



RESEARCH PAPER

Investor Protection as the Objective of Securities Regulation: A Comparative Study of Securities and Exchange Commission of Pakistan and IOSCO Principles

Noor-ul-ain Shabbir

Research Associate, Department of Law, University of Azad Jammu and Kashmir, Muzaffarabad, AJ&K, Pakistan

PAPER INFO	ABSTRACT
Received: March 26, 2022 Accepted: June 25, 2022 Online: June 27, 2022	Investors play a vital role in the market's development which certify the protection of investor's rights as one of the significant objective of Securities regulation. The fairness of the market also demands Investor protection. In Pakistan, The Securities and Exchange Commission of Pakistan (SECP), established in 1997, works as a regulatory body whose job is to regulate securities including investor's rights protection. However, SECP is unable to fulfill the objectives till now, therefore, it is need of the hour to develop an adequate and satisfactory mechanism in light of the principles laid down by International Organization for Securities Commission (IOSCO) to ensure investor protection. This paper based on analysis and comparison between SECP and IOSCO's investor protection mechanism, using analytical and descriptive methodology, covers the deficiencies in current Pakistan's law like being silent about misconduct of intermediaries, and absence of penalties to the accused in case of breach of law.
Keywords: International Organization Securities Commission's (IOSCO), Investor Protection, Securities and Exchange Commission of Pakistan (SECP)	
*Corresponding Author: noorulain.ajku@gmail.com	

Introduction

Investor protection is a significant issue of Securities regulation, which has been discussed among researchers, scholars, Law makers and regulators at national as well as international level. Researcher concerned in this paper refers to provide mechanisms and standards to safeguard as well as compensation for investors against issuers, financial intermediaries, and other market players and an effort is made to provide maximum protection to aggrieved investors. (Qayyum, 2013) When we look in the history, investors in the securities markets have faced a great number of challenges including financial crises, misconduct of issuers and financial intermediaries etc. especially in Pakistan. (Sattar, 2011)

In Pakistan, there is only one act named as Foreign Private Investment (Promotion and Protection) Act, 1976 is available to somehow for investor protection and then only SECP is dealing it as one of its objective but after that neither new Law is made nor this issue has been addressed.

So, investor protection of Securities and Exchange Commission of Pakistan needs improvement in the light of principles laid down by International Organization for Securities Commission to protect the investors from deceiving, dishonest and fraudulent Practices, together with insider trading, front running or trading ahead of customers and the misuse of client assets because these failures not only caused damages to investors, but

also had adverse effects on market confidence. (Carvajal, Ana, & Jennifer, 2007) The main aim of this paper is to analyze and compare investor protection mechanisms provided by SECP and IOSCO Principles.

The SECP is the apex regulator in Pakistan, whose concern is not only with the corporate sector but also dealing with the insurance sector, and capital market and roundabout 70,000 registered companies are supervising and overseeing by SECP. (Sommer, 1997) Generally, Securities & Exchange regulation provides three main objectives, one of them is protection of investors.

It is the duty of the Regulator to regulate the market in such an efficient manner where investor's protection is not being compromised at any cost and consider their protection as top priority and for that International Organization of Securities Commissions (IOSCO) should be adopted. (Roberta, 2011)

The International Organization of Securities Commissions (IOSCO) is an international regulatory and supervisory body for the securities region formed in 1983, providing the ideal principles for regulating bodies all over the world. This organization recommends and guidelines the universal standards in the developing global securities market to which the majority of countries in the world are following. IOSCO provides the main principles that help to regulate and enforce these standards for the effective management of global securities markets. (Deterrence & Credible, 2015) The members of IOSCO have following objectives, first is ensuring that markets are fair, efficient and transparent: To develop, implement, promote and work for the international standards. This will protect investors; maintain free and fair competition in transparent markets. Second is Protecting investors: Confidence building and protection of the investors and secure their interest in the securities markets by strengthening the exchange of information, negating the misconduct and supervising the markets and market intermediaries and third is reducing systematic Risk. (CHAO & NING, 2017)

IOSCO principles were formed to develop, implement, and promote high standards of regulation to enhance investor protection and reduce systemic risk, Share information with exchanges and assist them with technical and operational issues. It also plays its part in financing the new ideas and aiding the management of financial risk. Further, since investors, in the present market scenario, are placing an ever increasing ratio of their money in shared funds and other joint investments. (Corcoran & Andrea, 2010) Securities markets have become fundamental to individual wealth, prosperity and retirement planning. A sound and effective regulation, as provided by IOSCO, and the assurance it brings is important for the reliability, veracity, intensification and development of securities markets. (Roberta, 2011)

Literature Review

While searching on the topic the researcher has undergone through several writings. This research is based upon diverse literature about Regulating Securities Markets for investor protection of SECP in legal perspectives. The literature review provides a critical and in-depth analysis about the core area of the paper. The relevant books, research articles, policy briefs and reports offer a diverse perspective about the core area of the research and give rationale with regard to the genesis of Regulating Securities Markets for investor protection of SECP.

