FINAL REPORT

South Asian Federation of Exchanges

Report on Strengthening Stock Exchange Listing Regimes and Regional Harmonisation

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SAFE: STRENGTHENING STOCK EXCHANGE LISTING REGIMES AND REGIONAL HARMONISATION PROJECT

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Foreword

This report aims to assist South Asian Federation of Exchanges (SAFE) member exchanges strengthen their listing regimes as an essential element of efforts to develop their capital markets. The report also explores the scope for harmonisation of listing regulations in the SAFE region, as a step towards greater integration of regional capital markets.

Draft findings were presented at the 3rd Annual General Meeting and 6th Theme Conference of SAFE held in Lahore, Pakistan on 3rd and 4th December, 2003, and discussed at a special working session of exchange and national securities commission representatives.

The findings and recommendations on SAFE exchange's domestic listing regimes have been drawn up by the SAFE project team based upon the exchange's responses to a detailed Questionnaire and subsequent discussions with their managements during a round of short country visits. The findings and recommendations do not therefore constitute a statement of the strategic policies of the exchanges concerned, but represent views on how the listing regimes of SAFE member exchanges can be strengthened.

The extent of the review has been limited to the submissions and discussions with the SAFE exchanges and brief introductory discussions with most of their securities regulatory bodies, but not as yet with the corporate sector in the SAFE region, representatives of the domestic or international investment communities, or financial intermediaries such as broker-dealers and corporate finance advisers. The views and commitment of these key market users will be crucial to the form and viability of any sustainable regional capital market development.

It is also important to emphasise, as a general principle, that each SAFE exchange and related bodies responsible for the listing regimes in their countries (e.g. securities commissions) must, in devising and implementing development of their regimes, carefully weigh the benefits of imposing more onerous regulatory requirements on issuers of equity securities against the possible deterrent effects of the higher compliance and loss of privacy inherent in public listing. Given the diversity in size and current level of development and importance of their capital markets among the SAFE countries, the report is careful to emphasise that there is no "one-size-fits-all" solution to strengthening their domestic listing regimes.

In relation to the regional dimension of the project, harmonisation of listing regulations must be regarded as but one component of efforts to facilitate regional market development, along with other types of regulatory and infrastructural development. These include *inter alia* information dissemination and order routing mechanisms, trading systems linkages, and settlement and clearing arrangements, all of which are of central importance to market integration.

In contrast to other co-operative initiatives internationally, such as those in southern and eastern Africa and the Caribbean, which have been undertaken under the auspices of supra-national bodies drawing their authority from international treaties between sovereign governments, the current SAFE initiative is being promoted by a voluntary association of stock exchanges, each of which is subject to its own peculiar circumstances.

Notwithstanding the indications of support from SAFE exchanges for harmonisation of listing regulations, a wider consensus for developing harmonisation of listing regulations into a deeper form of regional capital market integration in South Asia is not yet apparent, as the current project has not tested the degree of interest and enthusiasm among governments, or private sector-issuers, major domestic investors in the SAFE countries or international investors and capital market intermediaries. In particular, concerns may emerge that a regionally-focused market may drain liquidity

from some of the smaller and weaker markets and that certain interest groups, such as broker-dealers who have control of the exchanges in some markets, may oppose reforms because they perceive the costs of regional integration to be higher than the potential benefits.

Experience of capital market development has shown that the impetus for growth must necessarily come from the private sector – companies, financial intermediaries and investors - although regulatory co-operation structures are also an essential feature underpinning integration.

These considerations mean that if SAFE is to play a central role in promoting greater regionalisation of capital markets its action plans need to encompass engagement with issuers, investors and other development partners (such as governments, securities commissions, and central banks) to address the range of implementation hurdles to market development, in addition to encouraging its member exchanges to strengthen and harmonise their listing regulations as set out in this report.

Executive Summary

Introduction

This report has been prepared as part of a SAFE[1] project on strengthening SAFE member's listing regimes and exploring the scope for harmonisation of listing standards. The aims of the project are to:

- Review the nature and operation of their listing regimes,
- Make recommendations on how these could be strengthened and improved, and
- Explore the scope for regional co-operation and harmonisation on listing matters.

Key comments and recommendations throughout the report are highlighted in the following format:

Recommendation
It is recommended that……………………………...etc,

SAFE domestic listing regimes – main features described

The summaries of the main features of the SAFE exchange's listing regimes, derived from the responses to the Questionnaire, are set out in the individual exchange summaries in Annex 2. The collation of this extensive body of information has allowed a detailed picture of the listing regulatory frameworks and market development priorities in the SAFE countries to be assembled, as a basis for implementation of the recommendations made on domestic and regional listing throughout the report.

SAFE domestic listing regimes - the context of the recommendations

The project TOR require that a report on the current listing regimes of the SAFE member exchanges is produced and strengths and weaknesses in national listing regimes diagnosed and assimilated.

Consideration of the nature and effectiveness of a domestic listing regime must necessarily be assessed in the context of its market environment, how this has evolved and how policy-makers wish to see it develop. Setting regulatory standards for listing and developing them must therefore take into account the regime's historical and legislative origins, evolution of the market, its current characteristics and dimensions, as well as wider legal and socio-economic considerations.

The capital markets of the SAFE member's countries vary widely in their size, diversity and depth of market infrastructure, with implications for the scope and direction of development of their listing regimes domestically and regionally. These contrasts and a number of factors that directly impact the nature and scope for development of listing

[1] SAFE membership comprises the 12 major stock exchanges in the following countries – Bangladesh, Bhutan, India, Mauritius, Nepal, Pakistan, and Sri Lanka.

standards in developing capital markets are set out in Part 2 and Annex 5 (Factors relevant to domestic capital market development) of the report under the following headings:

- Levels of private sector support from issuers, investors, financial intermediaries
- The stage of development of the overall corporate sector
- Macro-economic conditions conducive to market development
- Supportive Government policies, and
- Legal and regulatory framework.

Recommendations on strengthening SAFE countries domestic listing regimes

Specific findings and recommendations, action plans and topics requiring further exploration on each domestic listing regime are set out in individual country summaries in Annex 3, as referenced in the box below.

Specific recommendations on strengthening SAFE countries domestic listing regimes

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Some key policy issues relevant to a number of SAFE exchanges

In addition some key policy issues on listing regimes common to a number of the SAFE exchanges encountered through the project are:

- De-mutualised exchanges and listing regulation
- