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Report on the Observance of Standards and Codes (ROSC)

CORPORATE GOVERNANCE
COUNTRY ASSESSMENT
Pakistan
2018



Securities and Exchange
Commission of Pakistan





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About the Corporate Governance ROSC

What is corporate governance?

Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, board of directors, controlling shareholders, minority shareholders and other stakeholders. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

The G20 / OECD Principles of Corporate Governance provide the framework for the work of the World Bank Group in this area, identifying the key practical issues: the rights and equitable treatment of shareholders and other financial stakeholders, the role of non-financial stakeholders, disclosure and transparency, and the responsibilities of the board.

Why is corporate governance important?

For emerging market countries, improving corporate governance can serve a number of important public policy objectives. Good corporate governance reduces emerging market vulnerability to financial crises, reinforces property rights, reduces transaction costs and the cost of capital, and leads to capital market development. Weak corporate governance frameworks reduce investor confidence, and can discourage outside investment. Also, as pension funds continue to invest more in equity markets, good corporate governance is crucial for preserving retirement savings. Over the past several years, the importance of corporate governance has been highlighted by an increasing body of academic research. Studies have shown that good corporate governance practices have led to significant increases in economic value added (EVA) of firms, higher productivity, and lower risk of systemic financial failures for countries.

The Corporate Governance ROSC

Corporate governance has been adopted as one of twelve core best-practice standards by the international financial community. The World Bank is the assessor for the application of the OECD Principles of Corporate Governance. Its assessments are part of the World Bank and International Monetary Fund (IMF) program on Reports on the Observance of Standards and Codes (ROSC).

The goal of the ROSC initiative is to identify weaknesses that may contribute to a country's economic and financial vulnerability. Each Corporate Governance ROSC assessment benchmarks a country's legal and regulatory framework, practices and compliance of listed firms, and enforcement capacity vis-à-vis the OECD Principles.

- The assessments are standardized and systematic and include policy recommendations and a model country action plan. In response, many countries have initiated legal, regulatory, and institutional corporate governance reforms.
- The assessments focus on the corporate governance of companies listed on stock exchange. At the request of policymakers, the World Bank can also carry-out special policy reviews that focus on specific sectors, in particular for banks and state-owned enterprises.
- Assessments can be updated to measure progress over time.
- Country participation in the assessment process, and the publication of the final report, are voluntary.

By the end of December 2017, 86 assessments had been completed or were underway in 58 countries around the world.

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The assessment reflects detailed technical discussions with the SECP, the Ministry of Finance, the Pakistan Stock Exchange, the Pakistan Institute of Corporate Governance, the Institute of Chartered Accountants of Pakistan, and representatives of companies, banks, and market participants. Several rounds of reviews and discussions were held with SECP team led by its International Relations Department and supported by the Corporate Supervision Department and Corporatization and Compliance Department. The SECP team have given the report (and the Detailed Country Assessment) one of the most careful and detailed reviews that the ROSC program has received. As a result, the quality of the report has greatly improved.

The report also benefited from the comments of peer reviewers: Sunita Kikeri (Lead Financial Sector Specialist), Qurat ul Ain Hadi (Financial Management Specialist), and Mohsin Ali Chaudhry (Corporate Governance Officer, IFC).

Acronyms

AGM: Annual General Meeting
AMC: Asset Management Company
AOB: Audit Oversight Board
AUM: Assets under management
CEO: Chief Executive Officer
CFO: Chief Financial Officer
CA: Companies Act 2017
CLD: Company Law Division of the SECP
CSD: Corporate Supervision Department of the SECP
CSR: Corporate Social Responsibility
DCA: Detailed Country Assessment
EGM: Extraordinary General Meeting
GDP: Gross Domestic Product
IFRS: International Financial Reporting Standards
IOSCO: International Organization of Securities Commissions
ISA: International Standards on Auditing
LCR: Listed Companies (Code of Corporate Governance) Regulations, 2017
MOF: The Ministry of Economy and Finance of Pakistan
OECD: Organization for Economic Cooperation and Development
PSC: Public Sector Company
QAB: Quality Assurance Board
QCR: Quality Control Review
ROSC: (Corporate Governance) Report on Standards and Codes
RPT: Related Party Transaction
SBP: State Bank of Pakistan
SECP: Securities and Exchange Commission Pakistan
SRO: Self-Regulatory Organization

Executive Summary

This report assesses Pakistan's corporate governance policy framework. It highlights recent improvements in corporate governance regulation, makes policy recommendations, and provides investors with a benchmark against which to measure corporate governance in Pakistan. The report focuses on the governance of large and listed companies, but includes a special section on the governance of public sector companies.

The report highlights that corporate governance framework for listed companies has improved in recent years as the government has enhanced the legal and policy framework, and key institutions have grown in sophistication and maturity. Much more can be done to address corporate governance in Public Sector Companies.

The findings of the ROSC are based on the Detailed Country Assessment (DCA) of the OECD Principles of Corporate Governance, which is summarized in the tables at the end of each section. According to the World Bank methodology used to assess compliance with the 72 OECD Principles, 20 Principles were fully implemented, 33 were broadly implemented, 16 principles were partially implemented, and three were not applicable. A comparison with the 2005 Corporate Governance ROSC shows the level of improvement in the corporate governance framework; in 2005 out of a total of 32 applicable principles, only 4 were fully implemented, 17 were broadly implemented, 10 were partially implemented and 1 was reported as not implemented

The report (and this summary) is organized into five sections:

- The commitment of the public and private sectors to reform
- Shareholder rights
- Disclosure and transparency
- Boards of directors
- Public sector companies

Policy recommendations are developed in detail at the end of each section, and summarized at the end of the report.

Commitment of the public and private sectors to reform

Awareness of the importance of good corporate governance is very high among policymakers and standard setters. The government took many important steps to improve the regulation of corporate governance in 2017, including the updates to the Companies Act, the issuance of the Listed Companies (Code of Corporate Governance) Regulations and updates to the Public Sector Companies (Corporate Governance) Rules 2013. The legal and regulatory framework is considered by all observers to have been an important factor in corporate governance reform in Pakistan.

The private sector has also been a strong supporter of improved governance and has supported many initiatives. Many key institutions are in place, including the Pakistan Institute of Corporate Governance. But the support of the private sector has not been universal; many companies (especially smaller companies in industrial sectors) have not appeared to accept the challenge of improving governance and see it as an unnecessary and expensive compliance exercise.

The Securities and Exchange Commission Pakistan (SECP) is the regulator of the Pakistani corporate sector and capital markets. SECP is responsible for enforcement of all aspects of securities and company law and regulation. Complaints to the SECP appear to be the first line of defense for minority shareholder rights. Because of its authority over company law, the SECP has unusually strong powers to set and enforce corporate governance regulation.

The Listed Company Regulations (LCR) issued by the SECP set detailed corporate governance requirements. Listed companies are required to include statements of compliance with the LCR in their annual reports. Responsibility for compliance with these mandatory requirements rests with the Chairman and the members of the board and the CEO. The LCR (and previously the Code issued by the PSX as part of its listing regulations) has had great impact on the adoption of good corporate governance provisions (as detailed elsewhere in the report).

Shareholder rights

Concentrated ownership (from families, multinationals, and the State) establish the key shareholder concerns for shareholders. Concentrated control limits the influence that non-controlling shareholders can have on the company, and reduces their protection from potential abuse.

Basic shareholder rights are protected, and were improved by the enactment of the Companies Act 2017. Shareholders have full rights to participate at the AGM, both in person and through proxy. Postal and electronic voting were introduced in the new Act and have begun to be introduced in practice. Concerns have been raised about the traditional prevalence of “show of hands” voting (which can be a disincentive to participation by foreign institutional investors). The ROSC also notes that specific information may be available about board candidates in some companies prior to meetings, and that the rules regarding including voting procedures that govern the AGM might not be easily available to shareholders. Interviews with foreign investors noted high levels of disclosure, but a few cases reports and meeting notices had been uploaded too slowly to be useful for foreign analysts and shareholders before shareholder meetings.

Board members are elected through cumulative voting, allowing minority shareholders to pool their votes to elect specific directors to the board. The LCR contain a provision designed to encourage minority shareholders to propose additional candidates. As in most countries, contested elections apparently remain relatively rare. LCR has a designated chapter regarding remuneration of directors. Given strong shareholder control over boards, the level of remuneration directly linked to board evaluations is yet to be implemented in full letter and spirit.

Pakistan follows an internationally accepted approach in the review and approval of related party transactions, but they remain a major corporate governance concern, as in most emerging markets. The LCR sets related party transaction approval requirements; all details must be reviewed by the audit committee, and any RPTs which are not executed at arm's length price shall also be placed separately at each board meeting. The 2017 LCR introduced a new requirement that if a majority of the directors have a conflict of interest, the matter shall be placed before the AGM for approval. In

general, the letter of the law and regulation appears to be followed in most cases. However, the market also believes that many boards are not always able to remain objective in the face of pressures from controlling shareholders, especially for those transactions which are complex or for which there is no easy basis for making “arm's length” comparisons.

The institutional strength and capacity of the SECP provide the best source of redress for shareholders. Rights of shareholders to formal shareholder action through the courts are available in theory, but have not been common in practice. Many provisions require 10 percent of shareholders to take action. A key institutional weakness has been the ability of the judicial system to enforce corporate rules. The Companies Act 2017 includes provisions for a specialized bench at the High Court to handle corporate disputes. It is widely hoped that these provisions will improve the current process.

Disclosure and Transparency

The quality and timeliness of disclosure has continued to improve over the past few years. This is in part attributed to the adoption of international accounting and auditing standards, the increasing monitoring role of ICAP and the SECP, and changes to the regulatory framework. Law and regulation require the disclosure of many of the non-financial items recommended by the OECD Principles.

Financial reporting requirements for listed companies have been strengthened and are aligned with international good practices. Differences between IFRS (as issued by the IASB) and reporting standards for listed companies in Pakistan are small but significant. Full compliance cannot be claimed because of several exemptions and deferrals, mainly in the banking sector. Updates to several standards are under consideration. Listed companies largely comply with financial reporting requirements.

The CA 2017 and other regulation requires significant non-financial disclosures. However, there is no requirement for the disclosure of beneficial / indirect ownership. Other challenges include disclosure of the profiles of board members, the board nomination and appointment process, risk management policies, and information about stakeholders. Concerns about the quality of the disclosures regarding compliance with the

former Corporate Governance Code led to the its replacement by the LCR, which is directly enforced by the SECP.

Pakistan has adopted International Standards of Audit (ISA), including those related to quality control (QC) and the new audit report format, which has been required by the SECP since the beginning of 2017. Listed company auditors must rotate every five years. The audit profession in Pakistan was largely self-regulated by ICAP until the recent establishment of the Independent Audit Oversight Board of Pakistan (AOBP). As with any new organization, start-up issues remain key challenges.

Board Practices and Company Oversight

Pakistan has a one tier board system. The Companies Act provides basic board requirements. Traditionally, boards have been dominated by controlling shareholders; in family companies, boards are dominated by executive and non-executive members of the controlling family. In practice, there is often an unclear line distinction between ownership and control, and family owned companies are typically managed by the owning families themselves. Boards may not always be the driving force behind corporate strategy and strategic issues.

Fiduciary duties were codified in the new Companies Act and are one of its most important reforms. Directors must act with a duty of loyalty, “in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees the shareholders the community and for the protection of environment.” However, the fact that many boards are dominated by the controlling family / parent / Ministry makes it a challenge for board members to be truly accountable to all shareholders. In practice, there are almost no suits against directors. Liability insurance, while legal, is rarely used.

Board responsibilities are set by the LCR. Most elements of international good practice are mandatory for boards, including “preparing and adopting overall corporate strategy”, setting an ethical tone, selecting and monitoring the CEO, succession planning, overseeing internal control, and managing related party transactions. There are some challenges with the implementation of the LCR

/ former Code. For example, only 40% of companies surveyed noted that they have put a code of ethics in place; there is no explicit requirement that the board should take responsibility for the corporate governance practices; succession planning is not yet common in practice; there is no specific requirement for a “transparent nomination process” for board members; and the establishment of modern risk management frameworks, and the compliance function, is nascent outside of the financial sector.

Board composition requirements for listed companies are set by the LCR. Executive directors should be no more than 1/3 of the board. The board should be composed of 1/3 Independent directors or at least two, whichever is greater. According to interviews and the Deloitte survey, a majority of companies now have only one independent director, corresponding to the requirements under the old corporate governance code. This number may have been too small to be effective and was low by international standards. The SECP Thematic Review found one company that had no independent directors. The updated Companies Act now requires one female director for the boards of public interest companies, and the LCR mandates that at least one woman serves on the board of each listed company. The Act requires the Chairman and the CEO to be separate.

The LCR provides clear and transparent rules on board committees. An audit committee and a human resources committee are mandatory. Other committees are recommended by the LCR (or required by other legislation especially in the financial sector). There is no requirement for the audit committee to publicly disclose its mandate or terms of reference.

The LCR requires all listed companies to make “appropriate arrangements” to carry out orientation courses for their directors “to enable them to effectively manage the affairs of the listed companies for and on behalf of shareholders”. Board training is relatively well-developed in Pakistan, and the pool of sophisticated directors has grown. Courses have been provided by PICG, ICMAP, LUMS, IBA and ICAP, being the certified institutes for importing Directors’ training programs. In the past, the opt-out provisions in the old Code of Corporate Governance meant that still many directors. Under the LCR, all directors must complete a training program by 2021, although the SECP can still grant

waivers to experienced directors. Board evaluations are being done in Pakistan but their adoption is at an early stage.

Institutional Investors and Shareholder Engagement

Historically, the engagement and stewardship role of institutional investors has been limited in Pakistan. 20 asset management companies (AMC) held about PKR 490.4 billion (USD 4.7 billion) in assets under management at the end of June 2016. Most assets are in open-ended mutual funds, but there is also a small private pension funds sector. As in most countries, the asset management industry is relatively small and unassertive with respect to corporate governance, and the role of foreign investors has been limited. Asset managers worry about the expense and burden of taking additional responsibilities in this area.

The sector's largest player is the National Investment Trust (NIT), 46 % controlled by government. NIT plays an important role in corporate governance, and sits on approximately 67 boards. It has a proxy voting policy, but the policy is mostly limited to the process of granting permissions to vote, and does not discuss policies about how the company will vote on any particular issue. About half the appointed board members are professionals, the other half are NIT staff.

Since 2008, SECP Non-Banking Finance Companies and Notified Entities Regulations have required asset management companies to formulate proxy voting policies approved by their boards of directors. The policy should address the election of directors, the appointment of auditors, their positions on changes in law and capital structure, corporate restructuring, and mergers. The voting policy must be disclosed on the AMC's website and a summary of its voting in its annual report.

Public Sector Companies

The ROSC concludes with a special section that examines the governance challenges in a key set of public interest entities – Pakistan's Public Sector Companies (PSCs). The 169 PSCs in the government's portfolio represent a sizable part of Pakistan's economy, operating in a wide range of economic sectors including energy, finance,

industry and engineering, trading, services, and transportation. PSCs contribute around 10 percent of GDP and represent about a third of stock market capitalization. Over the years, financial support to SOEs has been a major contributor to the country's budget deficit and debt burden.

The existing governance framework for PSCs includes the Companies Act 2017; the Listed Company Regulations (for listed PSCs); and the Public Sector Companies (Corporate Governance) Rules 2013 (referred to as Rules). Some companies also have their own enabling statute. The Rules are a recent addition to the legal and regulatory framework and represent an important effort by the Government to improve the governance of the PSCs. The Rules and their enforcement by SECP have begun to put pressure on the PSCs which appear to be moving towards better overall governance practices.

In Pakistan, although practices are not formalized in any specific policy statement, the State's ownership and oversight functions are highly decentralized. Line ministries take many key decisions of the companies within their sectors. Most companies are (in the words of one board member) only "semi-autonomous"; the Ministries play a strong role in taking many decisions that good practice assigns to the board of directors or management. Market participants report that decisions are sometimes informally taken by the Minister or the Prime Minister's office, and then implemented by the boards. In general, while many companies report that day-to-day interference is limited, they also noted that government feels "that it is their right" to make requests of the company on large and small matters. These factors raise the possibility of political interference in the companies.

Overall, this system presents many challenges, including diffuse accountability, insufficient ownership capacity, lack of adequate oversight of the state sector as a whole, and in the end high costs and a significant loss of productivity. In practice, the boards of most PSCs are seen as weak, with ineffective oversight and prone to political interference. There have also been cases in the past where the boards were suspended by the Government (Pakistan State Oil, power generating and distribution companies, etc.) and delay in reconstitution led to the entity's inability to comply with corporate governance standards. A broad-based effort to reform the governance of

PSCs has stalled, contributing to steep fiscal losses and to worsening and cost ineffective services. All independent observers agree that the current approach can be improved.

Policy Recommendations

The following recommendations will increase the compliance with the OECD Principles of Corporate Governance. Given the recent passage of the Companies Act and the LCR, more focus is placed on implementation (rather than updates to law or regulation).

High Priority

1. Design and implement a wide-ranging PSC reform program

The PSC Rules issued by the SECP have played an important role, but direct action by the Government and its Line Ministries will be necessary for further reforms.

- **Reactivate the task force on public enterprises.** The task force formed by the Government, which resulted in the original drafting of the Rules in 2013, needs to be reactivated to carry the reform process forward.
- **Enact a new law that establishes an ownership framework for PSCs.** The *OECD Guidelines for the Corporate Governance of State Owned Enterprises* encourages the adoption of ownership laws and policies that define the overall goals and rationale for State ownership, set clear definitions of the roles and responsibilities of the key institutions, create the role of a centralized ownership unit to set and oversee policy for PSCs (see below), provide a broad framework for appointing boards of directors, and establish MOU / performance agreement procedures and responsibilities.
- **Create a centralized body for PSC Governance,** to separate the government's role as owner from its

role as policy maker and regulator. The government should refrain from getting involved in day-to-day management and should allow PSCs full operational autonomy to achieve their objectives by professionalizing PSC boards and holding them accountable through the development of a proper performance monitoring and evaluation system.

- **Develop ownership capacity,** to implement the ownership framework proposed above. This would include improving the capacity to appoint board members, and monitor the performance of portfolio companies.
 - **Improve corporate governance and accountability,** by adding dedicated enforcement resources within the SECP to enforce the CG Rules, and producing a consolidated report on the compliance status of PSCs (see below).
 - **Consider increasing private sector participation in profitable PSCs,** by reviving the privatization program for companies in competitive sectors.
- #### 2. Review non-financial disclosure requirements for listed companies
- **Require the disclosure of beneficial (indirect) ownership.** While disclosure of the direct shareholding structure is required by current law and regulation, the disclosure of indirect ownership of significant shareholders is not. This is an important element of international good practice, and has implications for the efficiency of other parts of the legal framework (especially preventing abusive related party transactions). Requirements to disclose group structures (the links between the company and a larger corporate entity) and all mechanisms for disproportionate control (shareholder agreements, multiple voting shares, etc.) would help to round out the overall picture of ownership and control.
 - **Supplement or make more explicit**

other elements of non-financial disclosure good practice. These include:

- ✓ Clarifying the profile of board members that must be disclosed (current employment, length of service, etc.)
- ✓ Information on the rules, including voting procedures that govern the AGM
- ✓ Policies required under the LCR (e.g. code of ethics, risk management policy, internal controls policy)
- ✓ Material foreseeable risk factors and risk appetite statement
- ✓ Board and committee charters, and committee composition and mandates.
- ✓ Information on remuneration at the individual level (on a voluntary basis)
- **Make additional information available on line.** SRO 634 (or the omnibus regulation) could expand the information that must be placed on company website. This could include company documents and policies for which there is no current required disclosure (e.g. code of ethics, articles of incorporation, remuneration policies, risk management policies, related party transaction policies, company meeting procedures, and board charters).
- **Consider segregating all non-financial disclosure requirements into a new omnibus regulation.** The legislative and regulatory changes of 2017 have left the non-financial disclosure requirements for listed companies in a state of flux. Relevant regulations are somewhat scattered across different documents (including the PSX Rules), and have slightly different definitions and priorities. A stand-alone disclosure regulation would maintain the focus on disclosure and transparency,

clarify and harmonize requirements, and distinguish what companies and boards should “do” from what they should disclose.

3. **SECP should maintain its strong focus on enforcement.**

- **Improve corporate governance and accountability of PSCs** by adding dedicated enforcement resources within the SECP to enforce the CG Rules, and producing a consolidated report on the compliance status of PSCs.
- **For listed companies, concentrate on those areas where risks are high and past compliance has been the weakest.** Implementation of the new LCR is a key step to improve corporate governance in listed companies. A risk-based enforcement strategy should focus on the companies and topics that can have the most impact, and where past compliance has been mixed. These include:
 - ✓ Adoption of code of ethics (40% compliance per the Deloitte survey)
 - ✓ Adoption of succession plans (low compliance)
 - ✓ Disclosure of internal controls procedures (28% compliance)
 - ✓ Risk management framework (low outside financial sector)
 - ✓ Compliance function (low outside financial sector)
 - ✓ Board independence (most companies only have one independent director)
 - ✓ Majority independent audit committee (64 % compliance)
 - ✓ Board evaluations (72% compliance)
 - ✓ Gender diversity (36% Compliance)
 - ✓ Board induction and training (40-56% Compliance)

A notable feature of this list is that many relate to the adoption of plans, policies, and procedures. Training could be provided to staff on how to distinguish “quality” in the different policies and developing tools to assess minimum standards as well as high quality.

- **Consider non-traditional approaches to improving corporate governance.**

- SECP could build on existing efforts to encourage the adoption of good governance, by reporting on the adoption of good governance practices, and providing assistance to companies who are having difficulties with adoption.
- ✓ *Develop a Report on LCR compliance.* Stakeholders can better understand the impact of the LCR if the SECP produces a periodic report or scorecards on LCR compliance. Reports in the UK, Portugal, Colombia, and Russia, among others, are good examples of reports that are useful to the market. The report should start by providing anonymous data, but could eventually move to “name and shame” those companies which are out of compliance (although this is rare around the world because of the political risks involved). The report will be a valuable tool to understand where the problems are in both regulation, capacity, and compliance. (This recommendation will be relevant after at least one cycles of LCR compliance disclosures have been made).
 - ✓ *Work informally with companies to improve their CG.* SECP could offer some companies that are having difficulty complying with the LCR to participate in technical assistance and capacity building programs (provided by pre-approved and trained firms) to

assist them in improving their governance framework. It is important to go beyond thinking of corporate governance as a pure compliance exercise. (This recommendation could also be supported by donor partners).

4. **Explore segmentation on the stock exchange.**

The 2016 merger and creation of the PSX represents an opportunity to improve the brand of the “Pakistan listed company.” One approach that has been tried in other countries is to create separate listing segments on the PSX with different corporate governance expectations. Another approach would be to introduce an exchange index for companies that meet high corporate governance requirements. International experience can be helpful in defining the segments and the requirements that could be applied.¹

5. **SECP and other market infrastructure institutions and government agencies should consider setting up a formal forum for foreign investors to discuss corporate governance and other matters.**

Participants could include custodial banks (with whom SECP already has regular discussions) but also foreign asset managers and proxy service providers.

Medium Priority

6. **Consider the adoption of a stewardship code for institutional investors.**

Asset management companies should increase their engagement and influence. The largest investors (particularly NIT) have a unique ability to influence companies to adopt better governance. NIT can become more assertive in developing its own expectations for corporate governance, and making those expectations clear to its investee companies. The industry as a whole can develop a forum to discuss a number of important topics, including minority shareholder rights and redress, and reaching out to smaller issuers that until now have not been interested in

¹ See *Raising the Bar on Corporate Governance: A Study of Eight Stock Exchange Indices*, World Bank Group, 2013, for international examples.

investor relations. The industry can also reach out to foreign investors, who can work through the local associations to register the importance they attach to corporate governance and to ESG issues more generally.

Regulatory authorities can indirectly improve the monitoring and enforcement corporate governance codes by encouraging institutional investors to play a stronger monitoring role. An increasing number of countries have put in place a stewardship code to define and encourage the corporate governance role of institutional investors. A stewardship code can play a long-term role in building a market-based system for investors to hold companies to account for their corporate governance practices.

7. **Support the new specialized bench at the High Court.** As much support as possible should be given to the new specialized bench at the High Court to handle corporate disputes. SECP (and its donor partners) could provide training and capacity building as necessary on corporate governance issues. This includes both large investors and proxy advisory firms. In addition, SECP, PICG and trade associations should encourage local and foreign providers of electronic voting systems to participate in corporate events and to open for business in Pakistan.
8. **All stakeholders should extend political and financial support to the new Audit Oversight Board.** The independent audit oversight board should be fully funded and staffed, and should receive high-level political support from all relevant stakeholders.
9. **SECP could also carry out studies of special topics to prepare for future legal and regulatory updates.**

Special topics could include:

- ✓ Viability of shareholder redress options for minority shareholders
- ✓ How the related party transactions approval and disclosure

requirements are working in practice

- ✓ Review of general meeting procedures, including show-of-hands voting (to see if rights of shareholders can be improved while making meetings more efficient)

Lower Priority (long-term, 2+ years)

10. **Update recent legislation based on international standards and local experience.**

Future reviews of the LCR, the Companies Act, and the Securities Act should consider several additional provisions:

Companies Act

- ✓ Encourage companies to adopt automatic poll voting
- ✓ Specify the board's conduct during shareholder meetings (i.e. providing explicit rights to ask questions without pre-conditions, and requiring the board to answer).
- ✓ Include a discussion of board duties within a holding company / group structure.
- ✓ Annul the provision that exempts boards of Public Sector Companies from the power to nominate the CEO.
- ✓ Consider the possibility of including "claw back" provisions to recover previously paid remuneration in the event of fraud or negligence.

LCR

- ✓ Increase the number of independent directors required on key committees, to at least a majority.
- ✓ Explicitly require boards to establish an investor relations

function in each company.

- ✓ Require companies and boards to develop explicit board nomination and elections policies.
- ✓ Explicitly require the remuneration policy to be aligned to both short and long term performance of the company, and to the board evaluation process.
- ✓ Explicitly refer to setting performance objectives and key performance indicators.
- ✓ Explicitly refer to the board's role in overseeing corporate governance practices.
- ✓ Clarify the role for the HR committee (and the Chairman) in the board nomination and elections procedures.
- ✓ Require companies to develop (and disclose) committee charters (or mandates)
- ✓ Explicitly describe key roles and responsibilities of a board chairman to complement the relevant provisions of the Companies Act
- ✓ Require companies to provide professional advice at the expense of the company to the board, and require the company to disclose the use of paid advisors by the board.
- ✓ Update Regulation 10 to clarify which required policies are mandatory and which are voluntary. Mandatory policies should include all of the policies required by the OECD Principles.

- ✓ Update Annexure A by reviewing compliance experience and clarifying those requirements that have proven to be difficult to understand by investors, or difficult to answer by companies. The regulation could also add a requirement for a narrative statement on corporate governance in the company, and an indication any approved exemptions to the Code requirements.

Securities Act

- ✓ Harmonize “creeping disclosure” requirements with other beneficial ownership disclosure requirements, and reduce the threshold for disclosure to 5 percent.
- ✓ Consider making the tender offer requirement applicable to outstanding shares.
- ✓ Consider requiring companies to disclose financing plans for a takeover.

11. **Consider carrying out a regulatory governance assessment of the SECP.** All organizations focused on good governance can continue to improve, and the SECP is no exception. The SECP could build on the recent assessment of the IOSCO Principles of Securities Regulation and request its own governance assessment. Governance assessments of regulators focus on independence, accountability, and integrity, how goals and strategies are set, and the role of their governing and management bodies.

Introduction

The purposes of the Corporate Governance ROSC are to: (i) benchmark Pakistan's legal and regulatory framework, practices, and enforcement framework against the G20/OECD Principles of Corporate Governance (OECD Principles), the international reference point for good corporate governance; and (ii) develop a series of recommendations to reduce or close potential gaps. The goal of the ROSC initiative is to identify weaknesses that may contribute to a country's economic and financial vulnerability. The ROSC reports focus on the governance of listed companies.

Corporate governance – an important part of the reform agenda

The report is intended to be used as a starting point for the development of an action plan for corporate governance development. The outcomes of the assessment will contribute to the Government reform agenda to improve the investment climate, the attractiveness of the capital market, and public sector company (PSC) reforms. The study is relevant to the FY 2015 – 19 Country Partnership Strategy (CPS) and provides a framework for the World Bank Group and other donors to support Pakistan in its reform plan.

This ROSC is the first report to use the revised G20/OECD Principles of Corporate Governance, and the updated World Bank assessment methodology

Each corporate governance ROSC is based on a detailed questionnaire, the Detailed Country Assessment (the DCA). The Detailed Country Assessment serves as both an information collection tool to be used in the drafting of the final ROSC report, as well as a “calculator” for scoring each of the 72 OECD Principles. The questions in the DCA address both the legal framework as well as corporate governance practices.

This ROSC is based on a revised assessment methodology. In response to the revised OECD Principles of 2015, the World Bank has updated its methodology and developed a new set of some 475 data points to more objectively benchmark a country's corporate governance framework against the OECD Principles of Corporate Governance. The completed DCA is not published.

For the chapter on public sector companies, the ROSC used a variety of information sources, including interviews with board members and managers, a review of the legal and regulatory framework, and reports prepared by the Ministry of Finance.

The report draws on several sources of data, including:

- Review of the legal and regulatory framework for listed companies and public sector companies;
 - Interviews with key stakeholders;
 - A “Thematic Review” of compliance by 30 large companies with the Code of Corporate Governance, carried out by the SECP in 2015;
 - A survey of annual reports of 25 companies carried out by Deloitte Pakistan for the ROSC (the “Deloitte Survey”)
-

The assessment is organized into six sections

The assessment report consists of the following standard

- The **Corporate Governance Landscape** reviews the economic performance, the capital market, and the corporate and ownership structure in Pakistan;
- **Commitment and Enforcement**, which reviews the overall efforts being made by the public sector to improve corporate governance, the role of the regulatory bodies, and the level of public and private enforcement.
- **Shareholder Rights** reviews the protections available to minority shareholders (Chapter II of the OECD Principles)
- **Disclosure and Transparency** reviews the disclosure requirements for listed companies, and the compliance with those requirements (Chapter V of the OECD Principles)
- **Board Practices and Company Oversight** reviews the regulatory framework and national practices for the boards of directors, the key institution in modern corporate governance (Chapter VI of the OECD Principles)
- **Institutional Investors and Shareholder Engagement** reviews the roles and of institutional investors in corporate governance (new Chapter III of the OECD Principles).
- **Key Findings**, which review the legal and regulatory framework and important practices in each area;

Each chapter includes three subsections, including:

- **Proposed Policy Recommendations**, which present a set of policy recommendations (sometimes organized by their priority) to improve the level of compliance with international good practice;
- **OECD Principles Assessment**, which summarize the scores for each of the relevant OECD Principles.

This assessment also includes a special focus on the governance of state-owned enterprises in Pakistan

The last chapter of the report is a special section that looks at the governance of Pakistan's state-owned enterprises, the Public Sector Companies (PSCs). The question of PSC governance was raised throughout the assessment process as the key corporate governance concern. In addition, many of the largest listed companies have state ownership. The ROSC summarizes previous World Bank and other analytical work in this area and makes systematic policy recommendations for reform.

Corporate Governance Landscape

This section reviews the relevance of corporate governance reform in the current economic climate, provides a brief background on equity markets, and provides information about the ownership and control of large companies in Pakistan.

Recent macroeconomic performance also highlights the importance of improved corporate governance

Pakistan's economy has been among the top performers of South Asia. Gross domestic product (GDP) growth increased to 4.7 percent in FY 2015/16, and is expected to reach 5.8 percent by FY 2019. Foreign direct investment is low but increasing; during FY 2016, FDI inflow was US\$ 2.8 billion. However, Pakistan has one of the lowest investment-to-GDP ratios in the world; at 15.6 percent of GDP, the rate is less than half of the average for South Asia.

Pakistan's continued growth will rely upon sustained progress on structural reforms

Pakistan's previous government implemented an ambitious economic reform program. External and internal macroeconomic balances have improved and the country made strides in important agendas, such as taxation, the energy sector and the business environment. However, there are concerns that progress is stalling.

Pakistan's Vision 2025 aims to raise Pakistan to an upper-middle-income country

Reviving growth will require (among other reforms) a reduction in the state's footprint on the economy, improvements to the investment climate; and strengthening governance through more transparency, better regulations and more effective control of corruption.

Over the 12 months ending in May 2017, the equity market was one of the best performing in the world

Share prices have increased rapidly over the past five years, especially to the year ending May 2017 (see charts 1 and 2 on page 18). The PSX-100 Index² increased from 13,801 at the end of FY 2012 to an all-time high of 52,637, an annual average growth rate of over 30% over the period. Political uncertainty and other factors resulted in the index falling back to 44,186.96 by mid-August. This performance put Pakistan in the leading position relative to other regional equity markets in Asia. This bullish trend in early 2017 was attributed to several factors, including the reclassification of Pakistan from a "frontier market" to an "emerging market" by Morgan Stanley Capital International (MSCI). This reclassification will increase foreign investment from funds that track the MSCI emerging markets index.

There are 550 listed companies

Despite this recent improvement, the market remains relatively small relative to the size of the country and the economy. At the end of June 2017, there were 550 listed companies, with a market capitalization of approximately 25% of GDP. This represents a low number of listed companies, with a low valuation, given the size of the economy.

² Formerly known as the KSE-100 Index.

The number of listed companies is declining over time

The number of listed companies has decreased in the past six financial years, from 590 listed companies in FY 2012 to 550 at the end of FY 2017. Over this period a total of 104 companies delisted, while there were 26 new listings.

Market participants report that delisting pressures flow from several sources. In the past, companies relied on low cost loans, often subsidized by the government, as their primary source of external finance. Listing was necessary for operating permits in some sectors, and encouraged by the tax code, but equity was not seen as a significant source of finance.

Tax benefits for listing—once significant—have been eliminated. Other incentives to list (e.g. mandatory listing requirements for large companies, ability to obtain manufacturing or other licenses) have been removed. Finally, many market participants argue that the introduction of mandatory compliance with the Code of Corporate Governance in 2012 increased the costs staying listed. Slow economic growth and lack of incentives to listed companies are also considered as contributory factors for low rate of listings. As shown in Chart 4 below, the number of IPOs has been relatively insignificant for many years.

It is important to note that the companies that have delisted were relatively small. The book capital of newly listed companies over the past five years (PKR 82.6 billion) is almost three times the delisted capital (PKR 29.3 billion). This implies that a natural re-sorting is taking place, as smaller companies leave the exchange and larger companies join.

Listed companies can be divided into one of three categories

There are three main types of listed companies: family-owned companies, state-controlled companies, and local branches of foreign multinationals.

The State dominates the corporate landscape.

As noted in the 2005 corporate governance ROSC, many listed “blue chips” are majority-state controlled (sometimes through various intermediary trusts and pension schemes). The State controls 12 of the top 40 listed companies and account for 52.8% of total capitalization. In addition, much of the free float in the market resulted from the divestiture of shares in public sector companies (PSCs). The current portfolio of PSCs is described in the chapter beginning on page 62.

The largest set of owners are families

Families feature prominently in the ownership of many private, public, and listed companies. They are particularly prominent in certain sectors such as textiles. As in other countries, key corporate governance concerns around family companies include informality, lack of transparency, and an attempt to maintain private benefits of control via a variety of corporate structures. Recent research in Pakistan notes that most small and family-owned companies in Pakistan have little awareness of the potential benefits of improved corporate governance and tend to resist reforms and legal changes. This group of companies is also reportedly among the first to threaten to delist in the face of new regulation.³

³ See for example, *Corporate Governance- Issues and Challenges in Pakistan*, Beenish Ameer, Department of Management Sciences, Abbasia Campus, Islamia University of Bahawalpur, Pakistan

Families use a variety of means to exercise control over companies

As in other countries, families maintain control by share ownership or through indirect methods such as pyramiding, cross-shareholding or interlocking management. Families also maintain control by appointing their family members or trusted board members, who have sometimes lacked the requisite qualifications and experience. Control is maintained to obtain “private benefits of control”. Cumulative voting allows minority shareholders to elect directors to the board of directors but the groups and families reportedly try to have maximum shareholding in their own hands to avoid minority representatives on the board.

Many listed companies are local representatives of foreign multinationals

Multinational companies (with parent groups mostly from the UK and the US) are the third major owners of listed companies in Pakistan. Multinationals listed in the past to receive special tax benefits, and because of political pressure. In 2003, multinational companies constituted 17% of the capitalization in the top 40 listed companies. In general, foreign companies⁴ are a healthy sign for the economy of a country, and a major source of foreign direct investment. In other countries, foreign companies can set an example for local companies in terms of governance, transparency, and management skills. However, they can also face difficulties in adapting their group governance policies to local requirements. There are also potential issues around related party transactions and transfer pricing between the local company and the global parent.

⁴ Table 2.3, page 173, *Corporate Governance in Pakistan: Ownership, Control and the Law*, by Ali Cheema, Faisal Bari, and Osama Siddique. Presented in *A Comparative Analysis of Corporate Governance in South Asia: Charting a Roadmap for Bangladesh*, edited by Farooq Sobhan and Wendy Werner, 2003.

