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THE WORLD BANK

Report on the Observance of Standards and Codes (ROSC)

Corporate Governance

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# Corporate Governance Country Assessment

Pakistan

June 2005

# Overview of the Corporate Governance ROSC Program

## 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 *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 of Directors.

## 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 ASSESSMENTS

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 reviews the legal and regulatory framework, as well as practices and compliance of listed firms, and assesses the framework relative to an internationally accepted benchmark.

- Corporate governance frameworks are benchmarked against the OECD Principles of Corporate Governance.
- Country participation in the assessment process, and the publication of the final report, are voluntary.
- The assessments focus on the corporate governance of companies listed on stock exchanges. At the request of policymakers, the ROSCs can also include special policy focuses on specific sectors (for example, banks, other financial institutions, or state-owned enterprises).
- The assessments are standardized and systematic, and include policy recommendations. In response, many countries have initiated legal, regulatory and institutional corporate governance reforms.
- Assessments can be updated to measure progress over time.

By the end of June 2005, 48 assessments had been completed in 40 countries around the world.

# REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)

## Corporate governance country assessment

## Pakistan

## June 2005

## Executive Summary


This report provides an assessment of 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 focus of the assessment is on listed companies, although reference is also made to banks and other financial institutions.

**Achievements**

Reform to improve corporate governance has been significant, including the introduction of a code of corporate governance and increased vigilance by regulators. Regulators, industry associations, academic institutions and non-governmental organizations have raised awareness of the value of good corporate governance practice, and have established the Pakistan Institute of Corporate Governance (PICG), which aims to build understanding and provide training.

**Key Obstacles**

Highly concentrated control by significant shareholders has limited the objectivity of boards and reduced the impact of some of the recent reforms. More generally, many smaller and family-owned companies have a limited awareness of the potential benefits of improved corporate governance.

**Next Steps**

Corporate governance reform needs to percolate throughout the corporate sector, including family-owned businesses. Further steps need to be taken to protect shareholder rights, including disclosure of beneficial ownership. Boards must become more effective, with stronger fiduciary duties, and more capable independent directors.

## Acknowledgements

This assessment of corporate governance in Pakistan was conducted in April 2005 by Mierta Capaul, Alexander Berg and David Robinett of the Corporate Governance Department of the World Bank, as part of the Reports on Observance of Standards and Codes Program. The assessment reflects technical discussions with Securities and Exchange Commission Pakistan, Karachi Stock Exchange, Islamabad Stock Exchange, Central Depository Company, legal experts, banks, asset managers, credit rating agencies, and the IFC.

The SECP, the State Bank of Pakistan, and the Institute of Chartered Accountants of Pakistan provided extensive additional information and comments. Sebastian Molineus, Isfandyar Zaman Khan, Tatiana Nenova, and Ismaila Ceesay provided advice and comments.

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# Country assessment: Pakistan

This ROSC assessment of corporate governance in Pakistan benchmarks law and practice against the OECD Principles of Corporate Governance, and focuses on listed companies.

*Awareness of the importance of corporate governance is rising*

In Pakistan, awareness of the importance of good corporate governance is high among policymakers and standard setters. In 2002 the Securities and Exchange Commission of Pakistan (SECP) issued a Code of Corporate Governance (Code), most of which was made mandatory for listed companies. The State Bank of Pakistan (SBP) requires non-listed commercial banks and DFI1 comply with the code. The SECP has issued a separate code for all companies in the insurance sector. Initially, the Code met with resistance from issuers and market participants, but compliance with the code has been improving. Some multinational companies, banks, and family controlled corporations are creating more transparent and modern corporate governance structures. Some banks have reportedly begun to include requirements to adhere to the Code in loan agreements. Companies began holding seminars and training programs for their boards. A credit rating agency has developed a local methodology to rate corporate governance, and has carried out nine assessments.

The Pakistan Institute of Corporate Governance (PICG) has recently been created as a public-private partnership, with the goal of training directors and building more awareness. While still in its nascent stages, the PICG recently held its first seminar for the Boards of Directors in November 2005. The PICG is also the focal institution to carry out the objectives of a recently launched International Finance Corporation (IFC) project, aiming at enhancing and inculcating good corporate governance practices in the country. The next step for the PICG is to mainstream this growing awareness amongst market participants, and make the business case so that firms will have the incentive to improve their corporate culture.

The SECP has become gradually more active in enforcing its relatively strong authority under the law. Recent years have seen the imposition of more penalties, the passage of new regulation, and a generally more activist regulatory approach. Regulatory enforcement must continue to be strengthened and be applied in a consistent fashion to close the gap between law and practice.

At the same time, some companies are considering delisting from the exchanges for a number of factors, including stricter corporate governance requirements.

## Market profile

*One of world's fastest growing equity markets in terms of market capitalization*

Market capitalization at the end of 2004 was 1,723 billion rupees, or USD 29.0 billion[2], a 95 percent annual average increase over the past three years: in 2002, Pakistan was the fastest growing emerging market in the world. Pakistan's equity market was the second largest in the region after India, both in absolute terms and as a percent of GDP. Market capitalization amounted to 24.1 percent of GDP at

[1] Development Finance Institutions
[2] At the end of 2004, the exchange rate was 59.38 Pakistan rupees to one US dollar.

the end of 2003. Equity market turnover is also high compared to other countries in the region. At the end of 2004 there were 661 companies listed on the Karachi Stock Exchange (KSE), the largest stock exchange.

*Low cost credit was the traditional source of external funds*

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. Much of the free float in the market resulted from the divestiture of shares in state owned enterprises (SOEs).

*Ownership and control are concentrated*

Ownership is concentrated; principal controlling shareholders are the state, foreign multinationals, and families. The latter make extensive use of pyramiding to maintain control over their business groups. This ownership structure, combined with high thresholds to initiate corporate actions (e.g. to call a shareholder meeting) have limited the effective protection of external investors.

*Institutional investors play a limited role at best*

Historically, the role of institutional investors has been limited, despite the fact that government owned investment funds were often represented on the boards of their portfolio companies. According to market participants, these directors often lacked specialized knowledge and did not always make effective contributions to board deliberations. The other institutional investors, brokerage houses and other financial institutions that are part of business groups, have focused on short term returns and have not managed conflicts of interest effectively.

*Pakistan is a common law country with a strong Securities Commission*

Pakistan is a common law country. Key legislation includes the 1969 Securities and Exchange Ordinance (SEO), the 1984 Companies Ordinance (CO), and the 1997 Securities and Exchange Commission of Pakistan Act that established the SECP as the principal regulator of securities markets and non-bank companies, including non-listed ones. The authority of the SECP has grown in recent years.

## Key issues

The following sections highlight of the principle-by-principle assessment of Pakistan's compliance with the OECD Principles of Corporate Governance.

### Investor protection

*Basic shareholder rights are protected*

Basic shareholder rights are in place in Pakistan. Registration is secure and in the process of being dematerialized through the CDC. Shareholders can demand a variety of information directly from the company and have a clear right to participate in the annual general meeting of shareholders (AGM). Directors are elected using a form of cumulative voting, and can be removed through shareholder resolution. Changes to the company articles, increasing authorized capital, and sales of major corporate assets all require shareholder approval. The regime for related party transactions (RPT) and conflicts of interest is developed in the law and requires the audit committee to concur with any departures from arms length pricing and approval by a supermajority of shareholders in the case of investment in "associated companies or associated undertakings".

*Shareholder participation in the AGM can cumbersome*

While more effective enforcement has contributed to improved compliance, some companies still do not hold the AGM, or hold it in difficult to reach or obscure locations. The law also does not support voting by post or electronically.

*Concentrated control limits influence of minority shareholders*

More generally, concentrated control limits the influence that non-controlling shareholders can have on the company, and effectively reduces their protection from abuse. When families dominate the shareholder meeting and board, director accountability to other shareholders becomes critical, and currently in Pakistan this accountability is absent in many companies.

### Disclosure

*Improved quality and timeliness of financial reporting*

It is generally agreed that the quality and timeliness of financial disclosure has improved over the past few years. This is in part attributed to the increasing monitoring role of the SECP and to the requirements of the new Code. Law and regulation require the disclosure of most non-financial items recommended by the OECD Principles (with the exception of any disclosures about stakeholders).

The SBP mandates comprehensive disclosure for banks / DFIs.

*Requirement to disclose indirect or ultimate beneficial ownership easily circumvented*

Shareholders owning 10 percent or more of voting capital must disclose their ownership and the annual report includes the pattern of major shareholdings. However, pyramid structures, cross shareholdings and the absence of the joint action or "acting in concert" concept makes it difficult for outsiders to grasp the ownership structure of companies – especially in the case of business groups.

*Controversy over related party transaction disclosure and transfer pricing*

Pakistan follows IAS 24. Nevertheless, there is general agreement that actual disclosure of related party transactions leaves much to be desired. The SECP recently issued specific guidelines to have more information on related parties, especially with regards to how these are priced. Auditors are expected to certify that the firm has followed certain valuation practices to determine transfer prices and that those valuation processes were used properly. This has created some controversy and is presently being revisited.[3]

*No system of independent oversight over the audit profession*

The Institute of Chartered Accountants (ICAP) has been an important force for corporate governance reform in Pakistan. However its role in the oversight of the accounting and auditing professions is now under review, given the international consensus that the professions' self-regulatory arrangements and authority to impose sanctions should be balanced with adequate and independent oversight systems. SBP maintains a list of approved auditors for banks/DFIs. The SECP monitors and regulates compliance with international standards in financial reporting and auditing.

The accounting and auditing ROSC provides additional details and recommendations.

### Company oversight and the board

*No clear distinction between ownership and control*

Family owned companies are typically managed by the owners themselves. In the case of SOEs and multinationals, there is often a direct relationship between the state/foreign owner and management, again bypassing the boards. Many important corporate decisions are thus never made at the board (or AGM) level

[3] On December 30, 2005, a joint task force (including the SECP and the Central Board of Revenue) finalized a detailed set of recommendations on related party transactions, including the withdrawal of Clause 6 of Part I of the Fourth Schedule to the Companies Ordinance, 1984 relating to transactions with related parties, regulation No. SRO 167 (I) /2003 dated February 14, 2003 and modifications to Listing Regulation No. 38 of the KSE.

and, a result, boards—as distinct from management—are frequently not the driving force behind corporate strategy and strategic issues.

*Insufficient guidance on duties of care and loyalty*

While the CO addresses conflicts of interest, fiduciary duties are based primarily on a small body of case law. The Code explicitly mentions directors' duties to act with objective an independent judgment and in the best interest of the company. Overall however a robust duty of care is absent, as is developed guidance on the duty of loyalty. Suits against directors are rare.

*Boards dominated by controlling shareholders*

In business groups, 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 as other boards become more professional.

*Independent directors are the exception rather than the norm*

One of the objectives of the Code is to revitalize the role of boards in the governance of firms. The Code strengthens the role of non-executive directors, restricting the percentage of executive directors to 75 percent in non-financial firms and recommending that institutional investors be represented. However, given the dominant ownership structure, this does not prevent controlling families from having disproportionate representation on the board. In order to make the board more professional and accountable to all shareholders, it is necessary for outsiders to play a more prominent role on the boards of listed companies.

*Board remuneration is not adequate to attract qualified independent directors*

The remuneration paid to directors has traditionally been token, because it was assumed that executive directors received their compensation through other means. The current compensation is inadequate to attract independent directors with the necessary knowledge and experience, especially for member who will serve on the audit committee, where financial and accounting expertise is required.

## Enforcement

*Enforcement is centered on the SECP and the State Bank of Pakistan. The Stock Exchanges are responsible for monitoring and enforcing compliance with the Code*

The SECP has committed itself to enforcing corporate governance regulations. The SECP is receiving technical assistance from the Asian Development Bank to improve its corporate governance enforcement program, and a recently-awarded IDF grant from the World Bank will also build awareness and training in corporate governance principles. The SBP has also been instrumental in improving corporate governance in the banking system, by requiring banks and DFIs to adopt the Code, and by assessing compliance with other relevant aspects of prudential regulation specifically applicable to banks/DFIs.

Other elements of the enforcement regime are not as strong. ICAP has some self regulatory functions, and the stock exchanges are responsible for overseeing listing requirements (including the Code). Although the stock exchanges have traditionally lacked the resources and expertise to effectively monitor implementation of the code, the KSE is now working to enhance its capability to monitor and ensure compliance with the Code. It has set up a Board Committee on the Code of Corporate Governance and a unit in the Company Affairs Department to monitor compliance with the Code. Market participants consider the judiciary to be inefficient and expensive, and an ineffective source of shareholder redress.

While the law seems to provide shareholders with adequate rights, concentrated

control undermines the possibility of self-enforcement through the shareholder meeting or board.

## Recommendations

Pakistan has made significant strides in improving corporate governance over the last few years. However fully tapping the potential of capital markets and professionalizing boards and management will require reform efforts to continue. Good corporate governance ensures that companies use their resources more efficiently and leads to better relations with workers, creditors, and other stakeholders. It is an important prerequisite for attracting the patient capital needed for sustained long-term economic growth.

***Establish corporate governance enforcement priorities***

*SECP should focus on enforcing the rules on the disclosure of ownership and related party transactions*

For the SECP, the most important priority is to improve compliance in three areas: the disclosure of beneficial ownership and control by shareholders and by companies, reporting or related party transactions, and compliance with regards to the AGM.

*SECP should continue to work to build its enforcement capacity*

To achieve these priorities the SECP should work to build its enforcement capability. Key steps include increasing the technical level of staff in key areas (particularly legal and accounting experts), continuing to define enforcement priorities, and refining enforcement procedures. When established, the new stock exchange should also play a more active role enforcing the code.

*Develop a system of independent audit oversight*

Pakistan's current system of self-regulation for accountants and auditors will not be adequate as responsibilities increase for external auditors and those preparing statements compliant with International Financial Reporting Standards (IFRS). Independent oversight for accounting and auditing should be introduced to enhance credibility. Since the SECP's mandate includes monitoring and regulating compliance with international standards in financial reporting and auditing, the proposed oversight arrangement would be best located within the Commission as one of its core independent activities.

A complete set of recommendations is developed in the Accounting and Auditing ROSC for Pakistan.[4]

***Mobilize the private sector to improve corporate governance***

*The Karachi Stock Exchange (and its successor demutualized exchange(s)) should consider a market differentiation strategy*

Given the wide variety of listed companies certain corporate governance rules and recommendations (especially board independence) are bound to remain controversial. An alternative strategy is to develop a new corporate governance listing tier. Companies listed on that tier would commit to complying with all corporate governance provisions of the Code, including enhanced provisions for majority board independence that are currently voluntary, mandatory director certification (perhaps by the PICG), and strengthened audit committees. Over time, this differentiation should voluntarily encourage companies to upgrade to international standards and the plus tier.

[4] Available on the World Bank website at http://www.worldbank.org/ifa/rosc_aa_pak.pdf

*Institutional investors should play a more effective corporate governance role*

Institutional investors can play a valuable role in monitoring companies and demanding governance changes. Institutional investors acting in a fiduciary capacity should adopt and disclose their corporate governance and voting policy. They should also disclose how conflicts of interest involving investors are managed.

*Build a core group of effective independent directors*

Effective and rapid implementation of the Institute of Corporate Governance could contribute to building a core group of talented independent directors that can make an impact, and reducing the role of family members on boards. The Institute can play a major role in the development of implementation guidelines for boards, and for audit committees. It is crucial that the Institute be led by the private sector, with support from regulators and other key stakeholders.

*At the CDC, dematerialization and the move towards a central registry should be encouraged*

The CDC can play a major role in the protection of shareholder rights and transparency. This role would be enhanced by accelerating the move towards a central registry. In those countries with strong central registries (e.g. Egypt) opportunities for hiding ownership and illegal insider trading appear to be reduced. The SECP could assist in this process by setting a future date at which the current registry system would be phased out.

***Legislative reform should focus on key areas of concern***

*Strengthen rules for independent directors, improve board compensation, and clarify the role of the Chairman of the board*

In comparison with other countries, the Code's provisions for independent directors are relatively weak. The independence provisions of the Code should be clarified and explicit requirements for independent directors should be introduced (with a minimum of one independent director, up to a total of 25%). These rules could be made mandatory for those companies on a proposed "corporate governance tier" of the stock exchange. In addition, the Code should contain an explicit recommendation/requirement that boards should pay adequate compensation to all board members (including independent ones).

Future amendments to the Company Ordinance could explicitly address the role of the chairman of the board. The lack of a permanent chairman weakens the independent and objective status of the board; the election of a permanent chairman would strengthen the board.

*Review the ownership disclosure framework and adjust as appropriate*

Although by law shareholders are required to disclose direct and indirect ownership, market participants report that in practice only direct ownership is reported, and many shareholders avoid this requirement by holding less than the 10 percent threshold. The requirement for shareholders to disclose indirect ownership should be clarified in the law. Companies should be required to disclose a list of significant shareholders in their annual report. Shareholders should disclose all shareholder agreements.

*Shareholder rights should be strengthened by improving access to the AGM, lowering thresholds for shareholder redress, and updating rules on changes in control*

The legal framework for basic shareholder rights is well established in Pakistan, and relatively minor changes in this area are needed. Distance voting for the AGM, by post or electronic means, should be introduced. Significant shareholders should be prohibited from voting when a conflict of interest is present.

In addition, the authorities could consider lowering the thresholds for shareholder action against companies and directors. The current threshold for filing lawsuits of 20% is high by international standards. Given Pakistan's concentrated ownership structure, lowering the thresholds may help to balance legitimate

shareholder interests against the possibility of frivolous lawsuits.

*Increase the accountability of directors*

As in many countries, boards are often ineffective in protecting the interests of minority shareholders, and are sometimes bypassed by controlling shareholders who work directly with management. While the Code plays an important role in setting the role and duties of the board, more can be done in the law to strengthen the accountability of directors to shareholders. A key step is to more clearly establish the general fiduciary duties of directors in the law; the relevant language in the Code is a good starting point. The PICG should work to develop a set of detailed guidelines for board members to define their duties in practice.

***Focus future technical assistance on high-priority implementation***

*Development of a national action plan*

A national action plan for corporate governance should be developed, in cooperation with regulators, issuers, and other stakeholders. The national action plan should be used to design high quality and relevant technical assistance programs in this area.

*Training and awareness programs should work to develop a culture of corporate governance that extends beyond the SECP*

The private sector should also be encouraged to take the lead in improving corporate governance. A broad effort should be made to increase awareness in the business community of the importance of good corporate governance and its potential to attract investors. Based on the successful efforts already underway in other countries the IFC technical assistance program would further enhance private sector efforts. This should include *inter alia:*

- Training for bank staff on how to encourage their clients to strengthen their corporate governance,
- The development of training and outreach programs that build awareness and address the special needs of family-held businesses.
- Education for shareholders on participating in AGMs to effectively protect their interests, and

*Another important next step is to improve the governance in the state owned enterprise sector*

Although not specifically reviewed for this assessment, it is clear (based on the experience in Pakistan and in other countries) that some of the most significant corporate governance issues are in the state owned and controlled companies. The relevant authorities should review and consider implementing the emerging international corporate governance standards in this area (the OECD Guidelines for SOE Governance), which stress the development of a state ownership policy, increased transparency for SOEs, and greater board professionalism.[5]

[5] Based on round table meetings and discussions with certain state owned enterprises, the SECP has recently prepared the draft rules for corporate governance in state owned enterprises and has shared them with the relevant ministries for comment.

# Summary of Observance of OECD Corporate Governance Principles: Pakistan and World Average

| | Principle | Pakistan | ROSC Average |
|---|---|---|---|
| **I. ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK** | | | |
| IA | Overall corporate governance framework | 100 | N.a |
| IB | Legal framework enforceable and, transparent | 75 | N.a |
| IC | Clear division of regulatory responsibilities | 75 | N.a |
| ID | Regulatory authorities have sufficient authority, integrity and resources | 75 | N.a |
| **II. THE RIGHTS OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS** | | | |
| IIA | Basic shareholder rights | 75 | 69 |
| IIB | Rights to participate in fundamental decisions | 75 | 64 |
| IIC | Shareholders AGM rights | 75 | 63 |
| IID | Disproportionate control disclosure | 50 | 50 |
| IIE | Control arrangements should be allowed to function | 50 | 56 |
| IIF | The exercise of ownership rights should be facilitated | 25 | 28 |
| IIG | Shareholders should be allowed to consult with each other | 75 | N.a |
| **III. EQUITABLE TREATMENT OF SHAREHOLDERS** | | | |
| IIIA | All shareholders should be treated equally | 75 | 56 |
| IIIB | Prohibit insider trading | 50 | 56 |
| IIIC | Board/Mgrs. disclose interests | 75 | 45 |
| **IV. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE** | | | |
| IVA | Legal rights of stakeholders are to be respected | 100 | 69 |
| IVB | Stakeholder redress | 50 | 68 |
| IVC | Performance-enhancing mechanisms | 100 | 68 |
| IVD | Stakeholder disclosure | 75 | 75 |
| IVE | “Whistleblower” protection | 50 | N.a |
| IVF | Creditor rights law and enforcement | 75 | N.a |
| **V. DISCLOSURE AND TRANSPARENCY** | | | |
| VA | Disclosure standards | 75 | 73 |
| VB | Accounting standards | 75 | 77 |
| VC | Independent audit annually | 75 | 66 |
| VD | External auditors should be accountable to the shareholders | 50 | N.a. |
| VE | Fair & timely dissemination | 75 | 67 |
| VF | Research conflicts of interests | 75 | N.a |
| **VI. RESPONSIBILITIES OF THE BOARD** | | | |
| VIA | Acts with due diligence, care | 50 | 55 |
| VIB | Treat all shareholders fairly | 50 | 49 |
| VIC | High ethical standards | 75 | 68 |
| VID | The board should fulfill certain key functions | 50 | 46 |
| VIE | The board should be able to exercise objective judgment | 50 | 41 |
| VIF | Access to information | 100 | 68 |

*Source: All Completed ROSCs FY02-FY04*

# Principle - By - Principle Review of Corporate Governance

This section assesses Pakistan's compliance with each of the OECD Principles of Corporate Governance. Policy recommendations may be offered if a Principle is less than fully observed. **Observed** means that all essential criteria are met without significant deficiencies. **Largely observed** means only minor shortcomings are observed, which do not raise questions about the authorities' ability and intent to achieve full observance in the short term. **Partially observed** means that while the legal and regulatory framework complies with the Principle, practices and enforcement diverge. **Materially not observed** means that, despite progress, shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance. **Not observed** means no substantive progress toward observance has been achieved.

**SECTION I: ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK**

**The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.**

**Principle IA: The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets.**

***Assessment: Observed***

***Capital markets.*** Market capitalization at the end of 2004 was 1,723 billion rupees, or USD 29.0 billion, a 95 percent annual average increase over the past three years; in 2002, Pakistan was the fastest growing emerging market in the world. Market capitalization amounted to 24.1 percent of GDP at the end of 2003. Pakistan's equity market was the second largest in the region after India, both in absolute terms and as a percent of GDP. The top 10 companies in the market represented 49.1 percent of total market capitalization at the end of 2004.

Pakistan's equity market turnover is much higher than in other countries in the region. The turnover ratio was 40.3 percent in 2003, about 54 percent of the OECD average.

**Pakistan and other Emerging Markets: Selected Market Data (2003)**

| Country Name | Market Cap % GDP | Market Cap (Billions $US) | Turnover Ratio (%) | Market Cap (% GDP) % of OECD Avg. | Market Cap ($) % of OECD Avg. | Turnover ratio % of OECD Avg. |
|---|---|---|---|---|---|---|
| **Pakistan** | **24.1** | **16.6** | **40.1** | **40.0** | **2.4** | **53.8** |
| India | 46.6 | 279.1 | 14.1 | 78.0 | 39.9 | 19.0 |
| Sri Lanka | 14.6 | 2.7 | 1.2 | 24.0 | 0.4 | 1.6 |
| Nepal | 14.6 | 0.8 | 6.9 | 24.0 | 0.1 | 9.3 |
| Bangladesh | 3.1 | 1.6 | 3.5 | 5.1 | 0.2 | 4.7 |
| *Average South Asian Region* | *20.1* | *13.9* | *2.8* | *29.3* | *2.0* | *3.8* |
| *OECD Average* | 60.1 | 699.4 | 74.4 | 100.0 | 100.0 | 100.0 |

At the end of 2004 there were 661 companies listed on the Karachi Stock Exchange (KSE)[6], a decrease of 101 companies since the beginning of 2000. However, this decrease hides significant IPO activity over the past five years: 33 new listings have come to the exchange, with 17 new listings in 2004, the amount of capital listed during the period is almost 15 times that of companies which delisted.[7] The government is continuing to sell and list small tranches of state enterprises, often at attractive prices. At the end of 2004 there were 141 companies out of 661 companies (21%) that had been placed on the "defaulter's counter" for violating the listing regulations of KSE.

**Listing and Delisting Activity on the Karachi Stock Exchange: 2000 – 2004**

| | Listed Companies at Start of Year | IPOs | Delisting due to merger | Other voluntary delisting | Involuntary delisting | Listed Companies at End of Year | Of Which: Defaulters Counter |
|---|---|---|---|---|---|---|---|
| 2002 | 747 | 4 | 16 | 9 | 15 | 712 | 116 |
| 2003 | 712 | 6 | 8 | 8 | 0 | 701 | 153 |
| 2004 | 701 | 17 | 39 | 15 | 3 | 661 | 141 |

Market participants report that delisting pressures flow from several sources. Tax benefits for listing—once significant—have been gradually reduced, and will disappear completely by 2007.[8] Other incentives to list (e.g. mandatory listing requirements

[6] Pakistan has three exchanges, in Karachi, Lahore and Islamabad (see below).
[7] Source: SECP data.
[8] Until 2002 public companies were given a 10 percentage point income tax rate preference. Under the Finance Ordinance 2002, tax rates

for large companies, in order to obtain manufacturing or other licenses) have long since been removed. Finally, recent corporate governance regulation and enforcement appear to have raised the cost of staying listed for some companies, resulting in increased pressure to delist.

***Institutional Investors.*** Pakistan has a small and growing investment fund industry. Total equity holdings are about 5 percent of market capitalization. The sector's largest players are the state controlled National Investment Trust (NIT) and the Investment Corporation of Pakistan (ICF). Many new funds have been formed or are in formation in response to new regulations. Currently there are 17 asset management companies, managing 36 funds with a total of about 100 billion rupees (USD 1.68 billion) under management, of which about 60 percent is controlled by NIT (100 percent equity). The remainder is approximately 50 percent equity and 50 percent debt. NIT plays a major role in corporate governance, and sits on hundreds of corporate boards. There are discussions of splitting NIT into five funds.

Other institutional investors include a number of international joint venture companies (e.g. Pak-Kuwait, Pak-Oman, and Pak-Saudi) that invest in both listed companies and private equity. Brokers also reportedly hold large proprietary positions, and can sit on boards (recent rules restrict board participation when holdings are less than 10 percent).

Company-owned provident plans can also invest in equity securities. The Securities and Exchange Commission of Pakistan (SECP) is encouraging the development of a voluntary system of private pensions. Pakistan also has Modarabas, a kind of Islamic bank. Regulation falls under the Non-Banking Finance Companies division of the SECP.

***Ownership framework.*** The State dominates the corporate landscape. Market participants report that most of the "blue chips" are majority-state controlled (often through various intermediary trusts and pension schemes). Some market participants believe that the Pakistan Army plays an indirect role in many companies.

There are a large number of listed subsidiaries of multinational companies. These include the large international oil companies, pharmaceutical companies (until recently), and manufacturing companies. Multinationals listed in order to receive the tax benefits, and as a result of political pressure.

**Ownership Structure of the Largest 40 Listed Companies (2002)**

| | Percent of companies in each category | | Percent of market capitalization in each category | |
|---|---|---|---|---|
| **Ownership Type** | **All** | **Non-Financial** | **All** | **Non-Financial** |
| **Government** | 35.0 | 26.0 | 52.8 | 52.4 |
| **Local Private** | 52.5 | 59.0 | 30.2 | 29.8 |
| **Foreign** | 12.5 | 15.0 | 17.0 | 18.0 |

*Source: South Asia Report, Table 2.3. "Government" in the table includes the categories of "government" and "semi-government" in the source table*

Concentration of control is much higher in Pakistan than in East Asia, while ownership concentration is lower—many companies in Pakistan use pyramids and cross-shareholdings to maintain control.[9] Families controlled almost half of the equity of an average listed textile company (either through direct ownership or through cross-holdings and pyramids) in 2002, and about a third of non-textile companies. Many companies are controlled at the 75 percent absolute control level.

**Ownership Structure of Local Private Companies (2002)**

| | Textile | Non-Textile |
|---|---|---|
| **Family ownership:** | | |
| **Direct holding** | 29.3 | 9.1 |
| **Associated companies of the controlling family** | 17.4 | 21.4 |
| **Total** | 46.7 | 30.5 |
| **NIT/ICP (large state mutual funds)** | 8.4 | 11.1 |
| **Financial Institutions** | 5.1 | 8.2 |
| **Foreign Investors** | 1.9 | 14.3 |
| **Joint Stock Companies** | 23.2 | 16.9 |

*Source: CBS, Sample includes 22 textile companies and 21 non-textile companies*

**Principle IB. The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.**

***Assessment: Largely Observed***

***Corporate legal framework.*** The Companies Ordinance 1984 (*CO*) sets the rules for the governance and regulation of companies and certain other associations, and is based on common law. Banks are regulated by the Banking Company Ordinance (BCO) 1962 and prudential regulations issued by SBP. SBP has also provided guidance to banks on risk

of private companies were reduced by 2 percentage points per year, beginning in 2003.

[9] CBS, (Table 2.5 and 2.6, Appendix 3 figures A.3.2 and A.3.39). In a sample of 32 companies, 78.3 percent of non-textile companies kept control through at least one other company.

management and internal controls.

***Company types.*** Partnerships and sole proprietorships remain important business forms. The two large company forms are Private Limited Companies and Public Limited Companies. Private companies restrict the right to transfer shares and do not sale shares to the public. At the end of 2004, there where 2,174 domestic public limited companies—a 20 percent decrease—and 41,054 domestic private limited companies, as well as 588 foreign companies, and 708 other types of companies (not for profits, unlimited liability, etc.).[10]

***Securities law framework.*** The Securities and Exchange Ordinance 1969 (SEO) is the basic securities law, and provides for the investor protection, market regulation, securities dealing and related matters, and the prevention of fraud and insider trading. The Securities and Exchange Commission of Pakistan Act, 1997 (SECP Act) established the SECP as the regulator of the capital markets and the controller of corporate entities. The Listed Company (Substantial Acquisition of Voting Shares & Takeovers) Ordinance, 2002 establishes additional takeover and ownership disclosure rules.

***Listing rules.*** In addition to establishing listing requirements (including disclosure), the listing rules also include special regulations on transfer pricing (see Principle IIIC) and the Code. Listed companies must inform the exchanges about dividends, AGMs, capital increases, and changes in its board.

***Code.*** The Code for Corporate Governance (Code), introduced by the SECP in early 2002, has been an important factor in corporate governance reform in Pakistan. The Code was the result of a joint effort by the SECP and the Institute of Chartered Accountants Pakistan (ICAP). All listed companies are required to comply with most provisions of the Code; companies can delist to avoid its requirements. The Stock Exchanges are responsible for enforcing the Code (including its mandatory provisions) and can delist companies or impose fines up to 200,000 rupees.

The Code includes many recommendations in line with international good practice. Major areas of focus include (i) reform of the board of directors in order to make it more accountable to all shareholders; (ii) strengthened internal control systems; and (iii) better disclosure, including improved internal and external audits for listed companies. However the Code's limited provisions on director independence remain voluntary and provide little guidance on internal controls and risk management.

Several provisions of the Code were directly added to the CO, when it was amended in late 2002, in order to strengthen minority shareholder rights. The State Bank also mandated the application of the Code for all listed and non-listed banks and Development Finance Institutions (DFIs). This requirement (backed up by the State Bank's considerable enforcement capacity) resulted in significant changes within the banking system. The SECP issued a separate code for insurance companies. No code is mandated for mutual funds.

The SECP has also begun a dialogue on the corporate governance of State-Owned Enterprises (SOEs). Based on round table meetings and discussions with certain SOEs, the SECP recently prepared draft rules for SOE corporate governance and has shared them with the relevant ministries for comment.

**Principle IC. The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.**

***Assessment: Largely Observed***

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

***Securities regulator.*** The SECP was established under the SECP Act, and began operations in January 1999. The SECP has the responsibility for regulating the issue of securities, stock exchanges, 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.

SECP has between five and seven 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 SECP is legally and financially independent of the government. While formally independent, some market participants expressed concerns about political influence over the SECP's operations.

Since merging with the Company Law Authority, the SECP has particularly strong authority over company law and registration. The SECP can issue secondary regulation. The law indemnifies SECP staff for any actions taken in good faith.

***Stock exchange.*** Pakistan has three stock exchanges, in Karachi, Lahore, and Islamabad. The Karachi Stock Exchange (KSE) is the oldest and accounts for about 75 percent of trading volume. The Lahore Stock Exchange has 22 percent and the Islamabad Stock Exchange, about 4 percent. Most companies are listed on all three exchanges.

Each exchange has similar governance procedures and rules, as mandated by the SECP. Each is required to enforce its listing rules, including the Code, and monitors for market abuse. The board of each consists of five member-directors and

[10] Data obtained from SECP / Company Law Administration Division.

four non-member directors and a managing director appointed by the SECP. However, the exchanges have little enforcement authority over issuers, other than suspension or delisting, and most violations are referred to the SECP. The three exchanges are expected to merge in the relatively near future.

***Central depository.*** The Central Depository Company of Pakistan (CDC) began operations in September 1997. It is owned by the three exchanges and a number of other private-sector, foreign, and state issuers and market participants. It provides standard depository services, including corporate actions, and provides custodial services to mutual funds. It is taking initial steps to provide registry services.

In 2004, the CDC launched the National Clearing and Settlement System (NCSS). The NCSS is a separate institution (owned by the three exchanges) designed to provide clearing and settlement services, and to replace the separate clearing functions previously maintained by the three exchanges.