There is quite relevant material in literature review explaining the Regulator must contribute to a procedure of monitoring, mitigating and management of systemic risk while SECP lacks a process to monitor, mitigate and manage systemic risk. (Qayyum, 2013) The careful and critical analysis of the literature review suggests that the prime objectives of IOSCO

principles are investor's protection which also should implement in SECP. It is necessary that the investors must be protected from misleading, controlling or dishonest practices. In addition to it, it must be ensured that the markets are fair, efficient and transparent. By this, the investors would be automatically protected. (Jordan & Cally, 2018)

Rights and challenges related to Investor's protection seeks attention internationally and have become the focus of increasing research as author in this paper explains and explores the main reasons and causes of the current global economic crisis, and focus to resolve systemic risk including investor protection as priority especially in United States. Author not only describes the mechanism for real estate investments, and also investigates the occurrence of systemic risk during the crisis. (Hellwig, 2008)

The fairness of the markets is closely linked to investor protection. Regulations of Securities and Exchange Commission of Pakistan for the investor protection in securities markets are unable to full fill the objectives. Hence, Compliance with the IOSCO principles is important to safeguard the integrity and credibility of financial system, strengthen legal and regulatory framework, and develop capital markets as a preferred investment choice for both local and foreign investors. (Shabbir, 2018)

Authors in this article not only describes the positive impact of IOSCO Standards but also give the backdrop to IOSCO standard Setting and said that IOSCO was no longer in control of its own standard setting agenda. New regulatory objectives, sometimes difficult to reconcile with traditional regulatory goals of investor protection, were dropped into international standards. (Dubow & Anthony, 2013)

The Asian Development Bank (ADB) has questioned the institutional independence and regulatory capacity of the Securities and Exchange Commission of Pakistan (SECP) and its top officials which is undermined by direct intervention of the ministry of finance, has highlighted how weak capital market governance in Pakistan results in poor market transparency and weak investor protection. (Sattar, 2011)

Marco Bodellini in his article argues that the current rules are not appropriate and enough to address the complications that can cause to investors and markets. Investor's Issues are not always considered as a top priority and investors who are allowed to invest are mostly belong to democrates, elite class and most are sophisticated and well-off investors, who do not need to be protected by regulation. So Regulators should be motivated by very important legislative aims, such as investor protection and systemic risk prevention and counteraction. (Bodellini, 2017)

Material and Methods

The doctrinal legal research method is mostly applied in legal research. During this research analytical approach along with descriptive methodology will be applied. The current laws and regulations on Regulating Securities Markets for investor protection of SECP will be analyzed critically and this paper includes systemization.

Results and Discussion

SECP adopted many principles given by IOSCO but still major deficiencies of the current law, i.e., SECP Act, 1997, includes lack of proper framework for protection of rights of investors, cooperation and collaboration on promotion of investor rights and financial literacy, and emphasizes the importance of the Statement of Investor Rights awareness among both investors and investment management professionals, limited financial/administrative independence of the SECP, power to constitute committees, task forces, and increase in the membership of the SECP Policy Board. (Corcoran and Andrea,

2015) Besides, the SECP has ineffective enforcement powers to call for information, lack of process for prosecution of cases, recovery of penalty, delay in decision of court cases, ex parte stays, and inadequate investigation powers. (Godwin, Andrew, Steve & Ian Ramsay, 2016)

IOSCO Principles effectiveness in the context of regulating securities Markets

IOSCO has provided almost 38 principles that are grouped into 10 categories. However, in order to achieve the objectives effectively, these principles must be implemented. ("IOSCO", 2010)

The crux of the main objectives of IOSCO principles are that the Investors must be protected from misleading, cheating and fraudulent Practices, as well as insider trading, fake information, abusive behaviour to clients by intermediaries and the misuse of client assets. Accurate disclosure of information and relevant material is necessary for effective investor's decisions and full and proper knowledge about investment is necessary for ensuring investor protection. (Godwin, Andrew, Steve-Kourabas, & Ian-Ramsay, 2016).

