Pakistan Institute of Corporate Governance

PICG ADVISORY UPDATE 14

AUGUST 2018

GOVERNANCE, COMPLIANCE

& CORPORATE REPORTING

The Update

Corporate governance refers to the way in which corporations are directed, administered, and controlled. It is concerned with both the relationship between internal and external stakeholders as well as the governance processes designed to help a corporation achieve its goals. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies as well as striking a balance between both economic and social goals and between individual and communal goals.

Compliance with applicable laws and regulations is fundamental to good governance. PICG's Advisory Update, therefore, aims at keeping our members updated with regards to the latest local and international governance-related changes to regulations, practices and corporate reporting.

The Update consists of a Summary Table (with links to relevant information) followed by a Synopsis of the changes.

A. Summary Table

Pakistan

Sr #	Issued by	Reference	Date (2018)	Topic / Update link
1.	**Regulations/ Rules issued**			
i	SECP	SRO 992(I)/2018	Aug 8, 2018	Draft General Takaful Accounting Regulations, 2018
2.	**Circulars**			
i	SECP	Circular No. 16 of 2018	Aug 29, 2018	Register of Ultimate Beneficial Ownership by Companies
3.	**Amendments**			
i	SECP	SRO995(1)/2018	Aug 10, 2018	Amendments to Real Estate Investment Trust (REIT) Regulations, 2015
4.	**Others**			
i	SBP	BPRD Circular No. 06 of 2018	Aug 06, 2018	Governance Framework for Bank's Overseas Operations
ii	SBP	____	Aug 29, 2018	IFC and SBP Join Forces to Boost Green Banking in Pakistan

International

Detail	Links
OECD's review of labour market trends and prospects in OECD countries	OECD Employment Outlook 2018
Singapore releases new Code of Corporate Governance	Code of Corporate Governance- Singapore
IFC/ World Bank Report on the drivers of productivity and competitiveness in the Arab world.	The Arab World Competitiveness Report 2018

B. Synopsis of changes

Pakistan

1. Regulations/ Rules issued

Various Regulations/ Rules have been notified by the Securities and Exchange Commission of Pakistan and State Bank of Pakistan to streamline procedures and improve governance structures of companies in Pakistan.

Following is a summary of such Regulations / Rules (both drafts issued for public comments and final versions) issued during the past couple of months as notifications, circulars, drafts, etc., which have been placed on their respective websites:

Draft regulations issued

Sr. no	Name of Regulations / Rules	Public comment deadline	Description
1	Draft General Takaful Accounting Regulations, 2018	Sept 7, 2018 (within 30 days)	The draft regulations provide: i. principles on which accounting and reporting of general takaful business of general takaful operators and window general takaful operators shall be made ii. the formats for reporting of financial statements and regulatory returns of general takaful/window takaful operators. The aim is to standardize the accounting treatments and presentation of financial results by general takaful/window takaful operators and bring in more transparency and enhanced disclosures. The draft proposes these regulations to come into force for accounting periods commencing on or after January 1st, 2019.

2. Circulars

a. Maintenance of Register of Ultimate Beneficial Ownership by Companies

The Financial Action Task Force (FATF), an independent inter-governmental body, has issued international standards containing recommendations to combat money laundering and the financing of terrorism and proliferation.' The FATF recommendations require countries to take measures to prevent the misuse of legal persons for money laundering and terrorist financing, and ensure that there is adequate, accurate and up-to-date information available with the companies on the ultimate (actual) beneficial ownership and control of legal persons that can be accessed in a timely manner by competent authorities. Pakistan is a member of the Asia/Pacific Group on Money Laundering (APG) - a FATF Styled Regional Body (FSRB) and is required to adopt FATF standards as per membership obligations, and also to comply with the UN resolutions.

In order to ensure compliance with FAFT recommendations, SECP has issued a circular directing all companies to ensure that they obtain 'ultimate beneficial ownership' information from their members, and maintain and update this information in a register of beneficial ownership as required under Section 453 of the Companies Act, 2017. (Section 453 requires every officer of a company to endeavor to prevent commission of any fraud, offences of money laundering including predicated offences as provided in the Anti-Money Laundering Act, 2010 with respect to affairs of the company).

All the companies having legal persons as their members/shareholders must obtain and maintain information relating to their ultimate beneficial owners, (i.e. natural persons who ultimately own or control the company) irrespective of the number of levels of ownership pattern, until the natural person exercising ultimate ownership or control and lying at the end of the ownership chain, is revealed. The circular also provides the minimum fields of information required to be reported. In case no natural persons are identified after having exhausted all possible means, or there is any doubt that the persons identified are the beneficial owners, the names of the natural person(s) who hold the position of senior managing official(s) of the company shall be entered in the register of beneficial ownership. Companies shall also provide this information to any other authority or agency of the Government pursuant to the powers to call for information entrusted by law to such authority or agency.

Failure to comply with the requirements of this circular is subject to penal action as provided under sub-section (2) of section 510 of the Companies Act, 2017.

3. Amendments

a. Draft Amendments to Real Estate Investment Trust (REIT) Regulations, 2015

The regulatory framework for Real Estate Investment Trusts (REITs) was introduced in 2008, and the revised in 2010 and 2015, whereby some of the requirements such as capital of the REIT Management Company (RMC), size of REIT scheme and units to be held by a single investor, were relaxed to encourage launch of REIT schemes. In spite of these improvements, only one REIT scheme was launched mainly because the requirements for setting up a REIT scheme were considered stringent by the industry.

Hence, to promote investment in real estate through the capital market SECP has recommended changes to the regulatory regime for real estate investment trusts and proposed new amendments on the basis of feedback and suggestions received from all the stakeholders, including RMCs, Mutual Funds Association of Pakistan, Central Depository Company, lawyers and vaulers.

The amendments envisage greater autonomy for the RMCs, enriched role of trustees, segregation of documentary requirements for developmental and rental REITs, permission to borrow against REIT assets, acquisition of commercially viable properties and permission to raise funds from investors before acquisition of property. A regulatory framework has also been provided for disclosure of 'value of target property' and 'basis of management fee' to be charged to a REIT scheme. An RMC will have to refund money to IPO investors if property is not acquired within the specified time.

4. Others

a. Governance Framework for Banks' Overseas Operations

The State Bank of Pakistan (SBP) has developed a 'Governance Framework' for banks' overseas operations in order to keep up with changing dynamics of the foreign environment under which banks operate and to further strengthen governance, risk management & compliance practices for overseas operations. The framework is aimed at strengthening a banks' capacity to understand, identify and manage various risks posed by its foreign operations.

Banks are advised to ensure strict compliance of the Framework in letter and spirit and within given timelines:

Timeline	Activity
Within 3 months	• Formulate a jurisdiction-wise board approved strategic plan with well-defined and measureable deliverables. • Implementation of strategy and achievement of deliverables shall be monitored periodically at senior management and board level.
Within six months	• Develop a comprehensive risk governance framework for its overseas operations • Maintain a separate system based log/inventory of observations related to its overseas operations • Develop related policy and procedural manuals • Identify themes from the log/inventory of observations and conduct comprehensive theme based assessments to identify gaps and take necessary corrective actions.
Within 3 months	• Develop a mechanism for the board to oversee and regularly evaluate financial and operational performance of its overseas subsidiary/sub-subsidiary/joint venture operations and that of overall overseas branch operations; and of each jurisdiction (branches & offices), associates and other undertakings against approved strategic & annual business plans. • Conduct a thorough variance analysis for subsidiaries/JVs and/or branches/jurisdictions. • Provide strategic guidance on expansion or reduction of operations in any jurisdiction and ensure that such overseas operations are in line with bank's overall business model & strategic plan.

b. IFC and State Bank of Pakistan Join Forces to Boost Green Banking in Pakistan

International Finance Corporation (IFC), a member of the World Bank Group, and SBP have signed an advisory agreement to support green banking in Pakistan as part of IFC's commitment to helping countries transition to green, low carbon, sustainable economies. IFC's advisory services team will assist the SBP and Pakistan's banking sector in improving their environmental risk management practices, and ensuring ethical lending practices. SBP has already taken an initial step towards this with the issue of its 'Green Banking Guidelines' last October.

'Green Banking' refers to the promotion of environmentally friendly practices that aid banks and their clients in identifying and managing environmental risks as well as reducing their carbon footprint and related socially adverse actions. Under the green banking initiative, commercial banks and DFIs are being encouraged by the SBP to set up green branches and offices. The guidelines deal with 3 areas including risk management, for increasing financial stability through understanding, management and mitigation of environmental exposures of financing portfolios. Secondly, business facilitation, for fostering development of 'green' market through actively tapping the emerging viable business opportunities of financing to clean energy and resource efficiency projects and thirdly, Own Impact Reduction for potential re-engineering of banks and DFIs' internal operations and procedures with a view to reducing the impact on environment and society

The SBP is also part of the IFC-supported Sustainable Banking Network, a global community of financial sector regulatory agencies and banking associations from emerging markets committed to advancing sustainable finance in line with international best practices.

International

a. OECD Employment Outlook 2018[1]

The Organisation for Economic Co-operation and Development (OECD) has been set up to promote policies that will improve the economic and social well-being of people around the world. In this regard, as part of its regular reporting on various matters OECD has issued the latest edition of its OECD Employment Outlook report on jobs and employment in OECD countries. Each edition reviews recent trends, policy developments, and prospects.

The 2018 report focuses on specific aspects of how labour markets function and the implications for policy in order to promote more and better jobs. This year's report covers:

i. recent wage developments,
ii. drivers of the decline in the labour share,
iii. the impact of collective bargaining on labour market performance,
iv. policies to smooth the transition back into employment for workers who lost their job due to economic change,
v. causes and consequences of recent trends in unemployment benefit coverage, and
vi. an investigation of the reasons why the gender gap in labour income increases over the working life.

The report also includes a statistical annexure providing data on unemployment rates, incidence of part-time employment, employment/population ratios, and activity rates. Furthermore, it includes data on expenditure on labour market programmes, average annual wages, and earnings dispersion.

b. New Code of Corporate Governance - Singapore

The Monetary Authority of Singapore (MAS) announced the adoption of a new Code of Corporate Governance along with the new Practice Guidance. The Code will initially take effect for companies with a financial year beginning January 1, 2019, concurrent with changes to the Singapore Exchange Limited Listing Rules, however some of the starker changes will not be phased in until 2022.

In terms of corporate governance practices, the new Code has made some notable changes, including:

(i) Director Independence and Director Nomination Processes

- From January 1, 2022, independent directors will have a tenure limit of nine years. Continuation as an independent director will be subject to a two-tier vote from (i) all shareholders; and (ii) all shareholders, excluding directors, the chief executive officer, and their associates.
- From January 1, 2022, boards must be majority independent where the board chair is not independent, and the Code establishes that regardless of board chair, non-executive directors will need to comprise the majority of boards.
- Companies will be required to disclose the criteria used for selecting, appointing, and re-appointing directors to the Board, including the criteria used to identify and evaluate potential new directors.

[1] OECD (2018), *OECD Employment Outlook 2018*, OECD Publishing, Paris, https://doi.org/10.1787/empl_outlook-2018-en.

- Criteria will also include disclosure of director relationships and time commitments, including outside board directorships and other professional obligations.
- The threshold to qualify as a "substantial shareholder" will now be 5% of issued share capital, as opposed to the previous 10%.