***Banking and other regulators.*** The SBP is the regulator of the banking system; it oversees statutory requirements and prudential rules and regulations. The SBP can take remedial action, and direct prosecution of a director or CEO, who has caused loss to depositors or the bank.[11] SBP has taken a number of steps to strengthen corporate governance in banks/DFIs. These include the issuance of fit and proper criteria for board members, CEOs and key executives; the issuance of prudential regulations on corporate governance; strengthening disclosure requirements for banks, publishing a handbook on corporate governance; and providing training to board members and CEOs. The SBP has mandated that listed and non-listed banks follow the Code, and closely monitors bank / DFI compliance with the Code and its own guidelines.

SBP works closely with the SECP; a Coordination Committee meets regularly under the terms of an MOU.

***Judiciary.*** Pakistan's legal system is based on common law, with Islamic Shari'a law provisions to accommodate Pakistan's status as an Islamic state. The Supreme Court is Pakistan's highest court. Each of the four provinces (Lahore, Sindh, Punjab, and Peshawar) has a high court. There are civil and criminal court systems. The civil system's hierarchy begins with the civil court, followed by the district court, then the High Court, and finally the Supreme Court. In the criminal system, the magistrate is the lowest court, followed by the sessions court, then the High Court, and finally the Supreme Court.

A variety of standard measures developed by the World Bank for 155 countries indicates that judicial efficiency in Pakistan is comparable to other countries in the region. Market participants report that the courts are frequently considered to be an expensive means of resolving disputes.

| Enforcing a Contract | Pakistan | Regional Average | OECD Average |
|---|---|---|---|
| Procedures (number) | 46 | 29 | 19 |
| Time (days) | 395 | 385 | 232 |
| Cost (% of debt) | 35.2 | 36.7 | 10.9 |

***Company Registrar.*** The Company Law Administration Division 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.

**Principle ID. Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfill their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.**

***Assessment: Largely Observed***

***Authority, integrity and resources of regulators.*** The SECP has considerable investigative and enforcement powers over listed and unlisted companies and has moved towards international good practice in a number of areas.

The SECP has "all such powers as may be necessary to perform its duties and functions"[12]. This includes broad investigative powers and the ability to impose a wide variety of administrative penalties on listed companies; which the SECP has made increasing use of. Administrative penalties can be appealed internally, and then to the court. SECP can also investigate shareholder complaints, appoint special inspectors, and overturn company decisions.

The SECP considers its funding to be adequate. SECP funding consists of fees and penalties imposed by SECP. SECP must submit its annual budget for approval by the SECP Policy Board. These arrangements appear to secure for the SECP a stable and continuous source of funding and an appropriate level of independence in the allocation of funds to its activities. The SECP has 502 employees, including 171 working in the 8 company registry offices. However, the SECP and market participants recognize that skills are not necessarily adequate in several key enforcement areas, particularly in law and accounting.

[11] Banking Companies Ordinance, Section 40A
[12] SECP Act

Market participants also report the Company Law Administration Division has significantly improved its efficiency and customer service in recent years.

The SBP has considerable authority and resources to regulate banks and DFIs, and as a regulator its effectiveness has improved considerably in recent years. Both onsite and offsite supervision of banks/DFIs is carried out to monitor performance of individual institutions and the overall banking system.

**SECTION II: THE RIGHTS OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS**

**The corporate governance framework should protect and facilitate the exercise of shareholders' rights.**

**Principle IIA: The corporate governance framework should protect shareholders' rights. Basic shareholder rights include the right to:**

***Assessment: Largely Observed***

| | |
|---|---|
| (1) Secure methods of ownership registration | Each company is required to maintain a shareholder registry; this function can be outsourced to one of 36 commercial share registry companies. To trade shares on an exchange, they must be deposited and dematerialized at the CDC, a process which takes 5 days. At the end of 2004, the shares of 550 companies were eligible for deposit at the CDC, out of 661 total listed companies, and 98% of the securities traded in the exchanges were settled through CDC. Major shareholders (including the State and most large sponsors) have not opted for dematerialization, and are listed directly in the register. The CDC maintains a number of different types of accounts, including client accounts (sub-accounts in the name of each owner), and investor accounts (direct accounts at the CDC that can be accessed without the need of an intermediary). Group (omnibus) accounts (in which shares are held in the name of the participant) were phased out in April 2005. CDC is moving to add registry services, and appears to be moving in the direction of a central registry. There are currently about 80,000 client accounts and 17,000 direct (investor) accounts.<br><br>The shareholder recordkeeping process for shares held in the CDC works efficiently. However, although the registrar's role has been reduced by the CDC's operations, some inefficiencies remain. Some reportedly do not pay out dividends on time, and take longer than 5 days to re-register shares into the name of the depository. |
| (2) Convey or transfer shares | Public (and listed) companies are not allowed to restrict the transfer of shares. Clearing and settlement for listed companies and has migrated to the NCSS and away from the separate systems of the three exchanges. Settlement is same day exchange of securities and cash, but is not true DVP (delivery versus payment). |
| (3) Obtain relevant and material company information on a timely and regular basis | Shareholders have a variety of legal rights to obtain information directly from the company, and from filings to the SECP (Annex). |
| (4) Participate and vote in general shareholder meetings | The law clearly gives the right to all shareholders to participate in general meetings, either personally or through proxy (CO §160). No shareholder with voting rights can be prevented from castings his vote (CO §160(5)). However, some listed companies do not hold the required AGM (See Principle IIC below). |
| (5) Elect and remove board members | ***Process.*** Anyone can nominate himself by notifying the company up to 14 days before the meeting. Shareholders must be notified of any late entrants to the election by publication in a newspaper. The Code (section i) contains an additional provision designed to "encourage effective representation of independent…directors, including those representing minority interests".<br><br>***Cumulative voting/proportional representation.*** Section 178 of the CO says that "a member may give all his votes to a single candidate or divide them between more than one of the candidates in such a manner as he may choose". This allows for cumulative voting. The term of office for directors is 3 years. There is no term limit.<br><br>Directors can be removed by the AGM if the resolution is passed by the number of votes that originally elected the director under cumulative voting. |
| (6) Share in profits of the corporation | Dividends are declared by the AGM, based on a recommendation of the board (which cannot be exceeded) (CO §248(1)). Dividends can only be paid out of profits, and must be paid within 45 days of the declaration. Listing rules require payment of dividends at least once every five years. Companies that do not meet this are placed on the "defaulters |

| | |
|---|---|
| | counter". SECP data suggests that the percentage of companies paying dividends has remained roughly constant, at about 35 percent.[13]. Payout ratios are reported to be increasing at many companies. Shareholders can complain to the SECP about non-payment of dividends. |
| **Principle IIB. Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as:** | |
| ***Assessment: Largely Observed*** | |
| (1) Amendments to statutes, or articles of incorporation or similar governing company documents | Any changes to the company articles require a special resolution passed by ¾ of the members of a company (CO §28). |
| (2) Authorization of additional shares | ***Issuing share capital.*** The board can increase capital and issue new shares within the level of authorized capital (CO §196(2)). Increasing authorized capital requires a shareholder resolution (CO §92). Special permission from the SECP is needed to issue preferred shares.<br>***Pre-emptive rights.*** Existing shareholders have pre-emptive rights (CO §86). In the case of a capital increase, existing shareholders are granted rights shares. A public company can only waive pre-emptive rights with a 75 percent supermajority vote of shareholders present and voting, and the subsequent approval of the SECP.<br>These issues are not generally seen as sources of shareholder abuse in Pakistan. |
| (3) Extraordinary transactions, including sales of major corporate assets | ***Sales of major corporate assets.*** Shareholder approval is required for a public company or its subsidiary to "sell, lease, or otherwise dispose of the undertakings or a sizeable part thereof, unless the main business of the company comprises such selling or leasing (CO §196(3)). This concept is fully developed in case law. |
| **Principle IIC: Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general shareholder meetings:** | |
| ***Assessment: Largely observed*** | |
| (1) Sufficient and timely information on date, location, agenda, and issues to be decided at the general meeting | ***Meeting deadline.*** Every company is to hold an AGM at least once every calendar year. The AGM must be held within four months of the close of the company's financial year, within 15 months of preceding AGM.[14] The SECP can extend the meeting deadline.<br>***Meeting notice.*** The AGM notice must be mailed to shareholders at least 21 days before the meeting date and be published at least in one English and one Urdu newspaper (CO §158(3)).<br>***Information available.*** The meeting notice must specify the place, time, and agenda of the meeting (CO §160). If any special business is on the agenda (i.e. other than approval of the accounts and annual reports, electing directors and auditors, approving dividends), a "statement setting out all material facts" related to the special business must be attached to the notice. The notice must specify where any revised documents can be inspected. The Company Law Department of the SECP reviews the "statement of material facts" and imposes penalties in the case of non-compliance.[15]<br>***Quorum rules.*** The quorum for a General Meeting is a minimum of 25 percent of total votes, and at least 10 voting shareholders. The quorum for a second meeting (if |

[13] SECP Annual Report 2003, Table 19.
[14] Listing Rules 20 (1), CO, Section 158
[15] Out of 93 companies reviewed in 2004, material deficiencies were identified in meeting notices of 34 companies (which were advised to circulate addendums to the notices), and 3 companies were stopped from passing resolutions that were considered to be against the interests of shareholders or against the law. Proceedings were initiated against five companies for failure to include the statement of material facts with the AGM notice, or for not including special business in the agenda of the notice, and penalties were imposed on three companies.
[16]The SECP imposed penalties of Rs. 1.06 million in 27 cases during FY 2004 (7 cases were closed when satisfactory explanations were received from companies). (SECP Annual Report 2004, page 50).

| | |
|---|---|
| | necessary) is two shareholders. The company articles may provide for larger quorums.<br>Most companies hold their AGMs at their registered offices. Some participants reported annual meetings held at distant factories or during hours of prayer in order to reduce participation. In recent years, the SECP has taken action to ensure better compliance with the AGM.[16] About 88 percent of listed companies held timely AGMs in 2004 (98.7 percent when companies in a winding-up process are excluded). (SECP Annual Report 2004). |
| (2) Opportunity to ask the board questions at the general meeting | ***Forcing items onto the agenda.*** Shareholders with at least 10 percent voting power have the right to give notice of a resolution to be considered at a general meeting (CO §164(2)). The notice must be provided to the company at least fifteen days before the meeting, the company is required to circulate such resolution to all shareholders.<br>***Questions.*** While not addressed in the law or the Code, in practice shareholders do ask questions at the AGM, which are answered by management. |
| (3) Effective shareholder participation in key governance decisions including board and key executive remuneration policy | The company's articles can allow for director remuneration to be determined by shareholders in the general meeting or by the board (CO §191). |
| (4) Ability to vote both in person or in absentia | ***Proxy regulations.*** Shareholders may vote either in person or by proxy (CO §160(7)). Proxies must be shareholders (unless specifically not required in the articles). No notarization is required. A simple proxy form is provided in the law.<br>***Postal and electronic voting.*** Since all voting must be in person (or by proxy) at the AGM, postal and electronic voting is not available, or used in practice. |

**Principle IID: Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.**

***Assessment: Partially Observed***

***Classes of shares.*** 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.[17] Preferred shares can be issued as private placements. To date, only five companies have actually issued preferred shares, which have tended to be non-voting shares.

