of 2009, an investment advisor has to determine before providing any investment advice or taking investment action on behalf of an investor, whether the investment being recommended is suitable in light of the agreement and approved investment policy statement of the investor. Circular 32 of 2009 requires NBFCs to provide a client with statements of account at an agreed upon frequency. Regarding the NBFC, Circular 32 of 2009 requires NBFC’s to provide a client with information about any fees and commissions associated with client’s transactions.

#### *Acting with Due Care and Diligence*

The Code of Conduct for brokers and Circular 32 of 2009 regarding NBFCs include regulations in order to require market intermediaries to act with due care and diligence in the best interests of its clients and their assets and in a way that helps preserve the integrity of the market.

#### **Supervision Program of the Regulator**

The regulatory division/department at the SECP responsible for reviewing the disclosures and reports of members/broker is the Securities Markets Division. During surveillance and inspection of the members of the exchanges the SECP checks the compliance of applicable rules and regulations by the members/brokers including the conduct of business, accuracy of calculation of capital adequacy, disclosure and segregation of clients’ assets. During the past two years only approximately 10% of the total number of brokerage houses were inspected on an annual basis although this number is expected to increase in the future with enhanced capacity of the relevant department. In addition, as referred above, there is a mechanism in place in the form of the system audit (for compliance with applicable rules and regulations, segregation of clients’ assets etc.) whereby compliance by market intermediaries is audited by an independent auditor. With regard to investment advisors, Specialized Company Division (SCD) performs licensing, registration, regulation, on-site inspection, off-site surveillance and enforcement for the NBFC Sector. SCD carries out on-going monitoring of the regulated entities under an annual plan devised at the start of each year.

There is no system of inspection in place whereby inspections are conducted based upon a risk assessment, although under the annual inspection plan entities to be inspected in each quarter are identified. The inspection plan is designed to ensure that major entities (i.e. entities with larger asset bases and/or higher level of deposits) are inspected every year.

Exchanges also supervise broker members through the System Audits, NCB reporting and RMR margining system. However, System Audits are outsourced and done by an external auditor. Selection of Broker/TREC holder for audit is done through a biannual balloting. Further, NCB reports are not detailed and risk based, but just a submission of the capital (as a number).

Assessment	Partly Implemented
Comments	<p>Eligibility rules regarding brokerage companies address requirements of knowledge and experience, financial soundness (including capital requirements), ethical attitude, some fit and proper criteria (applied on the CEO and one director of the board) and conflicts of interest. CDC participation requirements and NCCPL membership requirements complement the technical requirements for brokers. However, as noted in Principle 29, current rules are more focused on brokers as natural persons and do not provide enough specific criteria (requirements for organizational structures, risk management systems, supervisory systems, written policies and procedures, etc.) regarding the brokerage companies. KSE Rules are further developed in this regard, however these rules only apply to the KSE TREC holder</p> <p>The regulation does not explicitly mention:</p> <ul style="list-style-type: none"> <li>• the requirements related to appropriate management, organizational structure, and outsourced activities;</li> <li>• the requirement for adequate internal controls (except for the new KSE regulation, which applies only to KSE members);</li> <li>• that management of a market intermediary should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct;</li> <li>• requirements for brokers concerning segregation of key duties and functions, particularly those duties and functions which, when performed by the same individual, give rise to conflicts of interest.</li> </ul> <p>Further, there is no requirement for brokers to be subject to an objective evaluation of its internal controls through an internal audit function. Internal audit is an ongoing controlling process, whereas the system audit generally occurs once in two years; it is also very limited in scope as are the SECP's on-site inspections and off-site surveillance tools. In these circumstances it is important for the brokers to have a strong internal audit function.</p> <p>While there are some protection measures for the assets of the clients, with regard to the money of the clients, the account at the bank is in the name of the broker, with the client's segregation maintained in the back office of the respective broker. This raises concerns regarding the safety of clients' money through misuse by brokers (and has resulted in losses) or competing claims of other creditors in the event of a brokers' insolvency). In any case, in the latter case the regulatory framework does not provide for effective segregation of client money. A partial remedy might be found in a facility NCCPL has recently started offering which enables investors to keep their cash with NCCPL instead of brokers and settle their trades directly from the security/cash accounts maintained with NCCPL. This appears to eliminate the risk of misappropriation of cash for investors who choose to use the facility. It is not mandatory for brokers to use this facility.</p> <p>The regulations do not require market intermediaries to provide an efficient and effective mechanism to address investor complaints internally.</p> <p>In order to monitor compliance by market intermediaries, SECP supervises the entities however it takes a long time to supervise all the entities. SECP does not have a specific risk based supervision program. The regulatory capacity regarding supervision (both off-site and on-site) needs to be enhanced.</p> <p>Regarding the deficiencies, SECP has stated that it will upgrade broker' registration rules by December, 2015 and the Underwriter Rules and the Credit Rating Rules by June 2015.</p> <p>Further, SECP is planning to have a system called "Global/Joint Inspection" which will be developed with a view to eliminate the duplication and inefficiency created due to separate inspections conducted by each SRO. This plan aims to have a full coverage for broker inspection, by end May, 2015. The plan should provide for more effective and efficient supervision of brokers; however its application in practice will require assessment once it</p>

	has been operational for a period of time.
<b>Principle 32.</b> There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investor and to contain systemic risk.	
Description	<p><b>Plan for Dealing with the Eventuality of Failure</b></p> <p>The default management regulations (DMR) of all the three stock exchanges and the PMEX set out procedures in case of a settlement default of broker, including restraining conduct and dealing with the assets and liabilities of the defaulter. The DMR, after the initial process of closing out and squaring up of open positions and determination of final loss also cover the establishment of a defaulters' committee, which becomes responsible for managing and supervising all proceedings related to the collection and realization of the assets of a defaulter. Under Regulation 3 of the DMR, a TREC holder who has been declared a defaulter would at once cease to be a TREC holder of the exchange and its certificate along with other assets will vest in the exchange.</p> <p>DMR of the stock exchanges run parallel with the default management regulations and procedures of the NCCPL and there is a dedicated chapter on default management in the NCCPL regulations as well. Default proceedings (i.e. switching off trading terminals, claims invitation, claim verification, sales of broker' assets, investor protection fund contribution and disbursement and settlement of investor claims) are handled at stock exchange level. However, parallel to default proceeding at a stock exchange the SECP can initiate an enquiry against the defaulted broker, close the CDC accounts of the broker and coordinate with other law enforcement agencies to recover the investors' money. On the basis of an enquiry report the SECP can file a criminal complaint in the court of law, if required.</p> <p>Regarding the NBFCs, the regulatory framework under s.282J of the Ordinance 84 also empowers the SECP to take necessary action against a NBFC (including investment advisors), which may include cancellation or suspension of a license and also move in court for winding up of the investment advisor.</p> <p>S.282N of the Ordinance 84 gives the SECP the right to draw up a plan for the rehabilitation of a NBFC or a notified entity which is facing financial or operational problems.</p> <p>On the other hand, while the DMR of the exchanges sets out the actions to be adopted in case of a settlement default of a broker, there is no specific plan or a kind of scenario analysis in order to deal with failures other than settlement default or failures of large conglomerates. In the case of the financial insolvency of a broker, neither the broker rules nor the courts protect client money from other creditors.</p> <p><b>Early Warning Systems/Mechanisms</b></p> <p>There is no formal system in place which could generate early warning signals regarding possible default by an intermediary. However, the System Audit regime whereby a chartered accountant firm conducts an on-site inspection of the broker and submits its findings to the exchange, CDC on-site inspections and monitoring, SECP on-site inspections, NCB certificates to the SECP (semi-annual), complaints filed against an intermediary, failure to deposit additional exposure/margins, delivery defaults etc. are provided to the SECP and are considered by SECP to be the tools that might serve as warning signals.</p> <p>Regarding the capital levels, TREC holders of the stock exchange are required to report (not certified, not risk based) on a weekly basis that, at all times during the week they have had a NCB of not less than as specified and when the balance falls below the limit, they must inform the exchange of the same. In addition, stock exchange members are subject to a margining regime (see Principle 30) which aims to enable the stock exchanges to minimize risks caused by the failure of a broker and limit the loss to the clients. SECP does not receive offsite periodic reports other than NCB report.</p>



### **Regulatory Authority**

S.7(d) of the Ordinance 1969, Rule 8 of Broker Rules 2001 and Rule 15 of the Commodity Exchange Rules 2005, s.282J of the Ordinance 84, and s.282(B) of the Ordinance 84 give the SECP power to restrict the activities of brokers and investment advisors if it is considered necessary for the protection of investors.

