

Exclusive

Interview



“ ICMA Pakistan can utilize its infrastructure and professional faculty at hand in training its members for independent directorship; ICMA Pakistan may also contribute towards recently introduced concept of Authorized Intermediaries in Companies Act 2017 ”

Shaukat Hussain

Chairman, Securities & Exchange Commission of Pakistan (SECP)

ICMA Pakistan: Please tell us briefly about policy initiatives taken by SECP to implement good corporate governance?

Shaukat Hussain: Corporate Governance has emerged as a key component in the successful functioning of capital markets and the overall corporate sector. Corporate governance is concerned with promoting corporate practices that ensure transparency, enable compliance of laws and accountability.

SECP introduced Code of Corporate Governance (“CCG”) for Listed Companies in the year 2002, in order to strengthen the regulatory mechanism and its enforcement. “Comply or explain” approach was introduced through the CCG 2002. The Code was enforced through Listing Regulations of stock exchanges in Pakistan and its enforcement was primarily relied on front line regulators i.e stock exchanges. CCG 2002 was applicable on Listed Companies, Banking Companies, Development Finance Institutions, Non Banking Financial Institutions, and Insurance Companies. Major requirements introduced through CCG 2002 included statement of compliance with the Code be reviewed by external auditors of the listed companies, effective representation of minority shareholders and board committees. The requirements of CCG 2002 were primarily voluntary in nature.

Thereafter, due to changing dynamics and based on evaluation of the compliance level of the requirements of Code, a process was initiated to revamp the CCG 2002. SECP, after consultation with stakeholders, introduced Code of Corporate Governance

Mr. Shaukat Hussain has assumed the charge as Chairman, SECP on May 11, 2018. He is a fellow member of the Institute of Cost and Management Accountants of Pakistan. He has rich and diversified experience spanning over 32 years. Before assuming charge as a Commissioner on March 27, 2018, he was Executive Director/Registrar of Companies incharge of Corporatization and Compliance Department (CCD) at the SECP. He joined the SECP as a Joint Registrar in September 2000. He has headed the SECP’s offices in Karachi, Islamabad and Peshawar. He has also worked as Director, Securities Market Division. Accordingly, he has complete grasp of all the laws administered by SECP. Prior to joining the SECP, he had worked with a professional accountancy firm, a development financial institution and listed companies of both public and private sectors.

2012 for listed companies, which mainly focused on effective role of Board of Directors (BoD) as custodians of shareholder's interests. CCG 2012 mainly emphasize requirement of at least one independent director and preferably one third of board composition be independent directors, separation of office of CEO and Chairman, board evaluation and self appraisal, role of board committees, and requirements for appointment of internal auditors and CFOs as key management organs.

SECP also developed FAQs in order to enable Listed Companies to comply with the requirements of CCG 2012, which have addressed many queries. CCG 2012 is applicable on Companies listed on PSX. Moreover, we have also introduced

Principles of Corporate Governance for Non Listed Companies as well to address a large segment of the corporate sector.

ICMA Pakistan: What recent steps have been taken by SECP for strengthening the capital market?

Shaukat Hussain: Capital markets in Pakistan play a crucial role in mobilizing domestic resources and channeling them efficiently to productive uses, thus raising national productivity. We have taken significant steps in recent past to develop and strengthen the capital market in Pakistan:

Three stock exchanges KSE, LSE and ISE were integrated into a single, unified, national level, trading platform under the name of Pakistan Stock Exchange Limited. PSX became operational from January 11, 2016. Integration of stock exchanges has provided numerous benefits in terms of reducing fragmentation, increasing efficiency and improving governance standards.

Afterwards, the deal for strategic sale of 40% of PSX shares to an anchor investor consortium comprising leading Chinese exchanges and Pakistani financial institutions was completed by December 23, 2016. Subsequently, public subscription of 20% shares of PSX was successfully completed in accordance with applicable laws, subsequent to completion of divestment process. With commencement of formal trading of PSX shares on its trading platform from June 29, 2017, PSX has become the first South Asian self-listed stock exchange.