***Ownership disclosure by companies.*** Listed companies file an annual return indicating the pattern of shareholding, the number of shares and personal details of (i) associated companies, (ii) NIT and ICP, (iii) directors, senior management, their spouses and children, (iv) SOEs, (v) banks and other financial institutions, (vi) shareholders with 10 percent or more voting capital. The company is required to submit a complete list of shareholders and the percentages owned as of the day of the AGM to the stock exchanges and the PSEC (CO §156), although the company is not required to disclose this information in the annual report. In practice, pyramid structures, cross shareholdings and the absence of the joint action or "acting in concert" concept makes it difficult for an outsider to understand the ownership structure of a firm, especially when it comes to business groups.

***Ownership disclosure by shareholders.*** Any person who acquires more than 10 percent of voting shares in a listed company, whether directly or indirectly, must disclose his position to the company and to the stock exchange, within 2 days of acquisition.[18] Although the law refers to "indirect" disclosure, in practice shareholders disclose direct holdings, and reportedly frequently circumvent the law by holding in blocks of 9.9 percent of less.

There are indications that many companies in Pakistan use pyramids and cross-shareholdings to maintain control with a minimum of capital.[19]. Data suggests that pyramid structures are more common in Pakistan than in East Asia.[20] As a result, although market participants claim to understand overall ownership patterns, formal ownership is relatively opaque and relatively difficult to understand.

***Disclosure of shareholder agreements.*** Nominally, shareholders are required to disclose if they act in concert.

**Principle IIE: Markets for corporate control should be allowed to function in an efficient and transparent manner.**

[17] The Companies' Share Capital (Variation in Rights and Privileges) Rules, 2000.
[18] Listed Company (Substantial Acquisition of Voting Shares & Takeovers) Ordinance, 2002.
[19] See CBS (2003) for a complete discussion of the literature.
[20] CBS, Tables 2.7, A.3.2, A.3.3.

| ***Assessment: Partially Observed*** | |
|---|---|
| (1) Transparent and fair rules and procedures governing acquisition of corporate control | ***Basic description of market for corporate control.*** The market for corporate control in Pakistan is relatively inactive. As a result of regulatory changes and increases in capital requirements, there have been a number of mergers in the banking, insurance, and leasing sectors. Proposed mergers must be cleared by the Monopoly Control Authority (MCA) of Pakistan.[21]<br><br>***Tender rules/mandatory bid rules.*** The Listed Company Ordinance of 2002 introduced several tender offer rules. To pass the 25 percent threshold of voting shares, or to acquire control[22], requires a public tender offer. The legal language covering this threshold does not appear to cover indirect ownership and some feel it is not effective in the face of "creeping tenders".<br><br>Shareholders with more than 51 percent of voting rights must disclose any change in ownership. The SECP is working on secondary regulations to supplement the law.<br><br>The Code introduces an additional buy-out rule (§29). If a controlling shareholder sells at least 75 percent of the total shareholding of a listed company at a price higher than market value at the time of sale, "it shall be desirable and expected of the directors of the listed company" to prevent the transaction until the same offer has been made to minority shareholders. When the price offered to minority shareholders is lower than the price offered for the controlling block, the price is subject to the approval by the SECP. These rules do not apply to transactions between non-resident shareholder(s) or to privatization transactions.<br><br>***Delisting/going private procedures.*** Voluntary delisting requires the "majority holder/sponsor" to buy back the shares of other shareholders on terms specified in listing rules. However, a company can be delisted by the exchange for a number of reasons.<br><br>Conversion from a public company to private requires the approval of the SECP. There are no squeeze-out or sell-out rules currently in place.<br><br>***Abuse to buy-backs/treasury shares.*** By special resolution, a company may buy back and cancel its own shares. |
| (2) Anti-take-over devices | The takeover market is inhibited by concentrated ownership, pyramiding structures, and interlocking directors. Other devices do not appear to be in place. |
| **Principle IIF: The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.** | |
| ***Assessment: Materially not observed*** | |
| (1) Disclosure of corporate governance and voting policies by institutional investors | ***General obligations to vote/disclosure of voting policy.*** There are no regulations governing voting or voting policy of institutional investors. In practice, many institutional investors do not vote at the AGM. NIT holds shares in most listed companies in Pakistan, and sits on approximately 200 boards, but does not disclose its votes or voting policy.<br><br>***Special rules for institutional investors/pension funds.*** There are no rules related to the exercise of ownership rights for institutional investors. Clause (i) of the Code, as a voluntary requirement, details the procedure for the selection of an independent director by an institutional investor, and its disclosure in the directors' report.<br><br>***Blocked shares/record date.*** Shares are not blocked from trading before the annual meeting. The board may also suspend the registration of transfers for up to ten days immediately preceding a general meeting by giving seven days prior published notice (CO, 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. |

[21] Two recent examples of hostile takeover attempts are (i) the successful takeover of Adam Jee Insurance by Muslim Commercial Bank, and (ii) the unsuccessful takeover of ENGRO Pakistan by the Dawood Group.
[22] Control is defined as the right to appoint the majority of directors, or to control management or policy decisions, either individually or through any person acting in concert whether by virtue of his shareholding, management right, shareholders agreement, voting agreement or otherwise.

| | |
|---|---|
| (2) Disclosure of management of material conflicts of interest by institutional investors | There are no requirements in this area. |
| **Principle IIG: Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.** | |
| ***Assessment: Largely Observed*** | |
| ***Rules on shareholder cooperation in board nomination/election.*** The Code (section i) contains provisions to facilitate "candidates representing minority shareholders" to communicate with shareholders before the AGM.<br>***Rules on communication among minority shareholders.*** There are no requirements in this area.<br>***Proxy solicitation or other formalities required.*** There are no requirements in this area.<br>***Rules on communication among institutional investors.*** There are no requirements in this area. | |
| **SECTION III: THE EQUITABLE TREATMENT OF SHAREHOLDERS**<br>**The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.** | |
| **Principle IIIA: All shareholders of the same series of a class should be treated equally.** | |
| ***Assessment: Largely Observed*** | |
| (1) Equality, fairness, and disclosure of rights within and between share classes | ***Availability of share class information.*** The rights attached to shares must be listed in the articles (CO §26). The articles and other basic company information are filed with the local Company Registration Office and are available to the public for a nominal fee.<br>***Equal rights within classes.*** Equal rights are implied under the CO.<br>***Approval by the negatively impacted classes of changes in the voting rights.*** Any change to the share rights of a particular share class can only be carried out if ¾ of the class of members agree (CO §28). If 10 percent or more of the affected class of shareholders may apply to the Court for an order canceling the resolution (CO §108). |
| (2) Minority protection from controlling shareholder abuse; minority redress | Shareholders have a number of redress possibilities.<br>***Ability to call meeting.*** Ten percent of voting power can demand that the directors call an extraordinary general meeting (CO §159). A majority of those calling the meeting may themselves call a meeting, if the directors do not call the meeting within 21 days. The SECP can call a general meeting if there has been a default in the holding of any such meetings (CO §170). The SBP can order any banking company to call a general meeting within two months.<br>***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.<br>***Ability to sue to overturn meeting decisions.*** At least ten percent of shareholders can petition the court to overturn a resolution or meeting proceedings, 20 percent shareholders (and creditors) can also petition the court to regulate the affairs of a violation of their rights (CO §108). In addition, members having at least ten percent voting power can (within 30 days) petition the court that the proceedings of a general meeting be declared "invalid by reason of a material defect or omission" in the proceedings of the meeting, which prevented members from effectively using their rights.<br>20 percent shareholders (and creditors) can also petition the court on a more general basis (CO §290)[23]. Such suits are rarely filed. |

[23] If the court agrees that the company if it is being run in an "unlawful or fraudulent manner or in a manner not provided for it its memorandum, or in a manner oppressive to the members or any of the members or the creditors or any of the creditors or are being conducted in a manner prejudicial to the public interest"

| | |
|---|---|
| | ***Redress from regulators.*** The SECP is a growing and powerful source of potential 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).[24]<br><br>The SECP can also appoint a special inspector to investigate the company (CO §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.<br><br>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.<br><br>***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. |
| (3) Custodian voting by instruction from beneficial owners | The CDC is gradually assuming many of the traditional roles of the custodian in Pakistan. Domestic investors (including investment funds) are increasingly keeping their shares in sub-accounts in the CDC, and the traditional custody business is declining. |
| (4) Obstacles to cross border voting should be eliminated | Foreign share ownership is limited. No specific obstacles other than potential problems identified above were noted for foreign investors. |
| (5) Equitable treatment of all shareholders at GMs | The law provides a general injunction that no shareholder with voting rights can be prevented from voting (CO §160(5)). Show of hands votes are typical: a formal poll can be demanded by any five shareholders or by 10 percent of shareholder votes (CO §160). |

**Principle IIIB: Insider trading and abusive self-dealing should be prohibited.**

***Assessment: Partially observed***

***Basic insider trading rules.*** The SEO regulates insider trading, and the laws are enforced by the SECP which has also issued Insider Trading Guidelines.[25] 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.".

A person, dealing with the securities on the basis of unpublished price sensitive information shall be liable to compensate the person/entity suffering any loss or damage as a result of such transaction. The issuer of a security, the SECP or the person affected by such insider trading may obtain sanction of the court to enforce the liability.

***Insider trading disclosure.*** The company is required to annually disclose ownership by insiders in the annual report (see Principle IID). Insiders (including 10 percent shareholders) are required to disclose any changes in their shareholding to the company within 15 days, and the company is required to keep a register of insider shareholding, which is available for inspection by the SECP, or by shareholders 14 days before the AGM (CO §220&221). Every listed company is also required by the Code of Corporate Governance to disclose the pattern of shareholding and all trades in its shares, carried out by its directors, CEO, CFO, Company Secretary and their spouses and minor children. Insiders are also required to make a separate submission to the SECP within 30 days (CO §222). Insiders ("any director, Chief Executive, managing agent, chief accountant, secretary", auditor, or 10 percent shareholder) are not allowed to buy and sell the same securities within a six month period (i.e. a short-swing profit rule) (CO §224); those who do so must report it to the SECP and tender the amount of gain to the company.

***Criminal/civil/administrative penalties.*** 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.

Prosecution of insider trading is in its early stages in Pakistan. Two cases were successfully handled under administrative sanction in late 2004.

[24] CO, Section 170 (calling meetings), Section 261 (call for information), Section 262 (seizure of documents).
[25] Securities and Exchange Ordinance 1969, Sections 15A and 15B.

**Principle IIIC: Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.**

***Assessment: Largely observed***

***RPT approval rules/rules for approval of board/AGM.*** By law, the board and the audit committee must approve any departure from arms-length pricing (CO, Fourth Schedule, Para. 6). The listing rules also address transfer pricing / related party transaction issues. If an officer learns about a related party transaction that is not at arm's length, he must disclose it to the Company Secretary at least 15 days before the execution of the transaction. Listed companies must maintain a list of related party transactions, which must be presented to the Audit Committee, the board and the auditor. Management must explain any prices or deviations from arms length prices.[26]

Company law also requires shareholder approval of certain related-company investments (CO §208). Companies cannot make any investment in any of their "associated companies or associated undertakings" without a special 75 percent supermajority resolution of the shareholders meeting.

***Conflict of interest rules and use of business opportunities.*** The Chief Executive cannot engage, directly or indirectly, in a business competing with the company's business (CO §203). Directors and Officers must disclose "direct or indirect concerns or interests in any contract or arrangement entered into or to be entered into by or on behalf of the company" (CO §214&215). Directors who have an interest in a certain transaction are not allowed to discuss or vote on the matter in board meetings (CO §216). Violations of these rules could result in (small) financial penalties or in a court declaring a director as "lacking fiduciary behavior".

Banks/DFIs cannot (without prior approval of the SBP) enter into any kind of transaction with their directors, officers, employees or persons who either individually or in concert with family members beneficially own 5 percent or more of the equity of the bank (Prudential Regulation G 2).