DMRs of the exchanges give the Default Management Committee (DMC) special rights in order to protect investor' assets. Under Regulation 8 of the DMR the DMC is constituted to recover all moneys, securities and other assets due or deliverable to the defaulter by any other TREC holder in respect of any transactions or dealing made subject to any regulations of the exchange or NCCPL, and such assets become vested with the exchange. Further, the DMC is required to keep a separate account in respect of all money, securities or other assets payable or deliverable to a defaulter by other TREC holder or the NCCPL. These procedures have been followed when winding down a broker's business.

### **Additional Measures (Settlement Insurance Schemes, Guarantee Funds)**

In the event that the funds recovered through the sale of assets of the defaulter broker of a stock exchange are not sufficient to satisfy all claims admitted by the DMC then the following contributions are made available.

For the KSE:

- contribution from the Clearing House Protection Fund Trust (CHPFT) for satisfaction of claims of brokers in accordance with the provisions prescribed in the relevant trust deed of the CHPFT on recommendation by the board of directors; and
- contributions from the Investor' Protection Fund for satisfaction of claims of investors in accordance with the provisions prescribed under the relevant trust deed of the fund and investor' protection fund regulations.

Similar to the CHPFT, for the ISE there is a Settlement Protection Fund and for the LSE there is a Members Contributions Fund available for this purpose.

These trusts and funds are funded by seed capital contributed by the exchanges and contributions by the brokers based on the value of trades, and in case of utilization in a particular case, are also replenished from any surplus amount remaining from proceeds of sale of assets of the defaulting broker after settlement of claims.

With regard to PMEX, the exchange, can utilize the Settlement Guarantee Fund to meet the broker's obligations.

There are plans to create a Securities Investor Protection Corporation (SIPC). SIPC is expected to bring efficiency in the claim settlement process by eliminating any conflicts of interests and reducing the time that is normally taken for satisfying investor claims. SECP notes that cases referred to courts even after arbitration tend to linger on due to lack of knowledge of capital markets. The SIPC with its own bench of judges and professionals well-versed in capital markets is expected to be able to resolve ongoing investor complaints/claims more expeditiously.

### **Domestic and Foreign Cooperation**

SECP has entered into a protocol for information sharing with the SBP. Both regulators have established a mechanism of regular information sharing through a MoU on important issues that affect the overall financial sector and the economy. Further, to develop expertise for risk measurement and analysis across sectors, SECP and SBP have established a task force for appropriate supervision of conglomerates having direct or indirect holdings or influence on the financial sector through shareholdings as well as large exposures.

The SECP has also entered into a MoU on information sharing and coordination with the Federal Board of Revenue (FBR) to effectively carry out their respective statutory responsibilities and maintain the highest level of oversight quality, while minimizing

	<p>duplication of efforts. Both regulators hold consultations on fiscal policy measures pertaining to the NBFC sector (insurance and capital markets) and the corporate sector with the view to address any adverse policy impact on the regulated sector and facilitate detection of hidden income avenues.</p> <p>SECP regularly holds Coordination Committee meetings with SBP and FBR.</p> <p>The SECP has also established a Financial Markets and Corporate Sector Development Forum to coordinate with stakeholders for identifying and addressing any risks to the financial system posed due to evolving and developing markets, products and activities.</p> <p>There is no formal guideline/document for cooperation between the SECP and the exchanges. However, SECP and the exchanges have provided examples of cooperation (weekly coordination meeting, cooperation in dealing with a failure of an intermediary etc.). Internationally, SECP is a signatory to the IOSCO MMoU and has 11 bilateral MoUs signed with foreign regulators.</p>
Assessment	Partly Implemented
Comments	<p>The default management regulations of all the three stock exchanges and the PMEX set out procedures in case of a settlement default of broker, including restraining conduct and dealing with the assets and liabilities of the defaulter. On the other hand, there is no specific plan or scenario analysis in order to deal with failures other than settlement default or failures of large conglomerates.</p> <p>With regard to early warnings, SECP interprets early warning signals of a possible default through System Audit Reports, investor complaints, NCB certificates, CDC inspections, delivery defaults etc. However, enhanced off-site periodic reporting is essential in order to be preventive and to enable necessary action to be taken before a default occurs. SECP does not receive off-site periodic reports other than the NCB report. Further, the NCB reporting period and the coverage of the report does not give sufficient information regarding the financial risks that the intermediary carries. Therefore, once an audit/inspection is done in a single firm by the SECP or the Exchanges (via System Audits), it would take some time until the conduct of a new inspection. In the meantime, SECP receives semi-annual certified NCB reports which are actually a certification of the capital (as a number), but not a detailed risk-based capital report. Weekly NCB reports that the brokers submit to the exchanges are also not detailed or risk based, but include only a submission of the capital (as a number). As is noted in Principles .30 and 31, ongoing surveillance tools including periodic reporting in some critical areas need to be identified and improved capital adequacy reporting (including an obligation to report when a broker's capital declines to within a SECP defined percentage (e.g. 120%) of its minimum capital requirement imposed. These will serve as early warning signals of a potential default.</p> <p>SECP and the Exchanges have the authority to restrain conduct and take necessary steps in order to protect investors, in case of a default of the broker. Further, there are additional measures such as Insurance Schemes and Guarantee Funds to minimize the loss in case of a default.</p>
<b>Principles for the Secondary Markets</b>	
<b>Principle 33.</b> The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.	
Description	The legal regime for the establishment of trading systems gives the SECP comprehensive power in relation to authorization. S.3 of the Ordinance 1969 requires authorization of any exchange by the SECP, while s.4 provides for conditions and requirements. While not all the criteria for authorization are explicitly set out in the Ordinance 1969 or the Rules 1971,

the SECP subjects any application to appropriate scrutiny.

Obligations are imposed on the operators and members of exchanges by law and also through the exchanges' regulations, which the SECP must approve. Under s.34(4) of the Ordinance 1969 the SECP has the power to direct an exchange to make, change or rescind particular regulations where the SECP considers this expedient. The exchanges' regulations are publicly available on the internet.

All three stock exchanges have funds which are used to satisfy investors' claims and ensure smooth settlement in the case of a broker's default or inability to settle. They have regulations designed to limit risk, for example discouraging the broker from holding large quantities of securities on behalf of clients by limiting the total securities a holder may maintain, for both itself and clients, to 25 times the NCB. The three stock exchanges' RMR impose requirements such as position limits and capital adequacy requirements designed to limit the principal, settlement, guarantee and performance risk. That risk is assumed by the NCCPL.

Rule 12 of the Clearing Houses Rules 2005 requires the NCCPL to maintain the NCC Clearing and Settlement Fund, currently containing some PKR 1.4 billion, actuarially assessed as the necessary level, although a new actuarial re-evaluation will shortly be conducted. To be registered as a clearing house, the NCCPL was obliged to meet appropriate criteria. Clearing houses must renew their certificates of registration every year, at which time the SECP can cancel or suspend registration if the clearinghouse is not abiding by the law or if this is in the interests of the capital market.

PMEX acts as the clearing house for trades on it, so assumes the role of central counterparty and guarantees all trades under Regulation 7.3 of the PMEX General Regulations. That guarantee is, however, limited to the extent of the contribution made to the Settlement Guarantee Fund by the relevant broker. Chapter 12 of the PMEX General Regulations imposes the obligation to maintain the Fund. Chapter 13 provides for position limits. Chapter 8 provides for margins. The PMEX's automated system will cancel any transaction where adequate funds have not been earmarked for the transaction.