Promulgation of major laws such as the Securities Act, 2015 and the Futures Market Act, 2016. The Securities Act, 2015 was approved and promulgated with effect from May, 2015. It acts as a comprehensive modern law, which caters for deficiencies in earlier law and incorporates global benchmarks of securities regulation and investor protection. The Futures Market Act, 2016 was subsequently promulgated in April, 2016 which contains dedicated provisions for derivatives markets and is designed to protect public interest through a system of effective self-regulation of futures markets, clearing systems, market participants and market professionals under oversight of the SECP.

“SECP considers that existence of transparent capital market that ensures protection of investors' right is at core for capital market development”

Furthermore, in line with international standards, NCCPL commenced operations as a central counterparty with effect from May 02, 2016 whereby, it becomes counterparty to every transaction, which it accepts for guaranteed settlement. The reform entailed transfer of risk management from PSX to the NCCPL and establishment of a consolidated Settlement Guarantee Fund.

Moreover, as a result of investment friendly policies and ongoing regulatory reform process, Capital Market of Pakistan was upgraded in May, 2017 from MSCI Frontier Market Index to Emerging Market Index and the transition process was completed smoothly.

A Centralized Customer Protection and Compensation Fund has been established under the securities law and strengthened to

ensure that an adequate safety net is available to investors trading through brokers who have defaulted.

About strengthening the commodity futures market in Pakistan, SECP introduced number of currency and commodity contracts in the recent past, which is expected to broaden the investors' base resulting into increase liquidity in the market.

ICMA Pakistan: What are the regulatory enforcement challenges in the financial and capital markets?

Shaukat Hussain: Regulatory bodies in emerging markets face challenges in implementing effective & credible enforcement programs. One of the key challenges that regulators face is that even after taking appropriate and timely enforcement action, the regulated entity can easily obtain stay / restraining order from the court(s) of law, on the enforcement actions taken by the regulators. Such matters take considerably long time for resolution in the relevant court of law, hence, weakens the effectiveness of the enforcement action(s). Therefore, there is a need to increase speed of trials pending in courts so that enforcement actions are concluded in timely manner.

Furthermore, in case of foreign / cross border transactions where treaties / agreements with foreign countries have not been signed, enforcing actions in such jurisdictions becomes almost impossible. There are many cases, in which sponsor(s) of the entity who committed fraud, fled out of the country and settled in foreign countries with which Pakistan does not have any treaty. Hence, such person(s) could not be brought to justice. Therefore, there is a need to have appropriate treaties with the foreign countries so that enforcement against crime can be effectively carried out.

The role of front-end regulator(s) or SROs, like, PSX and NCCPL is also very important. Inadequate supervision mechanism(s) and influence of market players on SROs may also hamper enforcement over regulated entities.

Moreover, the conflict in the board of PSX is another challenge, which largely is addressed by demutualization and investment by strategic investor. Inclusion of professionals and independent directors on PSX board is welcoming and should be encouraged as a step toward capital market development.

Both PSX and SECP are of the view that strict regulatory compliance be ensured and is taking necessary steps to make our enforcement regime in line with international best practices and thereafter effective implementation of the regime.

Despite the above discussed challenges and difficulties, the need to continuously improve upon the supervision and enforcement mechanisms is of utmost importance and the efforts for enhancing effectiveness of supervision and enforcement should continue.

ICMA Pakistan: In your opinion, where the Pakistani stock market stands globally and what are its inherent weaknesses?

Shaukat Hussain: Pakistani stock market started its journey from an open outcry system to a sophisticated automated platform (PATS). PSX is upgraded to the MSCI Emerging Markets status from frontier market status in 2017, opening its door to global investors that track the index with \$1.4-1.7 trillion.

Pakistan's capital market regulatory framework is in line with international best practices and can be compared with

framework of any developed jurisdiction be it USA, UK or any other developed country. Only issue that needs directed efforts is development of financial products and enhanced liquidity. It's not only Pakistan, capital markets of almost every developing country is trying to combat ill liquidity. Development of bonds and Sukuk market is critical for increasing efficiency of capital market as this channelizes savings and results in capital formation.

ICMA Pakistan: Please highlight the role of SECP in ensuring transparency in the stock market?