No rules govern voting of interested parties during shareholder meetings or disclosure to shareholders or to the public.

## SECTION IV: THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

**The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.**

**Principle IVA: The rights of stakeholders that are established by law or through mutual agreements are to be respected.**

***Assessment: Observed***

While employees do not have a specific right to sit on boards, they are represented by works councils. Creditors may nominate directors to the board "by virtue of contractual agreement" (CO §182).

***List of relevant codes for stakeholders.*** Reportedly, a number of companies have adopted ethics codes and corporate social responsibility is becoming a prominent issue.

**Principle IVB: Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.**

***Assessment: Partially observed***

***Redress mechanisms available to stakeholders.*** Stakeholders have access to the courts. However, cases can take significant time to be resolved

**Principle IVC. Performance-enhancing mechanisms for employee participation should be permitted to develop.**

***Assessment: Observed***

It is not permitted to use treasury shares for stock options; firms have to issue new stock. This was reported as one of the

[26] A joint task force (including the SECP and the Central Board of Revenue) finalized a detailed set of recommendations on related party transactions, reaffirmed Pakistan's commitment to IAS (and IAS 24), and suggested the cancellation of the special disclosure rules for related party transactions, and the modification of relevant KSE Listing Regulations.

reasons why stock option plans are not popular. The financial sector has a performance related bonus system in place. Company boards have the right to approve bonuses for employees[27].

***Rules on employee stock option plans.*** The SECP has issued rules on stock options—which require the company to have a compensation committee and shareholder approval for such schemes.

**Principle IVD: Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.**

***Assessment: Largely observed***

Section 136 of the CO provides the right to inspect copies of mortgages to creditors and other persons during prescribed times and a defaulting company faces penalties.

***Annual report discloses economic and financial prospects.*** Yes.

***Annual report discloses significant facts on employees.*** No.

***Information is sufficient and reliable.*** See section V.

***Information is timely and regular.*** Yes.

**Principle IVE: Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.**

***Assessment: Partially Observed***

***Whistleblower rules.*** Some companies have started to adopt whistleblower policies, e.g. by creating websites, where employees can anonymously post complaints. Labor/trade unions have a "collective bargaining agent" who presents the grievances of employees on their behalf. However there is no specific whistleblower protection under the law.

**Principle IVF: The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.**

***Assessment: Largely Observed***

***Effectiveness of bankruptcy, security/collateral, and debt collection/enforcement codes.*** In the past, creditor protection was weak in Pakistan, and there was heavy reliance on concessionary finance. Significant reform, including the establishment of Banking Courts and legal changes to facilitate the collection and resale of collateral has improved the protection of creditors' rights. A variety of standard measures developed by the World Bank for 130 countries confirm that compared to its regional neighbors, Pakistan has relatively strong creditor rights. See *Doing Business 2005* at rru.worldbank.org.

| Creditor Rights Indicator | Pakistan | Regional Average | OECD Average |
|---|---|---|---|
| Cost to create collateral (% of income per capita) | 11.5 | 8.0 | 5.2 |
| Legal Rights Index (out of a possible 10) | 4 | 3 | 6.3 |
| Credit Information Index | 4 | 1 | 5.0 |
| Public credit registry coverage (borrowers per 1000 adults) | 2 | 1 | 76.2 |
| Private bureau coverage (borrowers per 1000 adults) | 3 | 3 | 577.2 |

One attempt to increase creditor protection, personalizing the liability of directors for loans in default, may be discouraging companies from fully tapping credit markets.

## SECTION V: DISCLOSURE AND TRANSPARENCY

**The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.**

**Principle VA: Disclosure should include, but not be limited to, material information on:**

[27] CO, Section 196 (2)

| Assessment: Largely Observed | |
|---|---|
| (1) Financial and operating results of the company | ***Annual report.*** The CO specifies financial reporting requirements. 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 Code requires additional disclosure, including corporate plans and decisions; investments; director attendance at board meetings; pattern of shareholding; and trading in shares of the company by directors, the chief executive, other executives and their spouses and minor children.<br><br>Banks are required to publish annual accounts and submit them to SBP. Management must include a statement of its responsibilities for establishing and maintaining adequate internal controls and procedures, followed by a self-evaluation of the effectiveness of internal controls. This self-evaluation must be endorsed by the board.<br><br>***Semi-annual report.*** The Code requires second quarter financial statements, which are subject to limited scope review by the statutory auditor.<br><br>***Quarterly report.*** Section 245 of the CO and the Code require the publication and circulation of quarterly un-audited financial statements along with a directors' report. Banks are also separately required to produce quarterly reports.<br><br>***Material events.*** The Code requires the immediate dissemination to the SECP and stock exchanges of all material information that will affect the market price of the firm. The exchanges may relax this requirement at their discretion. Insiders trading company stock is not considered a material event.<br><br>In the past few years, there have been significant improvements in the quality and timeliness of financial reporting. The SECP monitors the compliance of listed companies and grants exemptions and relaxations.[28] The Management Association of Pakistan manages a company reward program for the "top ten reporting firms" in order to promote disclosure. The Institute of Chartered Accountants of Pakistan, the Institute of Cost and Management Accountants of Pakistan, and the South Asian Federation of Accountants have instituted similar corporate reporting awards,. However, gaps remain and it is widely accepted that the quality and extent of disclosure of many firms should be further improved. |
| (2) Company objectives | The directors' report includes any material changes concerning the nature of the business of the company or in the classes of business in which the company has interest that have occurred during the financial year. |
| (3) Major share ownership and voting rights | Listed companies file an annual return indicating the pattern of shareholding, the number of shares and personal details of (i) associated companies, (ii) NIT and ICP, (iii) directors, senior management, their spouses and children, (iv) SOEs, (v) banks and other financial institutions, (vi) shareholders with 10 percent or more voting capital. The company must also submit a shareholder list with the SECP and the stock exchange. In practice, pyramid structures, cross shareholdings and the absence of the joint action or "acting in concert" concept makes it difficult for an outsider to understand the ownership structure of a firm, especially when it comes to business groups. |
| (4) Remuneration policy for board and key executives, and information about directors | The remuneration of the chief executive, other executives, and the board must be separately disclosed, in aggregate (CO, Fourth Schedule, Part III.4). Fees, bonuses, expenses, pensions, and benefits must be separately disclosed. The remuneration of directors is set by the articles of association (CO, §191). |
| (5) Related party transactions | Pakistan has adopted IAS 24 in full; all related party transactions must be disclosed in a note to the annual financial statements. SBP directives further specify related party |

[28] During 2004 a total of 1,279 quarterly reports of listed companies were due to be filed. 1,092 accounts were actually filed by listed companies (85.4 percent). 62 companies did not submit a total of 187 accounts for various quarters. The SECP issued 53 show cause notices to 42 companies (and 56 show cause notices were brought forward from the previous year). Penalties amounting to Rs. 1.383 million were imposed in 42 cases, while 51 cases not penalized, because of minor defaults or satisfactory explanations (including the fact that winding up proceedings had been initiated). The SECP also reviewed non-financial disclosure, including the quality of the director's report. Clarifications were sought and show cause notices were issued to directors of four companies for grossly inadequate disclosures in the directors' reports.

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| | transaction disclosures (BSD Circular 30 --October 10, 2001).<br>Company law and listing rules place significant additional disclosure requirements on listed companies. If any transactions during the year do not happen at an "arms length price"[29], the company must state in the financial statements that (i) all other related party transactions have been at arms length, (ii) the arms length price for the relevant transactions, and (iii) the financial impact of the departure from the arm's length price.[30] Listed companies must state their compliance with the transfer pricing rules (including board approval and maintenance of transaction lists).[31]<br>Market participants report that actual disclosure of related party transactions is inadequate at many companies. As a result, the SECP recently issued specific regulations regarding transfer pricing in the listing regulations.[32] Companies must now publish a statement along with their annual reports confirming that they comply with the Transfer Pricing regulations. This statement has to be certified by the external auditor. The regulation met with opposition from the audit profession and from listed companies and was not in effect as of January 2005.<br>On December 30, 2005, a joint task force (including the SECP, the Central Board of Revenue) finalized a detailed set of recommendations on the disclosure of related party transactions. The Task Force reaffirmed Pakistan's commitment to IAS (and IAS 24), and suggested the cancellation of the special disclosure rules for related party transactions, and the modification of relevant KSE Listing Regulations.[33] |
| (6) Foreseeable risk factors | The Director's Report discloses significant plans, such as restructurings, expansion and discontinuance of operations as well as future prospects, risks and uncertainties. All banks / DFIs are required to include a "Risk Management Framework" discussion in the Directors' Report that addresses bank plans and steps taken to meet the SBP's guidelines on risk management. |
| (7) Issues regarding employees and other stakeholders | There are no disclosure requirements regarding employees and other stakeholders in the law or Code. |
| (8) Governance structures and policies | The Director's Report includes a statement that there has been no material departure from the best practices of corporate governance, as detailed in the Code and listing regulations. In addition, companies publish a separate compliance statement that details their compliance with the Code, as part of their annual reports. The compliance statement is subject to review by the statutory auditors. Banks are also required by the SBP to report on compliance with corporate governance best practices.<br>***Regulator enforcement practice.*** The Stock Exchanges are responsible for the enforcement of Code disclosure provisions. Non-compliance can result in delisting or fines up to 200,000 rupees. While firms are complying with the formal reporting aspects of the Code, enforcement actions to date have been limited.<br>For banks, SBP monitors disclosure content and compliance. A governance self-assessment questionnaire (approved by the board) allows the SBP to monitor compliance with the SBP's guidelines on internal controls, risk management, and corporate governance. |
| **Principle VB: Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.** | |
| ***Assessment: Largely Observed*** | |
| ***Compliance with IFRS.*** According to the Accounting and Auditing ROSC, Pakistan has largely adopted International Financial Reporting Standards (IFRS). These are promulgated by the SECP in consultation with the Institute of Chartered | |

[29] Arms length price is defined as "the price applied in a transaction between knowledgeable and willing parties, not being related parties, in uncontrolled conditions".
[30] CO, Fourth Schedule, Part I, Paragraph 6.
[31] At the end of 2005,
[32] One of the objectives was an effort to control the price of raw material imports of multinational pharmaceutical companies.
[33] This includes recommendations to withdraw Clause 6 of Part I of the Fourth Schedule to the Companies Ordinance, 1984, regulation No. SRO 167(I)/2003 dated February 14, 2003, and modifications to Listing Regulation No. 38 of the KSE.

Accountants of Pakistan (ICAP).[34]

***Review/enforcement of compliance.*** The Enforcement Department of the SECP is responsible for enforcing IFRS compliance (CO § 234). If violations are detected, SECP can penalize both issuers and auditors. During FY 2004, 135 listed companies were asked to explain various deficiencies in their financial statements, and proceedings were initiated against eight companies for not presenting a "true and fair view" in the financial statements and not maintaining proper records (Annual Report SECP 2004). SBP can also take action in banks/DFIs, based on information from on-site/off-site inspections.

According to market participants, monitoring is constrained by a lack of human resources and technical ability. Hence enforcement tends to focus on form rather than substance and there are several cases of disclosure deficiencies – including with respect to related party transactions, where information does not disclose the extent of control by related parties.

**Principle VC: An annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.**

***Assessment: Largely observed***

The CO spells out audit requirements, including appointment and removal of auditors and the auditor's obligations in performing an audit. Section 252 of the CO states that external auditors are appointed and removed by the AGM. Where the company fails to appoint an auditor, the SECP can do so. Remuneration is fixed by the board or the SECP or the AGM.