Under s.20 of the SECP Act, the SECP is responsible for regulating the business in the exchanges, regulating SROs, including the stock exchanges, and undertaking inspections, conducting inquiries and audits of the stock exchanges, intermediaries and SROs. It is given such power as are necessary to do so. In particular, the SECP is empowered to assess exchange operators' arrangements for oversight, their dispute resolution and appeal procedures, their technical systems for dealing with operational failure, their record-keeping, any reports of suspected breaches of law, the arrangements for holding client funds and securities and information on how trades are cleared and settled.

With regard to the holding of client funds, exchange regulations require segregation (for example, Rule 4.19 of the KSE Rule Book), the annual system audits require that compliance to be checked, and the SECP says that it pays particular attention to compliance with this requirement. Nonetheless, as highlighted in Principle 31 the current arrangements require segregation only in the back office, so that brokers are still in a position to access clients' assets and those assets may still be vulnerable to their broker's creditors. This was identified as a weakness in the 2004 review. Moreover, a maximum penalty of PKR 50,000 (approx. US\$ 500) for non-compliance with Rule 4.19 is too low. The SECP is aware of the problem, and the considerable proportion of breaches that involve broker improperly accessing client assets. It considers that the launch of new products in January 2015, which provide for the NCCPL rather than the broker, to hold client assets, may go a considerable way to address the problem, although its use is not compulsory.

Appropriate mechanisms to deal with disorderly trading conditions are set out in Regulation 9.8 of the stock exchanges' RMR and Regulation 2.3 of the PMEX General Regulations.

Where a market outsources some of its activities, the SECP under ss.20, 29 and 30 of the SECP Act has power to access the books and records, not just of the market, but also of its service provider and to promptly obtain other relevant information.

An exchange's listing rules must be approved by the SECP. If an issuer seeks a listing, it must apply to a stock exchange, in accordance with those rules and any other regulations governing the particular product, and must submit a copy of its application to the SECP. The information required for the application will depend on the new product being proposed but generally includes a detailed product model, which sets out the purpose, significance and benefits of the new product. The SECP on receiving proposals from the stock exchanges analyses the same in detail with special focus on investor protection, foreseeable risks of market abuse or unfair trade practices, operational viability, impact on market transparency and international trends suited to local market needs. This allows the SECP and the exchange operator to take into account the product design and trading conditions.

Where any new commodity futures contract is proposed by the PMEX, an SECP guideline sets out the information that must be provided to the SECP, which it will take into account when reviewing the product. Proposals include contract specifications and include details about the product, its trading parameters, settlement procedures, pricing methodology, proposed risk management measures and any information pertinent to investors. For example proposals for new commodity futures contracts must include information on the underlying product; how a futures contract may be linked to the price of the underlying product in Pakistan; and any risks which may be associated with the specific commodity and its futures contract. The SECP accordingly reviews each new proposed commodity futures contract in detail for market suitability, investor protection, adequate risk management arrangements, transparency and fairness in pricing, and risk of manipulation. Chapter 4 of the PMEX General Regulations, as approved by the SECP, provides that the listing of all commodity future contracts is subject to the SECP's approval.

Through its power to approve all the exchanges' regulations, the SECP ensures that the regulations require fair access to the exchange for all participants and fair order execution procedures.

In the interests of fairness and equal access, the exchanges provide all their system users with the same system and hardware to ensure equal access. Where orders are not executed immediately on entry into the system, the regulations for automated trading systems provide for execution based on price and time priority. Time stamps at order placement and execution on the automated system allow comparison of order execution response times.

The regulations of the stock exchanges for proprietary trading also contain principles for order execution to be complied with by every broker. For example, the KSE's Regulations for Proprietary Trading 2004 cover such matters as chronological execution of orders, restrictions on and disclosure of proprietary trades, best execution, fair allocation where orders have been amalgamated, conflicts of interest and market integrity. These principles seek to ensure fair access to the exchange and trading system. The regulations follow very closely the wording and content of Rule 4 of the Rules 1971.

The PMEX has an electronic trading system established for the brokers, which provides fair access to its participants for carrying out trading activities. The functioning of the system is outlined in Chapters 5 and 6 of the PMEX General Regulations.

Moreover, Rule 4 of the Rules 1971 provides that participants must enter all orders they receive in a register in the order received and specifically prohibits practices like front-running. These measures are all publicly available.

In view of their relative simplicity, the SECP does not review the trade matching or execution algorithms of the automated trading systems.

To manage the risks of unfair or disorderly trading, each exchange has a fully automated collateral management system, which monitors pre-trade and post-trade margin requirements. Pre-trade margins at the stock exchanges under regulation 8 of the RMR ensure that a fixed percentage is available prior to execution of a trade. The system checks at the time an order is placed whether the member has sufficient margin deposits and is within his capital adequacy limit. For the post-trade margins, the collateral management system indicates the applicable exposure margins based on value at risk methodology and the concentration margins (deterrent to excessive accumulation/concentration), special

	<p>margins, liquidity margins, additional margins and the mark to market profit and loss calculations. The system also ensures applicability of market levels, broker levels, and client level position limits for each market segment as prescribed in the RMR of the stock exchanges, and provides for valuation of the collateral deposited by a broker based on pre-defined valuation methodology.</p> <p>In addition, the stock exchanges have a client unique identifying number (UIN) level margining regime at client level which ensures that all margin and mark to market losses of each UIN must be fulfilled from respective UIN securities or cash deposits.</p> <p>Chapter 13 of the PMEX General Regulations provides for position limits. Once those are reached, the exchange tells the broker, who may then not present further transactions until it deposits further collateral. Chapter 8 provides for margins.</p> <p>The exchanges' regulations and operating procedures are publicly available. Stock exchanges' trading information is provided daily to the SECP, which can then reconstruct trading activity. The SECP can obtain the information it needs from PMEX under Regulation 16 of the PMEX's General Regulations. The system allows information to be retrieved when needed. Conversely, s.19 of the Ordinance 1969, Part IX of the SECP Act and the exchanges' protocols (which the SECP could require to be amended, if it wished) impose appropriate confidentiality obligations. The SECP also has the power under s.40B of the SECP Act to issue directives in respect of particular information.</p> <p>Trading information such as bids, offers, volume, last trade price and index level are available to the general public through the trading system and on the website of the exchanges. The exchanges also provide historical trading data on their respective websites which can be readily accessed by anyone.</p> <p>All market participants have equal access to additional information made available by the exchange. The exchanges provide a separate trading window in the trading terminal available to the members for execution of different types of trades such as short sales or off market transactions. Exchanges provide terminals to all brokers which show, on a real time basis, the exposure taken by the broker, to assist brokers in taking timely decisions concerning management of risk. The exchanges also provide the brokers with software/utilities which enable the broker to monitor their house position and the position of their clients and to ensure compliance with the regulations of the exchanges.</p>
Assessment	Broadly Implemented
Comments	<p>Broadly, the SECP has the power it needs in law to license and oversee exchanges. The SECP has advised that more resources are being allocated to surveillance to allow it to exercise those powers more vigorously.</p> <p>Two particular areas were identified where oversight could be improved. Firstly, the SECP does not have a system in place to review the fairness of the trade matching or execution algorithms of automated exchanges for fairness. This may become more of an issue as automated trading becomes more prevalent. Secondly, the arrangements for segregation of client funds of broker members of exchanges only involve a back-office separation, meaning that the funds will not necessarily be protected from the broker's creditors. This significant vulnerability is highlighted in Principle 31.</p>
<p><b>Principle 34.</b> There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.</p>	
Description	<p><b>Monitoring of day-to-day trading activity</b></p> <p>The SECP has a monitoring and surveillance wing of its Securities Markets Division, which</p>

monitors the day-to-day trading activities at the stock exchanges, using in-house surveillance software. The SECP's software known as the Market Surveillance Suite includes an Alerts Module, which at the end of each day generates alerts regarding any unusual activity observed, based on pre-set parameters defined in the system. The exchanges also have some more limited market surveillance capabilities, with market monitoring and surveillance wings/departments, although no dedicated software.

Trading activity on PMEX is monitored electronically by PMEX which provides reports to the SECP. The SECP does not have real-time access to the trading data of PMEX, but has the power under Rule 28 of the Commodity Exchange Rules 2005, to obtain information from PMEX. This includes information on traders' financial and underlying market positions, allowing the SECP to monitor concentrations of positions and the overall composition of the market. Some opportunities for market misconduct are limited by the small size of the PMEX in international terms.