Shaukat Hussain: Under the Securities Act, 2015 and Stock Exchange (Licensing and Operations) Regulations, 2016, information disclosures by companies are administered. To this end, SECP has recently revamped framework for companies on defaulter segment. Amendments made to PSX Regulations for major overhaul of regulatory framework governing companies in violation/non-compliance of applicable laws, enabling earlier warning to investors, wider dissemination of defaults of such companies, stronger enforcement actions against such companies and their sponsors, directors and management, and earliest possible relief to investors. Various additional grounds for placement of a company on the PSX Defaulters' Segment have been introduced and the approved amendments address issues posed due to immediate suspension of companies consequent to action by PSX under its regulations.

Further, the pre-requisite of becoming a securities broker is to be a corporate entity. Thus, all relevant disclosure requirements under the Companies Act, 2017 are applicable on securities brokers, which in itself entail transparency. In addition, brokers are mandatorily required to report number of reports pertaining to net capital balance, financials etc., for regular monitoring. Accounts of brokerage house are also available on their respective websites, for greater transparency.

From the perspective of investors, it is now mandatory for the CDC to send SMS/e-alerts for movement in securities of a particular account. The NCCPL also sends trade alerts via SMS/email to every investor at the close of trading day. This enables investors to remain updated regarding their trading/account position at close of trading.

ICMA Pakistan: Please comment on stock market abuses and how SECP ensures protection to investors?

Shaukat Hussain: Stock market abuses include any kind of market manipulation; false trading; market rigging; fraudulently inducing others and insider trading, which are criminal offences as defined in the Securities Act, 2015. SECP considers that existence of transparent capital market that ensures protection of investors' right is at core for capital market development. SECP is taking all the measures required to ensure that material information is accessible to all the investors at same time and that no insider can take undue advantage of any information.

It must be in your knowledge that as the first leg, all corporate announcements by listed companies are done through online platform warranting equal dissemination to all market participants.

Another aspect of transparency is that all the investors are aware of activity-taking place in their trading accounts. SECP and PSX, in recent past have taken multiple steps to ensure client's assets segregation and have repeatedly evaluated the same.

Presently, complaints pertaining to misuse of assets by the brokers for their own benefit have drastically reduced when compared with past numbers. CDC and NCCPL have introduced SMS and email alert facility communicating movement of assets from investors' account. This provide immediate information of movement of securities to the investors from their sub-account and in the situation of any abnormality, the same is being addressed instantly.

Further strengthening of supervisory role by SRO's in line with international best practices is under consideration and SECP is providing all required support in this regard.

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It is also pertinent to mention here that the International Organization for Securities Commissions (IOSCO) has identified the protection of investors as one of the three essential objectives of securities regulation, the other two being, ensuring that markets are fair, efficient and transparent and reducing systemic risk.

Using the platform of ICMA Pakistan, I would like to emphasize that investors should keep in mind the concept of 'Buyer beware', which means that investors should also perform due diligence before executing any capital market transaction and take informed risks. SECP, being apex regulator has entered MOUs with number of educational institutions and approved a comprehensive Investor Education and Awareness Plan in 2013, which is being implemented through a dedicated investor education department. Basic purpose of this activity is to educate investors about capital market mechanics.

ICMA Pakistan: What procedures SECP adopts for registration and monitoring of brokerage houses and agents?

Shaukat Hussain: SECP has introduced the Securities Broker (Licensing and Operations) Regulations 2016, for licensing of securities brokers under the Securities Act, 2015. Any company duly incorporated in Pakistan under the Companies Act, 2017, and desirous of obtaining license, as securities broker shall submit its application along-with supporting documents through PSX to SECP in terms of the Regulations.

PSX is responsible to scrutinize the application for grant of license and the documents submitted by the applicant prior to submission of the same for consideration of the Commission along-with a letter of recommendation.

Considering the PSXs recommendation, clean CIB reports of directors/CEOs/Sponsors of the company and their associated/group companies and in house clearance by operational departments, the Commission grants license to a company as securities broker.

Since the brokerage activity can only be undertaken in a corporate structure, the concept of Agents for securities brokers has become redundant and accordingly, the Agents registration regime has been repealed.

Furthermore, in order to promote ease of doing business for the brokerage industry Commission has taken following steps:

- o Reduction of 08 mandatory licenses for a securities broker to a single license;
- o Introduction of single cut-off date concept for expiry of licenses for entire brokerage industry;
- o Simplified the existing procedure for renewal of licenses;
- o Mandatory advisory licensing requirement for securities brokers have been withdrawn;

Moreover, with regard to monitoring / Inspections of these brokerage houses and agents is a regular feature. Joint Inspection team, comprising of officers from SROs, perform inspections of brokerage houses. The team inspects around 70 brokerage houses annually.

