CFA Society Pakistan

CFA Institute Asia-Pacific Research Exchange

PACRA Together. Creating Value.

INDEPENDENT DIRECTORS IN PAKISTAN

REGULATIONS AND PRACTICE

PREAMBLE

This publication is prepared with respect to independent directors currently serving on boards of various companies in Pakistan. It mainly focuses on their role, responsibility, board diversity, selection, remuneration, minimum representation, independence, and terms on the Board.

The Securities and Exchange Commission of Pakistan (SECP) was set up under the Securities and Exchange Commission of Pakistan Act,1997 to regulate the corporate sector and capital markets and to bring regulatory reforms for the development of modern and efficient corporate structure based on sound regulatory principles, international legal standards, and best practices that may benefit not only the corporate entities but also support steady economic growth.

Primary regulatory framework applicable to companies in Pakistan includes the Companies Act of 2017, which works in conjunction with its relevant Rules, Regulations, and Guidelines issued thereunder. The Listed Companies Code of Corporate Governance Regulations, 2019 are the primary regulations guiding on the governance matters along with other sector specific regulations on the governance matters like as for insurance and banking sector. The Pakistan Credit Rating Agency Limited (PACRA) was established in 1994 as a joint venture with Fitch Ratings (the world's leading international rating agency), the International Finance Corporation (IFC), and Lahore Stock Exchange. Since this was a developmental initiative supported by Fitch and IFC, they took exit once PACRA gained appropriate understanding of rating business and has its processes developed and implemented in line with best practices. Currently, PACRA is a locally owned domestic Credit Rating Company. PACRA considers corporate governance a critical rating factor to be evaluated when assigning a credit opinion. PACRA has seen and assessed boards of all shapes and sizes, belonging to different types of entities including family-controlled, largely held, and public sector.

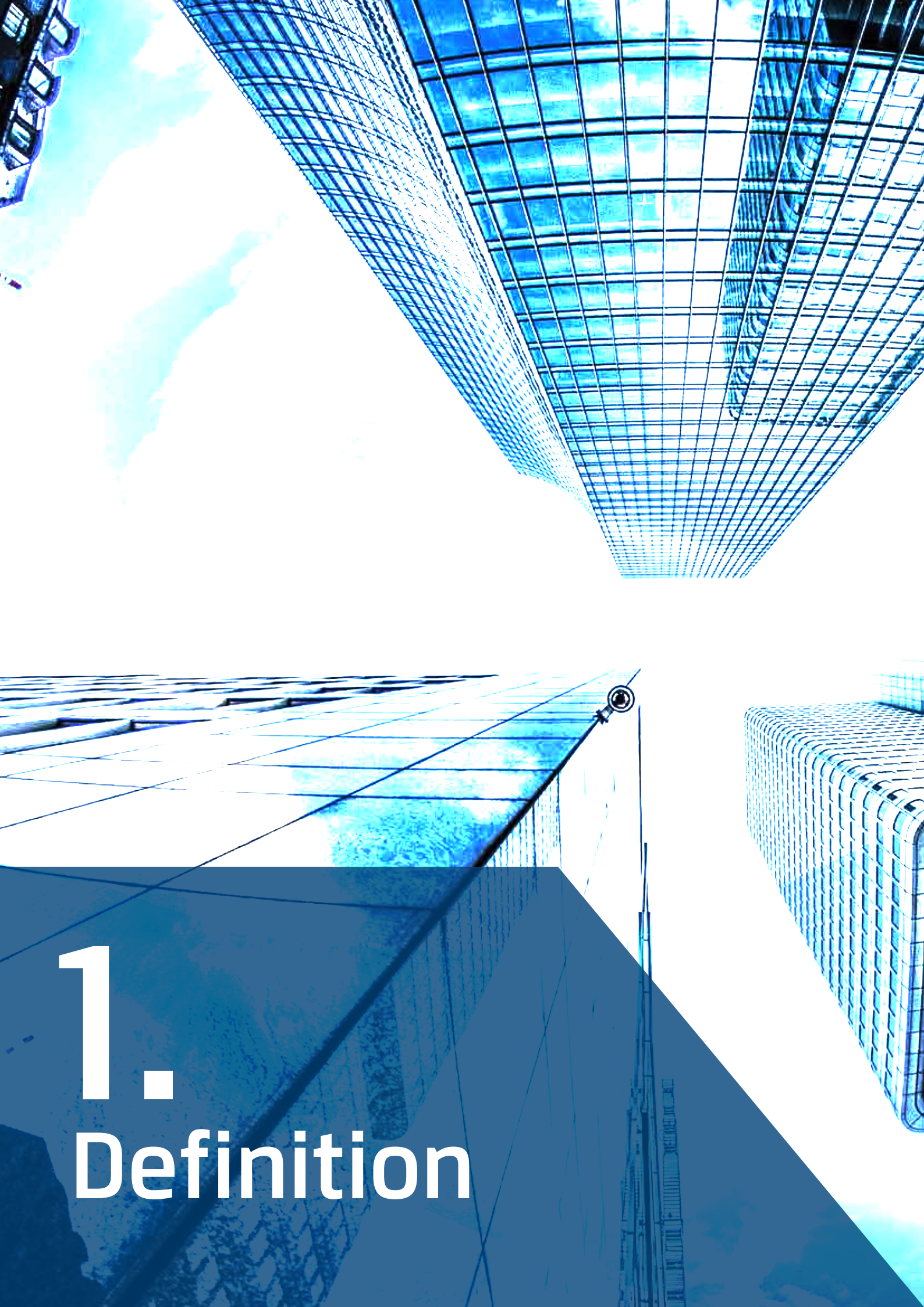
CFA Society Pakistan is registered with SECP under Section 42 of Companies Act, 2017. It derives its strength from a core team of dedicated investment professionals who volunteer significant time and energy to support the mission of CFA Society Pakistan. Activities conducted by the Society aim to provide members with opportunities to interact, share ideas, and keep abreast of the new developments in the industry as well as to deliver value to the investment management profession.

This report is a combined effort of PACRA and CFA Society Pakistan. This report takes inspiration from (Sivananth Ramachandran, CFA, Piotr Zembrowski, CFA, Sara Cheng, JD, & Mary Leung, CFA, 2021) "Independent Directors in Asia Pacific" report published by CFA Institute in 2021 that largely touched on the same set of issues as discussed in this report. Key contents for the comparative analysis of different Asia-Pacific markets are extracted from this report by CFA Institute. We thank CFA Institute for its guidance, support, and permission to use this report.

Recommendations of this report are for due consideration not only by the regulator but also by the listed companies.

1. https://www.cfainstitute.org/-/media/documents/article/position-paper/cfa-id_apac_web.pdf

Contents



1. Definition

1. Definition

Independent director

An independent director is a director who is not connected to and does not have any other relationship, whether pecuniary or otherwise, with the company, its associated companies, subsidiaries, holding company, or directors; and he or she can be reasonably perceived as being able to exercise independent business judgement without being subservient to any form of conflict of interest.[2]

2. Section 166 of the Companies Act of 2017.

2. Introduction

2. Introduction

Corporatization is the process of converting new and existing noncorporate entities into a registered and well-structured business form to create entities with sufficient administrative and financial transparency. The Securities and Exchange Commission of Pakistan (SECP), through its Company Registration Offices, plays an instrumental role in the continuous growth of the corporate sector in Pakistan.