#### **Monitoring of intermediaries' conduct (through examinations of business operations)**

##### *By the SECP*

The exchanges periodically report to the SECP on intermediaries' conduct, among other things, reporting for example a list of enforcement actions, the status of pending investor complaints, and progress made in proceedings in case of default by members. In total they periodically provide twenty different reports for the SECP. Exchanges must also file annual reports with the SECP.

The SECP also monitors intermediaries, with on-site inspections of the books and records of at least 10% of brokerage houses each year. The Stock Exchange Members (Inspection of Books and Record) Rules 2001 also specify records that must be kept in addition to records required under the Rules 1971. There is no risk-based assessment but inspections are conducted responding to complaints or other intelligence.

After an inspection, the SECP may require a member to take such measures as the SECP deems fit to ensure compliance with the Ordinance 1969 and the rules made under it.

The SECP reviews compliance of brokers with the relevant rules and regulations on an annual basis during renewal of their certificates of registration.

##### *By the exchanges*

It is the exchanges that are primarily responsible for monitoring members' conduct through examination of their business operations, using a variety of tools. These are discussed in more detail in the discussion of the Principles for Market Intermediaries.

Members report on a weekly basis that at all times during the week they have had the required NCB. Where the balance falls below the limit, they must inform the exchange. Twice a year the NCB is certified.

Under the risk management rules of the exchanges, members must also deposit with the exchanges different types of margins based on their exposures. Those margins are adjusted and monitored electronically to reflect the changing levels of exposure.

The stock exchanges do not themselves routinely conduct on-site monitoring. To monitor their members' conduct, they primarily use system audits conducted under the Regulations Governing System Audit (Regulatory Compliance) of the Broker of the Exchanges. The audits are conducted by chartered accountants, whom the brokers select from a panel. The intensity and frequency of a system audit is not risk-based. Selection of intermediaries for audit is done through a biannual balloting on January 31 and July 31 of each year. The target is that all members will be audited once in each two year 'cycle'. An exchange can also at any time have a broker audited/inspected/investigated or itself conduct the audit or inspection, with a different scope or period of audit from those in routine audits.

The aim of the audit is to assess compliance with the relevant laws, rules, regulations and directives/circulars/guidelines. Its scope must include checking compliance with a list of

requirements, grouped under the headings of Client Level Compliance, Recording of Orders Placed Through Telephone, Details to be Printed on Broker's Correspondence and Contract Notes, Registration with the Commission, Branch Offices and Agents, Segregation of Clients' Assets, Trading by employees of the Broker, Illegal Financing, Internet Trading, Leveraged Trading and General Obligations of the Broker. The auditors prepare system audit reports, which are submitted to the relevant exchange and the SECP.

If the report identifies any non-compliance, the exchange may take appropriate enforcement action including issuing warnings, imposing fines and suspending membership rights. It may direct the broker to pay a fine of PKR 10,000-200,000 (approx. US\$100-2000) for each instance of non-compliance, in addition to any penalty or enforcement action provided in the relevant law.

The exchanges also receive and respond to complaints, and particularly an abrupt increase in complaints about a broker. This can and does lead to actions being taken against broker for non-compliance. Rule 4.14 of the KSE Rule Book obliges broker to immediately report any breaches to the exchange. From 2010-2014 nine complaints resulted in the SECP issuing warning letters or orders.

The KSE has a Market Surveillance Department. Its Head of Department supervises both the Market Surveillance Wing and the Investigation Wing, each of which has three staff. The former's main tasks include:

- preparing surveillance reports using a web-based system for evaluation and monitoring purposes;
- scrutinizing material information, announcements, news and rumors to identify potential cases, which are either referred to the investigation team or kept on a watch list;
- maintaining a watch list of instances referred by the investigation team for routine monitoring and surveillance; and
- preparing and fetching Short/Blank Sale Reports and forwarding them to the investigation team for enquiry.

The latter's include:

- conducting Short/Blank Sale investigations;
- investigating cases of prohibited trading or market abuse and preparing a report that will go to the SECP; and
- completing a range of routine activities, including preparing daily activity logs of the department; updating and maintaining an enquiry tracking system on a daily basis; finding and forwarding SECP enforcement orders for the KSE website; compiling and submitting to the SECP every fortnight a list of inquiries initiated and enforcement actions taken; compiling and submitting a similar list internally; coordinating and assisting the audit program; and conducting research on surveillance and investigation programs/ techniques in different jurisdictions.

From 1 January 2010 to 18 December 2014, KSE's Market Surveillance Department looked into 3,300 possible cases, of which 41 were referred to the SECP, 31 resulted in a penalty, 551 resulted in advice or a warning and 2,677 were closed at inquiry level. There are significant limits to what the Market Surveillance Department can do with available resources. The KSE plans to boost the operations of its Market Surveillance Department by procuring surveillance software, hiring additional staff with relevant expertise and providing training to upskill staff.

In similar vein, Rule 21 of the Commodity Exchange Rules 2005 provides that PMEX's broker shall undergo an annual system audit in accordance with the directions issued by the SECP from time to time.

Under Chapter XVI of the PMEX General Regulations, brokers are required to maintain such records and submit such reports as PMEX or the SECP require. There is a further obligation under Regulation 3.22 to provide PMEX any information required. Members

must also notify PMEX of any breaches or various other adverse circumstances under Regulations 3.21 and 16.4 of the General Regulations. Under Regulation 3.35, PMEX can inspect records and documents, access broker' premises, interview and request confirmation of balances and other matters

#### **Collection and analysis of the information**

The SECP and the exchanges share information on broker' non-compliance for response and corrective action, including the imposition of penalties where appropriate. The exchanges' surveillance departments are required to submit to the SECP every fortnight details of different enquiries/investigations initiated by them and any enforcement action taken. The exchanges investigate and finalise most cases, although cases involving blank sales or short sales are usually investigated and actioned by the SECP, since it has the more sophisticated software.

The SECP reviews and analyses the information it receives. It does not seek independent verification of what is stated in the system audit reports, but pursues any questions raised for it by the reports. For example, when the SECP reviewed and analysed system audit reports submitted by the KSE about balloting held in January 2013 and July 2013, this revealed irregularities and non-compliance. The SECP took enforcement action against KSE, which had not ensured there was compliance, had not taken appropriate enforcement action against the broker in a timely manner and had wrongly declared the broker to be compliant. The SECP brought proceedings against the KSE, its Managing Director and his deputy. They were fined respectively 1 million, 200,000 and 500,000 rupees. At a hearing before the SECP Director, the Director noted that KSE as frontline regulator was required to vigilantly monitor and oversee the process of system audit of brokers and to enforce the KSE's regulations firmly.

#### **Mechanisms for oversight of exchanges by the SECP**

There are regulatory oversight mechanisms the SECP can use to verify compliance by the exchanges with their responsibilities, particularly as they relate to the integrity of the markets, market surveillance, the monitoring of risks, and the ability to respond to such risks. S.20(4)(k) of the SECP Act makes the SECP responsible for oversight of the stock exchanges and PMEX. Under s.20(4)(k) of the SECP Act, the SECP is responsible for calling for information from and undertaking inspections, conducting inquiries and audits of the exchanges. Under s.20(4) it is also responsible for regulating exchanges and the business in exchanges. Under s.20(1) it has all the power necessary to do this.

Twenty different reports to the SECP are currently required from exchanges under s.6(2) of the Ordinance 1969 and the Rules 1971. Many of the reports are, however, quite narrow in scope, such as monthly reports on details regarding the automatic cancellation of broker' or dealers' certificates. They cover for example a list of enforcement actions, status of pending investor complaints, and progress made in proceedings in case of default by members

The SECP also has access to other information such as minutes of exchange board and the Regulatory Affairs Committee meetings, regular meetings and frequent interaction with the exchange management for updates; and correspondence with the exchanges on ongoing and upcoming issues regarding stock exchange performance which also include taking up any concerns raised by market participants. In addition the SECP keeps track of complaints and assesses the process of complaint resolution via reports relating to investor complaints, arbitration proceedings and disposal of appeals. Inspection of stock exchange brokers, analysis of their system audit reports and in some cases instructions received through court orders in respect of litigation relating to a broker or the stock exchanges also contribute towards assessment of the performance of the exchanges.