(ii) Remuneration Matters

- Companies must disclose how the board and key management personnel's remuneration are appropriate and proportionate to a company's sustained performance and value creation, as based on a company's strategic objectives.
- Disclosure of remuneration for each director and CEO, aligned with the top 5 key management personnel in bands no wider than S$250,000, to be included in Annual reports.
- Companies need to disclose the names and remuneration of employees who are substantial shareholders of the company, or are immediate family members of a director, the CEO or a substantial shareholder, and whose remuneration exceeds S$100,000 during the year.

(iii) Audit, Risk Management, and Internal Controls

- Companies may choose to establish a separate board-level risk committee.
- Audit committees should meet independently with external and internal auditors without the presence of management at least annually.

(iv) Shareholder Rights and Engagement

- Companies should present proposals at general meetings that are not "bundled"; if any proposals are linked or interdependent, the company should disclose an explanation, including material implications, in the notice of the meeting.
- Shareholders would gain the ability to abstain from voting, provided a company's Constitution or other documents allow for such a voting option.
- Improved disclosure on board and shareholder communication, as part of policies to promote communication with shareholders.
- The development of new mechanisms to enable shareholders to contact companies with questions.
- Strengthened policies regarding engagement with stakeholder groups, including the role of corporate websites to communicate with stakeholders.

The Code also calls for the formation of a Corporate Governance Committee to promote industry-led good corporate practice. As for compliance, the Code is based on a comply-or-explain basis, with any variation from the Code requiring explicit explanations as to how the intent of their practices aligns with Code principles.

MAS also released the Practice Guidance, which forms a voluntary guide to best practices. They include:

- Encouraging companies to "go beyond their immediate circles of contacts" and to utilize their party search firms to find suitable candidates for directors on the Board.
- Companies should disclose how the skills of its directors meet the needs of the company.

- Setting values on significant or material transactions for recurring director services at S$50,000, or S$200,000 for family members or directors. Amounts beyond these values would help to determine whether or not a director is independent.
- Reviewing director time commitments, with a view toward nomination committees setting a maximum number of boards a director may serve on, especially if the other companies share the same fiscal year-end or reporting timelines.
- Recommendation that peer criteria be used in assessing director and board performance, with consistent benchmarks from year to year.
- Companies are encouraged to develop an annual remuneration report. The remuneration report would provide comprehensive disclosure of remuneration payable to directors and the top five key management personnel.
- Additional disclosure should set out the relationship between remuneration, performance and value creation, including how performance is measured and why the metrics were chosen.

c. The Arab World Competitiveness Report 2018

The Arab World Competitiveness Report 2018 was launched as part of the activities of the recent partnership between IFC and the World Economic Forum that aims to support entrepreneurs in the Arab World and promote private sector development. IFC—a sister organization of the World Bank and member of the World Bank Group—is the largest global development institution focused on the private sector in emerging markets.

The report is part of a series of studies that examine competitiveness across different regions. The UAE is ranked as the 17th most competitive country in the world as per the report. The other MENA nations to crack the top-30 globally were Qatar (25th) and Saudi Arabia (30th). The rankings are based on 12 factors, from education to infrastructure, that are critical for productivity and economic growth.

While the report cited improvements over the last decade in areas like infrastructure development and technological advancement across the region, it said many countries are struggling to diversify their economies and develop a vibrant, competitive private sector that can foster innovation and job creation. It said the region will need to generate 58 million jobs by the year 2040 to maintain unemployment rates and even more to lower them.

The aim of the Arab World Competitiveness Report is to stimulate discussions resulting in government reforms that could unlock the entrepreneurial potential of the region and its youth. The report said governments could improve the entrepreneurial ecosystem by drafting more policies that encourage risk-taking and innovation, and creating legislation that is supportive of angel investors and seed funds. Angel investment networks are also growing in a few countries in the Arab World, especially in UAE where investment in tech start-ups have jumped over the last couple of years. These networks are critically important as they provide financing, mentorship and market-access connections to entrepreneurs.

The report recommended countries diversify their economies and move away from a model of government-led growth and lessen reliance on natural resources exports. It commended countries that made significant progress in infrastructure development to enhance competitiveness.

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