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Brokerage houses submit quarterly reports to the Commission. SECP evaluates and monitors these off-site reports to ensure compliance with regulatory framework. SECP has also initiated multiple thematic reviews to ensure that all brokerage houses comply with specific regulatory requirements.

ICMA Pakistan: How SECP is nurturing corporate governance culture in SMEs and non-listed companies in Pakistan?

Shaukat Hussain: There are more than 70,000 registered companies that are not listed on PSX. These companies have been divided into mainly three classes of companies Small Sized Companies, Medium Sized Companies, Public Interest and Large Sized Companies including section 42/43 companies. Governance Literature on Non Listed Companies highlights following major features of such companies:

- (i) Effective internal controls do not exist due to limited resources and lack of ability to manage internal and external risk(s);
- (ii) Access to capital is limited and major reliance is on borrowings from financial institutions or sponsors providing loans to companies;
- (iii) Mainly family owned businesses and lack succession planning and conflict of interest;
- (iv) Transparency of disclosures in financial statements is variant due to existence of variety of classes of companies;
- (v) Ability to attract professional management and a conducive culture to retain high value employees is restricted;

- (vi) Idea of financial reporting is remote in such companies. Like in case of Pakistan, only approximately 25-30% of the total registered Non Listed Companies file accounts with the Commission, hence, financial performance of such companies cannot be ascertained.

In order to nurture governance framework in the best interest of stakeholders, it was essential to develop a framework for such companies. In this backdrop, Principles of Corporate Governance for Non Listed Companies were introduced.

These Principles are not Code or Rules/Regulations, rather, these are about establishing a framework of company processes and attitudes that add value to the business, help build its reputation and ensure its long-term continuity and success. These Principles are mainly voluntary guidelines of corporate governance for Non Listed Companies in Pakistan.

The Commission has proposed thirteen Principles in two phases of Corporate Governance for Non Listed Companies on voluntary basis. Phase 1 Principles are applicable on all Non Listed Companies except Small Sized Companies and Public Sector Companies that are governed under Public Sector Companies (Corporate Governance) Rules, 2013. Whereas, Phase 2 Principles are applicable on Public Interest and Large Sized Companies only.

Principles of Corporate Governance in Pakistan shall nurture corporate governance framework for Non Listed Companies due to following reasons:

- (i) Life cycle of companies has been considered important while developing these Principles.
Phase 1 Principles are applicable to companies in nascent or in growth phase. Whereas, Phase 2 Principles are applicable to companies in maturity or sustainable phase. Hence, adoption of these guidelines is easy with respect to stage of the company.
- (ii) The said framework provides clearly defined role of board of directors, independent directors and non executive directors in line with applicable legal framework;
- (iii) Encourages companies to hold board meetings and general meetings in order to discuss matters highlighted for effective performance and evaluation thereof.

ICMA Pakistan: The cost audit regime in Pakistan has not expanded as in India and other countries. What are the reasons?

Shaukat Hussain: Cost audit is an important tool for management to identify areas of cost inefficiency, which are inherent in industrial units. Considering the importance of this, a separate provision was inserted in the Companies Act, 2017 relating to audit of cost accounts. The law relating to cost audit is now in line with other jurisdictions around the world, including India.

There is a tremendous scope for the expansion of the cost audit framework in Pakistan, which would be beneficial to not only the organization but also the industry and the economy as a whole. Its scope can be enhanced with the recommendations of regulatory authorities supervising the relevant sector of business. ICMA Pakistan can take lead and coordinate with these bodies and seek their recommendations in terms of provision 250 (2) of the Companies Act, 2017. Based on the recommendations of regulatory authorities scope of cost audit can be enhanced for the benefits of consumers and industries.

However, the cost audit regime has not expanded, as it should have been. Very few Cost and Management Accountant firms have Satisfactory Quality Rating, while the Chartered Accountant firms performing this function are more focused on statutory audit and mostly undertake cost audit assignments as a secondary task. Companies thus have a very limited choice when searching for good Cost Auditors.