Pakistan: Key Capital Market Data

Chart 1: KSE-100 Index 2010-2017

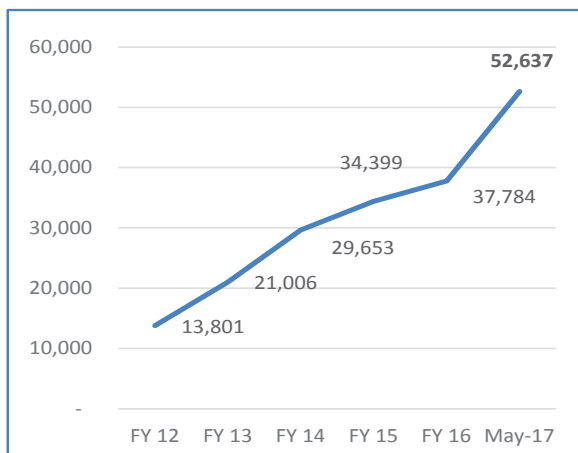


Chart 2: Regional Comparison

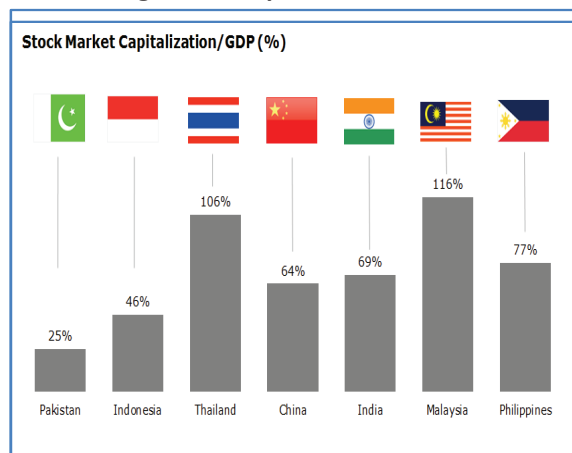


Chart 3: Number of Listed Companies FY12-16

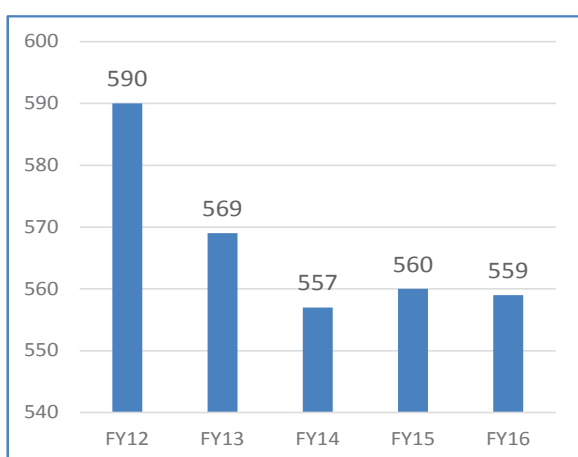
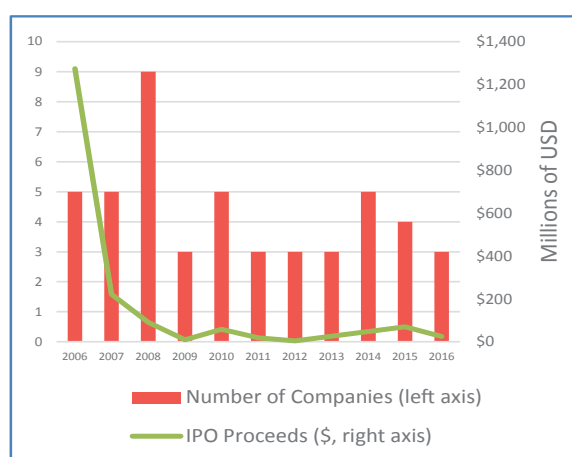


Chart 4: Initial Public Offerings



Sources: Pakistan Stock Exchange, S&P Emerging Markets Database, World Bank World Development Indicators. See notes on capital markets data in Pakistan in text.

Data on initial public offerings from OECD (2017), OECD Equity Markets Review: Asia 2017, www.oecd.org/corporate/OECD-Equity-Markets-Review-Asia-2017.pdf

Commitment and Enforcement

This section focuses on the perceived commitment of the public and private sectors in Pakistan to improving corporate governance. It covers the key issues in Chapter I of the OECD Principles of Corporate Governance (*Ensuring the Basis for an Effective Corporate Governance Framework*).

KEY FINDINGS

Corporate governance has been a major policy concern in Pakistan, and especially for the Securities and Exchange Commission of Pakistan (SECP), for about 15 years. Awareness of the importance of good corporate governance is very high among policymakers and standard setters. The government has taken many important steps to improve the regulation of corporate governance in the private sector, including the enactment of Companies Act and the Listed Companies (code of corporate governance) Regulations in 2017.

The most important challenge for the government is the corporate governance framework of the Public Sector Companies. These issues are summarized in a special section beginning on page 62.

The private sector has also been a strong supporter of improved governance, has supported many initiatives, and many key institutions are in place, including the Pakistan Institute of Corporate Governance. But its reaction has also been mixed; many companies (especially smaller companies in key industrial sectors) have not always accepted the challenge of improving governance, and see it as an unnecessary and expensive compliance exercise.

This section is organized as follows:

- The quality of the legal and regulatory framework
- Private sector commitment to good corporate governance
- Public enforcement

QUALITY OF THE LEGAL AND REGULATORY FRAMEWORK

The importance of law and regulation

The quality of the legal framework is a key indicator of a government's commitment to good corporate governance. The legal framework (including the company' law and regulation, the securities law and regulations, the listing rules of the stock exchange, and the corporate governance code) should reflect international good practice, and be well drafted, harmonized, and regularly updated. A strong legal framework sets minimum standards for good corporate governance.

The last 5 years have been a period of significant legal reform:

Pakistan's legal tradition is derived from the common law, which implies a relatively strong framework for minority shareholder protection. Many elements of the legal and regulatory framework have been recently updated:

- Companies Act 2017 replacing Companies Ordinance 1984, signed into law on May 30, 2017
- Issuance of the Listed Companies (Code of Corporate Governance) Regulations by the SECP in November 2017 to update the 2012 corporate governance code
- Securities Act 2015 replacing Securities and Exchange Ordinance (SEO) 1969
- Reporting and disclosure of shareholding by (directors, executive officers and substantial shareholders in listed companies) regulations (2015)
- Corporate Governance Rules for Public Sector Companies 2013, updated in 2017
- Separate guidelines issued by the SECP for appointment of CEOs of public sector companies.
- Demutualization law and restructuring of the Pakistan Stock Exchange

Company Law was significantly updated in 2017

The new Companies Act 2017 is the primary corporate law that sets out the framework for the establishment and governance of companies. The Companies Act also provides for enforcement power with respect to inquiry or investigation into the affairs of a company along with penal provisions.

The new Companies Act was enacted on May 30, 2017, replacing the Companies Ordinance 1984. Changes were significant, and included the codification of common law fiduciary duties, the creation for a special High Court bench to deal with Companies Act matters in a speedy manner, allowing the possibility of electronic board and shareholder meetings and voting, introducing requirements for women on boards, new requirements for related party transaction disclosure and approval, and overall simplification of filing requirements and other rules.

The code of corporate governance was also updated in 2017, in the form of the Listed Companies (Code of Corporate Governance) Regulations 2017

The Listed Companies (Code of Corporate Governance) Regulations 2017 (LCR) was issued in 2017, following a long period of consultation. The LCR is evolutionary, in that it represents the latest step in the development of corporate governance codes in Pakistan. But it is also a major change in that it is now a regulation directly issued by the SECP, rather than a part of the listing regulations of the Pakistan Stock Exchange.

The Codes of Corporate Governance is considered by all observers to have been an important factor in corporate governance reform in Pakistan.

The LCR includes many recommendations in line with international good practice. Major topics addressed include the responsibilities and composition of the board of directors, and non-financial disclosure requirements (as discussed in the relevant chapters below). Listed companies must disclose their compliance with the LCR in the annual report.

The LCR 2017 builds on the past Code and clarifies and enhances several requirements. Changes include an increase in board independence requirements and the addition of board gender diversity requirements. (but)

The LCR replaces the Code of Corporate Governance, first adopted in 2002 and then updated and incorporated into the PSX Listing Regulations in 2012

The Code was first drafted in 2002 as a joint effort between the SECP and the Institute of Chartered Accountants Pakistan (ICAP). In 2012, the Code provisions were incorporated into the PSX listing regulations, and all listed companies were required to comply. Over time, some provisions of the Code have migrated to the Companies Act. For example, minority shareholder rights were strengthened in 2002 when the ordinance was amended.

The SECP has also issued the mandatory “Code of Corporate Governance for Insurers” in February 2016 as a mandatory code under the regulations-making powers of the SECP, and the “Principles of Corporate Governance for Non-Listed Companies” which were issued in August 2016 on a voluntary basis.

The authorities provide significant opportunities to comment and consult on new laws and regulations

The government provides many opportunities to consult on draft corporate governance laws and regulations. The quality of laws and regulations and their level of internal harmonization is relatively high.

PRIVATE SECTOR COMMITMENT TO GOOD CORPORATE GOVERNANCE

Awareness of the importance of corporate governance in the private sector is also high

The private sector has also played a key role in building a strong corporate governance climate. Many institutions have shown strong commitment, including the Stock Exchange(s) (detailed below), associations of financial institutions, and the Institute of Chartered Accountants of Pakistan (ICAP) which has worked to improve financial reporting and auditing, and led the effort to draft the first Code, and has continued to push for improvements in corporate governance and financial reporting.

Pakistan Institute of Corporate Governance plays a leading role in building the awareness of the need for improved corporate governance

The Pakistan Institute of Corporate Governance (PICG) was created in 2005 with the goal of training directors and creating more awareness. The PICG now provides a variety of services including director training programs, director orientation programs, board evaluations, and other advisory services.

Some issuers remain unconvinced

However, commitment is not universal. Some market participants complain of overregulation in the corporate governance space. Some of this resistance appears to flow from the actions taken in enhancements to the Code made in 2012. These changes and their enforcement may have added to the delisting pressures mentioned above.

PUBLIC ENFORCEMENT

The key capital market institutions are the SECP and the PSX

The Securities and Exchange Commission Pakistan (SECP) is the regulator of the Pakistani capital markets. SECP is responsible for enforcement of all aspects of securities and company law and regulation. Complaints to the SECP appear to be the first line of defense for minority shareholder rights. Pakistan is a common-law country with a strong Securities Commission. Key legislation includes the 1969 Securities and Exchange Ordinance (SEO), and the 2015 Securities Act that establishes the SECP as the principal regulator of securities markets and non-bank companies, including non-listed ones.

In general, the division of regulatory responsibilities is clearly articulated under the law

The SECP has the responsibility for regulating the issue of securities, stock exchange, supervising depositories and clearing houses, brokers, investment funds, market abuse, and takeovers. The SECP also assumed the responsibilities of the Corporate Law Authority. The SECP performs supervisory functions for most Non-Bank Financial Institutions, including insurance companies, investment banks, discount houses and housing finance companies.

With the issuance of the LCR in November 2017, the LCR now has full oversight and enforcement authority over the corporate governance code.

SECP is governed by a policy board and a commission

SECP has five (and can have up to 7) commissioners, including the chairman and the chief executive officer, appointed by the federal government for a term of three years. Commissioners can be removed from office for reasons of conflict of interest or unfitness. The SECP is overseen by a Policy Board, also appointed by the federal government. The main objective of the Policy Board (of 11 members of which 5 are from the private sector) is to provide “guidance to the Commission in all matters relating to its functions and to formulate policies in consultation with the Commission.”

SECP is legally and financially autonomous, but its independence can be strengthened

The Policy Board is designed to be the “policy maker” and the Commission is the executor of policy, within the policy parameters defined by the Board to achieve its objectives. The organization is self-funded.

An unpublished self-assessment of the IOSCO Principles of Securities Regulation “did not find any evidence that the SECP does not operate in practice as an independent agency free from political or commercial interests.” However, it also found that more could be done to make the SECP operationally independent from political interference.

Because of its authority over company law, the SECP has unusually strong powers to set and enforce corporate governance regulation

The SECP has particularly strong powers over company law and registration (and thus corporate governance enforcement). The Company Law Administration Division (CLD) of the SECP supervises the registration of companies, enforces certain disclosure requirements, and has investigative and fact-finding powers. Company registration functions are carried out by Company Registration Offices in Karachi and seven other large cities.

SECP is adequately staffed to perform monitoring and enforcement of requirements applicable to listed companies.

The Corporate Supervision Department (CSD) of the SECP is responsible for the oversight of listed companies. The department includes 27 staff with a mix of accountancy and commercial experience in a range of industries. Both on-site and off-site reviews are conducted. On average, each staff member of the M&E team in the CSD reviews 40 listed and additional associated unlisted companies on an annual basis.

The SECP applies comprehensive, risk-based review techniques and provides a summary of inspection findings and enforcement actions in its publicly available annual report. The CSD has developed comprehensive, standardised checklists for reviewing the level of compliance with applicable requirements, including the Listed Company Regulations for listed companies.

The SECP monitors the compliance of listed companies and grants exemptions and relaxations. SECP works to increase effective compliance by actively participating in various seminars and discussion panels where market professionals and other stakeholders exchange their views and convey their practical difficulties.

There has been some enforcement of insider trading provisions

Any “associated” person is prohibited from trading in his company’s shares if he has information (obtained during the previous six months) which is not “generally available”, and which would affect the price of the securities, or related to any company transaction. “Associated” people include officers, employees, and any “professional or business relationship which gives him access.” The company is required to annually disclose ownership by insiders in the annual report (see Transparency and Disclosure, below).

Insider trading is an administrative offense under the SEC’s tribunal system, as well as a criminal offence. Penalties include compensation of those who have “suffered loss”, imprisonment for up to three years, or a fine of up to three times the amount of gain or loss avoided.

There has been some investigation and prosecution of insider trading in Pakistan. In FY 2016, 32 notices were issued to listed companies seeking explanation for unusual price and volume fluctuations. 4 cases were referred to adjudication, and 1 case was sent for criminal prosecution.

A new demutualized stock exchange has been created

In January 2016 three regional exchanges merged to become the Pakistan Stock Exchange. Owners of the exchange now include strategic investors (three Chinese stock exchanges with a total of 30 percent of shares) as well as the public (who acquired shares through an IPO in June 2017).

The merger and demutualization is expected to have many important benefits:

- The new governance structure reduces the conflict of interest inherent in an exchange owned by its member-brokers.
- The exchange will be able to provide trading and listing services across the country, with increased efficiency and lower costs for issuers and investors.
- The exchange should provide a simpler trading and regulatory environment and lower risk for both foreign and domestic investors.

Compliance with the Listed Company Regulations

Listed companies are required to include statements of compliance with the LCR in the annual report. Companies must publish a separate compliance statement (in the form as specified in Annex “A” in the LCR) along with their annual reports to set out the status of their compliance with the specific requirements. Responsibility for compliance with these mandatory requirements rests with the Chairman and the members of the board and the CEO.

All listed companies must ensure that the statements of compliance are reviewed and certified by statutory auditors. The auditors of listed company must highlight any non-compliance in their review report.

Until the issuance of the LCR in November 2017, the Stock Exchange was responsible for the enforcement of Code provisions. The PSX and its predecessor exchanges worked to enhance their capability to monitor and ensure compliance. However, market participants often complained that there was little sanctioning for violation of the provisions of the corporate governance code or elements of the listing rules. The SECP could also grant exemptions to the requirements laid out in the Code. The change in oversight from the PSX to the SECP is expected to increase oversight and enforcement pressure on listed companies.

Challenges remain with respect to the enforcement of the LCR

While the LCR / former code has had great impact on the adoption of good corporate governance provisions (as detailed elsewhere in the report), challenges remain. The Deloitte Survey of annual reports indicated that compliance with the old code was relatively low in several areas:

Adoption of code of ethics (reported 40% compliance in Deloitte survey)

- Adoption of succession plans (low compliance)
- Disclosure of internal controls procedures (28%)
- Risk management framework (low outside financial sector)
- Compliance function (low outside financial sector)
- Majority independent audit committee (64 %)
- Board evaluations (72%)
- Gender diversity (36%)
- Board induction and training (40-56%)

While SECP’s actions/rulings against companies in breach of statutory duties (including CG practices) are made available on the its website, there has been no standard report on the overall state of compliance with the former Code as responsibility of the Code was with PSX. In general, relatively little information is produced by either the public or private sector on the state of adoption of good governance practices.

The demutualized stock exchange has adopted a new regulatory structure to manage its conflicts of interest

The PSX is required to enforce its listing rules and monitor for market abuse. The exchange can suspend trading, delist, or move companies to a special defaulters' segment.

The PSX Listing Regulations establish a "Defaulters Segment" for companies that fall out of compliance for not holding an AGM, starting winding up proceedings, or for failing to pay listing fees. About 200 companies are now on the Defaulter's Segment.

The SECP has continued to make important updates to the legal and regulatory framework in 2018

The SECP has introduced a number of new regulations on corporate governance in 2018, many of which are noted in the rest of this report.

- Employees Contributory Fund (Investment in Listed Companies) Regulations, 2018
- Companies (Manner and Selection of Independent Directors) Regulations, 2018
- Auditors (Reporting Obligations) Regulations, 2018
- (Draft) Companies (Related Party Transactions and Maintenance of Related Records) Regulations, 2018
- (Draft) Companies (further issue of shares) Regulations, 2018
- (Draft) Companies (General Provisions and Forms) Regulations, 2018
- Consolidated material disclosures-Notification (423(I)/2018)
- Circular 16 of 2018-Register of Beneficial ownership

PROPOSED POLICY RECOMMENDATIONS

Market participants have seen major changes in awareness and behavior over the past 10 to 15 years. However, to achieve the various targets that have been set by policymakers, legal protection of minority investors must be strengthened.

The current legal framework has made significant impacts on corporate governance in Pakistan. The challenge now is to continue to move requirements towards international standards, and continue to raise expectations with respect to levels of enforcement.

The SECP should develop a holistic enforcement strategy. Elements of the strategy (based on experience around the world) could include:

- **Report on code compliance.** Stakeholders can better understand the impact of the LCR if the SECP produces a periodic report or scorecards on LCR compliance after a suitable period of transition.⁵ Reports in the UK, Portugal, Colombia, and Russia, among others, are good examples of reports that are useful to the market. The report should start by providing anonymous data (showing those where non-compliance is the greatest), but could eventually move to "name and shame" those companies which are out of compliance (although this is rare around the world because of the political risks involved). The report will be a valuable tool to understand where the problems are in both regulation, capacity, and compliance.

⁵ LCR was notified in November 2017. Compliance with board requirements (for e.g. independent director and female directors) are required within one year after LCR Notification. Therefore, reports on code compliance will not be representative of the new rules until the end of FY 2019, for a sizable part of listed companies.

Commitment and Enforcement

- **Consider active enforcement of the quality of the compliance statements.** This would require actively working with companies to improve the quality of their statements (and the quality of their governance).
- **Provide technical assistance to improve in lieu of enforcement actions.** SECP work with (volunteer) companies that are having difficulty complying to provide them with technical assistance and capacity building (provided by pre-approved and trained firms) to assist them in building their governance framework. It is important to go beyond thinking of corporate governance as a pure compliance exercise.
- **Update “Annexure A” based on lessons of experience.** Experience from a number of countries suggests that compliance statements like “Annexure A” are a good way to improve the quality and depth of compliance statements. In the future, SECP will be able to improve Annexure A by reviewing past compliance statements and clarifying those requirements that have proven to be difficult to understand by investors, or difficult to answer by companies. Future revisions could also add a requirement for a narrative statement on corporate governance in the company, and any exemptions that were approved by SECP.
- **Consider the adoption of a stewardship code.** As noted in the “Institutional Investors and Shareholder Engagement” section beginning on page 59, the authorities can indirectly improve the monitoring and enforcement corporate governance codes by encouraging institutional investors to play a stronger monitoring role.

Explore segmentation on the stock exchange

The 2016 merger and creation of the PSX represents an opportunity to improve the brand of the “Pakistan listed company.” One approach that has been tried in other countries is to create separate listing segments on the PSX with different corporate governance expectations. Another approach would be to introduce an exchange index for companies that meet high corporate governance requirements. International experience can be helpful in defining the segments and the requirements that could be applied.⁶

The government could also carry out an assessment of the governance of SECP itself

All organizations focused on good governance can continue to improve, and the SECP is no exception. The SECP could build on the recent self-assessment of the IOSCO Principles of Securities Regulation and request its own governance assessment. Governance assessments of regulators focus on independence, accountability, and integrity, how goals and strategies are set, and the role of their governing and management bodies.

The government can also establish its commitment to good corporate governance by focusing on improving the governance of Public Sector Companies.

The government has a special stewardship role to play in the oversight and governance of the PSCs that are also listed. The government should take a stronger role in putting strong corporate governance in place in its own companies. It should establish explicit areas where it will take decisions, and delegate as much as possible to a strong and empowered board of directors. The government should also appoint strong independent members to the board.

This recommendation is further developed in the special section on Public Sector Companies (beginning on page 62).

⁶ See *Raising the Bar on Corporate Governance: A Study of Eight Stock Exchange Indices*, World Bank Group, 2013, for international examples.

Existing law and regulation should be reviewed on a regular basis

Recommendations are presented below on topics that could be addressed in future reviews of the Companies Act and the LCR. The Transparency and Disclosure chapter recommends the creation of an omnibus regulation on disclosure for listed companies.

OECD PRINCIPLES ASSESSMENT: COMMITMENT AND ENFORCEMENT

The Detailed Country Assessment of the OECD Principles of Corporate Governance is summarized in the table below. Using the World Bank methodology to assess compliance with OECD Principles that cover the overall corporate governance framework, 2 principles were fully implemented, 2 principles were broadly implemented, and 2 principles were partially implemented.

OECD Principles covering the Overall Corporate Governance Framework		Rating	Level of Implementation
		76.9%	Broadly Implemented
I.A	The corporate governance framework should be developed to impact economic performance, market integrity, and transparent and efficient markets.	56.3%	Partially Implemented
I.B	The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.	75.0%	Broadly Implemented
I.C	The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.	100.0%	Fully Implemented
I.D	Stock market regulation should support effective corporate governance	50.0%	Partially Implemented
I.E	Regulatory authorities should have the authority, integrity, and resources to fulfill their duties in a professional and objective manner.	80.4%	Broadly Implemented
I.F	Cross border cooperation should be enhanced, including through bilateral and multilateral arrangements for exchange of information.	100.0%	Fully Implemented

Source: Corporate Governance ROSC Detailed Country Assessment. Figures represent the percent implementation of each OECD Principle. 95 % = Fully implemented, 75-95 = Broadly Implemented, 35-75 = Partially implemented, and less than 35% = not implemented.

Shareholder Rights

This section focuses on the rights of shareholders of listed companies. It covers most of Chapter II of the OECD Principles of Corporate Governance (Shareholder Rights). The discussion in this section is closely linked to the discussion on public and private enforcement in the previous section.

KEY FINDINGS

Shareholder rights are strong in Pakistan. Company law (recently updated) provides many of the basic protections required by the OECD Principles.

Concentrated ownership (from families, multinationals, and the State) establish the key shareholder concerns for shareholders. Concentrated control limits the influence that non-controlling shareholders can have on the company, and effectively reduces their protection from abuse. When a controlling shareholder dominates the shareholder and board meetings, director accountability to other shareholders becomes critical, and currently in Pakistan this accountability is absent in many companies. This basic challenge is offset by the strong role played by the SECP.

This section is organized around the key challenges, as follows:

- Basic shareholder rights
- Review and approval of related party transactions
- Shareholder meetings
- Appointment of directors
- Regulation of the market for corporate control
- Shareholder redress

BASIC SHAREHOLDER RIGHTS

Basic shareholder rights are protected, and were improved by the enactment of the Companies Act 2017

Basic shareholder rights (including strong shareholder recordkeeping, the rights to transfer shares, the right to appoint board members, the right to attend shareholder meetings, the right to receive dividends, the right to make changes to the key company documents, the rights to increase capital, and the right to approve extraordinary transactions) are largely guaranteed by the legal framework in Pakistan, as presented in the following table.

These issues are not generally seen as sources of shareholder abuse in Pakistan.

Strong shareholder recordkeeping	✓ a	Companies are required maintain a share registry, - the largest share registry is the Central Depository Company (CDC)).
Rights to transfer shares	✓ a	Public (and listed) companies are not allowed to restrict the transfer of shares.
Right to appoint board members	✓ a	Directors are elected by shareholders through cumulative voting (unless the number of nominated directors is the same as the number of vacant seats).
Right to attend shareholder meetings	✓ a	All shareholders have the right to attend meetings.

Right to receive dividends	✓ a	Dividends are declared by the AGM, based on a recommendation of the board (which cannot be exceeded).
Right to make changes to the key company documents	✓ a	By special resolution (3/4 vote), shareholders can approve changes in the articles of association.
Rights to approve capital increases		Shareholders must vote to increase the level of authorize capital. The board can then issue new shares within the level of the authorized capital. ⁷ Existing shareholders have a pre-emptive right to purchase new shares (and are granted rights shares).
Right to approve large / extraordinary transactions		Sale, lease and disposal of a sizeable part (25% of assets) of the company or its undertaking is subject to approval of shareholders. ⁸
Right to approve changes to share class rights		Changes to share class rights must be approved by the members of that class.

Companies can deviate from “one share, one-vote, but it is not common

Until 2000, companies in Pakistan were very restricted in the types of shares they could offer, and the law was essentially “one share, one vote”. In 2000, new rules were issued that give companies complete flexibility to issue preferred shares, including non-voting or multiple voting shares, subject to the approval of SECP and shareholders. Preferred shares can be issued as private placements. Only a few companies have issued preferred shares, which have tended to be non-voting shares.

SHAREHOLDER MEETINGS

Shareholders have full rights to participate at the AGM

The law clearly gives the right to all shareholders to participate in general meetings, either personally or through proxy. No shareholder with voting rights can be prevented from casting his vote. Shareholders may vote either in person or by proxy. No notarization is required. A simple proxy form is provided in the law. Postal and electronic voting was introduced in the new Companies Act 2017.

Every company must hold an AGM at least once every calendar year within four months of the close of the company’s financial year.⁹ The notice of an annual general meeting shall be sent to the Commission and shareholders at least twenty-one days before the date fixed for the meeting: The announcement must also be published in at least one English and Urdu newspaper. The meeting notice must specify the place and the day and hour of the meeting along with a statement of the business to be transacted.

⁷ CA 2017. Section 85. These rights are further defined in the Companies (Issue of Capital) Rules (1996) and the Companies (Variation in Rights and Privileges) Rules (2000), as amended.

⁸ CA, 2017, Section 183 (3):

⁹ CA 2017 Section 132. The SECP can extend the meeting deadline.

¹⁰ CA 2017 Section 140 (2).

Members holding at least 10 % of the votes may add a resolution to the agenda of a meeting. In general, this must be done at least 10 days before the meeting.⁹

Companies are required to place profile of candidates contesting election on their websites before the election of directors. However, there is no definition of the information that must be provided, and there were some complaints that little specific information is available about candidates. Some concerns were also raised that information on the rules regarding including voting procedures that govern the AGM might not be easily available to shareholders. There are also no legal provisions that provide shareholders with the ability to pose questions at the meeting. However, in practice, shareholders do ask questions at AGMs, which are answered by management.

Most voting at shareholder meetings remains “show of hands”

Under the Companies Act, the default approach to voting is by show of hands. The Chairman or 10% shareholders can request a poll in lieu of show of hands, or secret voting. However, the threshold for a shareholder request (10%) is high in an environment of highly concentrated ownership.¹⁰

While show of hands voting can simplify and speed up shareholder meetings, it is a significant departure from “one share one vote” and a disincentive to participation by foreign institutional investors.

Feedback from international investors is generally positive

International investors generally praise Pakistan’s shareholder meeting framework, and believe it to be comparable to advanced countries in the region. However, some complaints were received from foreign shareholders around the availability of information in time for shareholder meetings. International investors reported that meeting notices were sometimes uploaded too slowly to be useful for foreign analysts and shareholders before shareholder meetings.

APPOINTING BOARD MEMBERS

Board members are elected through cumulative voting, allowing minority shareholders to pool their votes to elect specific directors to the board

Directors are elected through a cumulative voting-type procedure.¹¹ Shareholders have votes equal to the product of the number of directors to be elected and the number of shares owned, and can allocate votes to one or many candidates as desired. This allows minority shareholders to concentrate their votes on their preferred candidates. Successful implementation requires more nominees than seats, and (depending on the shareholding structure) cooperation among different minority shareholders.

The LCR contains a provision designed to encourage minority shareholders to propose additional candidates

To encourage and “facilitate” contested elections, companies are required by the LCR to attach a statement by a candidate from minority shareholders who wish to obtain a seat on the board, and provide “information regarding members and shareholding structure” to those candidates.¹² Contested elections apparently remain relatively rare.

Companies are required to place profile of candidates contesting election on their websites before the election of directors. However, there is little definition of the information that must be provided. In practice, information provided is relatively limited.

¹⁰ CA 2017 Section 140 (2).

¹¹ The new Companies Act removed the former provision that allowed 5 shareholders to request a poll.

¹² CA Section 159(5). The term “cumulative voting” does not appear to be commonly used in Pakistan.

¹³ PSC Regulations (Code) 5.19.1.

RELATED PARTY TRANSACTIONS

Related party transactions remain a shareholder rights concern in Pakistan, as in most emerging markets.

The LCR sets related party transaction approval requirements

Related party transactions (RPTs) are now governed through Section 208 of the CA 2017. The Act requires that RPTs shall be entered only in accordance with an RPT policy. The LCR (Chapter V) establishes approval requirements. It requires that the details of all RPTs must be reviewed by the audit committee, and following its approval, placed before the board for review and approval. Any RPTs which are not executed at arm's length price shall also be placed separately at each board meeting along with necessary justification for consideration and approval of the board on recommendation of the Audit Committee of the listed company. The LCR also introduced a new requirement that if a majority of the directors have a conflict of interest, the matter shall be placed before the AGM for approval.

The Companies Act 2017 provides additional support to strengthen the duties of the board in reviewing RPTs

Section 204 of the CA 2017 (Duties of Directors) explicitly requires directors to "promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company". Directors are not supposed to "involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company... A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company."

The ability of the current rules to prevent abusive related party transactions is unclear

Pakistan follows an internationally accepted approach in the review and approval of related party transactions. In general, the letter of the law and regulation appears to be followed in most cases. However, the market also believes that many boards are not always able to remain objective in the face of pressures from controlling shareholders, especially for those transactions which are complex or for which there is no easy basis for making "arm's length" comparisons.

The new shareholder approval requirement could be very influential, but the provision is too new to know much about its effect.

Many other countries in Asia provide a different approach for the review of RPTs

Per the *OECD Survey of Corporate Governance Frameworks in Asia 2017*, only Pakistan and Mongolia place such significant weight on the role of the audit committee and board in approving RPTs. Three other countries (Indonesia, Malaysia, and Singapore) provide for disinterested shareholder approval of RPTs, and 9 other countries require a mix of shareholder and board approval depending on the size of the transaction. While there is not an international consensus on the right approach, shareholder approval may inhibit abusive transactions, although at the expense of considerable time and resources.

REGULATION OF THE MARKET FOR CORPORATE CONTROL

The market for corporate control in Pakistan remains relatively inactive.

The market for corporate control is inhibited by concentrated ownership, pyramiding structures, and interlocking directors. Anti-takeover devices do not appear to be necessary or in place. Changes in control are generally limited to friendly mergers of listed companies (e.g. 2015 merger KASB Bank with BankIslami Pakistan, 2013 merger of Mustehkam Cement with Bestway Cement, 2011 merger of Royal Bank of Scotland with Faysal Bank Limited). In general, takeovers and changes in control are not seen as significant corporate governance issues in Pakistan.

Takeover rules were updated as part of the revisions to the Securities Act 2015.¹³ Anyone who acquires more than 30% (and later 50%) of the voting shares of a listed company, acquirer must make a public tender offer for at least 50% of outstanding shares. If the acquirer obtains at least 90% of shares, he has a “squeeze-out” right to obtain the remaining shares. Offers must be approved by the SECP. The rules appear to be followed in practice. Abuse of shareholder rights during changes of control does not appear to be significant corporate governance concern.

Based on data from the PSX, there have been 38 public tender offers made under the takeover rules, since 2009:

	Number of Transactions	Average amount acquired
2008	3	15.5%
2009	4	32.8%
2010	5	13.5%
2011	1	20.3%
2012	6	34.4%
2013	4	28.0%
2014	2	33.0%
2015	7	16.3%
2016	3	13.8%
2017	3	25.8%
Total	38	23.0%

“Creeping” ownership disclosure rules have been tightened since the last CG ROSC. Under the Securities Act 2015, directors, executive officers, and “substantial shareholders” must disclose any changes beneficial ownership changes to the company (see Transparency and Disclosure chapter, below). Anyone who acquires more than 10 percent of shares must inform the company, the exchange and the Commission within 2 working days.

Under the Companies Act 2017, mergers require the approval of $\frac{3}{4}$ of shareholders. Proposed mergers must be cleared by the Competition Commission of Pakistan.

¹³ Takeover rules were previously regulated by the Listed companies (Substantial Acquisition of Voting Shares and Take Overs) Ordinance, 2002).

Some changes to the legal framework might improve shareholder protection during changes of control

The OECD Principles (and the Methodology to assess them) suggest some items that are missing from the legal framework:

- The law does not appear to provide tag along rights, so that indirect changes of control are not covered by the law. This is an important issue in some countries with complex ownership structures.
- Tender offers are not required to be for all outstanding shares – this potentially hurts some minority shareholders (although lowers the cost of takeovers).

There are no requirements for the plans and financing of the transaction to be disclosed to both the shareholders of the offering enterprise as well as to those of the target company.

PRIVATE ENFORCEMENT (SHAREHOLDER REDRESS)

Rights of shareholders to formal shareholder action through the courts are relatively weak in theory, and (at least to date) and are not common in practice. Complaints to the SECP are the most common form of activism.

Shareholders have several redress possibilities.

- **Ability to call shareholder meeting.** Ten percent of voting power can demand that the directors call an extraordinary general meeting (CA §132).
- **Withdrawal rights.** Withdrawal (dissenters') rights are only available in the event of a merger. After a merger is approved by a 9/10 majority of shareholders, the "transferring company" must acquire the shares of dissenting shareholders on the same terms as the ones on which shares of the approving shareholders are being acquired.
- **Ability to sue to overturn meeting decisions.** At least ten percent of shareholders can petition the court to overturn a resolution or meeting proceedings, or to declare a resolution "invalid by reason of a material defect or omission" in the proceedings of the meeting, which prevented members from effectively using their rights.
- **Ability to sue directors.** Derivative and direct suits are allowed in theory, based on case law in India and the UK. However, there are no provisions in Pakistani law to support them, and there has been no case precedence. Some directors have been sued by banks for violating personal loan guarantees.
- In general, the 10 percent thresholds may prevent these provisions from being used more frequently (especially by institutional investors).

Per indicators collected by *Doing Business*, it is relatively difficult for minority investors to bring legal actions in Pakistan

Per the "Ease of Shareholder Suits" subindex of the Protecting Minority Investors indicator (Doing Business 2018), Pakistan ranks about 94th in the world. Weakness that could potentially hurt minority investors that were identified by the data include the inability of the plaintiff to request categories of documents from the defendant without identifying specific ones, a requirement that the plaintiff can only address the defendant with preapproved questions, and the lack of a clear ability for plaintiffs to recover their legal expenses from the company.

Doing Business Indicator 2018 Ease of Shareholder Suits Index

Before suing can shareholders representing 10% of Buyer's share capital inspect the transaction documents? (0-1)	Yes	1.0
Can the plaintiff obtain any documents from the defendant and witnesses at trial? (0-3)	Any relevant document	3.0
Can the plaintiff request categories of documents from the defendant without identifying specific ones? (0-1)	No	0.0
Can the plaintiff directly question the defendant and witnesses at trial? (0-2)	Preapproved questions only	1.0
Is the level of proof required for civil suits lower than that of criminal cases? (0-1)	Yes	1.0
Can shareholder plaintiffs recover their legal expenses from the company? (0-2)	At the discretion of the court	0.0

A key institutional weakness has been the ability of the judicial system to enforce corporate governance rules.

The court system in Pakistan has been generally perceived to lack independence and objectivity, Court actions are considered to be expensive and slow.

The Companies Act 2017 includes provisions for a specialized bench at the High Court to handle corporate disputes. It is widely hoped that these provisions will improve the current process.

Actions by the SECP

The SECP is a more common source of redress for shareholders in Pakistan. The SECP can call a shareholder meeting (if a meeting has not otherwise been called); call for information or explanation from officers, directors, or the company; and seize documents (on reasonable grounds).

Ten percent shareholders can petition the SECP that the affairs of the company are being conducted, or are likely to be conducted, "in an unlawful or fraudulent manner ... or in a manner oppressive to the members." The Commission in turn may make an application to the Court to overturn decisions or actions taken by the company.

The SECP can also appoint a special inspector to investigate the company (CA §263). Inspectors are appointed following the application of 10 percent of shareholders, or as a follow-up from internal investigations. Inspectors have the power of a court under the Civil Procedure code, and can compel discovery and subpoena witnesses. The inspection report can be the grounds for prosecution by the SECP. If the SECP finds evidence of corporate misbehavior, it can take action against the company, including removing officers, directors, call a shareholders meeting, and canceling contracts.

In practice, the SECP investigates complaints even when the ten percent threshold is not met. There have been approximately 40 inspections during the past five years.

PROPOSED POLICY RECOMMENDATIONS

The following recommendations would increase the compliance with the OECD Principles of Corporate Governance. Given the recent passage of the Companies Act and the LCR, the higher priority should be placed on implementation (rather than updates to law or regulation).

SECP and other market infrastructure institutions and government agencies should consider setting up a formal forum for foreign investors to discuss corporate governance and other matters	Participants could include custodial banks (with whom SECP already has regular discussions) but also foreign asset managers and proxy service providers.
Implement the new specialized bench at the High Court	As much support as possible should be given to the new specialized bench at the High Court to handle corporate disputes. SECP (and its donor partners) could provide training and capacity building as necessary on corporate governance issues. This includes both large investors and proxy advisory firms. In addition, SECP, PICG and trade associations should encourage local and foreign providers of electronic voting systems to participate in corporate events and to open for business in Pakistan.
SECP could carry out studies of special topics to assist in future legal and regulatory updates	<p>Special topics could include:</p> <ul style="list-style-type: none"> • Viability of shareholder redress options for minority shareholders • How the related party transactions approval and disclosure requirements are working in practice, and whether additional requirements for shareholder approval should be considered • Review of general meeting procedures (to see if rights of shareholders can be improved while making meetings more efficient)¹⁴
Future reviews of the LCR, the Companies Act, and the Securities Act should address shareholder rights concerns	<p>A future review of the Companies Act could consider several additional provisions:</p> <ul style="list-style-type: none"> • Encourage companies to adopt automatic poll voting • Specify the board's conduct during shareholder meetings (i.e. providing explicit rights to ask questions without pre-conditions, and requiring the board to answer). • Include a discussion of board duties within a holding company / group structure. • Annul the provision that exempts boards of Public Sector Companies from the power to nominate the CEO. • Consider the possibility of including "claw back" provisions to recover previously paid remuneration in the event of fraud or negligence. <p>Future reviews of the Securities Act could address concerns raised about the takeover rules</p> <ul style="list-style-type: none"> • Harmonizing the "creeping disclosure" requirements with other beneficial ownership disclosure requirements, and reducing the threshold for disclosure to 5 percent. • Considering make the tender offer requirement for all outstanding shares. • Consider requiring companies to disclose financing plans for the takeover.

¹⁴ A set of guidelines on Guide on general meeting is currently being finalized by the SECP, and will address many of these issues.