Investors are, thereby, in this way, betterable to assess the potential risks and rewards of their investments and, thus, to protect their own interests and well-being. However, as key components of disclosure requirements, it is the necessary of time that the accounting and auditing standards should be in place, and they should be of a high and internationally acceptable quality as mentioned in the IOSCO Principles. (Elliott, Jennifer & Ana-Caryajal, 2007)

It is also observed that the Investors are particularly facing the misconduct and misbehaviour by intermediaries and others in the securities market, but the measurements available to individual investors to take action and complained against the misconduct is very limited. Further, the complex character of securities transactions and of fraudulent schemes in the developing times requires strong enforcement of securities laws. (Porta, Rafael, Florencio, Lopez-de-Silanes, Andrei-Shleifer, & Robert, 2000)

Moreover there is no remedy available to investor in case of breach of laws and because of non-availability of protection against breach of Law, investors always feel insecure while investing in securities market especially so it is dire need in the developing time that where and whenever a breach of law occurs in securities market, investors need to be protected through the strong enforcement of the law and new Laws should be made for safeguarding them against such breach.

The fairness of the markets is closely linked to investor protection and, in particular, to the prevention of improper and deceitful trading practices. (American Bar Association, 2013) However, the IOSCO Regulations should aim to guarantee that investors are given unbiased, fair and impartial approach to market facilities. That would ensure the effective achievement of the objectives of IOSCO Principles. Regulation should also promote market practices that ensure fair treatment of orders and a price formation process that is reliable. (Institute of Financial Markets, 2013) An analysis of IOSCO principles shows that they fulfill this objective. In an idea of an efficient market, the giving out of relevant information is timely and widespread and the price formation process reflects it. Thus, it is necessary for the market efficiency. (Bodellini & Marco, 2017)

IOSCO principles are effective enough to establish the sound domestic markets as they are necessary for the development of a domestic economy and that in the modern times, domestic security markets are progressively more incorporated into the global market. The IOSCO principles also express the intent that securities regulators, at both the

domestic and international levels are guided by a constant concern for investor protection and to some extent, they are quite successful in achieving it. ("Country Review", 2015)

Analysis of Implementation of IOSCO Principles by SECP for investor's protection

Many legislative and regulatory reforms have been implemented, which include the promulgation of the 2015 Securities Act, the 2016 SECP Amendment Act, and new regime for securities' brokers, investor education program, supervisory architectural reforms and risk-based supervision and enforcement. (Gillis & John, 1978). The implementation of these recommended reforms aims at contributing to investor protection, fair and efficient markets and reducing systemic risk in Pakistan's securities markets; and improving regulatory capability by making SECP's independent and accountable. (Shabbir, 2018)

SECP, in this regard has established The Securities Market Division (SMD) which is responsible for monitoring, regulating, and developing the securities market. It regulates the primary and secondary markets as well as market intermediaries through registration, surveillance, investigation, enforcement, and rulemaking, with the objective of protecting investor interests. SMD also processes and grants approvals to prospectuses for public offering of both debt and equity securities (Asad & Sami, 2019) In addition, it institutes appropriate regulatory reforms to develop and promote the market, engender investor confidence and instill transparency, effective risk management and good governance at the Pakistan Stock Exchange, Pakistan Mercantile Exchange, Central Depository Company and National Clearing Company. (Stanger, 1973).

Principle 6 of IOSCO states that it is duty of Regulator to contribute and help in examine a procedure of monitoring, lessening and managing the systemic risk, appropriate to its mandate and obligation. While SECP lacks proper process of monitoring, mitigating and management of lessening the systemic risk. At the time of the assessment, amendments have been proposed for the SECP Act with regard to the powers and functions of SECP which, if passed, will enable SECP to identify and address systemic risk factors. (Jordan & Cally, 2018)