As of July 2022, 172,206 companies have been registered with SECP, of which 551 are listed on the Pakistan Stock Exchange (PSX). This report focuses primarily on listed companies. Most of these companies are family-controlled companies. In family-controlled companies, the shadow of the sponsoring shareholders looms largely over the board. Pakistan has a comprehensive criterion on establishing the independence of any individual director. In 2018, selection of independent directors was mandated exclusively by way of nomination from a data bank maintained by Pakistan Institute of Corporate Governance (PICG). In the case of licensed entities, the aforementioned nominations are notified to SECP for seeking its prior approval.

Gender diversity on boards of directors was introduced in Pakistan through the Listed Companies (Code of Corporate Governance) Regulations, 2017 and it has been carried forward in the Listed Companies (Code of Corporate Governance) Regulations, 2019. Women are making their presence known on the Board of the Companies as independent and executive / nominee directors. For Listed Companies, Asset Management Companies and Deposit taking NBFCs, board member training is encouraged and specific Director Training Programs (DTPs) are approved by the regulator. For public sector companies, an Orientation Course is required by Public Sector Companies (Corporate Governance) Rules, 2013 to be held at least on an annual basis. This is expected to enable directors to better understand the specific context in which a board operates, including its operations and environment.

At present, listed companies, Asset Management Companies and Deposit taking NBFCs are required to have two or one-third of its board members whichever is higher as independent. In the public sector, at least one-third representation by the independent directors is mandatory. SECP has designed a comprehensive set of Codes of Corporate Governance (CCG), including the following:

- Listed Companies (Code of Corporate Governance) Regulations, 2019
- Public Sector Companies (Corporate Governance) Rules, 2013
- Code of Corporate Governance for Insurers, 2016
- Principles of Corporate Governance for non-listed companies

2. Section 166 of the Companies Act of 2017.

3. Executive Summary and Comparison with Other Asia-Pacific Companies

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In Pakistan, a formal corporate governance regime materialized with the publication of the Code of Corporate Governance (the 2002 Code) on 28 March 2002. It was subsequently made part of the listing regulations of the stock exchanges and became applicable to all public listed companies. Since then, the code has been subject to multiple reviews considering observations of different stakeholders and evolving practices in this domain. SECP now has a well-designed set of corporate governance framework covering listed, non-listed, and public sector entities. For listed companies, Asset Management Companies and Deposit taking NBFCs, the applicable regulations are the Code of Corporate Governance Regulations (2019).

The 2002 Code stated, "All listed companies shall encourage effective representation of independent non-executive directors, including those representing minority interests, on their Board of Directors so that the Board as a group includes core competencies considered relevant in the context of each listed company."

A task force put together by SECP in collaboration with the Pakistan Institute of Corporate Governance (PICG) and other market participants revised the 2002 Code in keeping with global best practices. The 2012 Code brought in a comprehensive governance infrastructure to the companies. For the very first time, appointment of one independent director was made mandatory on the Board of Directors of listed companies and the criteria for establishing independence was substantially expanded. In addition, the "Chairman of the Audit Committee shall be an independent director, who shall not be the Chairman of the Board. Audit Committee shall comprise non-executive directors."

> "All listed companies shall encourage effective representation of independent non-executive directors, including those representing minority interests, on their Board of Directors so that the Board as a group includes core competencies considered relevant in the context of each listed company."

In 2017, SECP issued the Listed Companies (Code of Corporate Governance) Regulations. With this issuance, the corporate governance regime graduated from a primarily principle-based approach to a rule-based approach. Under this approach, non-compliance of mandatory stipulations exposed the company to regulatory repercussions in the form of fines and penalties. These regulations also solidified the corporate governance framework in Pakistan, materially enhancing the role and function of independent directors on the board: "The independent directors of each listed company shall not be less than two members or one third of the total members of the Board, whichever is higher." In addition, the Chair of the Audit Committee must be an independent director. These regulations were revised and updated in 2019. Notably, current regulations have introduced the "comply-or-explain approach," which states that it is discretion of a company with respect to non-mandatory provisions of these Regulations either to comply or provide appropriate explanation as to any impediment in its compliance in the CCG Compliance Report. It is the responsibility of the Board of Directors to use this approach prudently. An Independent Auditor reviews the Statement of Compliance to ascertain that the status of the company's CCG compliance is in congruence with the provisions of the Regulations and reports non-compliance thereof. It also highlights any non-satisfactory explanation to the deviation from non-mandatory provisions of the Regulations.

To empower independent directors, the Companies Act provides some protection and says that they shall be liable only to the extent of their acts of omission or commission that occurred with their knowledge, attributable through board processes, and with their consent or connivance or where they have not acted diligently.

Listed companies form less than 1% of all registered companies; however, the most prominent companies are listed. To encourage better governance practices and provide guidance to non-listed companies, SECP issued "Principles of Corporate Governance" in 2016.

The presence of independent directors on boards has been improving gradually and is largely at par with other Asia-Pacific companies. Notably, the roles of CEO and Chair of the Board are separated, although the chair is not required to be independent. The Board composition, appointment of independent and other directors has been covered in the Companies Act, 2017 along with guidance thereon in the CCG regulations.

Pakistani regulations rank well within the region for corporate governance practices encompassing well established board practices and independence of the independent directors. Company practices are catching up at a good pace with shift through CCG 2019 towards comply and explain approach being helpful in this regard.

SECP is playing its part, but all companies need to understand the same concept and maintain a minimum threshold of board independence. The board's knowledge and experience may bring exponential results to a company's financial and non-financial performance. Independent directors are necessary for the protection of the individual as well as collective interests of all stakeholders.

Table 1 is extracted from the CFA Institute report "Independent Directors in Asia Pacific," which mainly discusses the common issues related to the independent directors in six countries and provides jurisdiction-specific comments. We incorporated information for Pakistan to this same table to extend this research and align this report with the report previously issued by CFA Institute. Hence, readers can now better grasp the distinctive features in seven Asia-Pacific companies.

Table 1 Summary of Independent Directors in Asia-Pacific Companies[3]