OECD PRINCIPLES ASSESSMENT: SHAREHOLDER RIGHTS

The Detailed Country Assessment of the OECD Principles of Corporate Governance is summarized in the table on the following page. Using the World Bank methodology to assess compliance with the OECD Principles that cover shareholder rights, 11 Principles are Fully Implemented, 8 are Broadly Implemented, and 3 are Partially Implemented, and one is not applicable.¹⁵ Basic shareholder rights show high levels of implementation.

¹⁵ One Principle (principle II.H.2 related to anti-takeover devices) is considered to be not applicable in the Pakistan market.

OECD Principles covering Shareholder Rights		Rating	Level of Implementation
	Level of Implementation	85.5%	Broadly Implemented
II.A.1	Basic shareholder rights should include the right to secure methods of ownership registration.	100.0%	Fully Implemented
II.A.2	Basic shareholder rights should include the right to convey or transfer shares.*	100.0%	Fully Implemented
II.A.3	Basic shareholder rights should include the right to obtain relevant and material information on the corporation on a timely and regular basis.	100.0%	Fully Implemented
II.A.4	Basic shareholder rights should include the right to participate and vote in general shareholder meetings.	100.0%	Fully Implemented
II.A.5	Basic shareholder rights should include the right to elect and remove board members of the board.	100.0%	Fully Implemented
II.A.6	Basic shareholder rights should include the right to share in profits of the corporation.	100.0%	Fully Implemented
II.B.1	Shareholders should have the right to participate in amendments to the statutes.	100.0%	Fully Implemented
II.B.2	Shareholders should have the right to participate in the authorization of additional shares.	100.0%	Fully Implemented
II.B.3	Shareholders should have the right to participate in fundamental corporate changes such as extraordinary transactions.	100.0%	Fully Implemented
II.C.1	Shareholders should be furnished with sufficient and timely information on the date, location and agenda of the GMS as well as full and timely information on the issues to be decided on.* vote in general shareholder meetings and should be informed of the rules,	68.8%	Partially Implemented
II.C.2	Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes. including voting procedures, that govern general shareholder meetings:	83.8%	Broadly Implemented
II.C.3	Shareholders should have the opportunity to ask questions to the board and to place items on the agenda.	91.7%	Broadly Implemented
II.C.4	Effective shareholder participation in key corporate governance decisions, such as the nomination and election of directors should be facilitated.	83.3%	Broadly Implemented

OECD Principles covering Shareholder Rights		Rating	Level of Implementation
II.C.5	Shareholders should be able to vote in person or in absentia and equal effect should be given to votes whether cast in person or in absentia.	87.5%	Broadly Implemented
II.C.6	Impediments to cross border voting should be eliminated.	91.7%	Broadly Implemented
II.D	Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights.	75.0%	Broadly Implemented
II.E.1	Within any series of a class, all shares should carry the same rights.	100.0%	Fully Implemented
II.E.2	Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.	58.3%	Partially Implemented
II.F.1	Conflicts of interest inherent in related-party transactions should be addressed.	78.3%	Broadly Implemented
II.F.2	Members of the board and key executives should be required to disclose to the board whether they have a material interest in any transaction.	100.0%	Fully Implemented
II.G	Minority shareholders should be protected from abusive actions by controlling shareholders	78.0%	Broadly Implemented
II.H.1	The rules and procedures governing the acquisition of corporate control in the capital markets should be clearly articulated and disclosed.	70.8%	Partially Implemented
II.H.2	Anti-take-over devices should not be used to shield management and the board from accountability.		Not applicable

Disclosure and Transparency

This section focuses on the disclosure obligations and transparency of listed companies. It covers most of Chapter V of the OECD Principles of Corporate Governance (*Disclosure and Transparency*). It draws from the recently completed Accounting and Auditing ROSC for Pakistan.¹⁶

KEY FINDINGS

The quality and timeliness of disclosure has continued to improve over the past few years. This is in part attributed to the adoption of international accounting and auditing standards, SECP and SBP regulatory requirements, and the increasing monitoring role of ICAP and the SECP. Law and regulation require the disclosure of many non-financial items recommended by the OECD Principles.

This section is organized as follows:

- Financial reporting
- Non-financial disclosure
- Audit and audit oversight
- Channels of information disclosure

FINANCIAL REPORTING¹⁷

Financial reporting requirements for listed companies have been strengthened and are aligned with international good practices.

Listed companies are required to publish annual financial statements and quarterly balance sheet and profit and loss statements. The financial statements must include a balance sheet, income and cash flow statement, changes in equity and explanatory notes and must be accompanied by an auditor's report and a directors' report. The CA and the Code require the publication and circulation of quarterly financial statements along with a directors' report. Quarterly financial statements may be unaudited, but auditors are required to perform a limited scope review on the half-yearly statements.

Pakistan has adopted IFRS (International Financial Reporting Standards)

Differences between IFRS (as issued by the IASB) and reporting standards for listed companies in Pakistan are small but significant. Full compliance cannot be claimed because of several exemptions and deferrals, mainly in the banking sector. Updates to several standards are under consideration.

Perceptions about the quality and timeliness of financial reporting have continued to improve.

Listed companies largely comply with basic financial reporting requirements. A sample of 39 recent financial statements carried out for the Accounting and Auditing ROSC 2017 determined that the statements "largely align with the expected presentation and disclosure requirements of the applicable financial reporting framework and have been prepared without significant errors or omissions." The financial reporting of listed companies (and financial institutions) was reported in a separate survey as "high quality and useful for decision-making purposes and in lending decisions.... the financial reporting of PSCs and SMEs was seen as relatively less credible and useful."

¹⁶ The Accounting and Auditing ROSC 2017 for Pakistan can be found <https://openknowledge.worldbank.org/bitstream/handle/10986/28393/Final-Pakistan-ROSC-Report-2017-P154547.pdf?sequence=1&isAllowed=y>.

¹⁷ See the Accounting and Auditing ROSC 2017 for full details.

NON-FINANCIAL DISCLOSURE

The CA 2017, the LCR 2017, and the PSX Regulations require significant non-financial disclosures, including corporate plans and decisions; investments; director attendance at board meetings; and pattern of shareholding.¹⁹

Disclosure of key documents and company objectives

Key company documents are required to be disclosed; copies of memorandum and articles of association must be provided.²⁰ Shareholders also have rights to obtain the minutes of the AGM within 7 days.²¹

Direct share ownership is disclosed; disclosure of indirect (or beneficial) share ownership is not required.

Under the CA 2017, companies are required to disclose “information about the pattern of holding of the shares in the form specified”.²² The Fourth Schedule of the Act requires disclosure of foreign significant ownership. The PSX regulations include language from the old Code which mandated companies to identify “shareholders holding five percent or more voting rights in the listed company (name wise details)”. These requirements are complied with in practice.

There do not appear to be requirements for beneficial (indirect) ownership disclosure. There is also no disclosure required of group structures. Pyramid structures, cross shareholdings and the absence of the joint action or “acting in concert” concepts can make it difficult for outsiders to grasp the ownership structure of more complex business groups. The Fourth Schedule of the Act requires shareholder agreements must be disclosed.

SECP took an important step in 2018 by introducing Circular 16, which requires all companies having legal persons as shareholders to take “reasonable measures” to obtain and maintain up-to-date information relating to their ultimate beneficial owners, i.e. “natural persons or individuals who ultimately own or control the company” in a register of ultimate beneficial ownership.

¹⁸ The LCR removed several disclosure requirements that were present in the old Code of Corporate Governance from the PSC Listing Regulations. These changes are noted below.

²⁰ CA 20-17, Section 39

²¹ CA, Section 152.

²² CA 2017 Section 227 (2,f). However, little additional detail is supplied and it appears that additional regulations on ownership disclosure are required for full implementation.

Remuneration of members of the board and key executives.

The LCR require listed companies to include in the Annual Report "... details of the aggregate remuneration separately of executive and non-executive directors, including salary/fee, benefits and performance-linked incentives etc."²³ Part III 35 of Fourth schedule of CA 2017 requires disclosure of:

- fees;
- managerial remuneration;
- commission or bonus, indicating the nature thereof;
- reimbursable expenses which are in the nature of a perquisite or benefit;
- pension, gratuities, company's contribution to provident, superannuation and other staff funds, compensation for loss of office and in connection with retirement from office;
- other perquisites and benefits in cash or in kind stating their nature and, where practicable, their approximate money values; and
- for any other services rendered.

There are no requirements to disclose at an individual level, or links with long-term performance.

In general, companies appear to comply with the past regulations. Two of the 25 companies in the annual report survey disclosed remuneration on an individual basis, as well as the link between remuneration and company performance.

Information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board.

Under SRO 634 (i) July 10, 2014 issued under S506 B, companies are required to disclose the "profile" of members of the board. However, the Annual Report survey indicated that only 25% of surveyed companies mentioned board member qualifications.

Board members and key executives required to disclose transactions in the company's securities. In the annual report survey, 100% of companies appeared to comply with this requirement. The shareholding of directors, their spouse(s) and minor children (name wise details) is disclosed in the statement of shareholding pattern attached with annual financial statements. However, in case of executives only direct shareholding is disclosed in shareholding pattern. In the annual report survey, 92% of companies complied with this requirement.

Companies are not required to disclose a board nomination and appointment process.

Related party transactions.

Pakistan follows IAS 24, which requires full disclosure of related party transactions in the annual report. In the annual report survey, all companies surveyed made detailed related party transaction disclosures (including (i) the type of transactions; (ii) names of the related parties involved; (iii) amount of the transactions; and (iv) other details of the transaction(s) including, whether it was at market price). All companies are required to maintain a party wise record of transactions, in each financial year, entered into with related parties in that year along with all relevant documents and explanations. The annual report survey indicated that all companies complied with this requirement.

²³ LCR, paragraph 38.

Foreseeable risk factors	<p>The CA 2017 mandates that the directors' report must contain "... a description of the principal risks and uncertainties facing the company". In the annual report survey, 96% of companies disclosed information about foreseeable risk factors.</p> <p>There is no requirement has been entailed in law or regulation regarding public disclosure of policies on risk management and internal controls in their annual report. The LCR does include in the terms of reference for the audit committee a "Appropriate extent of disclosure of company's risk framework and internal control system in Directors report."</p> <p>Companies are not required to publicly disclose their policies on risk management and internal controls in the directors' report.</p>
Issues regarding employees and other stakeholders	<p>There is no requirement for companies to disclose material issues regarding their employees. FRS 7 requires disclosure of breaches, defaults of loan agreements issues materially affecting the users understanding of the entity. The Annual report survey indicates that few companies appear to make disclosures in this area.</p> <p>The annual report survey indicated that in the past 38% of companies surveyed made disclosures about environmental impact. The CA 2017 (Section 227) now requires that the business review in the annual report include a discussion of the impact of the business on the environment.</p>
Governance structures and policies, including the content of any corporate governance LCR or policy and the process by which it is implemented.	<p>Listed companies are required to include statements of compliance with the applicable IFRS in the annual reports as an annexure to the directors' report. Companies are also required to submit a standard questionnaire (Annex A) that describes compliance with the LCR. Responsibility for compliance with these mandatory requirements rests with the Chairman and the members of the board and the CEO.</p>
AUDIT AND AUDIT OVERSIGHT	
All companies are required to prepare an audited annual report	<p>Pakistan has adopted International Standards of Audit (ISA), including those related to quality control (QC) and the new audit report format, which is required by the SECP since the beginning of 2017.</p> <p>Companies are required to appoint an auditor at the AGM on an annual basis. Listed company auditors must have a satisfactory rating from ICAP's quality control review (QCR) program.</p>
The audit profession in Pakistan was largely self-regulated by ICAP until the recent establishment of the Independent Audit Oversight Board (AOB)	<p>The Audit Oversight Board (AOB) was established to provide independent oversight of the audit profession, in line with international good practice. The organization was created by 2016 amendments in the SECP Act, 1997, at the initiative of ICAP, the SECP, and other regulators and stakeholders. The organization is now being put in place.</p> <p>The AOB's roles will include (a) registering and de-registering audit firms, (b) overseeing the QAB and the QCR system, (c) directing ICAP to make changes to the QCR system as the AOB deems necessary, (d) ensuring auditing standards in Pakistan conform with ISA, and (e) conducting inspections and inquiries. The AOB</p>

	will have seven members appointed by the GoP upon the recommendation of a Nominating Committee comprising high-level government officials (for example, Secretary to the GoP's Finance Division, SBP Governor, President ICAP, and the SECP Chairman). Adequate resources and other operational issues remain key challenges for the AOB.
ICAP has upgraded its own quality assurance program.	The QCR program is under the oversight of the Quality Assurance Board (QAB), nominated by the ICAP Council (5), the SECP (4), and one member each from the SBP and the PSX. Board members are appointed for a three-year term, renewable once. The QAB reviews the results of the QCR and approves the assigned ratings. In 2017, the QAB published a comprehensive report on QCR activities conducted during the financial year 2015-16, including a summary of the main deficiencies uncovered by the QA reviews. The report is published on ICAP's website. ²⁴
Listed company auditors must rotate every five years	<p>Listed companies may only appoint audit firms with a satisfactory rating from ICAP's QCR program and auditor rotation is mandatory. Approximately 100 audit firms currently have a satisfactory rating from ICAP.</p> <p>Listed companies must at a minimum rotate the audit engagement partner every five years. Financial institutions (banks and insurance companies) are required to rotate audit firms every five years.</p> <p>The auditors of listed companies are restricted in the non-audit services they may provide. The PSX listing regulations provide a detailed list of services that auditors of listed companies are prohibited from providing to their clients, including financial statement preparation, actuarial services, and corporate finance services.</p>
Auditor accountability	<p>Per the LCR, the board of a listed company recommends the appointment of external auditors for a year, following a suggestion from the audit committee. The rationale for any change in auditor must be noted in the Directors' Report. Auditors have the obligation to ensure that financial statements provide a true and fair picture of company affairs. Despite an increasing number of qualified audit opinions, auditors sometimes prefer to issue "subject to/except for" opinions with a list of observations. These are inappropriately qualified opinions which can mislead or confuse investors.</p> <p>Auditors are not directly liable to shareholders, because there is no contractual relationship between the auditor and the shareholders. However, the listing rules define "professional misconduct" for auditors. SECP has been pro-active in prosecuting auditors in cases of non-compliance.</p> <p>While indemnity insurance is not required by law, some affiliates of international firms are covered.</p>

CHANNELS OF INFORMATION DISCLOSURE

In general, the regulations require information to be sent to the SECP and to the PSX. Some information is now required by SECP to be posted on each company's website. Annual filings are submitted to the SECP and the stock exchange and are transmitted to shareholders by post. The audited annual financial statements must be circulated no later than four months from the close of the financial year.

²⁴ <http://www.icap.org.pk/wp-content/uploads/QA/annual/QAB-report2016.pdf>

Companies are required to disclose any information that could affect the price of the company's shares

Listed companies must immediately disseminate all material information relating to the business and other affairs of the listed company that will affect the market price of its shares. Examples of information that must be disclosed include the issue or redemption of any securities; a major change in borrowings including projected gains to accrue to the company; any default in repayment or rescheduling of loans; and change in directors, Chairman or CEO of the listed company.

The Securities Act provides that a listed company may delay the public disclosure of price sensitive information such as not to prejudice its legitimate interests. This is also done under certain circumstances/situations.²⁵

In general, most observers believe that there is relatively good awareness of and compliance with these requirements.

Selective disclosure

The Securities Act 2015 prohibits selective disclosure. A listed company must make sure that its methods for disclosure provide equal and timely access to holders of its securities.

PROPOSED POLICY RECOMMENDATIONS

Require the disclosure of beneficial (indirect) ownership

While disclosure of the direct shareholding structure is required by current law and regulation, the disclosure of indirect ownership is not. This is an important element of international good practice, and has implications for the efficiency of other parts of the legal framework (especially preventing abusive related party transactions). Requirements to disclose group structures (the links between the company and a larger corporate entity) and all mechanisms for disproportionate control (shareholder agreements, multiple voting shares, etc.) would help to round out the overall picture of ownership and control.

Supplement or make more explicit other non-financial disclosure requirements

The following disclosure requirements of the OECD Principles do not appear to be required under current regulation, and could be added to the regulatory framework

- Full disclosure of the profile of board members under SRO 634 (including current employment and length of service)
- Information on the rules, including voting procedures that govern the AGM
- Disclosure of policies required under the LCR (e.g. code of ethics, risk management policy, internal controls policy)
- Material foreseeable risk factors and risk appetite statement
- Full disclosure board and committee charters, and committee composition and mandates.
- Information on remuneration at the individual level (on a voluntary basis)

Make additional information available on line

SRO 634 could expand the information that must be placed on company website. This could include company documents and policies for which there is no required disclosure (e.g. code of ethics, articles of incorporation, remuneration policies, risk management policies, related party transaction policies, company meeting procedures, and board charters).

²⁵ Section 96(4)

Consider segregating all the non-financial disclosure requirements into a new omnibus regulation

The legislative and regulatory changes of 2017 have left the non-financial disclosure requirements for listed companies in a state of flux. Relevant regulations are somewhat scattered across different documents (including the PSX regulations), and have slightly different definitions and priorities. A stand-alone disclosure regulation would maintain the focus on disclosure and transparency, clarify and harmonize requirements, and distinguish what companies and boards should “do” from what they should disclose).

The Audit Oversight Board should be made operational

The independent audit oversight board should be made operational as quickly as possible, including full funding and staffing

OECD PRINCIPLES ASSESSMENT: DISCLOSURE AND TRANSPARENCY

Using the World Bank methodology to assess compliance with the OECD Principles that cover disclosure and transparency, 6 principles were fully implemented, 3 principles were broadly implemented, and 4 were partially implemented.

As noted, adoption of a few specific non-financial disclosure requirements would increase compliance with the OECD Principles.

OECD Principles covering Disclosure and Transparency			
		Rating	Level of Implementation
		81.4%	Broadly implemented
V.A.1	1. Material information on the financial and operating results of the company.	100.0%	Fully Implemented
V.A.2	2. Material information on company objectives.	100.0%	Fully Implemented
V.A.3	3. Material information on major share ownership and voting rights.	37.5%	Partially Implemented
V.A.4	4. Remuneration of members of the board and key executives.	37.5%	Partially Implemented
V.A.5	5. Information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board.	74.2%	Partially Implemented
V.A.6	6. Related party transactions	100.0%	Fully Implemented
V.A.7	7. Material information on foreseeable risk factors.	75.0%	Broadly Implemented
V.A.8	8. Material information on issues regarding employees and other stakeholders.	45.8%	Partially Implemented
V.A.9	9. Governance structures and policies, in particular, the content of any corporate governance code or policy and the process by which it is implemented.	100.0%	Fully Implemented
V.B	Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.	100.0%	Fully Implemented
V.C	An annual audit should be conducted by an independent, competent and qualified, auditor.	94.6%	Broadly Implemented
V.D	External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.	100.0%	Fully Implemented
V.E	Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.	93.8%	Broadly Implemented

Board Practices and Company Oversight

KEY FINDINGS

This section focuses on improving the composition, performance, and professionalism of the boards of directors of listed companies. It covers most of Chapter VI of the OECD Principles of Corporate Governance (*Boards of Directors*).

- It is organized in the following sections:
- Board Duties and Responsibilities
- Board Composition and Selection
- Board Structures
- Board Professionalism

A company survey provides a basic picture of boards in Pakistan

The charts on the following page summarize boards of listed companies, based on the survey of annual reports conducted by Deloitte for this report.

- The average size of surveyed boards was 8.0 directors; most surveyed boards had seven. A few companies had much larger boards, mostly PSCs.
- Independent directors were present on every surveyed board, with an average of 2.0 directors. 11 out of 20 companies only have one.
- There was an average of 4.4 other non-executive directors and 1.6 executive directors on the surveyed boards.
- Three quarters of the surveyed companies had no women directors.
- All companies in the survey had an audit committee, but half the companies had not independent members of the audit committee.

BOARD DUTIES AND RESPONSIBILITIES

Board structure and duties are driven by the Companies Act

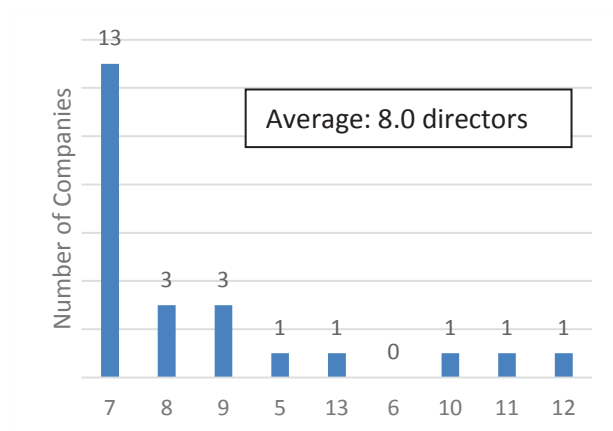
Pakistan has a one tier board system. The Companies Act provides basic board requirements. Board tenure is three years, except for appointed directors (nominee directors). Only natural persons may serve as directors. Board members must be shareholders unless they represent the government or an institution which is a shareholder or creditor, or is an employee of the company.

Boards dominated by controlling shareholders

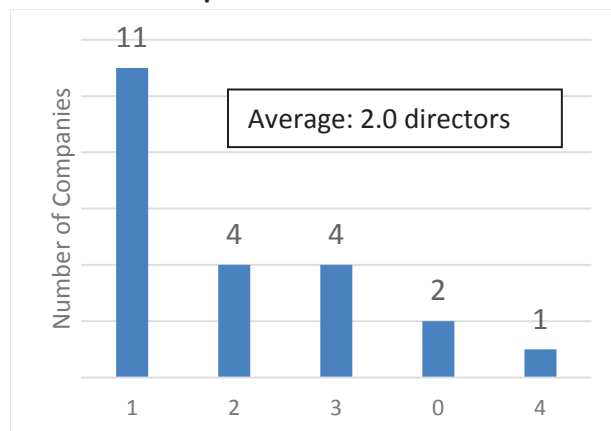
In family companies, boards are dominated by executive and non-executive members of the controlling family and by proxy directors appointed to act on their behalf. Inter-locking directorships are often used to retain majority control. Family-dominated boards are less able to protect minority shareholders, and risk a loss of competitiveness relative to other companies.

Boards of Directors: Results from the Survey of Annual Reports

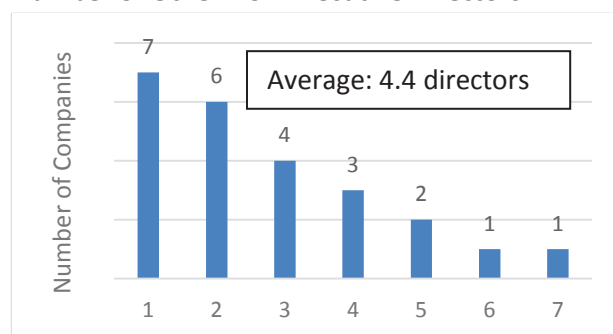
Total Board Size



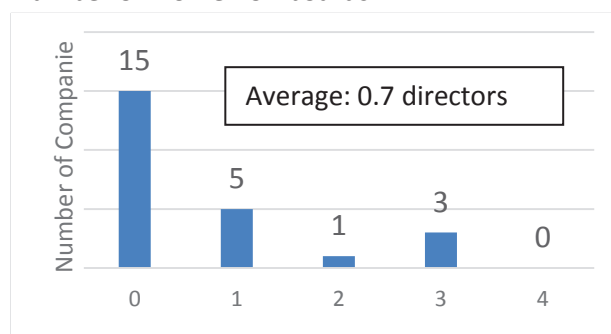
Number of Independent Directors



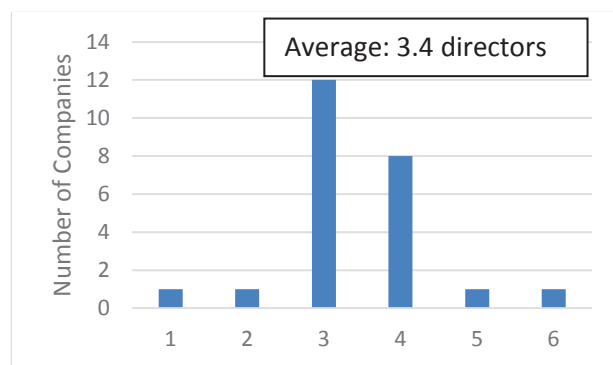
Number of Other Non-Executive Directors



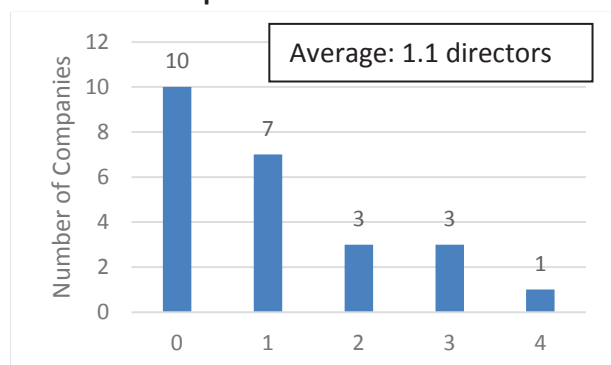
Number of women on boards



Size of audit committee



Number of independent members



Source: Survey of 2015 Annual Reports conducted by Deloitte. Sample included 20 listed companies, from different sectors, including 5 public sector companies.

In practice, there is often an unclear line distinction between ownership and control	Family owned companies are typically managed by the owning families themselves. In the case of PSCs and multinationals, there is often a direct relationship between the Ministry/foreign owner and management, again bypassing the boards. Many important corporate decisions are not made at the board (or AGM) level and, as a result, boards—as distinct from management—may not be the driving force behind corporate strategy and strategic issues.
The position of chairman is not well-covered in law or regulation	The Companies Act requires a listed company board to appoint a chairman from among the non-executive directors, for a period of three years unless he earlier resigns or becomes ineligible.
Fiduciary duties were codified in the new Companies Act and are one of its most important reforms	<p>In the past, the duties of directors were based on case law. The 2017 Companies Act codified general director duties for the first time. Directors must act with a duty of loyalty, “in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees the shareholders the community and for the protection of environment.”²⁶ Directors also have a duty to “...discharge his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.” The LCR goes further urges boards to “...carry out its fiduciary duties with a sense of objective judgment and independence in the best interests of the company and stakeholders.”</p> <p>However, the fact that many boards are dominated by the controlling family / parent / Ministry makes it a challenge for board members to be truly accountable to all shareholders.</p> <p>The new fiduciary duties of directors also include a basic duty to protect the interests of stakeholders, including “employees”, “community”, and the “environment”.</p> <p>In practice, there are almost no suits against directors. Liability insurance, while legal, is rarely used.</p>
Companies are required to put a code of conduct in place	<p>The LCR requires that boards ensure that a Code of Conduct is put in place to promote ethical culture in the company, and the Code of Conduct is disseminated throughout the company along with supporting policies and procedures</p> <p>However, only 40% of companies in the Annual Report survey noted that they have put a code of ethics in place.</p>
Responsibilities of the board: strategy and key decisions	The LCR requires the board to “prepare and adopt... a vision and/or mission statement and overall corporate strategy”. The LCR also describes a number of “significant issues” that must be placed before the board or its committees, and requires the board to “formulate significant policies”. These may include procurement, capital expenditure, investment, and “determination and delegation of financial powers”. In practice, boards in many companies do play a central and strategic role.
2. Monitoring the effectiveness of the company’s governance	The board is also required to set significant policies on “governance, risk management and compliance issues”. The board is required to report on its compliance with the LCR. But there is no explicit requirement to take

²⁶ CO 2017, Section 2014.

practices and making changes as needed	responsibility for the corporate governance practices of the company.
3. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.	<p>Under Section 187 of the Companies Act, the board appoints the CEO. Under the LCR, boards are responsible (through the HR and Remuneration Committee) for “the selection, evaluation, compensation (including retirement benefits) and succession planning of the CEO”. In practice, in many cases, the CEO is informally appointed by the majority / controlling shareholder. Succession planning is not yet common in practice.</p> <p>The new Companies Act stipulates that the government is responsible for the appointment of the CEO in Public Sector Companies. This represents a significant departure in the CA from international standards.</p>
4. Aligning key executive and board remuneration with the longer term interests of the company and its shareholders.	Under the LCR, the company must have a “formal and transparent procedure” for fixing the remuneration packages of individual directors. “Directors remuneration packages shall encourage value creation within the company. These shall be subject to prior approval of shareholders/board as required by company’s Articles of Association. Levels of remuneration shall be appropriate to attract and retain the directors needed to govern the company successfully.”
5. Ensuring a formal and transparent board nomination and election process	<p>A board nomination and election process is defined in Section 159 of the Companies Act. There is no specific requirement for companies to develop a “transparent nomination process”, and board is not required or encouraged to play a role.</p> <p>The LCR requires companies to “facilitate” the nomination of directors by minority shareholders.</p>
6. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.	<p>The LCR also requires the board to ensure that a system of sound internal control is established and effectively implemented and maintained at all levels within the company. In practice this is carried out through the audit committee. In most companies, the internal control system is effectively reviewed / overseen by controlling shareholder directors.</p> <p>The Deloitte Survey revealed some weaknesses in the disclosure of internal control systems.</p>
The audit committee is responsible for related party transaction approval	Under the Companies Act, directors “shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.”
7. Ensuring the integrity of the corporation’s accounting and financial reporting systems	<p>The LCR requires the board to oversee the establishment of a risk management framework and an internal control system designed to ensure for the integrity of the financial reporting system. The LCR asks boards to establish “significant policies” including those covering governance, risk management and compliance issues</p> <p>An internal audit department is required in every company. The LCR requires the Head of internal Audit to functionally report to the Audit Committee and</p>

administratively to the CEO. The board (through the audit committee) also manages the relationship with the external auditors. The terms of reference for the audit committee includes compliance with applicable accounting standards, and compliance with other statutory and regulatory requirements.

In practice, the establishment of modern risk management frameworks, and the compliance function, is nascent outside of the financial sector. .

8. The board is to oversee company disclosure and take responsibility for the company's communications strategy.

In practice, boards do appear to oversee the process company disclosure and communications. The LCR mentions that boards should produce policies on "investors' relations including but not limited to general investor awareness, complaints and communication, etc. However, there is no specific reference to the board's responsibility in this area."

BOARD COMPOSITION AND SELECTION

Board composition requirements are set by the LCR

The LCR "encourages" the board of directors to have balance of executive and non-executive directors, including independent directors and those representing minority interests with the requisite skills, competence, knowledge and experience so that the board as a group includes core competencies and diversity, including gender, considered relevant in the context of the company's operations.

In a major change, the LCR now mandates that the board must be composed of 1/3 Independent directors (or at least 2, whichever is greater). Executive directors should be limited to one-third of the total. The board shall state in the annual report the names of the directors.

According to interviews and the Deloitte survey, a majority of companies currently have only one independent director in line with the requirements of the old Code. This number may be too small to be effective, and is low by international standards. The SECP Thematic Review found one company that had no independent directors.

A requirement for gender diversity was introduced in the new Companies Act and the LCR

The LCR require at least one board member of every listed company to be a woman. As noted below – the representation of women on boards has been traditionally limited in Pakistan – of the 20 companies in the Deloitte Survey, 15 had no women members.

The definition of independent director is set by the Companies Act

An independent director is defined as someone "who is not connected or does not have any other relationship, whether pecuniary or otherwise, with the company, its associated companies, subsidiaries, holding company or directors; and he can be reasonably perceived as being able to exercise independent business judgment without being subservient to any form of conflict of interest"

The criteria for determining independence specifically exclude recent CEOs and employees, a "material business relationship", major (10%) shareholders, close relatives of major shareholders, and directors who have served more than three terms. Because of a lack of definition of beneficial / ultimate ownership, this definition may not capture all of the potential (indirect) links with controlling shareholders. .

The Chairman and the CEO must be separated

The LCR mandates that the Chairman and the CEO cannot be the same person. The Chairman is elected from among the non-executive directors. The Chairman is responsible for leadership of the board and ensures that “the board plays an effective role” in fulfilling all its responsibilities. The Board of Directors must clearly define the respective roles and responsibilities of the Chairman and CEO. There appears to be a high level of compliance with this requirement; the SECP Thematic Review found one example of a company where the two positions were combined, and one where an executive was selected as chairman.

The institution of the independent director remains controversial

Some observers complain about the institution of independent director. First, some independent directors are seen as actually representing the controlling shareholders. Second, the characteristics of independence may be overemphasized relative to director experience and professionalism. Increasing the number of independent directors, strengthening the credentials of board members, and expanding board training and the frequency and quality of board evaluations will help to overcome these concerns and improve board performance in the long term.

BOARD STRUCTURES

The LCR provides clear and transparent rules on board committees

An audit committee and a human resources committee are mandatory under the LCR. Other committees are required by other legislation (especially in the financial sector).

An international standard audit committee has been adopted by the market

The boards of listed firms are required to establish an audit committee, composed of at least three non-executive directors and at least one independent director. The committee Chair must be independent. The board must “satisfy itself” that at least one member of the audit committee has relevant financial skills/expertise and experience. The LCR provides a new and clear definition of financial literacy.

There is no requirement for companies to disclose their committee mandates and terms of reference.

The Code also requires a Human Resource and Remuneration Committee

The Human Resource and Remuneration (HR&R) Committee should be composed of at least of three members comprising a majority of non- executive directors, including preferably an independent director. The committee chair must be independent, and cannot be the CEO.

The committee is responsible for recommending human resource management policies to the board, including the selection, evaluation, compensation (including retirement benefits) and succession planning of the CEO, COO, CFO, and other officers.

BOARD PROFESSIONALISM

Director training

The LCR requires all listed companies to make “appropriate arrangements” to carry out orientation courses for their directors “to enable them to effectively manage the affairs of the listed companies for and on behalf of shareholders”. The LCR states that “all the directors of listed companies” must be certified by taking approved training programs. However, the requirements are optional for members with more than 14 years of experience. The LCR allows companies to

meet this requirement by 2021; this deadline has been continuously extended for several years, under previous regulation.

Competencies include the review of periodic financial statements, facilitation of the external audit, coordination of the internal and external audit functions, review of the internal audit, consideration of major findings of internal investigations, financial and operational controls, accounting systems, reporting structures, compliance with statutory requirements, monitoring compliance with the LCR, and other issues or matters assigned by the board. According to the new rules on transfer pricing issued by the SECP, the audit committee should review all related party transactions and approve any transaction not executed at arm's length prices.

The LCR also introduced a new requirement for companies to arrange training for at least one female executive and one head of department every year (beginning June 30, 2019 and 2021, respectively). These requirements will help to build a strong pool of future directors. Board training is relatively well-developed in Pakistan, and a pool of sophisticated directors has grown. Courses have been provided by PICG, ICAP, and various Universities. However, the regulatory extensions and the opt-out provisions means that there are still many more directors to reach. The director training requirements appear to have low levels of compliance, both in the Deloitte Survey and the SECP Thematic Review, in which almost all the 30 companies in the sample failed to meet the training requirements under the old Code.

Board commitment to responsibilities

The LCR mandates that no person shall be elected or nominated as a director of more than five listed companies simultaneously (excluding subsidiaries).

The OECD Principles ask companies to publicly disclose information about board members, to allow them to make judgements about their level of commitment. SECP SRO 634 requires all companies are required to disclose the "profile of board of directors" in the governance section of their company website. Per the Deloitte survey, compliance with many of these requirements are mixed in practice. However, there are no requirements for companies to disclose a director's length of service as a board member, tenure on various board committees, "primary employment", information regarding the number of board and committees' meetings held during the year, or attendance by each director.

Board evaluations are being done in Pakistan but their adoption is at an early stage

The LCR requires that companies adopt a "mechanism" for an annual evaluation of the board's performance. There is no required link to the remuneration of non-executive board members. The Deloitte survey reported that 72 percent of respondents reported compliance with this requirement.

Corporate governance in Pakistan meets many international standards

Using the World Bank methodology to assess compliance with Chapter 6 of the OECD Principles one principle was fully implemented, and 14 were broadly implemented.

PROPOSED POLICY RECOMMENDATIONS

Boards of directors of many listed companies function relatively well in Pakistan. However, more can be done to bring the legal and regulatory framework in line with international practice.

The SECP should focus its future enforcement efforts on those areas where risks are high and current compliance is weakest

Implementation of the new LCR is a key step to improve board effectiveness. The risk-based enforcement strategy should focus on the companies and topics that can have the most impact.

SECP should focus its LCR enforcement efforts on the areas which are important and where compliance with the former Code was mixed:

- Adoption of code of ethics (40% compliance per the Deloitte survey)
- Adoption of succession plans (low compliance)
- Disclosure of internal controls procedures (28% compliance)
- Risk management framework (low outside financial sector)
- Compliance function (low outside financial sector)
- Board independence (most companies only have one independent director)
- Majority independent audit committee (64 % compliance)
- Board evaluations (72% compliance)
- Gender diversity (36% Compliance)
- Board induction and training (40-56% Compliance)

A notable feature of this list is that many relate to the adoption of plans, policies, and procedures. Therefore, training should be provided to staff on how to distinguish “quality” in the different plans and how to encourage companies to improve.

A future review of the LCR should clarify existing requirements and address areas to improve board practices

Possible future changes to the LCR could include:

- Increase the number of independent directors required on key committees, to at least a majority.
- Explicitly require boards to establish an investor relations function in each company.
- Require companies and boards to develop explicit board nomination and elections policies.
- Explicitly require the remuneration policy to be aligned to both short and long term performance of the company, and to the board evaluation process.
- Explicitly refer to setting performance objectives and key performance indicators.
- Explicitly refer to the board's role in overseeing corporate governance practices.
- Explicitly require boards to oversee disclosure and communication.
- Clarify the role for the HR committee (and the Chairman) in the board nomination and elections procedures.
- Require companies to develop (and disclose) committee charters (or mandates)
- Explicitly describe key roles and responsibilities of a board chairman to complement the relevant provisions of the Companies Act
- Require more specific disclosures about current and prospective board members, including length of service as a board member, tenure on various committees, primary employment, and the number of other seats held.
- Require companies to provide professional advice at the expense of the company to the board and require the company to disclose the use of paid advisors by the board.

Section 10(4) of the LCR should be clarified

Regulation 10 of the LCR (focusing on the responsibilities of the board) is an important section. But subparagraph 4 is relatively unclear in its intent and meaning. It calls for the board to "...maintain a complete record of particulars of the significant policies along with their date of approval or updating". The paragraph notes that the "... significant policies may include but are not limited to" a long list of policies including risk management internal controls, and communication.

This language is unclear on whether companies must have explicit policies in these areas, and whether these policies need to be disclosed. This list should include all the policies recommended by the OECD Principles. Disclosure requirements should be made explicit in the LCR or elsewhere in law or regulation.

As a lower priority, future revisions to the Companies Act should address some currently missing elements of the legal framework

Future revisions to the Companies Act should:

- Include a discussion of board duties within a holding company / group structure.
- Annul the Section 187 (4) that explicitly gives the government the authority to nominate the CEO.
- Consider the possibility of including "claw back" provisions to recover previously paid remuneration in the event of fraud or negligence.

The PICG and other training providers should build on the support provided by the recent regulatory changes

As the LCR now provides for significant additional board training, the PICG and other training providers should upgrade its training curricula (based on recent regulatory and legal changes) and expand its marketing efforts to reach as many directors as possible, in both public and private sector companies.

OECD PRINCIPLES ASSESSMENT: BOARD OF DIRECTORS

Using the World Bank methodology to assess compliance with the OECD Principles that cover the responsibilities of the board of directors, 1 Principle was Fully Implemented, 11 Principles were Broadly Implemented, 4 Principles were Partially Implemented, and 1 Principle was Not Applicable.

OECD Principles covering the Responsibilities of the Board		Rating	Level of Implementation
		73.8%	Partially Implemented
VI.A	Board members should act in good faith, with care, and in the best interest of the company and shareholders.	83.3%	Broadly Implemented
VI.B	Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.	75.0%	Broadly Implemented
VI.C	The board should apply high ethical standards. It should take into account the interests of stakeholders.	75.0%	Broadly Implemented
VI.D.1	The board should fulfill certain key functions, including reviewing and guiding corporate strategy, risk policy, business plans; setting performance objectives; monitoring corporate performance; and overseeing major capital expenditures.*	86.4%	Broadly Implemented
VI.D.2	The board should fulfill certain key functions, including monitoring the effectiveness of the company's governance practices and making changes as needed.	91.7%	Broadly Implemented
VI.D.3	The board should fulfill certain key functions, including selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.	81.3%	Broadly Implemented
VI.D.4	The board should fulfill certain key functions, including aligning key executive and board remuneration with the longer term interests of the company and its shareholders.	38.3%	Broadly Implemented
VI.D.5	The board should fulfill certain key functions, including ensuring a formal and transparent board nomination and election process.	41.7%	Partially Implemented
VI.D.6	The board should fulfill certain key functions, including monitoring and managing potential conflicts of interest of management, board members and shareholders, including abuse in related party transactions	83.3%	Broadly Implemented
VI.D.7	The board should fulfill certain key functions, including ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, internal controls, risk management, and compliance are in place.	90.0%	Broadly Implemented
VI.D.8	The board should fulfill certain key functions, including overseeing the process of disclosure and communications.	100.0%	Fully Implemented
VI.E.1	Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest.	78.1%	Broadly Implemented
VI.E.2	When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board.	75.0%	Broadly Implemented
VI.E.3	Board members should be able to commit themselves effectively to their responsibilities.	37.5%	Partially Implemented
VI.E.4	Board members should be able to commit themselves effectively to their responsibilities.	58.8%	Partially Implemented
VI.F	In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.	85.0%	Broadly Implemented
VI.G	When employee representation on the board is mandated, mechanisms should be developed to facilitate access to information and training for employee representatives, so that this representation is exercised effectively and best contributes to the enhancement of board skills, information and independence.		Not Applicable

Institutional Investors and Shareholder Engagement

This section focuses on the role played by institutional investors and other supporting institutions in the corporate governance process. It covers the key issues in Chapter III of the OECD Principles of Corporate Governance (*Institutional investors, stock markets, and other intermediaries*).

KEY FINDINGS

Historically, the engagement and stewardship role of institutional investors has been limited in Pakistan. As in most countries, the asset management industry is relatively small and unassertive with respect to corporate governance, and the role of foreign investors has been limited. Asset managers worry about the expense and burden of taking additional responsibilities in this area.

Pakistan has a small but growing investment fund industry

20 asset management companies (AMC) held about PKR 490.4 billion (USD 4.7 billion) in assets under management (AUM) at the end of June 2016. Most assets are in open-ended mutual funds, but there is also a small private pension funds sector. About one third of AUM are in Shariah-compliant mutual funds. Total equity holdings are about 41 percent of total AUM, equivalent to about 6.5 percent of market capitalization.

Fund managers are required to have a proxy voting policy and disclose their votes

Since 2008, SECP Non-Banking Finance Companies and Notified Entities Regulations have required asset management companies to formulate proxy voting policies approved by their boards of directors. The policy must cover a variety of corporate governance issues, including authority and responsibility for voting proxies, voting procedures, internal decision-making around voting proposals. The policy should address the election of directors, the appointment of auditors, their positions on changes in law and capital structure, corporate restructuring, and mergers. The voting policy must be disclosed on the AMC's website.

The AMC must also disclose a summary of its voting in its annual report (the number of resolutions for, against, etc.) but votes on specific resolutions are not disclosed.

State-controlled investors play a major role

The sector's largest player is the National Investment Trust (NIT), whose funds represent about 120 billion of total AUM. NIT's ownership is about 56% private sector / 46 % government, a legacy of its past nationalization. Its 201 staff manage eight funds, of which the main Unit Trust has about 80,000 clients representing about 56 percent of the fund industry, and invests in about 370 companies. As in many institutional investors, the value of NIT's portfolio is held back by a lack of liquidity. Only about 29% of the portfolio is liquid; and more than 100 of the 370 companies have seen no recent trading activity.

NIT plays an important role in corporate governance, and sits on approximately 67 boards. It has a proxy voting policy, but the policy is mostly limited to the process of granting permissions to vote, and does not discuss policies about how the company will vote on any particular issues. About half the appointed board members are professionals, the other half are NIT staff.

Shares are blocked from trading before the annual meeting.

One legal and regulatory provision that has been identified as potentially harmful to the interests of institutional investors is the ability of companies to block share trading before the annual meeting. The board may suspend the registration of transfers for up to ten days immediately preceding a general meeting by giving seven days prior published notice (CA, First Schedule, §10). During the period when the register is closed, trades can take place on the exchange, but updates are not recorded in the share register.

Disclosure of conflicts of interest by analysts, brokers, rating agencies, etc.

The SECP has mandated a Code of Ethics for credit rating agencies and has drafted codes of ethics for financial analysts and asset managers.

PROPOSED POLICY RECOMMENDATIONS

Asset management companies should increase their engagement and influence

The largest investors (particularly NIT) have a unique ability to influence companies to adopt better governance. NIT can become more assertive in developing its own expectations for corporate governance, and making those expectations clear to its investee companies.

The industry as a whole can develop a forum to discuss a number of important topics, including minority shareholder rights and redress, and reaching out to smaller issuers that until now have not been interested in investor relations. The industry can also reach out to foreign investors, who can work through the local associations to register the importance they attach to corporate governance and to ESG issues more generally.

Increase the capacity of asset managers to constructively engage

SECP (or investor bodies, through self-regulation) should encourage AMCs to play a stronger stewardship role by building local capacity in the area of corporate governance and stewardship. The SECP can informally review the quality of corporate governance and proxy voting policies.

The SECP can also directly encourage AMCs to play a stronger stewardship role, perhaps through the adoption of a stewardship code. An increasing number of countries have put in place a stewardship code to define and encourage the corporate governance role of institutional investors. A stewardship code can play a long-term role in building a market-based system for investors to hold companies to account for their corporate governance practices. Donor partners could also provide technical assistance in this area.

SECP can review its regulations on asset management companies

Future revisions to the Regulations can include an acknowledgement that AMCs can move beyond proxy voting and engage with companies to change their governance practices, in line with the interests of their ultimate investors. SECP can also update other relevant rules and regulations that affect the conflicts of interest faced by asset management companies when their representatives sit on boards.

OECD PRINCIPLES ASSESSMENT: INSTITUTIONAL INVESTORS

The Detailed Country Assessment of the OECD Principles of Corporate Governance is summarized on in the table below. Using the World Bank methodology to assess compliance with Chapter III of the OECD Principles 5 principles were Broadly Implemented, one was partially implemented, and one was not applicable. Several of the Principles rated as “Partially” implemented are not particularly relevant in Pakistan, given the lack of cross listings and the absence of local proxy advisors.

OECD Principles covering Institutional Investors		Rating	Level of Implementation
	Chapter III Overall	65.2%	Partially Implemented
III.A	Institutional investors acting in a fiduciary capacity should disclose their corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights.	93.8%	Broadly Implemented
III.B	Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.*	87.5%	Broadly Implemented
III.C	Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.*	75.0%	Broadly Implemented
III.D	The corporate governance framework should require that proxy advisors, analysts, brokers, rating agencies and others that provide analysis or advice relevant to decisions by investors, disclose and minimise conflicts of interest that might compromise the integrity of their analysis or advice.	41.7%	Partially Implemented
III.E	Insider trading and market manipulation should be prohibited and the applicable rules enforced.	83.0%	Broadly Implemented
III.F	For companies who are listed in a jurisdiction other than their jurisdiction of incorporation, the applicable corporate governance laws and regulations should be clearly disclosed. In the case of cross listings, the criteria and procedure for recognising the listing requirements of the primary listing should be transparent and documented.		Not Applicable
III.G	Stock markets should provide fair and efficient price discovery as a means to help promote effective corporate governance	75.0%	Broadly Implemented

Source: Detailed Country Assessment. Figures represent the percent implementation of each OECD Principle. 95 % = Fully implemented, 75-95 = Broadly Implemented, 35-75 = Partially implemented, and less than 35% = not implemented.

Special Topic:

Governance of Public Sector Companies

This section of the report details the governance challenges in a key set of public interest entities—the Public Sector Companies (PSCs).²⁷ The analysis below summarizes Pakistan’s reform experience and recent research, as well as new interviews carried out as part of the ROSC process, and proposes recommendations for reform. The section is organized as follows:

- The portfolio of public sector companies
- The legal and regulatory framework for the corporate governance of PSCs
- State ownership arrangements
- Board composition and appointments
- Transparency and disclosure
- Proposed policy recommendations

The governance of State Owned Enterprises is a key element of the public policy agenda

Around the world, many state-owned enterprises underperform, with high economic, financial, and opportunity costs for the wider economy. Inefficient provision of critical inputs and services can increase costs for local businesses and divert scarce public sector resources and taxpayers’ money away from social sectors that directly benefit the poor.

Past efforts at reform have made clear that poor SOE performance, where it occurs, is caused less by exogenous or sector-specific problems than by fundamental problems in their governance—the underlying rules, processes, and institutions that govern the relationship between SOE managers and their government owners. These governance problems can include contradictory mandates, the absence of clearly identifiable owners, politicized boards and management, lack of autonomy in day-to-day operational decision making, weak financial reporting and disclosure practices, and insufficient performance monitoring and accountability systems.

Improvements to corporate governance can boost the efficiency of SOEs and that of the economy as a whole. Good corporate governance can also contribute to an investment friendly environment and can attract private sector investment in support of development, particularly in the infrastructure sectors. Poorly performing SOEs cannot access financing through the capital markets, which is critical to infrastructure and financial sector development.

KEY FINDINGS

THE PORTFOLIO OF PUBLIC SECTOR COMPANIES

The 169 public sector companies (PSCs) are a sizable part of Pakistan’s economy

There are 169 Federal PSCs²⁷. The PSCs include 126 commercial companies (including 60 subsidiaries) and 43 non-commercial companies (including 12 subsidiaries). There are 120 PSCs that fall under the purview of the Companies Act, and six have their own special enactments. Non-commercial companies are covered by section 42 of the Companies Act 2017. Out of the 169 PSCs, 12 of the largest are listed on the PSX. According to data from the 2015-16 *State Owned Entities Performance*

Review, ownership structures are relatively complex; many companies have (mostly small) minority shareholdings, although all appear to be majority controlled by the State. Many PSCs own stakes in other PSCs (most notably the 72 subsidiaries).

²⁷ This chapter focuses on Public Sector Companies rather than the broader concept of state-owned enterprises. This is because the PSCs are generally incorporated under the Companies Act, and recent regulation (especially the Public Sector Companies Rules (2017) are applicable to PSCs. The whole SOE sector includes 169 PSCs, 7 Development Finance Institutions, and seven Federal Authorities. In practice, although each of the different types of institutions has a distinct legal basis, they share similar governance challenges.

²⁸ Source: *State Owned Entities Performance Review, FY2014-15*. PSCs are defined as any company in which the state is the beneficial owner, directly or indirectly controls a majority of voting shares or can nominate or appoint a majority of its board of directors http://www.finance.gov.pk/publications/State_Owned_Entities_FY_2014_15.pdf

PSCs are an important part of the economy

- PSCs operate in a wide range of economic sectors including energy, finance, industry & engineering, trading, services, and transportation. PSCs contribute around 10 percent of GDP and represent about a third of stock market capitalization.²⁹
- In 2014-15, gross revenues amounted to PKR 4,175 billion (approximately USD 40 billion) or about 15% of GDP. Profits (excluding non-commercial PSCs) amounted to PKR 52 billion (around USD 0.5 billion) equal to 0.2% of GDP.³⁰
- Employment for all state-owned entities was approximately 400,000 workers, about 0.74% of the total employment. Commercial PSCs account for the largest share in employment (255,036), with the power sector accounting for 41% of total PSC employment.
- PSCs have a major impact on public finances as the sources of dividends but also as recipients of operating subsidies, government loans, guarantees, and capital injections.

PSCs remain a significant fiscal burden

The table on the next page shows that the government financial support to the SOE sector (including PSC) continues to be a significant burden. The total of financial support provided during FY 2014-15 amounts to over USD 5 billion, including almost \$2.5 billion in loans and guarantees.³⁰

Subsidies remain high, although the Government has been able to gradually phase out untargeted subsidies (and converting them to loans). Electricity subsidies were reduced from 2.3 percent of GDP in FY11/12 to 0.6 percent in FY15/16 by introducing significant increases for all tariff classes following the introduction of the National Power Tariff and Subsidy Policy Guidelines 2014³¹.

**GoP Support of the SOE Sector
FY 2014-15**

Support Provided	Rupees (Billion)	USD (Millions)
Loans	110.3	1,051.4
Domestic	93.4	890.3
Foreign	16.9	161.1
Guarantees	154.8	1,475.6
Subsidies	229.0	2,182.9
Grants	37.0	352.7
Total	531.1	5,062.6
Source: State Owned Entities Performance Review, FY2014-15.		

²⁹ Source: State Owned Entities Performance Review, FY2014-15. There were 183 State Owned Entities, including the 169 PSCs, 7 Federal Authorities, and 7 Development Finance Institutions (DFI). Some data is only available for the SOE sector as a whole.

³⁰ MOF, Finance Division, 2016. <http://www.mowp.gov.pk/gop/index>.

³¹ <http://www.mowp.gov.pk/gop/index>.

THE LEGAL AND REGULATORY FRAMEWORK

The existing governance framework for PSCs includes the Companies Act 2017; the LCR (for listed PSCs); and the Public Sector Companies (Corporate Governance) Rules 2013, as amended up to 2017 (referred to as the Rules below). Some companies also have their own enabling statute.

The Rules represent an important effort by the Government to improve the governance of the PSCs

The Rules were formulated by a Task Force formed by the Federal Government, and issued by the SECP. Companies must file annual statements of compliance with the SECP (in a manner like a code of corporate governance). The Rules were last updated in April 2017.

The Rules are enforced by SECP. PSCs that fail or refuse to comply with, or contravene any provision of the rules, or knowingly and willfully authorize or permit such failure, refusal or contravention are liable to a fine of PRs 5 million plus PRs. 100,000 per day for continuing default. The SECP Annual Report for FY2016-17 notes that “show-cause” notices were issued during the year to 87 companies that failed to file their statement of compliance for the year ending June 30, 2016 and earlier. The SECP also issued letters, emails and reminders to all companies to file statement of compliance, and demand notices were issued to 130 companies. The SECP also granted 26 “relaxations” from the Rules.

The Rules and their enforcement have begun to put pressure on the PSCs and appear to be improving overall governance practices. Interviews suggest a high level of awareness of the Rules in many companies, and a grudging respect and acceptance of the SECP’s role by other parts of the government. The courts have upheld different provisions of the Rules in different judgements. The Public Accounts Committee (PAC) of the National Assembly also adopted a resolution in 2014 which encouraged implementation of Rules.

However, the implementation of the Rules remains very much a work in progress

Many observers have complained that enforcement (and the resources dedicated to PSC enforcement activities) has been insufficient. Going forward the SECP intends to enforce the Rules more closely. Although specific compliance figures are not publicly available, it is estimated that 40-50% of companies do not comply with some aspect of the Rules on paper. Most observers also agree that the incidence of companies that comply with the spirit of the law is lower still.

This level of compliance is partially due to the fact that the government has delegated this task to the SECP, which must essentially regulate other federal ministries who are carrying out ownership responsibilities. The SECP is placed in the difficult situation of imposing policies on other Ministries that are normally outside of its purview. The Rules set government corporate governance policy, but are not a substitute for active and commercially-based ownership by the State.

STATE OWNERSHIP ARRANGEMENTS

In Pakistan, although practices are not formalized in any specific policy statement, the State’s ownership and

Line ministries take many key decisions of the companies within their sectors. The line ministries are responsible for the exercise of the government’s ownership rights in PSCs, and make many key decisions at both the strategic and operational level, depending on the company. They nominate most of the government-appointed board members and the chief executives³³

There are sixteen ministries that are engaged in the administration of the 169 PSCs.

³³ SECP has issued the Public Sector Companies (Appointment of Chief Executive) Guidelines, 2015 as a benchmark for companies to follow in the appointment of their Chief Executive Officer.

oversight functions are highly decentralized

A large majority of the PSCs (69%) are concentrated under five main ministries namely: Ministry of Industries & Production; Ministry of Water & Power; Ministry of Finance, Revenue, Economic Affairs, Statistics and Privatization; Ministry of Ports and Shipping; and Ministry of Petroleum and Natural Resources.

In general, in this system the Ministries play a significant role in the activities of companies

Interviews with Ministry officials and board members suggest a wide variety of practices. Many companies are (in the words of one board member) only “semi-autonomous”; the Ministries informally take some decisions that good practice assigns to the board of directors or management. Board members appointed by the Ministry sometimes dominate board meetings. In general, while many companies report that day-to-day interference is limited, they also noted that government feels “that it is their right” to make requests of the company on large and small matters. These factors raise the possibility of political interference in the companies.

Some companies report more autonomy. For example, Oil and Gas Development Company Limited is one of the largest and most profitable PSCs. A listed company with 85% government ownership, the board and management report no specific day-to-day interference. The board is appointed by the government, and includes the Secretary of the Ministry of Petroleum. The chair is independent. The company’s work program and decision-making is independent, with no approval of expenditures. However, there are a few rules and regulations that slow down the company and result in lost productivity. These include procurement regulations and approval of any external travel. A major issue faced by the company is the payment of debts owed to the company by various levels of government.

Other Ministries and bodies play important roles in the system

The Ministry of Finance oversees budgets and expenses, and often appoints a board member to the PSCs. The Ministry also produces an annual report on the PSCs and their performance. The Prime Minister’s office often formally appoints board members. The SECP sets and enforces corporate governance policy for the PSCs through its Rules. Since the promulgation of the Rules, the SECP along with the Institute of Chartered Accountants of Pakistan (ICAP), Ministry of Finance (MoF), Pakistan Institute of Corporate Governance (PICG) and other institutions have undertaken training and advocacy efforts to bring clarity to the roles of the different stakeholders in the governance framework of PSCs.