Exchanges must also file annual reports with the SECP. The surveillance departments of the exchanges are required to submit to the SECP on a fortnightly basis, details of different enquiries/investigations initiated by them and any enforcement action taken. Reports are also generated by the market surveillance software of the SECP, which are periodically



	<p>reviewed.</p> <p>The SECP does not conduct on-site assessments of exchanges' arrangements, although this is a future target. Based on the information available to it, it considers that it does make an assessment of the fairness and transparency of the exchanges' arrangements as well as their compliance with their obligations.</p> <p>The SECP's observations are communicated to exchanges for their response and corrective action. The SECP might, for example, intervene if it considered complaint handling systems are inadequate or claims against defaulting members are not being settled fairly. If appropriate, the SECP will take independent action, as in the case brought against the KSE described above. A more typical example would be where the SECP, after reviewing minutes of the exchange Board and the Regulatory Affairs Committee meetings, considered the exchange was not taking appropriate action and took the issue up with the exchange. It will continue until it is satisfied the issue has been resolved and there is effective compliance by the exchange with its obligations. Usually the matter is resolved by agreement, although the SECP may proceed to warnings, show cause notices or orders. Where exchanges have not taken sufficient preventive or disciplinary action against brokers, the SECP has issued directives requiring them to do so or has initiated disciplinary action on its own accord.</p>
Assessment	Broadly Implemented
Comments	<p>The systems in place for electronic surveillance appear to be adequate.</p> <p>The SECP oversees compliance by the exchanges through a variety of mechanisms.</p> <p>The monitoring of intermediaries' conduct (through examinations of their business operations), however, raises issues. There does not appear to be sufficiently vigorous and risk-based monitoring, combined with on-site inspections. There is heavy reliance on regular system audits by chartered accountants to uncover any non-compliance by brokers. Although they are selected from a panel, not all auditors may have the expertise to fully assess a broker's operations. The system runs the risk of leading to a "checklist" approach. System audits are focused on ensuring there has been compliance with relevant legal requirements and are not a substitute for a fuller overview of participants' behaviour.</p> <p>There have been recent moves aimed to improve the quality of monitoring. With demutualization in 2012, KSE's regulatory and commercial functions were separated. The Regulatory Affairs Department, which is responsible for monitoring of broker, now operates under a Chief Regulatory Officer and Regulatory Affairs Committee, to reduce any potential conflicts of interest. The Regulatory Affairs Committee is tasked with, among other things, assessing the performance of the Regulatory Affairs Department in the light of its regulatory program. This paves the way for a more vigorous and proactive approach to monitoring.</p> <p>The SECP and the stock exchanges have been working on developing closer links and cooperation in the area of monitoring and inspections. Processes are underway to design a joint inspection regime, which they consider will improve the quality of supervision. Among other things, it will classify brokerage houses into three tiers based on their size. This will allow resources to be focused in those areas where they can address the greatest risks. Additional resources at the SECP have also been assigned to surveillance.</p>
<b>Principle 35.</b> Regulation should promote transparency of trading.	
Description	<p>There is no specific legal requirement for pre-trade or post-trade transparency. In practice, however, there are effective arrangements. The SECP has the legal authority to impose such requirements through exchange regulations, should this ever become necessary.</p> <p>Real time information regarding all bids and offers is available to brokers and their clients</p>

	<p>through the automated trading systems and trading terminals provided by the stock exchanges. Also, the posting of bids and offers for the top 30 highest volume stocks during the day are readily available to the general public on the websites of the stock exchanges with a time lag of 50 seconds. The open price, last sale price, highest price, lowest price, and total traded volume for a particular scrip is updated on the respective websites of the stock exchanges.</p> <p>The PMEX provides a trade portal on its website which displays information about bids, offers, last executed price and last executed volume. It provides information related to each contract, namely ask price and volume, bid price and volume, last traded price, last traded volume, total volume, high and low prices, price change in terms of value as well as percentages and also indicates whether the contract is open or closed. This information is also accessible by the brokers of PMEX and their clients through the trading systems provided by PMEX.</p> <p>Deals may also be negotiated off market. Although these are not subject to pre-trade transparency, they must be reported to the stock exchange (through its negotiated deals reporting system) or NCCPL on the same day and then made available to the SECP before the market opens on the next day. The information is also made available on the exchange's terminals indicating the volume price and member's code for the transaction. Deals would be made directly between the buyer and seller off market and settled directly between them. There are no cases in which brokers or others operate alternative trading systems on which actual deals can be made.</p> <p>There is a derogation from transparency in Rule 8.7 (and its mirror 8B.11 for bonds trading) of the stock exchange regulations, which allows for an order on the automated trading system to specify the total volume while specifying a lesser amount to be disclosed to the market. The rules permit the use of undisclosed volumes at the discretion of the person making the order. The rules make this clear. The exchange will be advised of the total volume and the undisclosed volume when the order is entered. The disclosed volumes of orders participate in the queue priority whereas the undisclosed volumes only do so as they become disclosed.</p> <p>Iceberg orders are commonly allowed internationally, as contributing to stability, preventing unnecessary price swings from large orders and as simply facilitating what could be achieved through multiple smaller orders. Either the SECP or the relevant exchange can access sufficient information to assess the need for derogation and could, if it considered necessary, prescribe alternatives.</p>
Assessment	Fully Implemented
Comments	While there is no legislative authority for transparency, this could be invoked if needed. The system functions effectively to provide transparency, both pre-trade and post-trade. The provision for undisclosed volumes represents a derogation from transparency, but one that is common internationally and for which the justification is widely accepted.
<b>Principle 36.</b> Regulation should be designed to detect and deter manipulation and other unfair trading practices.	
Description	<p>The Ordinance 1969 prohibits fraudulent or deceptive conduct and market abuses. Other provisions such as the Rules 1971, the Broker Rules 2001 (including the Code of Conduct annexed as a 3rd Schedule), Chapter III of the PMEX General Regulations, the Commodity Exchange Rules 2005 and the KSE regulations on proprietary trading reinforce the prohibitions.</p> <p>While penalties are prescribed for some particular breaches of the Ordinance 1969, there is also a catch-all provision. Penalties are imposed under s.22 for willful breach of the Ordinance 1969 or any rules or regulations made under it. The maximum penalty is 50 million rupees (approx. US\$ 500,000) or 200,000 rupees (approx. US\$ 2,000) per day for</p>

	<p>continuing offences. There are in addition civil liabilities, set out in s.23.</p> <p>A broker's registration on a stock exchange can also be suspended under Rule 8 of the Broker Rules 2001 and a fine of 100,000 rupees (approx. US\$ 1,000) imposed in various situations. These include where it fails to comply with the Ordinance 1969, the rules and regulations of the stock exchange, the Code of Conduct or SECP directives and where it fails to provide information the SECP requires; fails to submit returns; provides wrong information; fails to cooperate in a SECP enquiry or inspection; or manipulates price rigging or cornering activities. Under Rule 9, the broker's registration can be cancelled during suspension where it fails to remedy the position and also where it engages in insider trading, has been found guilty of fraud, or is convicted of a criminal offence.</p> <p><b>The prohibitions</b></p> <p><i>Market or price manipulation</i> would amount to a breach of s.17 or s.18A of the Ordinance 1969. S.17 prohibits a range of actions including employing a scheme calculated to operate as a fraud or deceit on any person, inducing a person by deceit to act in a way he would not otherwise have done and acting in a way which operates as a manipulation on any person, in particular through making a fictitious quotation, creating a misleading appearance of active trading or a price rise or fall, effecting a transaction which does not change beneficial ownership and entering into cross-trades. S.18A prohibits making fictitious or multiple applications for shares in a public offering.</p> <p>For breaches of s.17, s.24 states that penalties are a maximum of 3 years in prison and/or 500,000 rupees (approx. US\$ 5,000). The financial penalty under s.17 is clearly inadequate.</p> <p><i>Providing misleading information</i> is a breach of s.17, which prohibits making statements as a fact which the offender does not believe to be true or omitting to state a material fact known or believed where the offender has the purpose of turning the sale or purchase of any security to their advantage. The penalties are as described above.</p> <p><i>Insider trading</i> is a breach of s.15A, with a maximum penalty under s.15E of 10 million rupees (approx. US\$ 100,000) or three times the gain made or loss avoided by the offender or the loss suffered by another, whichever is higher. In addition, the offender can be required to surrender the amount of the gain made or loss avoided or to pay any victim the amount they lost; can be removed from their offices with any listed company and debarred from auditing a listed company for up to three years; or where the offender is a broker or agent, can have their registration cancelled. Insiders can also be subject to a fine of up to 30 million rupees (approx. US\$300,000).</p> <p>Rule 7.6.1 of the KSE's Rules (on proprietary trading) also forbids insider trading. If there is a breach, the KSE may direct the offender to pay a penalty of up to a maximum of 100,000 rupees (\$1,000) per contravention and suspend their registration for a period determined by the KSE from time to time.</p> <p><i>Front running</i> can fall under several prohibitions. The Ordinance 1969 prohibits engaging in an act which operates or is intended to operate as a fraud or deceit. Front running may also amount to insider trading and so be caught by ss.15A-E because the broker is transacting a deal using insider information. This is the provision the SECP relies on when pursuing front running. Front running would also amount to a breach of the Code of Conduct.</p> <p>Rule 7.2.2 of the KSE's Rules (on proprietary trading) provides that a broker shall not engage in a proprietary account transaction:</p> <ul style="list-style-type: none"> <li>• if there is an "at best" order from his client, except where there is a prior "at best" order from the client and the broker discloses this to his client; or</li> <li>• if there is a limit order from his client, at a better price.</li> </ul> <p><b>The mechanisms to detect and deter misconduct</b></p> <p>One crucial mechanism is the SECP's system of electronic surveillance, which it uses to</p>
--	--

	<p>assess data obtained daily from the stock exchanges. Trading activity on PMEX is monitored electronically by PMEX which provides reports to the SECP.</p> <p>Under s.20(4)(k) of the SECP Act, the SECP has the power necessary to call for information from and undertake inspections and conduct inquiries and audits of stock exchanges, intermediaries and SROs. S.20(7) allows the SECP, for the purposes of a proceeding or enquiry, to require anyone to produce books or accounts or other documents and to furnish information and documents in their possession. Under s.21 of the Ordinance 1969 it may conduct inquiries.</p> <p>All the exchanges have obligations to report to the SCEP. The reports it currently receives are limited in scope, but the SECP is taking steps to impose greater surveillance over misconduct and to cooperate more closely with the exchanges in doing so. Non-electronic monitoring of market participants' conduct falls primarily to the exchanges, which monitor their respective brokers' conduct.</p> <p>Knowing that there is effective monitoring of conduct on markets, that breaches are likely to be detected, and that significant penalties are likely to be imposed is a crucial part of deterrence.</p> <p>For the four years 2010-2014, the SECP identified 335 breaches by brokers, of which 9 were initially identified by complaints, 242 by the SECP's surveillance activities and 84 by compliance and enforcement activities. They resulted in 165 warning letters and 170 orders. Of 3,300 cases dealt with by KSE's market surveillance department over that period, 2,677 were closed at enquiry level, in 551 warnings or advice was issued, in 31 penalties were imposed and in 41 the cases were referred to the SECP.</p> <p>Generally, cases are dealt with by the exchanges or the SECP, although from 2009 to 15 May 2014, the SECP filed complaints against 6 broker before the Session Courts. Given the difficulty and delays in bringing cases to finality, the SECP has preferred to rely largely on administrative sanctions.</p> <p>The following are details of enforcement actions taken by the SECP's Market Surveillance Wing from 2012 to 19 January 2015. Discounting those resolved by warning letter or orders (including one prohibitory order for price manipulation), 46 resulted in penalties:</p> <ul style="list-style-type: none"> <li>• 1 case of misstatement/failure to provide information to SECP, incurring a penalty of 50,000 rupees.</li> <li>• 1 case of non-cooperation and non-provision of information, incurring a penalty of 300,000 rupees.</li> <li>• 1 case of non-maintenance of AOF, incurring a penalty of 500,000 rupees.</li> <li>• 1 case of non-filing of annual accounts, incurring a penalty of 50,000 rupees.</li> <li>• 1 case of non-compliance with SECP, incurring a penalty of 50,000 rupees.</li> <li>• 11 cases of insider trading/front running, incurring penalties of 51,378 to 5,333,257 rupees.</li> <li>• 12 cases of insider trading, incurring penalties from 200,000 to 11,798,370 rupees.</li> <li>• 4 cases of wash trades incurring penalties of 10,000 to 100,000 rupees.</li> <li>• 4 cases of blank sales, incurring penalties of 25,000 to 100,000 rupees.</li> <li>• 2 cases of price ramping, each incurring a penalty of 200,000 rupees</li> <li>• 1 case of violating the Code of Conduct and s.22 – proprietary and group trading, incurring a penalty of 500,000.</li> <li>• 5 cases of violating the listing regulations, incurring penalties of 25,000 to 1m rupees.</li> <li>• 2 cases of failing to provide fair business to clients, incurring penalties of 1m and 50m rupees respectively.</li> </ul> <p>It is not clear how many of those penalties have been paid and how many cases are still subject to appeal or further actions.</p>
--	--

	<p>Details of the SECP's insider trading and insider trading/front running enforcement actions from 2012 to 19 January 2015 showed 35 cases all resulting in orders, of which 12 received warnings and 23 penalties (as described above). 12 of the penalties were 1m rupees or more, of which 5 were more than 3m rupees. In 9 cases, the order was challenged. In 2, the order has been set aside. In 2 more, the matter is pending in court, in 2 the matter is to be fixed for hearing, in 2 an order is awaited after a hearing at the appellate bench and in the 9th case the order has been challenged in court.</p> <p>Other mechanisms to deter or minimise misconduct include the exchanges' listing requirements, position limits, margin requirements and order handling rules. The exchanges' rules and regulations provide for circuit breakers. They cover the opening, closing, daily and final settlement price mechanisms for the stock exchanges, while pricing mechanisms on the PMEX are covered under the contract specifications approved by the SECP under the Commodity Exchange Rules 2005. There are arrangements covering quotation display.</p> <p>Given the relatively small size of the ISE and KSE and the fees that would be involved, the possibilities for cross-market trading are limited. Since the SECP obtains trading data from all three stock exchanges through its surveillance software, any cross market trading abuses can be monitored.</p> <p>The SECP, as a signatory to the IOSCO MMoU on enforcement and cooperation, cooperates with foreign regulatory and enforcement authorities through it. The SECP has further entered into bilateral MoUs and cooperative arrangements with many jurisdictions relating to sharing of information on cross border enforcement issues. For example, it recently signed an MoU with European Union authorities on mutual assistance in the supervision and oversight of managers of alternative investment funds, their delegates, and depositaries that operate on a cross border basis.</p> <p><b>Following up on possible misconduct</b></p> <p>Where exchanges detect possible misconduct, they may take direct action against the broker and may also refer cases to the SECP for appropriate action.</p> <p>If there are suspicious transactions or patterns of trading, SECP can initiate an enquiry under s.21 of the Ordinance 1969, and investigations under s.29 of the SECP Act.</p> <p>Where analysis of information reveals possible non-compliance or market abuse, the officers of SECP compile reports recommending appropriate actions. The reports are shared with the head of the SECP's surveillance department/wing (HOD), who can:</p> <ul style="list-style-type: none"> <li>• Recommend the dealing office to directly initiate proceedings on the basis of the available information and record. Subsequently, the HOD will take enforcement action on the basis of established violations of the regulatory framework.</li> <li>• Authorise initiation of a formal enquiry.</li> </ul> <p>Once the grounds are established through a final investigation report, the HOD issues show cause and hearing notices. Orders are passed based on the contents of the written response and the submissions made by the respondent during the course of the hearing. In order to file a criminal suit, the recommendation by the inquiry officer is submitted to the Commission, which has the power to initiate criminal proceedings in court.</p>
Assessment	Broadly Implemented
Comments	<p>The law prohibits all the forms of market misconduct identified in this Principle.</p> <p>The Ordinance 1969 provides for penalties for particular offences that are in some cases inadequate. While the catch-all s.22 of the Ordinance 1969 to some extent closes this gap, providing for penalties of 50 million rupees (approx. US\$ 500,000), it does not provide for prison terms. For insider trading, the available penalties should include imprisonment. Although the available penalties for insider trading do not currently include imprisonment,</p>