Principle 8 of IOSCO principles states that it includes in the duty of Regulator to guarantee and manage the aviodness, disclosure and elimination of conflicts of interest and misalignment of incentives. Conflicts of interest are identified and evaluated by SECP in the process of supervision of regulated entities. The applicable legal framework prohibits regulated entities from undertaking various activities and requires them to establish policies and procedures for internal control which properly address conflicts of interest. (Daniela & Russo, 2013). However, treatment of misalignment of incentives in intermediaries is not clearly articulated in the SECP rules and will be addressed in the draft Securities Bill which at the time of the assessment had been approved by the Senate Standing Committee and was awaiting promulgation by the Parliament. Further, appropriate amendments have been made in NBFC Rules that are in public consultation. (American Bar Association, 2002)

Principle 16 of IOSCO Principles states that is also comes under the duties of Regulator to disclose full and accurate information and timely disclosure of financial results, risk and other information that is necessary to investor's decisions. In Pakistan, Current offering documents provide potential investors with a level of comfort through the way risks are presented that may in reality give an untrue depiction of the actual risks associated with the offer. Additionally, current regulations have a requirement that issuers are to present prospectuses to potential investors in English only, which may be problematic due to English not being the most widely spoken language in Pakistan. Renounceable rights issues do not require a full prospectus. Under earlier regulations

issuers were allowed to advertise the offering with information that is not present in the offering document. (Dubow & Anthony, 2013)

Principle 25 of IOSCO Principles states that the regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets. The current regulatory regime has been effective in providing for rules governing the legal form and structure of CISs and the segregation and protection of client assets. (Bodellini & Marco, 2017)

Although Trustees play a major role in the CIS business and are required under the current regulations to oversee the activities of AMCs they have not been subject to inspection by SECP. There are two trustees and one is dominant. SECP has recently begun an on-site inspection program. Subject to a judgment of the scope and intensity of the inspection process, an upgrade may be merited in due course. (American Bar Association, 2002)

Principle 32 of IOSCO Principles states that there should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investor and to contain systemic risk. SECP and the exchanges have the authority to restrain conduct and take necessary steps in order to protect investors, in case of a default of the broker. Further, there are additional measures such as Insurance Schemes and Guarantee Funds to minimize the loss in case of a default. With regard to early warnings, SECP interprets early warnings signals of a possible default through System Audit Reports, investor complaints, net capital balance certificates, CDC inspections, delivery defaults etc. However, enhanced off-site periodic reporting is essential in order to be preventive and take necessary action before a possible default. (Shabbir, 2018)

Under section S. 15-A, the directors are held responsible for insider trading and as per Section 15- E of SECP Ordinance 1969 heavy fines are also imposed. SECP has drafted strict regulations on insider trading as it is more exploiting to the investors. Under Section 159 of Securities Act, 2015 insider trading is an offence with three years' imprisonment and a fine of up to two hundred million rupees. (Brummer & James, 1989)

In addition to it, section 131 of securities act, 2015 obliges the listed companies to disclose inside information. In Pakistan, SECP has developed a dedicated Investor Education Program (IE Program) "Jamapunji" in line with IOSCO principles, for investor education and awareness. (Hellwig & Martin, 2010)

Conclusion

With the ongoing discussion, it can be concluded that we need to enhance the securities regulations. For effective securities markets, we need the corporations and a regulatory environment, for the formation of capital. There are three objectives that need to be achieved. More than 90% of security regulators are members of IOSCO. These members are committed to the principles of IOSCO. The prime objectives of IOSCO principles are investor's protection. It is necessary that the investors must be protected from misleading, manipulative or fraudulent practices. In addition to it, it must be ensured that the markets are fair, efficient and transparent. By this, the investors would be automatically protected. The third and foremost objective is the protection from systematic risk. Systematic risk is the risk that is for the whole market and generally includes the market on the whole. It is not specified for only one component or domain of the market. Moreover details of relevant examination reports, inquiry and investigation reports and other examination data and material must be available to the parties, Information regarding the financial markets, including the securities financing markets, to assess the

conditions in such markets, that may materially affect the operations or financial condition of their respective regulates .Each party will inform the other about any major relevant policy changes and will discuss with the other, in advance, any policy changes which are likely to have a bearing on the regulatory responsibilities of the other. By looking at the securities markets in the ongoing era, we observe that the systematic risk is so silent. In essence, it is foreseeable but invisible.

To minimize the risk, they are selling shares. However, no balance between demand and supply is seen in them. This leads to the downfall of share price and in turn, the companies and investors suffer at large. IOSCO principles are one of the measures that are playing a vital role in achieving these objectives. Hence, they are effective in economic growth and capital formation.