MARKET	AUSTRALIA	HONG KONG SAR	INDIA	JAPAN
Main regulator of corporate governance	Australian Securities and Investments Commission (ASIC)	Securities and Futures Commission (SFC) The Stock Exchange of Hong Kong Limited (SEHK)	Securities and Exchange Board of India (SEBI) Ministry of Corporate Affairs (MCA)	Financial Services Agency (FSA) Securities and Exchange Surveillance Commission (SESC)
Key corporate governance codes and principles	Corporate Governance Code	Corporate Governance Code (Appendix 14 of Main Board Listing Rules)	SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015	Corporate Governance Code
Corporate governance regime	Comply or explain	Comply or explain	Mandatory	Comply or explain
Ownership structure (end of 2017)	Institutional investors (27%), Family/Corporation (9%), Public sector (3%), Retail (62%)	Institutional investors (12%), Family/Corporation (23%), Public sector (38%), Retail (27%)	Institutional investors (20%), Family/Corporation (45%), Public sector (17%), Retail (19%)	Institutional investors (37%), Family/Corporation (21%), Public sector (11%), Retail (31%)
Definition of director independence	Freedom of conflicts of interest that might influence ability to exercise independent judgement and act in the interest of shareholders,	A set of criteria, including on share ownership, business relationships, and previous employment, none of which is conclusive on its own. Companies can argue a director's independence despite failing these criteria.	A set of criteria on shareholding, financial arrangements, audit and consulting relationships, and relationships with promoters and key management.	Absence of conflict of interest with general shareholders. Companies can define specific criteria.
Required cooling-off period for director independence	Three years	Two years for most relationships; one year for business activities with the company	Three years for key positions; two years for pecuniary relationships or transactions	10 years
Minimum representation of independent directors on boards	Majority	Three directors or one-third of the board, whichever is higher	One-third or two, whichever is higher; one-half for companies in which chair is related to controlling shareholder	Minimum two
Tenure limits for independent directors	No cap	No cap; after nine years require separate shareholder resolution and board justification	Maximum of two consecutive term of five years each, and a cooling-off period of three years after	No cap
Limit on the number of concurrent directorships	None	None; if an independent director holds more than six listed company directorships, then an issuer must explain why it has proposed to elect an independent director who holds a seventh or more directorship and still believes the individual to be able to devote sufficient time to the company's board	Capped at seven, or three if the independent director is a full-time director of another listed company	None
Appointment and removal	Majority of shareholder votes at the annual general meeting (AGM) required for appointment or removal	Majority approval for appointment and removal	Majority approval for appointment; 75% approval for removal	Majority of shareholders' approval for appointment and removal
Separation of the roles of chair and CEO	Recommended, standard business practice (98%)	Recommended, common practice (71%)	To be mandated for top 500 companies, pending implementation in 2022; common practice (80%)	No requirement or recommendation; rare (53%)
Independence of chair	Independent chair recommended	No requirement for the chair to be independent	Chair to be a nonexecutive, with no relationship with CEO for top 500 companies with controlling shareholding from April 2022	No requirement for chair to be independent

3. Sivananth Ramachandran, Piotr Zembrowski, Sara Cheng, and Mary Leung, "Independent Directors in Asia Pacific" (CFA Institute, 30 June 2021), https://www.cfainstitute.org/advocacy/policy-positions/independent-directors-in-asia-pacific

MARKET	MALAYSIA	SINGAPORE	Pakistan
Main regulator of corporate governance	Securities Commission Malaysia (SCM)	Monetary Authority of Singapore (MAS) Accounting and Corporate Regulatory Authority (ACRA)	Securities and Exchange Commission of Pakistan (SECP)
Key corporate governance codes and principles	Malaysian Code on Corporate Governance	Code of Corporate Governance	Code of Corporate Governance Regulations, 2019 and Public Sector Companies (Corporate Governance) Rules, 2013
Corporate governance regime	Apply or explain an alternative	Comply or explain	Comply or explain for listed companies / mandatory for Public sector companies
Ownership structure (end of 2017)	Institutional investors (12%), Family/Corporation (29%), Public sector (40%), Retail (19%)	Institutional investors (12%), Family/Corporation (41%), Public sector (12%), Retail (34%)	Institutional (9%), Strategic individuals (17%), Public sector (6%), Retail (25%), Private (43%)
Definition of director independence	Independence of management and freedom from relationships that could interfere with the exercise of independent judgement or the ability to act in the best interests of the company.	Absence of relationship with the company, related corporations, substantial shareholders, or officers that could interfere with the exercise of independent judgement.	Director not connected or does not have any other relationship with the company, its associated companies, subsidiaries, holding company, or directors; exercises independent business judgement.
Required cooling-off period for director independence	Three years	Three years	Three years in case of listed companies Two years in case of public sector companies
Minimum representation of independent directors on boards	One-third or two, whichever is higher (listing requirements); at least half, and majority for large companies (corporate governance code)	Minimum two or one-third of the board, whichever is higher; a majority for companies where the chair is not independent	One-third or two, whichever is higher for listed companies One-third for public sector companies
Tenure limits for independent directors	Maximum of nine years; between nine and twelve years require majority shareholder approval; after twelve years, require approval by a two-tier voting process	No cap; after nine years require approval by a two-tier voting process	Three consecutive terms of three years each in case of listed companies Two consecutive terms of three years each in case of public sector companies
Limit on the number of concurrent directorships	Capped at five	None; if an independent director holds many directorships, the company to provide a reasoned assessment of the ability of the director to diligently discharge his or her duties	Seven directorships for listed companies Five directorships for public sector companies
Appointment and removal	Majority approval for appointment and removal	Majority approval for appointment and removal	The independent director is to be appointed with the approval of the Board and elected with the approval of shareholders. Majority of shareholder votes at the AGM required for removal Regulators prior approval is required to appoint or remove independent directors in case of licensed companies
Separation of the roles of chair and CEO	Recommended; standard business practice (97%)	Not required; common practice (82%)	Mandatory for listed, AMCs, Deposit taking NBFCs and public sector companies
Independence of chair	Independent chair recommended; if the chair is not independent, the majority of board should be independent	No requirement for the chair to be independent	No requirement for the chair to be independent for listed companies and public sector companies, but it has to be a nonexecutive director for listed companies.

4. A. De La Cruz, A. Medina, and Y. Tang, "Owners of the World's Listed Companies" (OECD Capital Market Series, Paris, 2019), Annex Figure A.4, https://www.oecd.org/corporate/Owners-of-the-Worlds-Listed-Companies.pdf

4. Overview of the Regulatory Landscape and Industry Practices

4. Overview of the Regulatory Landscape and Industry Practices

SECP is the primary regulator for all companies in Pakistan. Moreover, according to nature of underlying business, additional set of regulatory requirements may be imposed by SECP and, in case of certain financial institutions by the State Bank of Pakistan (SBP). Meanwhile, PSX imposes certain requirements for listed companies. These regulators, inter-alia, focus on renewal of underlying licenses, compliance with applicable laws and regulations, and surveillance and regular inspection to improve regulatory environment.

Table 2 Corporate Governance Rules and Regulations in Pakistan

Governing Body	Applicable to	Legislation / Regulation / Code*	Level of Requirement
Securities and Exchange Commission of Pakistan	All listed and non-listed companies	Companies Act 2017	Mandatory
Securities and Exchange Commission of Pakistan	Listed companies, AMCs and Deposit taking NBFCs.	Listed Companies (Code of Corporate Governance) Regulations, 2019	Comply or explain
Securities and Exchange Commission of Pakistan	Public sector companies	Public Sector Companies (Corporate Governance) Rules, 2013	Comply or explain
Securities and Exchange Commission of Pakistan	Insurance companies	Code of Corporate Governance for Insurers, 2016	Comply or explain
Securities and Exchange Commission of Pakistan	Non listed companies	Principle of Corporate Governance	Encouraged
Pakistan Stock Exchange	Listed companies	Rule Book	Mandatory
State Bank of Pakistan	Financial sectors	State Bank of Pakistan Act Banking Companies Ordinance Listed Companies (Code of Corporate Governance) Regulations, 2019 Corporate Governance Regulatory Framework	Mandatory Comply or explain Mandatory

The Companies Act of 2017 requires public listed companies to have at least seven directors, and public non-listed companies to have a minimum of three directors. In addition to the directors elected by shareholders, a company may have directors nominated by the company's creditors or other special interests by virtue of contractual arrangements. These directors are called nominee directors. Independent directors are selected out of databank maintained by the Pakistan Institute of Corporate Governance (PICG). PICG maintains a list of qualified individuals who have successfully completed Directors' Training Program from any accredited training institution or have obtained exemptions from Commission for such programs. SECP has given detailed mechanism in its Companies (Manner and Selection of Independent Directors) Regulations 2018 for directors' eligibility and procedure to be followed for inclusion in databank maintained for Independent Directors.