	<p>s.159 of the draft Securities Bill, currently awaiting the approval of Parliament, provides for imprisonment in the case of insider trading.</p> <p>Given the lack of actions resulting in prison sentences, the possibility of delaying the enforcement of penalties and the large potential profits from market misconduct, it would be appropriate to consider reviewing the penalties to see whether they are still adequate. It might be that, without changing the penalties, the Commission could exercise its power to impose higher penalties.</p> <p>It would be appropriate to review other penalties as well, to ensure they remain internally consistent and appropriate. A Corporate Law Review Commission is looking into this, but that is a wide-ranging review of penalties it will take some time to be completed.</p> <p>There are weaknesses in the monitoring of the conduct of market intermediaries participating in the market place. The SECP and exchanges are working together to strengthen such monitoring.</p>
<p><b>Principle 37.</b> Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.</p>	
<p>Description</p>	<p>There are mechanisms intended to continuously monitor and evaluate the risk of large open positions or credit exposures.</p> <p>Pakistan relies firstly on prohibitions and on limits designed to reduce the possibility of excessive exposures, which are automatically applied electronically to prevent exposures outside the limits. The SECP considers this system operates effectively to reduce the risks of excessive exposures.</p> <p>Rule 3(b) of the Rules 1971 requires brokers who are members of a stock exchange to maintain a minimum net capital balance (NCB). It is fixed by reference to turnover on the cash counter in the previous year and can range from 0.75 to 2.5 million rupees (approx.US\$ 7,500 – US\$ 25,000). Brokers must submit biannually a certificate (certified by an auditor) of the NCB and confirm weekly that they have maintained it.</p> <p>Schedule 2 and r.2.2 of the RMR set the total exposure and leverage position that a member may take in all stock markets at 25 times the NCB (that is, 18.75 million to 62.5 million rupees or approx. US\$ 187,500 to US\$ 625,000). Separate exposure limits linked to the NCB are prescribed for each market segment. Position limits have also been imposed, market-wide, member-wide and client-wide, under the RMR.</p> <p>The RMR impose various margin requirements, including concentration margins, payable by broker in the Cash Settled Futures Market and the Deliverable Futures Contracts Market. Additionally, slab based liquidity margins have been specified for the ready market, payable by members once their exposure limit in the ready market reaches certain thresholds.</p> <p>Regulation 8 of the RMR prescribes that all position limits shall be monitored by the stock exchanges through a preventive automated mechanism, whereby trading activity beyond the prescribed limits will not be allowed. The system applies all monitoring requirements and mark to market collection requirements and displays the value of collateral deposited by a broker after applying applicable haircuts.</p> <p>The PMEX General Regulations, Regulation 6.8 provide that an order shall be subject to validation of position limits. Chapter 8 requires initial margins to be paid to the clearing house against each client’s open position and the broker’s own open position. Margin accounts are then marked to market daily, so that variation margin may be required. There is provision for PMEX to call for additional margin. Chapter 13 allows PMEX to specify the clearing limits of open positions, based on the deposit a broker has made to the Settlement Guarantee Fund. PMEX may also impose special margins under the circular on risk management for short durations to limit increased volatility. PMEX has an electronic system which automatically restricts trades beyond the exposure threshold.</p>

Since all off-market trades must be promptly reported and that information is made available to the SECP daily, the SECP can also monitor exposures incurred off-market.

There is potential for market participants acting as firm commitment underwriters to incur exposures which would not be detected or prevented by the system and would not show up in a firm's financial reporting until the settlement date for the new issue. The existing regulatory framework, and in particular the BTU Rules 2001 do not prescribe any restriction on exposure taken by underwriters pursuant to the underwriting, although the prudential regulations of SBP prescribe such restrictions for those they regulate. Proposed new rules for underwriters will address this issue. They will require underwriters to ascertain, before entering into an underwriting agreement, that the regulatory requirements relating to the exposure limits on investment in securities are not breached. The proposed new rules will restrict the quantum of the underwriting to a maximum of five times the equity of the underwriter.

#### **Information on size and beneficial ownership of holdings**

Such information is available in a number of ways. Under s.222 of the Ordinance 84, the beneficial owner of more than 10% of the shares in a listed company must provide details to the SECP, which maintains a database of such beneficial owners and monitors their trading activities through an automated system.

Where, during its monitoring of the stock exchanges, the SECP observes that a particular person or group seems to be taking excessive exposure in the market, it can get information about their holding from CDC and broker to confirm the amount of exposure taken. Generally, information about positions taken by broker and their clients in the market is readily available to the exchanges through their automated trading systems. Similar arrangements allow the SECP to obtain similar information from PMEX and its broker

Each issuer is also required to file a list of beneficial owners with the CDC under the CDC Rules 1996. The SECP has the power to solicit any information from the CDC, including such a list of beneficial owners, and if required compare the same with the exposure taken by each beneficial owner, based on information available through its surveillance software. However, there have been cases, as elsewhere, where the SECP has ultimately been unable to extract the information it seeks from the apparent owner. This is discussed, with a recommendation, in Principle 17.

#### **Power if information required is not provided by a broker**

If a broker does not file its NCB certificate when due, there are automatic reductions in the permissible exposure of the broker, together with penalties on the broker.

Under Section 6 of the Ordinance 1969 brokers must provide such information relating to their business on the exchange as the SECP may require. For non-compliance, brokers are subject to prohibitory orders and penalties under s.20 and 22 of the Ordinance 1969 respectively.

Additional margins can be imposed under the NCCPL Regulations and the market conduct regulations of the stock exchanges on the instructions of the SECP. Although powers under the SECP Act and the Ordinance 1969 can be used by the SECP to compel market participants to reduce their exposure, this would be rare because the automatic barrier would generally mean such intervention is not needed. Generally the stock exchanges under their relevant regulations would take this step, so the SECP would not need to exercise its power

The SECP can suspend a brokerage license under Rule 8 of the Broker Rules 2001.

If a broker fails to deposit margins or mark to market losses or is otherwise non-compliant, the stock exchange under r.9.5 of the RMR can take action against the broker under the Broker' Default Management Regulations of the Exchange and the relevant NCCPL Regulations. For example, Chapter 20 of the KSE General Regulations provides for KSE to direct that any breach be remedied, suspend or forfeit the broker's certificate, and restrict suspend or terminate the broker's access.

PMEX under its circular on Risk Management may impose administrative fines; ask broker/clients to close out; or reduce positions in case of any contravention.

Under s.20 of the Ordinance 1969, SECP can give directions to a broker where that broker has or is about to contravene the Ordinance or any rules made under it.

#### **Sharing information with other regulators and markets**

The SECP has wide-ranging power under ss.35(6), (7) and (8) of the SECP Act to disclose information to domestic entities, namely its Board, the Government, a Government agency, a stock exchange, a clearing house, a central depository or such other body corporate as the FG may specify. It is working on improving the current informal arrangements to share information with the exchanges and strengthening links with the exchanges, but considers those arrangements are working efficiently. It has no formal MOU with the exchanges for such information-sharing and does not consider one is necessary, since it has the ability to get the information it needs from the exchanges and to share the information it wishes to share.

Arrangements among exchanges are less clear. The format of the NCB Certificate filed biannually with each stock exchange requires a broker to disclose the broker's NCB. So each stock exchange is aware of the maximum amount of exposure that a broker may have taken on the other stock exchanges. However, there is no formal or informal arrangement between the exchanges to share information on large exposures of common market participants with each other.

The NCCPL to some extent fills this role. It has information regarding exposure of all market participants in the three stock exchanges and can monitor large exposure positions of common market participants. At present NCCPL is doing so only to the extent of shifting obligations of collection of margins from the institutions through the institutional delivery system, and for inter-exchange trades through its Broker to Broker model, once the trade is affirmed by the initiating institution/broker. The NCCPL also shares information with CDC.