There is also a dire need to develop and implement proper cost auditing standards. This would provide a structured approach to measurement of costs and lead to adaptation of uniform practices in the preparation and presentation of cost statements. Uniformity and consistency not only helps in better understanding of all the related issues by companies, but is also of great value to various government bodies and regulatory organizations.

ICMA Pakistan: What are your views in performance of audit in Pakistan? Are we following international best practices?

Shaukat Hussain: An auditor has a pivotal role in the corporate framework as the auditor is responsible for providing independent third party assurance to the users of financial statements. This assurance provides reliance to the users of financial statements such as the shareholders, creditors, financial institutions, regulators, potential investors etc., in decision making. Auditors act as front line regulator and act as first line of defense to safeguard the interest of the shareholders. I am generally satisfied with the performance of audit function in Pakistan. Performance of the Audit in Pakistan has been strengthened due to numerous steps taken by SECP in coordination with ICAP over the years. These include but are not limited to introduction of Quality Control Review Program (QCRP). Therefore, as per the CCG, no listed company shall appoint as external auditors a firm of Chartered Accountants, which has not been given a satisfactory rating under the QCRP of the ICAP and is registered with Audit Oversight Board (AOB) of Pakistan. Similarly, no listed company can appoint as external auditors, a firm of auditors which or a partner of which is non-compliant with the International Federation of Accountants' Guidelines on Code of Ethics, as adopted by the ICAP. SECP in March 2012 has extended this program to non-listed companies. Now all non-listed companies, falling under the definition of 'Economically Significant Companies' are required to appoint QCR rated firms as their statutory external auditors. The presence of these requirements in the legal thread is evidence of the fact that audit profession in Pakistan is at par with the world.

Quality Assurance Board is instrumental in implementation of QCR program, having four nominees of the Commission apart from ICAP, SBP & PSX representatives. Furthermore, adoption of latest auditing standards and the new audit report, improvements in the licensing regime by the ICAP, formation of SECP-ICAP coordination committee are playing significant role in improvement of performance of auditors. Latest development in this area is the formation of the AOB last year. My observation in this respect is that our audit professionals are working across the globe and are well known for their technical expertise and professional soundness.

Having said this, I feel that there is always a room for improvement and the principal duty for improvement in the audit profession is the responsibility of the audit and accounting

bodies. I want the accounting bodies to take the initiative and suggest appropriate changes needed in the legislation.

ICMA Pakistan: How ICMAP can assist SECP in strengthening corporate governance culture in Pakistan?

Shaukat Hussain: I appreciate the role being played by ICMA Pakistan in furthering the cause of accounting profession in Pakistan. On the other hand, it may be seen that the key to success towards realization of this dream of corporate governance lies in the change in corporate approach towards it. It is therefore the collective responsibility of all key players and not just for the regulators to pursue this goal single handedly. It is imperative that professional institutes like ICMA Pakistan contribute to this cause. ICMA Pakistan shall share its

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viewpoint and give input/suggestions on SECP's initiatives in relation to Corporate Governance and also in cases of opinions sought by SECP while amending various laws/regulations. SECP will always welcome any beneficial and constructive ideas in such areas. ICMA Pakistan can utilize its infrastructure and professional faculty at hand in training its members for independent directorship; ICMA Pakistan may also contribute towards recently introduced concept of Authorized Intermediaries in Companies Act 2017. In short, ICMA Pakistan has the professional capacity to help SECP in its endeavors towards betterment of corporate governance and ICMA Pakistan shall come forward in this regard and capitalizing such opportunities.

ICMA Pakistan: In what areas you think ICMAP and SECP can jointly conduct policy research and capacity building trainings?

Shaukat Hussain: SECP believes in synergy with all stakeholders and pursues consultative approach to strengthen its regulatory regime. Research studies highlighting the areas for improvement and bringing local corporate laws enacted by SECP at par with international best practices will be a mutually beneficial initiative. I suggest that both institutions can join hands to take advantage of working together for betterment in different fields. Furthermore, elaborative sessions and comprehensive training programs under the umbrella of Director's Training Program, Investor Education and training programs for registered intermediaries can prove to be a practical way forward for increased business awareness and development of business professionals, which is vital for the growth of corporate and financial industry.

The Editorial Board thanks Mr. Shaukat Hussain, Chairman, SECP for giving his exclusive interview for Management Accountant Journal.