Several other statutory bodies exercise oversight over the financial and operational affairs of PSCs, including Public Accounts Committee (PAC), Auditor General of Pakistan (AGP), Public Procurement Regulatory Authority (PPRA), and sectoral regulatory authorities. Regulatory bodies set standards for operations at sector level.³³

³³ <https://www.oecd.org/corporate/SOEs-Asia-Performance-Evaluation-Management.pdf>

The government has not put in place any formal performance management system for PSCs, although some line ministries have started to evaluate PSCs performance on an ad-hoc basis. For instance, in case of power sector the evaluation system includes performance contracts signed between the Ministry of Water and Power (MoWP) and state-owned electricity distribution companies to set performance targets for the next financial year and then evaluate their performance at year-end. The companies are required to submit a report to the MoWP on the actual performance against the set targets on a monthly, quarterly and annual basis. The MoWP does not publish an annual consolidated report on the performance of the PSCs under its purview. However, the National Electric Power Regulatory Authority (NEPRA) - sector regulator, publishes an annual report on the overall performance of the power sector.

Overall, this system presents many challenges:

Diffuse accountability

In general, the ownership framework results in a fragmentation of ownership responsibilities and diffused accountability. Although many observers see too much power concentrated with the Ministries, Ministry staff have other complaints, and feel that they do not have the authority or resources to properly exercise the ownership rights over companies. The current system undermines ownership focus, consistency in approach, and accountability. It is also not conducive to the sharing of lessons learned, such as, for example, how to structure performance contracts.

Insufficient ownership capacity

Ministries tend to focus on the PSC's compliance with Ministry rules, rather than on overall operational and financial performance and the long term health of the company. Ministries may lack staff with the commercial and financial experience to properly exercise the state's ownership functions. The skills and experience necessary for operating a ministry are likely to differ significantly from those necessary for operating or monitoring commercial companies. The involvement of multiple entities also leads to the dispersion of scarce ownership skills and capacity where they do exist.

Lack of adequate oversight of the state sector

As responsibilities are spread among many different agencies, no one entity is actively overseeing and monitoring PSCs as a whole.

High costs and a significant loss of productivity

The current system hurts the companies, as regulations and ownership interference take decision-making power away from boards and managers. For example, while procurement and hiring / firing of management are formally under purview of the board of directors as per PSC Rules, the reality may be somewhat different. In interviews, many companies complained about the drag on productivity caused by slow decision-making.

BOARD COMPOSITION AND APPOINTMENTS

The boards of PSCs generally range from 5 to 9 board members including executive, non-executive and independent members

Board size varies in PSCs. For instance, the three state owned insurances entities – State Life Insurance Corporation, National Insurance Company Limited and Pakistan Reinsurance Company Limited, have 9,7, and 7 directors, respectively. Similarly, the National Bank of Pakistan (NBP) has 8 directors and First Women Bank of Pakistan has 7 directors.

³⁵ <https://www.oecd.org/corporate/SOEs-Asia-Performance-Evaluation-Management.pdf>

Board members of PSCs include in-service and retired civil servants, businesspersons, academics and professionals (auditors, lawyers, etc).

For example, the board of SME Bank Limited includes:

- 1 representative from the Ministry of Finance (the Deputy Secretary, Finance Division)
- 1 representative from Ministry of Industry (Joint Secretary)
- The CEO of Small and Medium Enterprises Development Authority
- 3 independent directors (generally from the private sector)
- The CEO of SME bank (as the single executive director)
- Another, less-standard example that shows the variety of practices, is ZTBL, the Agricultural Development Bank of Pakistan. ZTBL has 7 directors, of which six are independent and one is an executive. The board is provincially based – there is one independent director from each of four provinces where the Bank has operations. Six of the directors have been certified by director training programs.

- The Pakistan Institute of Corporate Governance (PICG) in 2016 carried out a limited survey³⁵ on board practices of PSCs. For the 14 companies who responded to the survey,
- 46% percent of directors represent the government.
- The positions of the Chairman and CEO were held by two different individuals
- More than 90% of directors on the average PSC board were either non-executive or independent directors, and the CEO was the only executive director.
- Gender diversity was low (4.8% of directors were female).³⁶
- CEO was appointed by the government in almost all cases including those appointments based on the board's recommendation.
- The survey report also highlighted the suggestions given by PSCs with the most common one being the experience and competency of directors, merit-based selection of directors to the board, accountability and transparency in processes and immunity from political interference.
- Elements of the board appointments process are laid out in the Rules.
- Under the Rules, the board is required to establish a "nomination committee, to identify, evaluate and recommend candidates for vacant positions ... including the candidates recommended by the Government".
- PSC CG Rule 3(6) requires that the authorities nominating members of the board of directors, including the Government and other shareholders, apply specific "fit and proper criteria". Criteria include a university degree; relevant professional experience; and lack of court convictions and conflicts of interest.
- Depending on the government's stake in a PSC, it may nominate a majority or all members of the board. In many cases, several Ministries nominate board members; the Ministry of Finance often has a seat on the board. Generally, the line ministry proposes candidates to their Minister, who then submit them to the office of the Prime Minister for final approval. Minority shareholders (where present) may also nominate Board members. Directors are appointed for three-year terms and may be removed before the end of their term only in the event of misconduct or poor performance documented in a formal performance evaluation. The names received from the nominations committee may be changed by the line ministry or new names added.

³⁵ Survey questionnaire was sent to 182 PSC's monitored by the Federal Government. PICG received information from 14 PSC's covering both large and small scale PSC's, as well as PSC's from various sectors such as Banking & Financial Services, Promotional & Advocacy, Power & Energy, Oil & Gas etc.

³⁶ The PSCs have a total of 970 board members with women representation of only 4% in commercial PSCs and 7% in non-commercial PSCs.

³⁷ SECP has through a Notification dated 25.1.2018 authorized PICG to create and maintain a databank of independent directors. The databank became operational in July 2018. To date 285 individuals have registered in the databank. On 26.4.2018, the SECP issued The Companies (Manner and Selection of Independent Directors) Regulations, 2018.

	<ul style="list-style-type: none"> The Companies Act 2017 requires that independent directors appointed to the board should be selected from a data bank maintained by an outside organization, approved by the SECP. This system is now being put in place.³⁶ Some Ministries have asked PICG for help with names of certified directors.
Board evaluations are in their early stages	<p>Under the Rules (Section 8) the “government” is required to evaluate the board (including the chairman and chief executive) on at least an annual basis. The board is also required to “monitor and assess the performance of senior management on a periodic basis, at least once a year, and hold them accountable for accomplishing objectives, goals and key performance indicators set for this purpose.” The line ministry is assigned the task of evaluating the performance of the board members that it appoints. Some boards are undertaking periodic board evaluations.</p>
Experience in Pakistan and other countries suggests that board composition and appointment practices weaken boards in many important ways	<ul style="list-style-type: none"> Boards are not sufficiently independent and not fully empowered to govern the company -- important board and management decisions often require further informal approval from the parent Ministry. This hampers the board’s accountability and responsibility. Many boards do not have enough industry experience and business acumen to develop or approve timely and relevant business strategies. The Parliamentary model weakens fiduciary duties of directors; each director represents the interest that appointed him. The inclusion of Ministry officials may create a conflict of interest for the Ministry and reduce candid discussion. Many observers note that the current process does not prioritize commercial or private sector experience, but rather loyalty and ties to the government. Some boards are assisted by too many committees (as many as 10 in the financial sector), each with too many members. The role of company-level nomination committees can be awkward, with the expectation that the government nominations are reviewed by the committee and passed back to the government for final appointment, with the implication that a committee (chaired by non-executive member of the board) could overrule its largest shareholder. Other observers report high levels of passivity and even incompetence, as the boards do not play an active or assertive role, and simply comply with statutory requirements while following the Ministry’s lead. Without a performance management process (or an effective board evaluation process), boards and Chairmen are not held to account, and do not feel responsible for the success or failure of the institutions. Rule 8 was amended to require a periodic performance contract to be signed between the director and the line Ministry. Passive PSC boards in turn are unable to attract high-caliber, private sector individuals as board members and further compound the board composition problem.

BOARD RESPONSIBILITIES

The Rules specify the roles and responsibilities of the boards of directors so that they understand and perform their responsibilities effectively and are held accountable where they fail to perform their job. The key principle underlying the Rules is that the PSCs will act in the public interest at all times by following strong commitment to integrity, ethical values and the rule of law.

According to the CG Rules, PSC boards are responsible for making strategic policy decisions; establishing internal corporate governance arrangements; appointing the Internal Auditor; approving investment, divestment, and borrowing decisions; monitoring the company's performance with reference to its objectives; and exercising fiduciary oversight, including approving the company's financial statements and reviewing internal audit reports, to ensure that the company's resources are used efficiently to achieve the company's objectives.

Under the 2017 amendments to the Rules (and to the Companies Act), the Government has full authority to nominate the CEO, for final appointment by the board.³⁸ The market believes that this is contrary to corporate governance good practice, because the board is unlikely to go against its main shareholder,

To perform their functions effectively, PSC boards are required to establish five committees: (i) audit committee; (ii) risk management committee; (iii) human resources committee; (iv) procurement committee; and (v) nominations committee. These committees must be chaired by non-executive Board members and the majority of the committees' members must be independent. Committees must also have written terms of reference, which outline their duties and authority. Finally, the minutes of all committee meetings must be circulated to all Board members.

In practice, the boards of most PSCs are seen as weak, with ineffective oversight and prone to political interference. There have also been cases in the past where the boards were suspended by the Government (Pakistan State Oil, power generating and distribution companies, etc.) and delay in reconstitution led to the entity's inability to comply with corporate governance standards.³⁹

TRANSPARENCY AND DISCLOSURE

The transparency and disclosure requirements for PSCs are established by the Companies Act and the PSC CG Rules

Under the Companies Act, the board is required to submit an annual report to shareholders. The report should cover the company's operational and financial performance, major investments, government financial support, as well as the Board's assurance regarding compliance with the company's corporate governance policies and fiduciary requirements.

The Rules require PSCs to provide quarterly balance sheets to the Board, and to publish their annual financial statements on their websites. The Rules also require PSCs to implement the International Financial Reporting Standards (IFRS). The annual report must contain statements on: compliance with the relevant principles of CG Rules in which the company is not in compliance, and the reasons for non-compliance; maintenance of proper books of account; application of appropriate accounting policies; establishing and maintaining sound system of internal control, which is regularly reviewed and monitored; and the remuneration policy adopted.

The 12 listed PSCs are subject to the disclosure requirements put in place by the SECP and the PSX.

In practice, however, not all PSCs have complied with these requirements.

³⁸ Under CA 2017 190(2) the Government has the right to dismiss the CEO if the government has minimum of 75% holding in the company.

³⁹ Pakistan State Oil is subject to a special law, the Marketing of Petroleum Products Act 1974, which confers special powers to the Government. Section 165 of the CA 2017 empowers the Government to appoint or remove the directors at its pleasure. In certain cases, courts have struck down the acts of the government where the BOD was competent to decide.

The Rules require all PSCs to develop an internal audit function. The Rules require PSC boards to establish an Audit Committee and mandate the appointment of a qualified Internal Auditor. The Chairman of the Board and the company's CEO may not be members of the Audit Committee. The Committee's functions include reviewing internal audit reports and choosing the company's external auditor. The Internal Auditor reports directly to the Audit Committee.

Audit requirements are also set by the PSC Rules

The Rules require all PSCs to have their accounts reviewed by external auditors. Only audit firms that comply with the IFAC Code of Ethics and have received a satisfactory rating by ICAP may be hired as external auditors. The SECP regulations also require the mandatory rotation of external auditors every five years to safeguard independence. PSCs are required to provide the external auditors with full financial information, including the company's internal audit reports. In addition to the completeness and accuracy of financial accounts, external auditors need to review a PSC's compliance with applicable laws and regulations, including the CG Rules. External auditors' reports are to be submitted to the Board and disseminated to all shareholders. Like other public sector units, PSCs may also be subject to external audit by the Auditor General of Pakistan.

In practice, many PSCs have difficulty implementing these requirements. The Accounting and Auditing ROSC 2017 reports significant problems in the financial statements of some PSCs, and notes that the audit reports of many PSCs contain significant exceptions.

The Ministry of Finance is now producing a consolidated performance report

In 2016, the Ministry of Finance began publishing a consolidated performance report covering financial and non-financial information on PSCs.⁴⁰ The objective of publishing 'State Owned Entities Performance Review' Report was to manage fiscal risk and strengthen oversight effectiveness. Two reports have been published to date. The reports provide detailed information on the financial performance of the overall government portfolio, groups of PSCs (and all state-owned enterprises) by sector of activity, as well as each of the 183 enterprises covered by the report for the period FY2013/14 to FY2014/15.

- The formulation and implementation of the Rules and the annual publication of the PSC performance review report were welcome steps. Some companies (especially some of the larger listed companies) are performing reasonably well, with relatively high degrees of autonomy, and show what can be accomplished with better governance arrangements.
- However, there is still a long way to go. A broad-based effort to reform the governance of PSCs has stalled for too long - contributing to steep fiscal losses and to worsening and cost ineffective services. All independent observers agree that the current approach can be improved.
- This section addresses how to move forward. PSC reform is the highest corporate governance reform priority. Direct action by the Government and its Line Ministries will be necessary for further reforms.

⁴⁰ The report includes the following information for each SOE: legal status, area of activity; share of government ownership and stakes of other shareholders; turnover by fiscal year; profits and losses by fiscal year; assets and liabilities; outstanding debt; debt covered by sovereign guarantees; budget subsidies received by fiscal year; loans received from the government or other state institutions; capital injections received from the government by fiscal year; and number of employees.

- Various reform options have been discussed by different elements of the government and stakeholder groups for many years. This process resulted in the eventual formulation and implementation of the Rules by the SECP. The key now is to build on what has already been accomplished and extend to the wider group of important PSCs. PSC reform should be a high government priority.
- A high-level reform proposal that draws from international good practice and experience in other countries is discussed below in five sections:
- Enact a law that establishes an ownership framework for PSCs
- Create a centralized ownership entity for PSC governance
- Develop ownership capacity in the Line Ministries
- Improve corporate governance and accountability
- Consider an increase in private sector participation in profitable PSCs

Enact a law that establishes an ownership framework for PSCs

There is a clear gap in the legal and regulatory framework. The current framework (especially the Rules) focuses on the responsibilities of companies and boards. It is crucial to have a clear, coherent, and modern legal and regulatory framework for the State as the owner and shareholder of the PSCs. Many countries have adopted “ownership policies” or Acts that define the State’s role, and the rationale for state ownership. In Pakistan, a PSC Act or equivalent law is needed to clearly establish an ownership policy that defines how the state, as owner, governs its PSCs. The Act or subsidiary legislation thereunder should:

- Define the overall goals and rationale for State ownership
- Set clear definitions of the roles and responsibilities of the key institutions (Ministries, boards, management)
- Create / empower a centralized ownership entity(see below)
- Clarify responsibilities to set clear mandates for each PSC
- Establish MOU / performance agreement procedures and responsibilities
- Unify processes for appointment of boards of directors
- Require “hard budget constraints” and for the government to make timely payments for services provided by PSCs
- Lay out a road map for implementation.

As the legal framework for PSCs evolves, the PSC CG Rules could become a part of the PSC Act. However, as an independent regulator, SECP could be given the role of overseeing corporate governance policy in the PSC Act.

Create a centralized ownership entity

Ownership arrangements for state-owned enterprises vary substantially around the world, and fall broadly into four categories:

- The decentralized model, where ownership responsibilities are dispersed among different line ministries.
- The dual model, a variation of the decentralized model, where in addition to line ministries a second ministry, such as the ministry of finance, may also have certain responsibilities.
- The advisory model, where ownership remains dispersed but an advisory or coordinating body is created to advise ministries on ownership matters.

- The centralized model, where ownership responsibilities are centralized in an entity or entities that may be independent or may fall within government.
- The *OECD Guidelines on the Corporate Governance of State-Owned Enterprises* suggest that the fully centralized model is probably the best way to minimize political interference, and professionalize the ownership function.
- The goal of future reforms will be to further separate the government's role as owner from its role as policy maker and regulator. The government should refrain from getting involved in day-to-day management and should allow PSCs full operational autonomy to achieve their objectives by professionalizing PSC boards and holding them accountable through the development of a proper performance monitoring and evaluation system.
- The centralized ownership body or agency should put in place a well-structured and transparent board-nomination process. Appointing and monitoring the boards is a key ownership function. As the owner, the government is accountable to Parliament, and it needs to appoint directors capable of meeting the owner's expectations, following a skills-based appointment process. Anything less—such as patronage or representation—diminishes the skills on the board. The approach laid down in the Companies Act can be the starting point. The boards, once appointed, should be allowed to exercise their responsibilities independently. Centralized reporting systems should be put in place to allow regular monitoring and assessment of PSCs performance.
- The role of the centralized ownership entity would be to:
- Set the basic policies and guidelines for PSCs
- Vote the shares of the companies at shareholder meetings;
- Appoint board members to the companies (under the overall policy established by the ownership entity);
- Establish and implement a performance monitoring system, and establish performance contracts (and associated targets and indicators) that reflect each company's strategy, with each of the companies in its control. The Ministries should explore performance contracts that commit the government to deregulatory approach to each company, in exchange for governance and performance improvements.
- Professionalize and create the infrastructure for the process of board appointments
- Prepare an annual report on the PSCs and their performance

Develop ownership capacity

The new ownership body will need to build capacity carry out its roles. Its responsibilities will:

- Significant financial and human resources should be allocated to implement its ownership responsibilities. The Ministries should encourage cooperation with donor partners to build capacities in these areas, through advisory services, training, and study tours.

Improve corporate governance and accountability

- The SECP should continue to implement its enforcement of the CG Rules for PSCs. The Rules have already yielded important results, but more can be done.
- The SECP should develop partnerships with the Line Ministries and work through the Ministries to systematically encourage the adoption of the CG Rules and more generally build a commitment to good governance. The task force formed by the Government could also be reactivated, with new objectives that go beyond the creation of the CG Rules.
- SECP along with other stakeholders should continue holding workshops, training and awareness sessions to build advocacy and understanding of the Rules. This will also help clarify the roles and responsibilities of the line ministries, Ministry of Finance, SECP and other stakeholders. The government should also consider extension of the PSC CG Rules to SOEs that are not in corporate structure until all SOEs are corporatized.
- There is no consolidated report on the compliance status of PSCs to track yearly progress on compliance with the Rules. SECP should start publishing an annual compliance report on PSCs that sheds light on the extent to which PSCs are complying with CG rules.
- The SECP needs to add resources and upgrade its professional capability for performing effective regulatory role to ensure compliance and enforcement of CG Rules.

Consider increasing private sector participation in profitable PSCs

- The government should consider reviving the privatization program for companies in competitive sectors. The government has already identified priority entities that need greater private sector participation but the implementation process has stalled owing to political pressures. Corporate governance reforms and private sector participation are mutually reinforcing: corporate governance reforms improve the attractiveness of companies to investors, and (minority) private sector participation increases transparency and corporate governance requirements, and reduces possibilities for political interference. To build public confidence, the process needs to be reinstated with caution but with consistency and transparency.
- Privatization alone is not the answer and it must be coupled with good governance of PSCs and strengthening of sector regulators. Not all PSCs will be privatized even if the program goes back on track. Going forward, the PSE corporate governance reforms suggested above are key to improve management and delivery of better and more cost-effective distribution of goods and services to the public at large.
- Many countries are now exploring the listing of minority (non-controlling) amounts of shares, with the goal of “crowding in” private capital, increasing transparency, and imposing private sector governance requirements.



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