The SECP considers that the sharing with NCCPL appears sufficient at this stage, although it would be better if an arrangement could be developed to allow for greater sharing of information on a more regular basis, and in particular arranging for the exchanges to formally share information on large exposures, so they could analyse them for risk management purposes. The dominant position of the KSE has meant that arrangements for such sharing of information are not seen as a priority.

In relation to sharing of information on related products, the stock exchanges have not developed any formal or informal arrangements. However, the risk management regime and new and existing product models are continuously reviewed by both the SECP and the stock exchanges in collaboration with each other, and as part of this process they share any information regarding unusual exposures, adequacy of margins, or any unusual market situations. To date, it does not appear that there is any need for more.

The SECP has wide-ranging power under ss.35(6), (7) and (8) of the SECP Act to disclose public and non-public information within its possession to foreign governments and their agencies. Accordingly, any such information may be shared with foreign jurisdictions in accordance with the power granted to SECP under the SECP Act.

The stock exchanges have signed MoUs to enter into arrangements of mutual cooperation and information sharing with stock exchanges of various other jurisdictions. Further, the SECP is a full signatory to the IOSCO MMoU and shares and receives information concerning assistance in enforcement from various foreign counterparts. Apart from the MMoU, the SECP has also entered into similar bilateral agreements with its counterpart organizations in other countries.

#### **Default procedures**

A comprehensive set of default management procedures have been developed by the



relevant exchanges and the clearing company NCCPL and incorporated as part of their respective regulations. The relevant regulations are readily available to the general public.

Regulation 21 of the Default Management Regulations of the stock exchanges, Chapter 14 of the PMEX General Regulations and Chapter 13 of the NCCPL Regulations are the relevant provisions. They set out in detail when action may be taken, by whom and what will be done. The procedures allow for the defaulter's position to be isolated, for him to be denied access to the exchange and the NCCPL, for the defaulter's unsettled and open positions to be closed out and squared-up, for the application of various funds such as his margins to meet claims against him and for access to the relevant guarantee funds where needed to meet claims against him.

All orders entered into the trading system are mapped to the UIN of each broker/client, making it relatively easy to distinguish clients' orders from proprietary transactions and isolate a failing firm. The UIN database is maintained at the NCCPL and the SECP also has access to it. Margins and other cash deposited by the broker with the exchange will also be segregated for respective clients, using their UINs. It will be applied towards margin requirements and mark to market losses against trades or transactions of that client. Margins deposited in the form of securities are marked directly from the client's sub-account maintained under the participant umbrella of the broker.

If a broker defaults, the securities and cash deposited by the client as margin can only be used by the exchange to the extent of margin requirement against the client's trades and transactions and relevant mark to market losses on a UIN basis.

There exists no formal mechanism or forum where the exchanges for related products can consult with each other in order to minimize the adverse effects of defaults or other market disruptions. However, based on past practice, the stock exchanges have been known to informally pursue similar market practices where necessary. Generally, there are few cross-listings and the situation rarely arises.

#### **Short-selling on the equity market**

Short-selling is subject to appropriate controls, aiming to reduce potential risks to stability and efficiency.

All three stock exchanges have in place regulations for short selling under the ready market, which detail the framework and conditions for short selling. With some exceptions, short selling is only permitted on an uptick or a "zero plus tick" (no difference from the previous price, which was an uptick). "Blank sales", where the seller neither owns the shares nor has a contract to borrow them and the sale is (broadly) not the squaring up of an earlier purchase, are prohibited. Short sales are only allowed in such securities as are prescribed by the exchange from time to time. And the shares must be delivered on the day of settlement.

The regulations also require that short sale orders should be declared as short sale at the time of placement of the order by placing them in a separate window available in the trading systems of the exchanges. If short sale orders are placed through normal ready market windows, they are treated as blank sales, and appropriate action is taken against the broker under the Short Selling Regulations and the laws administered by the SECP.

The rule allows short sales with a pre-existing interest, which are essentially covered short sales. These sales are allowed because they are considered unlikely to result in any delivery default as blank short sales might do.

For settlement of failed trades the normal default management procedures under the NCCPL Regulations and/or the default management regulations of the stock exchanges would apply. For any delivery default, the schedule of charges to the NCCPL Regulations provides for a penalty of 0.5% of the delivery default value of each scrip, with a minimum penalty of 2,000 rupees. For money default, the NCCPL imposes money default charges. The NCCPL monitors settlement failures.

The surveillance wings of the three stock exchanges and the SECP monitor the trading

	<p>activities of the brokers and take enforcement actions in case of non-compliance. The SECP also obtains trading data from all three stock exchanges on a daily basis and analyses that data to check for any non-compliance with the short selling regulations. Although the surveillance system does not generate alerts for short-selling as such, the system does allow for the generation of reports, on the basis of which further information is sought from the CDC.</p> <p>The short-selling regulations are contained in the exchanges' rules, which allow exceptions. For example, under r.3 of the KSE Regulations for Short Selling under Ready Market 2002, three exceptions are made to the Uptick or Zero-Plus Tick rule:</p> <ul style="list-style-type: none"> <li>• UIN-Wide Position: Anyone will be allowed to make a short sale (using his own UIN) to the maximum extent of 2% of average daily turnover of the respective security for the previous one month.</li> <li>• Member-Wide Position: A member will be allowed to make short sales for all his UINs (including Clients' Positions) to the maximum extent of 4% of average daily turnover of the respective security for the previous one month.</li> <li>• Market-Wide Position: All members on a cumulative basis will be allowed to make short sales to the maximum extent of 40% of average daily turnover of the respective security of previous one month.</li> </ul> <p>The three exceptions are designed to improve liquidity and price discovery by allowing a certain amount of short-selling with a downward tick, but not enough to disrupt the market. To ensure they will not be available in the case of a declining market and there is no misuse of these exceptions, regulation 3(d) provides that they will not be available:</p> <ul style="list-style-type: none"> <li>• during a day when the price of the security has declined by 2.5% that day;</li> <li>• for the next 2 working days when a lower circuit breaker applies on the closing price of a security; and</li> <li>• for the next 15 working days after a lower circuit breaker applies on the closing price of a security for 5 consecutive days.</li> </ul> <p>Where a person is performing a market-making activity, he is required to register a separate UIN and allocate separate client codes, open a separate account with the CDC and ensure that none of his authorised agents or traders for market-making activities indulge in normal trading activities during the designated market making period. Market makers notify their trading activities to the exchange at the end of each trading day through an automated interface. They are not required to declare orders and quotes for short selling through the usual window when they place such orders.</p>
Assessment	Broadly Implemented
Comments	<p>Regulation aims to ensure the proper management of large exposures through a series of limits. An automated mechanism prevents trading activity beyond the prescribed limits. The exchanges and the SECP have adequate access to information to be able to monitor exposure levels, and adequate power to demand more information where needed and to intervene where necessary.</p> <p>There is a potential gap in the regime in that market participants acting as firm commitment underwriters could incur exposures which would not be detected or prevented by the system and would not show up in a firm's financial reporting until the settlement date for the new issue. Proposed new rules for underwriters will address this issue. They will require underwriters to ascertain, before entering into an underwriting agreement, that the regulatory requirements relating to the exposure limits on investment in securities are not breached. The proposed new rules will restrict the quantum of the underwriting to a maximum of five times the equity of the underwriter.</p> <p>While the SECP has adequate arrangements to share information with exchanges, there are no formal arrangements for information sharing among the exchanges in order to better</p>

	<p>manage risk. It would be desirable to address this and strengthen such information-sharing, both in regard to the monitoring of large exposures and in order to minimise the effects of a market disruption.</p> <p>The exchanges have appropriate and publicly available arrangements to deal with default risk and isolate the problems of a failing firm.</p> <p>The practice of short selling is subject to adequate controls, designed to minimise risks to stability.</p>
<b>Principles Relating to Clearing and Settlement</b>	
<b>Principle 38.</b> Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.	
Description	
Assessment	Not assessed
Comments	