PSX listing rules[5] has a fit-and-proper-person test for company directors, including those of regulated financial institutions. These rules[6] require that, at the time of listing, each director is "of good fame and character."

SECP is entrusted with the supervision of registered companies under its purview and enforcement of the laws and regulations under its ambit. This enforcement is conducted mainly through ongoing surveillance, periodic reviews, and on-site and off-site inspections. SECP plays a supervisory role and communicates non-compliance for timely correction. This may result in having to show cause of non-compliance with an opportunity of being heard. SECP may impose a penalty and, in severe case, may revoke licenses and cancel registrations, as deemed appropriate.

The State Bank of Pakistan (SBP) is incorporated under the State Bank of Pakistan Act of 1956, which gives SBP the authority to function as the central bank of the country. SBP Act mandates the Bank to regulate the monetary and credit system of Pakistan and to foster its growth in the best national interest with a view toward securing monetary stability and fuller utilization of the country's productive resources. Like a central bank in any developing country, SBP performs both the traditional and developmental functions to achieve macroeconomic goals. [7]

5 Rule Book of PSX, Chapter 3, condition 3.1.
6 Rule Book of PSX, Chapter 3, condition 3.1.
7 "About Us," State Bank of Pakistan, https://www.sbp.org.pk/about/index.asp

SBP has issued various prudential regulations for infrastructure project finance (IPF), small and midsize enterprise (SME) financing, agriculture financing, corporate and commercial banking, consumer financing, micro-finance banks, and housing finance. The definition of Independent Director as used by SBP builds on what is defined in Companies Act, 2017, and elaborates it further. It reads as follows, "Independent Director means such a person who is not linked directly or indirectly with [a] Bank/DFI [development finance institution] or its sponsor or strategic shareholders." For the purpose of such determination, an "independent director" is a director who—

- has not been employed by a bank or DFI within the past five years;
- has not been an employee or affiliate of any present or former external auditor/consultant/legal adviser of a bank or DFI within the past three years;
- has not been an executive officer or employee of a subsidiary or associate company of the bank or DFI or for which directors of the bank or DFI have substantial beneficial interest (e.g., 20% or more shareholding of director's own or combined with family members);
- has not been employed by a company of which an executive officer of the bank or DFI has been a director within the past three years; and
- is not affiliated with a not-for-profit entity that received contributions from a bank or DFI exceeding 10 million or 2% of such charitable organization's consolidated gross revenues during the current fiscal year or any of the past three completed fiscal years.

An independent director submits a declaration of independence to SBP at the time of his or her appointment. At least one-third of the total strength of the board of a bank/DFI (other than joint ventures between Government of Pakistan and Governments of other countries) should consist of Independent Directors.

The board of a bank/DFI may form specialized committees with well-defined objectives, authorities, and tenure. These committees, having at least one non-executive board member or independent director, shall oversee areas like audit, IT, risk management, credit, HR/recruitment /remuneration, and any other area of special interest. The Chairman of the board may chair and/or be a member of any of the Board Committees except Audit and Risk Management Committees. Furthermore, the Audit Committee of the board shall be chaired by an independent director. The Board HR/Remuneration Committee shall have non-executive directors preferably independent directors in majority. In case, independent directors are not in majority then the chairmanship shall be with Independent Director.

5. Test of Independence

5. Test of Independence

The Companies Act of 2017 provides the following criteria to evaluate "independence":

No director shall be considered independent if one or more of the following circumstances exist:

(a) he has been an employee of the company, any of its subsidiaries or holding company within the last three years;

(b) he is or has been the chief executive officer of subsidiaries, associated company, associated undertaking, or holding company in the last three years;

(c) he has, or has had within the last three years, a material business relationship with the company either directly, or indirectly as a partner, major shareholder (a person who, individually or in concert with his family or as part of a group, holds 10% or more shares having voting rights in the paid-up capital of the company) or director of a body that has such a relationship with the company;

(d) he has received remuneration in the three years preceding his/her appointment as a director or receives additional remuneration, excluding retirement benefits from the company apart from a director's fee or has participated in the company's stock option or a performance-related pay scheme;

(e) he is a close relative (spouse(s), lineal ascendants and descendants and siblings) of the company's promoters, directors, or major shareholders:

(f) he holds cross-directorships or has significant links with other directors through involvement in other companies;

(g) he has served on the board for more than three consecutive terms from the date of his first appointment, and for more than two consecutive terms in case of a public sector company, provided that such person shall be deemed "independent director" after a lapse of one term;

(h) a person (who is) nominated director and representing special interests.

Provided further that for determining the independence of directors for the purpose of subclauses (a), (b), and (c) in respect of public sector companies (PSC), the time period shall be taken as two years instead of three years. Given large number of PSC with a relatively limited pool of independent directors, this relaxation would help enhancing available options for appointment on PSC boards. Further, an independent director in case of a public sector company shall not be in the service of Pakistan or of any statutory body or any body or institution owned or controlled by the Government.

6. Requirements for Regulated Financial Institutions

6. Requirements for Regulated Financial Institutions

The apex regulator for all banks, DFIs, and credit bureaus is SBP. All other kinds of financial institutions, including insurance companies and Non-banking finance companies, fall under the oversight of SECP. Both regulators require its subjects to comply with applicable regulations.

For all regulated financial institutions, Audit Committee of the Board shall be chaired by an independent director. The role of the chair of the Board has been separated from that of CEO.

Each director must satisfy the requirements of propriety, including character, honesty, integrity, diligence, and judgement. Final appointment of directors in regulated financial institutions is subject to approval by respective regulator.

7. Board Structure and Composition

7. Board Structure and Composition

This report primarily focuses on different regulatory framework impacting role of Independent Director in Pakistan. A comparison of the same has been drawn with selected Asia-Pacific markets. However, it is important to analyse actual practices in Pakistan. Accordingly, a sample of 100 listed companies has been selected. PSX had a total of 551 listed companies at end-July 2022: having a total market capitalization[8] of PKR 6.8 trillion. This sample has two distinct set of companies – top 40 companies of KSE-100 Index and 60 randomly selected companies from the rest. The top 40 companies contributed more than half towards the total market capitalization, while top 10 captured one-fourth of the total. In this report, wherever possible, relevant information of the selected companies has been analysed and discussed.