Hence, Compliance with the IOSCO principles is important to safeguard the integrity and credibility of financial system, strengthen legal and regulatory framework, and develop capital markets as a preferred investment choice for both local and foreign investors.

References

- ADB questions SECP regulatory independence.* (2007, August 07). Islamabad, p.6.
- American Bar Association. (2002, August). Special Study on Market Structure, Listing Standards and Corporate Governance. *The Business Lawyer*, 57, 1487-1567.
- American Bar Association. (2013, April). Transparency and Accountability. *Creamer III Business Law Today*, 1-4.
- Bodellini, & Marco. (2017, June). From Systemic Risk to Financial Scandals: The Shortcomings of U.S. Hedge Fund Regulation. *Brooklyn Journal of Corporate, Financial & Commercial Law*, 11(2), 2-11.
- Brummer, J., & James. (1989, April). Accountability and the Restraint of Freedom: A Deontological Case for the Stricter Standard of Corporate. *Disclosure. Journal of Business Ethics*, 5(2), 155-164.
- Carvajal, Ana, & Jennifer. (2007). Strengths and weaknesses in securities market regulation: A global analysis. *IMF Working Papers*, 1-49.
- Daniela, & Russo. (2013). CPSS-IOSCO Principles for financial market infrastructures: vectors of international convergence. *Financial Stability Review* 17, 69-78.
- Deterrence, & Credible. (2015). *In the Enforcement of Securities Regulation*. <https://www.iosco.org/news/pdf/IOSCONEWS383>.
- Dubow, A. Jay., & Anthony. B. (2016). *Fair Value Accounting: Reinforcing Organizational*.
- Elliott, A., Jennifer & Ana-Caryajal. (2007). Strengths and Weakness in Securities Market Regulation: A Global Analysis. *United States: International Monetary Fund*, 8.
- Future Market Act, 2016
- Gillis, & John. (1978, Mar. – Apr). Securities Law and Regulation: The Spotlight Is on outside Directors. *Financial Analysts Journal*, 34 (2), 18-21.
- Godwin, Andrew, Steve-Kourabas, & Ian-Ramsay. (2016). Twin Peaks and financial regulation: The challenges of increasing regulatory overlap and expanding responsibilities. *The International Lawyer*, 49 (3), 273-298.
- Hellwig, & F., Martin. (2010, January). Pital Regulation after the Crisis: Business as Usual. *SSRN Electronic Journal*, 8, (13), 77.
- Hellwig, (2008, Dec). Systemic Risk in the Financial Sector: An Analysis of the Subprime-Mortgage Financial Crisis. *Max Planck Institute for Research on Collective Good*, 43(2), 57.
- Jordan, & Cally. (2018, September). Beyond International Standards: Mapping the Future of Capital Markets Regulation. *Centre for international Governance innovation*.
- Karmel, & Roberta. (2011). IOSCO's Response to the Financial Crisis. *J.Corp. Law Journal*, 37, (3), 849.
- Levenson, B., Alan. (1971, November). The Role of the SEC as a Consumer Protection Agency. *The Business Lawyer*, 27(1), 61-70.

- Porta, Rafael, Florencio, Lopez-de-Silanes, Andrei-Shleifer, & Robert. (2000). Investor protection and corporate governance. *Journal of financial economics*, 58(1-2), 3-27.
- Porta, Rafael, Florencio, Lopez-de-Silanes, Andrei-Shleifer, & Robert. (2000). Investor protection and corporate governance. *Journal of financial economics*, 58(1-2), 3-27.
- Sattar, Babar. (2011, June 25).SECP has now become a captured agency. *Securities and Exchange Commission of Pakistan: The Official letter*, p. 8.
- SECP (Amendment) Act 2013
- SECP (Amendment) Act 2016
- Securities ACT, 2015
- Securities and Exchange Commission of Pakistan Act, 1997
- Shabbir, Noor-ul-Ain. (2018).*The independence and accountability of SECP in the light of IOSCO principles*. LL.M thesis, Islamic International University, Islamabad.
- Sommer, Jr. (1996). IOSCO: its mission and achievement. *Nw. J. Int'l L. & Bus*, 17, 15.
- Stanger, Abraham. (1973, July).Is the Securities and Exchange Commission Backing into Fair Value Accounting. *The Business Lawyer*, 28 (4), 1003-1009.
- Stock Exchange (Corporatization, demutualization and integration Act, 2012
- Sub-sections (4-C) and (4-D) of section 10-E of the Companies Act, 1956