The auditor of a listed company must be a practicing member of the ICAP. The Code (Clauses xxxvii to xliv) supplements existing law by requiring firms appointed as external auditors; (a) have been given a satisfactory rating by the Quality Control Review of ICAP; and (b) are compliant with the International Federation of Accountants' (IFAC) guidelines on Code of Ethics, as adopted by ICAP.[35] According to the accounting and auditing ROSC, about 40 percent of the audits of listed firms are conducted by the affiliates of large international accounting firms. SBP maintains a list of approved auditors for banks/DFIs.

***Compliance with ISA.*** Pakistan has adopted International Standards on Auditing (ISA) without any modifications. Members of ICAP must follow the Code of Ethics, revised in 2003 to comply with the IFAC Code. The ICAP is moving to adopt the 2005 IFAC Code of Ethics.

***Who must be audited.*** All companies incorporated in Pakistan must be audited.

***Auditor independence.*** Auditors may not hold shares in the company. Listing rules prohibit listed companies appointing as auditor any person who is or has been during the preceding three months a consultant or advisor to the firm (or if a person associated with the auditor has done so).[36] The "cooling off" period for auditors before they can assume a senior position in the client firm is two years.[37] The Code prohibits auditors from providing certain non-audit services. Mandatory audit firm rotation is required every five years for financial institutions (including banks, NBFCs, insurance companies and modarabas). Other listed companies are required, at a minimum, to rotate the audit engagement partners every five years.[38]

According to the Accounting and Auditing ROSC, some companies have shifted the responsibility for preparing financial statements to the auditors, a serious compromise to auditor independence.

***Audit committee.*** Under the Code, the audit committee recommends the appointment of external auditors and provides direction in related matters such as resignation/removal, audit fees and the provision of additional services. The CFO, head of internal audit and a representative of the external auditors are required to attend meetings of the audit committee, at which issues relating to account and audit are discussed. At least, once a year, the audit committee is required to meet the external auditors without the CFO and head of internal audit.

***Requirements for oversight of audit.*** ICAP acts as an examining and licensing body, as well as disciplinary authority. In practice, very few disciplinary actions have been taken by ICAP against its members. There is an emerging consensus among regulators that an independent oversight for the auditing profession should be established in line with recent developments in industrialized countries. Since the SECP's mandate includes monitoring and regulating compliance with international standards in financial reporting and auditing, the proposed oversight arrangement would be best located within the Commission as one of its core independent activities.

***Audit enforcement competent/qualified.*** Reportedly, a lack of understanding by company management and/or board with regards to the nature of the audit makes it more difficult for them to obtain proper audit evidence.[39]

***Auditor qualifications.*** Students who enter the ICAP education process must have a Higher Secondary Certificate or A

[34] The Banking Ordinance outlines additional accounting and auditing standards for banks.
[35] The SECP does not maintain a list of "eligible" auditors. The SBP maintains three lists: A, B, and C.
[36] The Listing Regulations of the Karachi Stock Exchange (Guarantee) Limited, regulation 31
[37] The Listing Regulations of the Karachi Stock Exchange (Guarantee) Limited, XI Code of Corporate Governance
[38] Listing Regulations, KSE, regulation 37 (xii).
[39] *See* Accounting and Auditing ROSC, 2005.

levels. The curriculum consists of six modules covering 21 subjects. In addition, accountants must have four years practical training under the guidance of a qualified chartered accountant.

**Principle VD: 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.**

***Assessment: Partially Observed***

***Auditor accountability.*** 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 prefer to issue "subject to/except for" opinions with a list of observations. These are inappropriately qualified opinions which can mislead or confuse investors.[40]

***Auditor liability.*** Auditors can be fined up to 100 thousand rupees if reports contain willful untrue statements or material omissions. They also face up to one year in prison if they intend to profit themselves or another with a report (CO §260).

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.

***Auditor insurance.*** While indemnity insurance is not required by law, some affiliates of international firms are covered.

**Principle VE: Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.**

***Assessment: Largely observed***

Audited annual financial statements should be circulated no later than four months from the close of the financial year. The first and third quarterly accounts have to be submitted within one month of the close of the respective quarters; the second quarterly account within two months. These accounts are submitted to the SECP and the stock exchanges and are transmitted to shareholders by post. Material events must be disclosed immediately to the SECP and stock exchanges.

***Published information (papers, web).*** Starting in 2005 the SECP allows issuers to publish quarterly accounts on their website instead of mailing them to each shareholder. This has to be authorized by a special shareholder resolution.[41] Banks/DFIs are required to publish reports in newspaper and are further encouraged to post their quarterly and semi-annual accounts on their websites.

**Principle VF: The corporate governance framework should be complemented by an effective approach that addresses and promotes the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to decisions by investors, free from material conflicts of interest that might compromise the integrity of their analysis or advice.**

***Assessment: Largely observed***

***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. These deal with situations involving conflicts of interest. The Code recommends that brokers and their spouses not be members of boards of directors of listed firms.[42] This prohibition does not apply to children of brokers – a loophole which reportedly has been exploited in the past. Another SECP directive deals with business conduct, and brokers have a code of conduct that deals with certain conflicts interest.

## SECTION VI: THE RESPONSIBILITIES OF THE BOARD

**The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.**

**Principle VIA: Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.**

***Assessment: Partially observed***

***Basic description of board.*** Pakistan has a one tier board system. Board tenure is three years, except for appointed

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[40] *See* Accounting and Auditing ROSC, 2005. Auditors should provide disclaimers or adverse opinions instead of apparently positive ones, to ensure compliance and provide a clear understanding to the market.
[41] approximately 100 companies have already applied.
[42] Unless they own more than 10 percent of the company's stock (in which case they are not allowed to trade the shares).

directors (nominee directors). The Code recommends that executive directors (working or whole-time directors) should not constitute more than 75 percent of the elected directors and that the chairman should be elected from the non-executive directors[43]. It is not mandatory to elect a permanent chairman; companies may opt for electing a different chairman for each meeting. The absence of a permanent chairman weakens the accountability of the board. In practice, in family firms boards are mainly a family affair. Among business groups, interlocking boards are common.

***Size requirements.*** The minimum number of directors for a listed company is seven.

***Eligibility requirements.*** Only natural persons may serve as directors. No person may act as director if he (i) is a minor, (ii) is of unsound mind; (iii) has applied to be adjudicated as an insolvent, (iii) is an un-discharged insolvent, (iv) has been convicted of an offense involving moral turpitude, (v) has been debarred, (vi) has betrayed lack of fiduciary behavior by the court during the preceding five years, (vii) is not a shareholder (unless he represents the Government or an institution which is a shareholder, is an employee of the company, or represents a creditor), (viii) has been adjudicated as defaulter in the repayment of a loan exceeding 1 million Rupees (USD 16,840) (unless he represents the Government or a financial institution). The Code also excludes persons who are not registered as taxpayers (unless they are non-resident).

SBP has established fit and proper tests for board members, the CEO, and key executives. Significant shareholders or executives of brokerage companies and exchange trading firms cannot serve on bank boards (SBP Prudential Regulation Annexure VII-A).

***Adequacy of duties of loyalty and care.*** Fiduciary duties are relatively under-developed in Pakistani law. There is no clear general duty of care, and only a limited general duty of loyalty. Existing fiduciary duties are based primarily on a limited amount of case law, which is sparse and emphasizes loyalty to the company (not shareholders) and the provisions on conflict of interest in the CO. Implicitly, the duties require that the affairs of the company must not be conducted in an unlawful or fraudulent manner, or in a manner not provided for in the articles or in a manner oppressive to shareholders or creditors or prejudicial to the public interest.

The CO specifies some fiduciary-type duties. Directors may be declared to lack "fiduciary behavior" if they fail to disclose conflicts of interest with company transactions, or if when conflicted they vote at board meetings (CO, § 214-217). There is also case law on this issue.[44] However, these obligations are quite specific, and relate to conflicts of interests and their disclosure by directors. The Code supplements the written and case law. Paragraph (vii) provides that directors of listed companies must exercise their powers and carry out their fiduciary duties with a sense of objective judgment and independence in the best interests of the listed company. The Code also requires directors to confirm at the time of election that they are aware of their duties under the law, company bylaws and listing rules. These duties are vital to shareholder protection, but may be too important to be left to the "soft law" of the Code.

SBP may prosecute any company officers who have knowingly "acted in manner causing loss of depositors' money or of the income of the banking company."

***Insurance for directors.*** In practice, there are almost no suits against directors. Liability insurance, while legal, is rarely used.

***Business judgment rule/board accountability.*** Only criminal action is mentioned explicitly in the law, there is nothing specific on derivative action or direct suits against directors. There is a limited case law, but suits against directors are rare. Under the National Accountability Bureau Ordinance (1999) the sponsors, CEO, and directors can become liable for a company's unpaid loans. The State Bank may bring prosecution against any director or officer who (in its opinion) has knowingly acted in manner causing loss to depositors.

**Principle VIB: Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.**

***Assessment: Partially observed***

The Code urges directors to exercise their powers objectively and independently and in the best interest of the company and all shareholders, not just in the sectional interest of controlling shareholders. However, the fact that many boards are dominated by the controlling family is a limitation for the board to be truly accountable to all shareholders.

**Principle VIC: The board should apply high ethical standards. It should take into account the interests of stakeholders.**

[43] 25 percent in the case of banks.
[44] In the case of Muhammad Bakhsh & Sons Ltd. v Azhar Wali Muhammad 1986 MLD 1870 (Karachi), it was held that the nature of the relationship between a director and the company was fiduciary in nature and that a director was always required to act in good faith vis-à-vis the company. Other cases include: Shahid Saigol v Kohinoor Mills Ltd. PLD 1995 Lahore 264, where it was held that a director can only be declared to lack fiduciary behavior under section 217 of the CO 1984 if he contravenes the provisions of sections 214, 215(1) and 216 of the CO 1984; and Haroon Ayoob Abdul Karim v Sulleman Ahmad and 4 others 1983 CLC 162 (Karachi), where it was held that a director is in a fiduciary relationship with the company and not with shareholders.