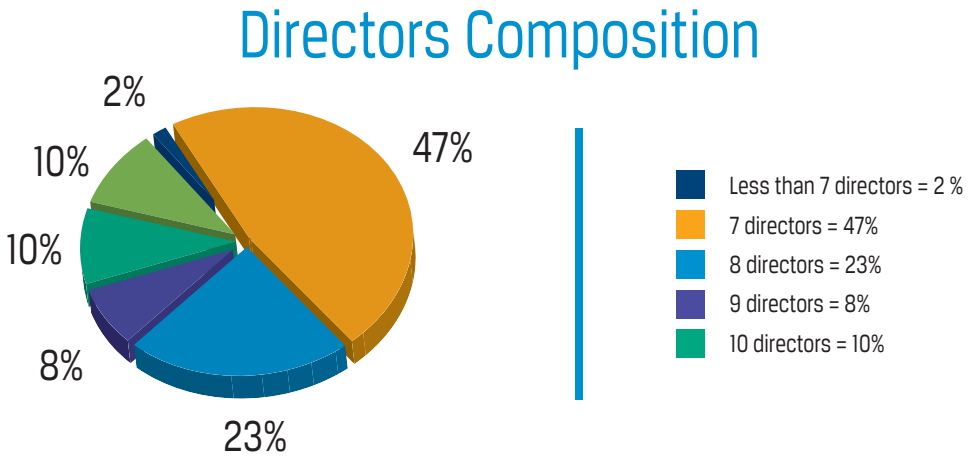
7.1 Board Size

Good practices of corporate governance suggest that the size and composition of a board may reflect the scale and complexity of the company's activities. The board may not be so large as to be unwieldy. A public company, other than a listed company, is required to have a minimum board size of three directors; and a listed company shall have not less than seven directors. Listed companies are required to have a minimum two or one-third of independent directors, whichever is higher, on their board. Hence, the size of a board commensurates with the scope and complexity of the operations of the entity.

According to the analysis, a significant number of the boards of selected listed companies have seven or eight directors. A small proportion has a larger board of more than 10 directors. A few (just 2%) has less than seven directors, and these are primarily Modarabas[9] managed by their Modaraba Management Company (MMC), which do not require a minimum of seven board members. MMCs normally are incorporated as private limited or public non-listed companies with a minimum directorship of two or three directors, respectively.

Exhibit 1 is extracted from the annual reports of the selected sample for the year ended 30-June-2021.

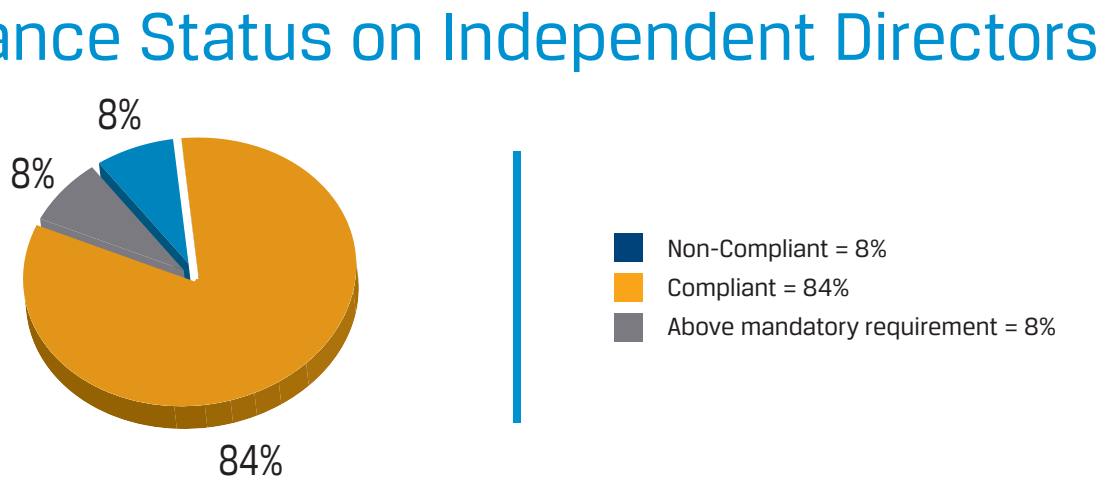
Exhibit 1 Directors' Composition



8. "Pakistan Market Cap: PSX: All Shares, 1990–2022," CEIC, https://www.ceicdata.com/en/pakistan/karachi-stock-exchange-market-capitalization-new-classification/market-cap-psx-all-shares
9. Modaraba is one of the prime modes of Islamic financing. It is a special kind of partnership in which one member gives money to another for investing it in a commercial enterprise. The investment comes from the first member, the "rabb-ul-mal," while the management and work is an exclusive responsibility of the other, the "mudarib." The profits generated are shared according to a predetermined ratio.

Exhibit 2 shows that 84% of the selected listed companies are fully compliant with the mandatory requirements of the independent directors. This includes the results of companies that were rounded up to their minimum director's ratio. Although 8% of the selected listed companies have not been fully compliant with the required number of independent directors, 8% of the companies not only achieved compliance on this required number but also engaged independent directors beyond the required number.

Exhibit 2 Compliance Status on Independent Directors



7.2 Board Structure

In Pakistan, board structures are geared toward effectiveness in terms of regulatory requirements and guidelines. Practical effectiveness of the board; however, has room for improvement.

SECP requires an appropriate mix of core competencies, requisite skills, knowledge, and experience to make up a board. The idea is to ensure that, while structuring their boards, companies fulfil relevant criteria in the context of the company's operations. Interest of minority shareholders is duly protected and required to be facilitated by the Board to contest the election of directors by way of proxy solicitation. It is mandatory that each listed company inducts independent directors. An Independent Director is required to submit his or her consent to act as a director to the company. It is mandatory that the boards have at least one female director. Executive directors, including the Chief Executive Officer, cannot make up more than one-third of the board, and the Chairman and the CEO cannot be the same person.

Regulations require companies to have two mandatory board committees: an Audit Committee and a Human Resource and Remuneration Committee. Two other committees are encouraged but are not mandatory: a Risk Management Committee and a Nomination Committee. However, an explanation is required in CCG compliance report for not having Board risk committee. Audit Committee must have at least three members who are non-executive directors and one of them is required to be independent director who would be the Chairman of the Committee.The Chairman of the Board shall not be the Chairman of the Board Audit Committee. Human Resource and Remuneration Committee shall be composed of three non-executive directors, including one independent director, and it is recommended to be chaired by an independent director. Nomination Committee and Risk Management Committee members are selected at the discretion of the board and do not have a fixed number.

7.3 Nomination and Removal of Independent Directors

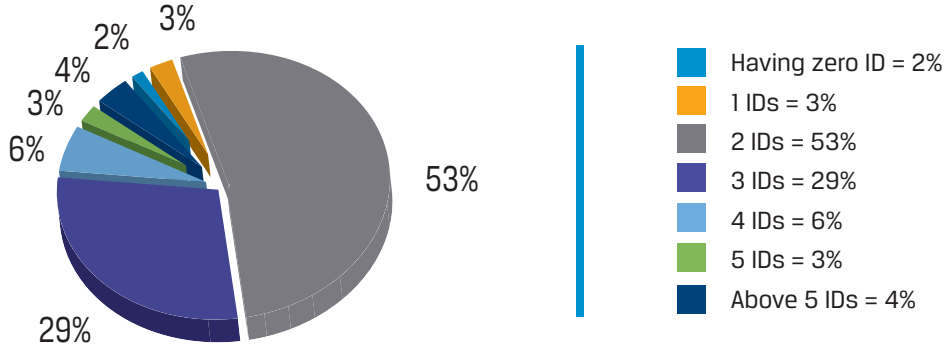
In Pakistan, an SECP-specified institution (i.e., PICG) maintains a databank of individuals who are interested in acting in the capacity of an independent director for a company. This data bank contains names, addresses, qualifications details and CVs of eligible and willing to act as independent directors. The responsibility of exercising due diligence before selecting a person from the data bank lies with the company intending to induct the director. After conducting due diligence, the details of the individuals who are selected from the data bank for the Board of NBFCs /Modarabas are submitted to the SECP for final approval.

Subsequent to SECP approval, independent directors are elected in the annual general meeting in accordance with the provision of Section 159 of the Companies Act,2017. The company has to provide a statement of material facts indicating the justification for choosing the individual for appointment as an independent director.

Exhibit 3 shows the number of independent directors present on the board of selected listed companies. Companies that have only one independent director or none are not in compliance with the requirements of the Code of Corporate Governance Regulations of 2019. Most of the companies have seven directors on board. The minimum number of independent directors is two or one-third the entire board. Most companies; however, have rounded down this ratio and instead included a reasonable explanation for not rounding up in the company's compliance statement, which is published along with their annual reports.

Exhibit 3 Number of Independent Directors on Boards

Number of Independent Directors (ID) on Board



7.4 Tenure

In Pakistan, applicable regulations and guidelines govern board tenure. Directors are elected for three years and can be re-elected in subsequent elections if law permits. For listed companies, AMCs and deposit taking NBFCs; however, the maximum number of times an independent director can be elected is three consecutive terms, and for public sector companies, the limit is two consecutive terms. After completing the maximum number of terms, a cooling-off period of three years in listed companies and two years in public sector companies is necessary to qualify as an independent director on the same board. A lengthy board tenure potentially calls into question the independence of a director. Long-serving directors may cause potential risk of familiarity threat for becoming close to management and can find it difficult to question policies and decisions. They may get constrained in their ability to challenge the management task and may become too reliant on information provided by senior management.

Conversely, the practice of maintaining seasoned directors on the board, especially when these board members are part of a sponsoring family in Pakistan, has demonstrated superiority in the ability to support the company's long-term vision and pursue an effective strategy.

7.5 Training and Qualifications

Code of Corporate Governance Regulations, 2019 encourage all listed companies to arrange and get certification for directors training program within one year of a director's appointment.

However, directors having a minimum of 14 years of education and 15 years of experience on the board of a listed company, local or foreign, are exempted from the requirement of directors training.

Currently, in Pakistan, five institutions are approved by SECP to offer DTP. Together, they have certified more than 4,000 directors.

It is essential that directors have knowledge and experience to contribute to the work of the board. The board should reflect a mix of skills and experience to allow it to cover all issues relevant to the company and its industry. Hence, in addition to certification-based training, Pakistani regulations require a listed company, AMCs and deposit taking NBFCs to make appropriate arrangements to carry out an orientation program for their directors to acquaint them with the regulatory and legal framework and their duties and responsibilities in the context of the operations of the company.

Evaluation of board performance is a recognized mechanism to measure board effectiveness in terms of their contribution towards their objectives as a whole as well as its individual members and committees. CCG regulations require that a listed entity's board should establish a formal and effective mechanism for an annual evaluation of the board's performance, members of the board, and its committees. Such performance evaluation may be conducted directly by the Board itself or through board's Human Resource and Remuneration Committee or by engaging an external independent consultant. In the latter case, if such an appointment is made, the company is required to publish a statement in the directors' report disclosing the name and qualifications of the consultant and key terms of appointment.

According to the SECP Principles of Corporate Governance, the board evaluation should focus on key areas including, but not limited to, adequacy of executive management in board meetings, demonstration of balance between expertise and independence, ability to set direction and control environment, devotion of sufficient time and effort, access to information and advice, engagement with shareholders and key stakeholders, factors inhibiting independence of individual directors, and procedure for effective board meetings.

The Oil and Gas Development Company (PSX symbol: OGDC), the state-owned oil exploration giant in Pakistan, provides a good example of a company that follows these guidelines in practice. According to its 2020 annual report:

> *OGDCL's Board carries out self-evaluation, whereby a questionnaire is disseminated amongst the Board members for the assessment of their performance. This evaluation exercise is undertaken on annual basis to enhance effectiveness and better understanding of the roles and responsibilities as member of the Board. Performance evaluation of Managing Director/CEO and senior management is reviewed and assessed by the Board against specific performance criteria, KPIs and assigned targets and responsibilities.*

7.6 Maximum Number of Board Seats

Pakistan sets legal limits on the number of board seats that can be held by an individual (independent or otherwise). An individual can hold, at any one time, a maximum of seven directorships in listed companies. This also includes acting as an alternate director.

Disclosures about independent directors are made in the Corporate information section of the Annual report, Directors' Report and CCG compliance report. The overall board's gender bifurcation, specifying directors as independent directors, non-executive directors, executive directors, and female directors along with their presence on board committees is required to be disclosed by CCG regulations however Companies Act, 2017 requires to mention the names of directors on the Board of the company in the Annual Directors Report. Listed companies have to report the remuneration policy of non-executive directors, including independent directors, as approved by the board. In addition, the company's annual report is required to disclose details of the aggregate amount of remuneration separate for executive and non-executive directors, including salaries and fees, perquisites, benefits, and performance-linked incentives. Companies are encouraged to provide these remuneration details for all individual directors. The Companies Act, 2017 requires disclosure with respect to remuneration package of each of the directors and chief executive including but not limited to salary, benefits, bonuses, stock options, pension and other incentives.

All listed companies in Pakistan generally provide a significant amount of information about their directors, including independent directors. This information must be released to the stock exchange at the time of a director's initial appointment /election and subsequently is included in the company's annual reports and on its website.

All listed companies in the selected sample have shared the necessary level of detail and explanation of their board selection, including the directors' employment background, academic qualifications, other board memberships, and corporate commitments.

8. Effectiveness of Independent Directors on Boards

8. Effectiveness of Independent Directors on Boards

Effectiveness of independent directors on the board is yet to be established in Pakistan as the role of independent directors is being expanded in a comprehensive manner.

The groundwork is in place for independent directors to feel secure and protected in discharging their responsibility. Independent and non-executive directors are held responsible in respect of an omission or commission by a listed company or a public sector company that occurred with their knowledge, attributable through board processes, and with their consent or connivance or in cases in which they have not acted diligently.

SECP Principles of Corporate Governance state that care may be taken to ensure that non-executive or independent appointees have enough time available to devote to the job. This is particularly important in the case of Chairmanship. The principle states that the letter of appointment may set out the expected time commitment, and other significant commitments may be disclosed to the member before appointment and the board may be informed of subsequent changes. Furthermore, non-executive directors and independent directors may scrutinize the performance of management in meeting agreed-upon goals and objectives and monitor the reporting of performance and independent directors may satisfy themselves on the integrity of financial information and ensure that financial controls and systems of risk management are robust and defensible. The chair may decide to hold meetings with the non-executive directors without the executive directors present. Upon resignation, a non-executive director may provide a written statement to the chair for circulation to the board, if they have significant concerns about the running of the company.

It is important to have significant presence of independent directors on a board. Healthy composition of a board includes the presence of independent and non-executive members who have a limited relationship with the sponsoring group of the entity.

8.1 Are Independent Directors Truly Independent?

It can be difficult for investors to ascertain the true independence of directors. They usually do not have access to board minutes or discussions and generally must rely on company claims in that matter.

However, investors can consider relationships arising from memberships in other board or executive roles that the directors currently hold or previously held.