| **Assessment: Largely observed** | |
|---|---|
| Section 197 of the CO prohibits companies from making contributions to political parties or distributing gifts. The Code requires companies have a *'Statement of Ethics and Business Practices'* to establish a standard of conduct for directors and employees. They must sign the statement and acknowledge their acceptance and understanding of the standard of conduct. The board approves employee bonuses and has authority over loans and major contracts. | |
| **Principle VID: The board should fulfill certain key functions, including:** | |
| ***Assessment: Partially observed*** | |
| (1) Board oversight of general corporate strategy and major decisions | ***Board functionality by law, in practice, as recommended by Code.*** The Code requires the board to adopt a mission statement and formulate an overall corporate strategy and a number of significant policies. For board members of banks / DFIs, board responsibilities have been defined in prudential regulations (Regulation G1).[45] ***Director training, IOD.*** The training of board members is in its early stages. The Code calls for orientation courses for directors. Market participants report a positive response to this initiative, mainly from independent directors. The Pakistan Institute of Corporate Governance (PICG) was established in December 2004 in public-private partnership to provide an enabling environment for effective implementation of the Code of Corporate Governance. The founder members represent the corporate and financial sectors, academia and professional institutions. |
| (2) Monitoring effectiveness of company governance practices | Directors have to specify in the Directors' Report that there has been no departure from the Code of Corporate Governance, as detailed in the listing regulations. Bank board s are required to clearly define its own key responsibilities, and to set policies in a variety of areas, including internal control, compliance, risk management, human resources, credit, and other operational areas. |
| (3) Selecting / compensating / monitoring / replacing key executives | The law does not define a distinct role for the board and senior management. The Code requires the board to determine the appointment, remuneration and other terms and conditions of employment for the CEO and other executive directors. In practice, most family controlled firms are managed by the controlling shareholders. |
| (4) Aligning executive and board pay with long term company and shareholder interests | Remuneration is set by the company or by the board, in accordance with the company articles. Traditionally, board remuneration has been low. The issue is not addressed in the Code. Unless this issue is resolved, it is unlikely that independent directors will put in the requisite effort. Some multinationals are beginning to pay more adequate compensation. |
| (5) Transparent board nomination / election process | The board determines the number of elected directors thirty-five days before the convening of the AGM (CO §178). The Code proposes that firms circulate at their expense the minority shareholder resolution proposing their candidate to the board, as well as a proxy form in their AGM notice. In practice, most boards are dominated by executive and non-executive family members of the controlling shareholder. |
| (6) Oversight of insider conflicts of interest, including misuse of company assets and abuse in RPTs | Directors must disclose their direct and indirect interests in any contract or arrangement entered into by or on behalf of the company (CO §214&215). Directors are not to discuss or vote on any contract or arrangement in which they are interested. The Code designates oversight of transactions with associated companies and related parties as a key responsibility of the board. According to anecdotal evidence, this has led to requests for legal opinions from CEOs who are directors of other companies on whether they are allowed to make treasury investments in those companies. Loans to directors are prohibited, unless approved by the SECP for purposes specified in the CO (§195). |

[45] Bank boards are required to clearly define the authority and key responsibilities of both Directors and Senior Management, without delegating its policymaking power to management, and approve and ensure implementation of policies, including but not limited to, in areas of internal audit & control, compliance, risk management, human resources, credit, write-offs, recovery, rescheduling/restructuring of debt, treasury management, investments, acquisition/disposal of fixed assets, donations/charities, prevention of fraud and forgery and any other operational area which the 'board' and/or the 'management' may deem appropriate from time to time. The board is responsible to review and update existing policies periodically and whenever circumstances justify.

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| (7) Oversight of accounting and financial reporting systems, including independent audit and control systems | The CO gives the board responsibility for the preparation of annual financial statements and presenting them to the AGM. They must provide a true and fair picture of company affairs. Failure to do so is punishable with a fine or imprisonment. The Code requires that the CEO and CFO certify the financial statements before submitting them to the board.<br>The Code requires the Director's Report provide statements that: (a) the financial statements of the company present a fair picture; (b) proper books of account have been maintained; (c) appropriate accounting policies have been applied; (d) IFRS has been followed; (e) a sound internal control system has been implemented and monitored and; (f) the company can continue as a 'going concern', beyond significant doubt.<br>Also see "audit committees" under VIE (2). |
| (8) Overseeing disclosure and communications processes | Recently, some companies started to hold regular analyst meetings. |
| **Principle VIE: The board should be able to exercise objective independent judgment on corporate affairs.** | |
| ***Assessment: Partially Observed*** | |
| (1) Director independence | ***Director independence in law and in Code.*** The Code recommends—voluntarily—that boards include independent directors, including representatives of institutional investors[46].<br>In banks, only 25% of the board can be from the same family, and up to 25% of directors can be executives. No bank director can serve on another bank board, or on the board of companies that control 20 percent or more of a bank's shares.<br>***Director independence in practice.*** Multinationals, banks and state-owned enterprises have one or two independent directors on their boards, but it is still rare to find independent directors on the boards of most family held firms. Dissenting shareholders can request for their dissent to be recorded in the board minutes. |
| (2) Clear and transparent rules on board committees | ***Audit committees.*** According to the Code, the boards of listed firms are required to establish an audit committee, composed of at least three directors who meet every quarter. The majority must be non-executive. There is no requirement to include independent directors or directors with financial and accounting expertise. In practice, non-executive family members end up dominating audit committees, which frequently include the CFO as a voting member. 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 Code, 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. SECP monitoring indicates that the great majority of listed companies comply with the audit committee requirement.<br>***Other committees.*** No other committees are mandated or common in practice. |
| (3) Board commitment to responsibilities | The Code stipulates the frequency of board meetings; defines the tenure of directors; and proposes a list of significant issues for consideration and decision by the board.<br>***Restrictions on the number of board seats.*** According to the Code, a director may serve on a maximum of ten boards. This provision is not enforced. Reportedly, there are prominent directors who sit on many more boards.<br>***Board meeting requirements.*** The directors are required to meet at least every quarter.<br>***Public availability of board attendance.*** Section 173 of the CO mandates the maintenance of board meetings minutes, which are open to inspection by shareholders at prescribed times. Board minutes shall also be circulated amongst the board and senior management within thirty days of the board meeting. Clause (xix) (h) of the Code requires the number of board meetings held during the year and attendance by each director to be |

[46] An independent director is defined as a director who is not connected with the firm, its promoters or directors on the basis of family relationship and who does not have any other relationship with the listed company, its associated companies, directors, executives or related parties.

| | disclosed in the directors' report. |
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| **Principle VIF: In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.** |
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| ***Assessment: Observed*** |
| Accounting records and other books and papers must be open to inspection by directors during business hours (CO, Section 230(4)). The Code requires that board meeting agendas must be circulated together with the notice not less than seven days before the board meeting, in order for directors to adequately prepare for the meeting. Given that the vast majority of directors are insiders – controlling shareholders– access to information is not a problem in practice. This will become a more important issue once independent directors are more common. |

## ANNEX: Summary of Shareholder Rights to Information[47]

The following are some other disclosure requirements under the CO, which give certain specific rights to the members of a company to have access to information. All these are tools for shareholders and creditors (when applicable) to remain informed as to how the company is being run and to protect their respective rights.

*Copies of updated memorandum and articles of the company.* Sections 35 and 36 of the CO require the Company to provide the same, upon request, within fourteen days of such a request.

*Right to inspect copies of instruments creating mortgages and charges and the company's register of mortgages.* Section 136 of the CO provides this right to members, creditors and other persons during prescribed times and a defaulting company faces penalties.

*Register of Members and Debenture Holders.* Sections 147 and 149 of the CO require a company to maintain a register of members and a register of debenture holders in the prescribed form. Section 150 of the CO mandates that these registers be open to inspection at prescribed times and default entails penalties.

*Requirement on part of a company to file annual list of members with the Registrar.* Section 156 of the CO mandates this and default carries a penalty.

*Minutes of proceedings of general meetings and meetings of directors.* Section 173 of the CO mandates the maintenance of books containing this information, which are open to the inspection of members at prescribed times.

*Register of directors and other officers.* Section 205 of the CO mandates the maintenance by companies of a regularly updated register of their directors and officers, at its registered office, which is to be open to inspection of members and other persons at prescribed times.

*All investment made by a company on its own behalf to be held in its own name. Record to be maintained of shares and securities invested in by a Company.* Permissible investments under Section 209 of the CO are required to be recorded and open to the inspection of members, debenture-holders and creditors, during prescribed times.

*Maintenance of Register of contracts, arrangements and appointments in which directors, etc are interested.* Section 219 of the CO mandates the maintenance of such a register, open to inspection of members of the company during prescribed times.

*Register of director's shareholdings.* Section 220 of the CO requires every listed company to maintain a register as respects each director, chief executive, managing agent, chief accountant, secretary or auditor of the company and every person holding at least ten percent of the beneficial interest in the company, the number, description and amounts of any shares in or debentures of the company and other related entities, which are held by him or in trust for him etc. Such register is to be open to inspection during prescribed times. It is the duty of directors etc to make disclosures to the company under Section 221 of the CO for it to comply with the requirements of Section 220 of the CO.

*Maintenance of proper book of accounts by the Company.* Section 230 of the CO requires that the books give a true and fair view of the state of affairs of the Company in order to qualify as 'proper'. These are to be open to inspection by directors during business hours.

*The right of every member of a company to acquire from the company, on payment of a prescribed maximum sum, copies of balance sheet, income statement, director's and auditor's reports.* Section 243 of the CO gives this right to the members and Section 247 of the CO gives the same right to debenture holders.

*Requirement on part of a company to file annual list of members with the Registrar.* Section 156 of the CO mandates this and default carries a penalty.

[47] Taken from "Corporate Governance in Pakistan: Ownership, Control and the Law". Ali Cheema, Faisal Bari and Osama Siddique authors.

# Pakistan Terms/Acronyms

**AGM:** Annual General Shareholders Meeting

**CDC:** Central Depository Company of Pakistan

**CEO:** Chief executive officer

**CO:** Companies Ordinance, 1984

**Code:** Code of Corporate Governance

**Cumulative voting:** Cumulative voting allows minority shareholders to cast all their votes for one candidate. Suppose that a publicly traded company has two shareholders, one holding 80 percent of the votes and another with 20 percent. Five directors need to be elected. Without a cumulative voting rule, each shareholder must vote separately for each director. The majority shareholder will get all five seats, as s/he will always outvote the minority shareholder by 80:20. Cumulative voting would allow the minority shareholder to cast all his/her votes (five times 20 percent) for one board member, thereby allowing his/her chosen candidate to win that seat.

**DFI:** Development Finance Institutions

**EGM:** Extraordinary Shareholders Meeting

**GDP:** Gross Domestic Product.

**ICAP:** Institute of Chartered Accountants Pakistan

**ICF:** Investment Corporation of Pakistan

**IFRS:** International Financial Reporting Standards

**ISA:** International Standards on Auditing

**KSE:** Karachi Stock Exchange

**NCS:** National Clearing and Settlement System

**NIT:** National Investment Trust

**PICG:** Pakistan Institute of Corporate Governance

**Pre-emptive rights:** Pre-emptive rights give existing shareholders a chance to purchase shares of a new issue before it is offered to others. These rights protect shareholders from dilution of value and control when new shares are issued.

**Proportional representation:** Proportional representation gives shareholders with a certain fixed percentage of shares the right to appoint a board member.

**RPT:** Related party transactions. The OECD Principles of Corporate Governance hold that it is important for the market to know whether a company is being operated with due regard to the interests of all its investors. It is therefore vital for the company to fully disclose material related party transactions to the market, including whether they have occurred at arms-length and on normal market terms. Related parties can include entities that control or are under common control with the company, and significant shareholders, such as relatives and key managers.

**SECP:** Securities and Exchange Commission of Pakistan

**SEO:** Securities and Exchange Ordinance, 1969

**SOE:** State owned enterprise.

**Shareholder agreement:** An agreement between shareholders on the administration of the company. Shareholder agreements typically cover rights of first refusal and other restrictions on share transfers, approval of related-party transactions, and director nominations.

**Squeeze-out right:** The squeeze-out right (sometimes called a "freeze-out") is the right of a majority shareholder in a company to compel the minority shareholders to sell their shares to him. The sell-out right is the mirror image of the squeeze-out right: a minority shareholder may compel the majority shareholder to purchase his shares.

**SBP:** State Bank of Pakistan

**Withdrawal rights:** Withdrawal rights (referred to in some jurisdictions as the "oppressed minority," "appraisal" or "buy-out" remedy) give shareholders the right to have the company buy their shares upon the occurrence of certain fundamental changes in the company.

This report is one in a series of corporate governance country assessments carried out under the Reports on the Observance of Standards and Codes (ROSC) program. The corporate governance ROSC assessments examine the legal and regulatory framework, enforcement activities, and private sector business practices and compliance, and benchmark the practices and compliance of listed firms against the OECD Principles of Corporate Governance.

The assessments:

- use a consistent methodology for assessing national corporate governance practices
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