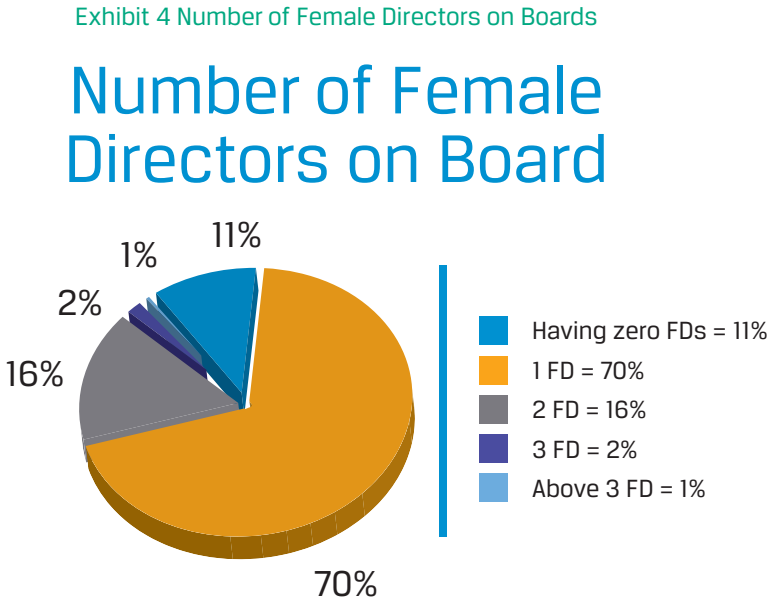
The other issue, mentioned earlier, is the potential impact of a long tenure on independence. It is possible for long-serving directors to become less independent as they become more ingrained in a company's culture and grow closer to its management.

8.2 Gender Diversity

Appointment of at least one female director is mandatory on the boards of listed companies which is a very positive move and should improve effectiveness of the boards. This requirement is largely adhered to by most companies. Given the relative newness of this stipulation; however, the underlying pool of female directors is limited. Hence, on a number of boards, female directors are from close circles of sponsoring family. Nevertheless, with the provision of DTP and an increasing pool of professionals, gender diversity is improving in boards and creating the impact which greater inclusion brings with it.

SECP initiative will enable female directors to play a role in strategic planning and decision making. But, as per the sample of 100 listed companies, 11% of the companies are reluctant to assign female directorships on their board and are not in compliance with the requirements of the Code of Corporate Governance Regulations of 2019. However, 19% of the companies have more than one female director on their board.

Exhibit 4 Number of Female Directors on Boards



8.3 Independence of the Board Chair

In Pakistan, the Companies Act of 2017 clearly states the division of responsibilities between the Chair and the Chief Executive. The Chair shall be responsible for leadership of the board and ensure that the board plays an effective role in fulfilling its responsibilities. Every financial statement shall contain a report by the Chair on the overall performance of the board and its effectiveness in achieving the company's objectives.

Code of Corporate Governance Regulations and Company's Act 2017 both, specify that the Chair of the board of a listed entity should be a non-executive director. Further the code also requires that CEO and Chairman should not be the same person. The Chair is expected to have an independent role. The division of responsibilities between the Chair and Chief Executive should be clearly established. The responsibilities of CEO has been laid down in CCG however guidance is to be sought on the role of Chairman.

9. Recommendations

9. Recommendations

Section 166 of the Companies Act, 2017 provides guidance on appointment of independent directors; these may require further explanation and detail to be implemented according to the letter of the law. SECP had a practice of publishing Frequently Asked Questions. This may be made a practice that these FAQs be updated at a regular frequency (say annual) based on questions from different stakeholders and experiences of SECP with different entities while evaluating compliance with regulations.

It would be better to make director training program mandatory rather than an encouragement to undertake as per CCG.

These regulations play a pivotal role for corporate governance and to protect shareholder's interest in a regulated manner. Considering the importance, there has to be a transition framework from "comply or explain" approach to a full compliance approach for all significant practices of governance.

Chair of the board is a distinct role compared to other board members. An individual is marked distinctly for this role. This distinct role carries additional responsibilities compared to other members of the board. This requires additional training. This may be captured in DTP or a separate set of trainings for the chair may be encouraged. At the same time, these responsibilities require devotion of additional resources by such individuals. Although regulations permit distinction in remuneration of different members, it may elaborate the same or provide some additional guidance for drawing this distinction in case of the Chair.

Board performance evaluation is a good practice. However, respective regulations are brief. Consequently, there is limited sharing of details of such exercise and results. SECP may specify minimum parameters of board evaluation and give guidance as to respective disclosures. This would encourage better performance tendency amongst board members and investors would get further insight into governance practices of an entity. SECP may issue guideline similar to SBP specifying detailed Board evaluation practices along with evaluation responsibilities of different type of directors applicable to Banks/DFIs.

The chair of the board should be independent; this should be encouraged. This will strengthen the board independence, promote a culture of inclusion, and allow independent directors to perform their job more effectively. The need for an independent chairperson is particularly important, as this role leads the board and is the key connection between the board and management.

Independent directors' data bank is a good initiative. However, it needs attention to improve its scope and utilization. This may have information as to current and past directorships of an individual, preferably sourced through PSX and/or SECP database. It would be good to have some information related to individual specific board performance evaluation. Further, there should be a mechanism for ensuring the completeness of information / profile of the directors on the data bank of PICG wherein a person can simply be inducted without providing the complete information. An undertaking should be obtained by PICG prior to inducting a person on this data bank.

Family-controlled companies, beyond a particular size or influence, should be subject to additional regulations to achieve improvement in transparency and governance standards, in turn achieving sustainability.

Companies should place a greater emphasis on ongoing training in the area of related party, fiduciary duties, and business ethics supported by disclosures that will add value to the board and also will be viewed positively by investors.

10. Case Studies

10. Case Studies

A set of nine listed companies was selected for a deep dive to understand and evaluate corporate governance practices. To ensure a broader spectrum, this set has a mix of financial institutions and corporate entities. In terms of ownership structure, it has family-controlled, widely held, and public sector entities. The diversity of set has offered interesting insights:

- Degree of compliance with CCG is high
- Boards have adequate diversity amongst members – educational background, experience, age, gender, and life with the board
- Except one company from the sample, executive directors are usually not a norm
- Five is a more common number of board meetings in a year except for in case of PSEs or regulated entities like banks
- Number of board committees vary significantly. Risk Management Committee is the most common committee in addition to mandatory committees on Audit and HR. Other committees are usually a function of specific regulatory requirements of underlying company
- The Chair is amongst non-Executive directors in all cases; however, no company has appointed an independent director as chair yet
- Independent director as Chair is a common sighting in case of committees. This is true even for committees that are not mandatory under any law

Table A | Board Structure / Composition

Particulars	Engro Corporation Ltd.	Hum Network Ltd.	Sui Southern Gas Company Ltd.	Oil and Gas Development Company Ltd	Lucky Cement Ltd.	Habib Bank Ltd.	IGI Life Insurance Ltd.	Cnergyico PK Ltd.	Ghani Glass Ltd.
Annual Report Year	2021	2021	2020	2021	2021	2021	2021	2021	2021
Board Members	10	9	12	12	7	8	7	7	18
- Male	7	6	10	11	6	7	5	6	17
- Female	3	3	2	1	1	1	2	1	1
- Independent Director	5	3	6	5	2	3	3	2	6
- Other Non-Executive Directors	4	4	5	6	4	4	3	4	6
- Executive Director	1	2	1	1	1	1	1	1	6
Number of Board Meetings	10	2	19	13	5	9	4	5	5
Chair	Non-Executive Director (NED)								
Independent Auditors	A.F. Ferguson & Co.	EY Ford Rhodes	BDO Ebrahim & Co., Chartered Accountants	(1) A. F. Ferguson & Co (2) KPMG Taseer Hadi & Co.	A. F. Ferguson & Co.	KPMG Taseer Hadi & Co.	A. F. Ferguson & Co.	EY Ford Rhodes	EY Ford Rhodes

Table B | Board Committees, Meeting held & Chair

Particulars	Engro Corporation Ltd.	Hum Network Ltd.	Sui Southern Gas Company Ltd.	Oil and Gas Development Company Ltd	Lucky Cement Ltd.	Habib Bank Ltd.	IGI Life Insurance Ltd.	Cnergyico PK Ltd.	Ghani Glass Ltd.
Number Of Committee Meetings									
HR And Remuneration Committee	14 / ID	-	6 / NED		2/ID	5/ID		2/ID	2/ID
Audit Committee	5/ID	1/ID	10/ID	4/ID	5/ID	8/ID	4/ID	5/ID	4/ID
Risk Management Committee			8/ID	1/ID		6/ID	4/NED	-	
Board Compliance & Conduct Committee						8/NED			
Board Development Finance Committee						3/ID			
Board IT Committee						4/ID			
Board Oversight Committee						4/NED			
Board Nomination & Remuneration Committee						3/ID			
Board Special Committee On UFG			9/NED						
Board Finance & Procurement Committee			8/NED						
Board Nomination Committee			10/NED						
Human Resource & Nomination Committee				4/ID					
Business Development & Operation Committee				4/ID					
Investment Committee	7/NED						4/ID		
Ethics, Human Resource, Remuneration & Nomination Committee							1/ID		
Underwriting & Reinsurance Committee							4/ID		
Claim Settlement Committee							4/NED		

10.1 Engro Corporation Limited

Engro Corporation Limited (the Company), is a public listed company incorporated in Pakistan. Its shares are quoted on Pakistan Stock Exchange Limited. The Company is a subsidiary of Dawood Hercules Corporation Limited (the Parent Company). The principal activity of the Company is to manage investments in subsidiary companies, associated companies, and joint venture engaged in fertilizers, power generation, telecommunications infrastructure, petrochemicals, mining, food, LNG, and chemical storage businesses.

Engro Corporation Limited is among the top 10 KSE-100 listed companies. Its board is duly compliant with the CCG requirements for independent directors, and it has a fair representation of female directors on its board.

10.2 Hum Network Limited

Hum Network Limited (the Company) was incorporated in Pakistan as a public limited company on 25 February 2004 under the Companies Ordinance, 1984 (now the Companies Act, 2017). The shares of the company are quoted on Pakistan Stock Exchange. Its core areas of operation are media production and distribution in the areas of entertainment, news, education, health, food, music, and society.

Hum Network Limited is one-of-a-kind company listed in entertainment sector. The company had legal challenges related to conduct of its board activities. This is reflected in its non-compliance with minimum number of board meetings in a year.

10.3 Sui Sothern Gas Company Limited

Sui Sothern Gas Company Limited is a public limited Company incorporated in Pakistan and is listed Pakistan Stock Exchange. The main activity of the company is transmission and distribution of natural gas on provinces of Sindh and Balochistan. The company is also engaged in certain other activities related to the gas business including manufacturing and sale of gas meters and construction contracts for laying of pipelines. This is a majority owned and controlled PSE.

SSGC has a big board (12 members) and a significantly higher number of board meetings (19 in a year). The board has formed six committees.

10.4 Oil and Gas Development Company Limited

Oil and Gas Development Company Limited (OGDCL), 'the Company', was incorporated on 23 October 1997 under the Companies Ordinance, 1984 (now the Companies Act, 2017). The Company was established to undertake exploration and development of oil and gas resources, including production and sale of oil and gas and related activities formerly carried on by Oil and Gas Development Corporation, which was established in 1961.

Oil and Gas Development Company Limited (OGDCL) is one of the largest companies with the market capitalization of PKR 408 bln as of June 30, 2021. OGDCL, being a PSE, shares certain characters of its board with SSGC. It also has big board of 12 members and it met for 13 times during a year.

10.5 Lucky Cement Limited

Lucky Cement Limited (the Company) was incorporated in Pakistan on September 18, 1993 under the Companies Ordinance, 1984 (now the Companies Act, 2017) and is listed on the Pakistan Stock Exchange. The Company has also issued Global Depository Receipts (GDRs) which are listed and traded on the Professional Securities Market of the London Stock Exchange. The principal activity of the Company is manufacturing and marketing of cement. Additionally, it has a diversified portfolio of investments that include businesses in Power, Motor and Chemicals Sectors.

10.6 Habib Bank Limited

Habib Bank Limited (the Bank) is incorporated in Pakistan and is engaged in commercial banking services in Pakistan and overseas. The Bank's shares are listed on the Pakistan Stock Exchange.

The board of HBL, considering specific peculiarities of its business, has formed 8 distinct committees, a high number compared to most other companies.

10.7 IGI Life Insurance Limited

IGI Life Insurance Limited ("the Company") was incorporated in Pakistan on October 9, 1994 as a public limited company under the Companies Ordinance, 1984 (now the Companies Act, 2017). Its shares are quoted on the Pakistan Stock Exchange Limited. The Company commenced its operations in May 1995.

IGI Life Insurance Limited is the leading insurance company of Pakistan and has additional committees (six in total), mainly in line with regulatory framework for insurance companies.

10.8 Cynergico PK Limited (formerly BYCO Petroleum Pakistan Limited)

Cynergico PK Limited (the Company) was incorporated in Pakistan on 09 January 1995. The shares of the Company are listed on Pakistan Stock Exchange. The Company is a subsidiary of Cnergyico Mu Incorporated, , Mauritius (the Parent Company). The Company currently operates two business segments namely Oil Refinery Business and Petroleum Marketing Business. The Company has an aggregate refining capacity of 155,000 bpd. Petroleum Marketing Business has 415 (30 June 2020: 391) retail outlets across the country.

10.9 Ghani Glass Limited

Ghani Glass Limited was incorporated in Pakistan in 1992 as a limited liability company under the Companies Ordinance of 1984 (now the Companies Act of 2017). The company is engaged in the business of manufacturing and sale of glass containers and float glass. Ghani Glass has dominated the glass market for a long time by owning the largest glass manufacturing operations and maintaining leading market share in all glass products available in Pakistan.

Ghani Glass has a significantly large size of the board; with 18 members, it is by far the largest board. This is also amongst few boards with a high representation of executive directors; it has six executive members.

This publication is prepared with respect to independent directors currently serving on boards of various companies in Pakistan. It mainly focuses on their role, responsibility, board diversity, selection, remuneration, minimum representation, independence, and tenure limit.

This report is a combined effort of PACRA and CFA Society Pakistan. This report takes inspiration from (Sivananth Ramachandran, CFA, Piotr Zembrowski, CFA, Sara Cheng, JD, & Mary Leung, CFA, 2021)[1] "Independent Directors in Asia Pacific" report published by CFA Institute in 2021 that largely touched on the same set of issues as discussed in this report. Key contents for the comparative analysis of different Asia-Pacific markets are extracted from this report by CFA Institute. We thank CFA Institute for its guidance, support, and permission to use this report.

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1. https://www.cfainstitute.org/-/media/documents/article/position-paper/cfa-id_apac_web.pdf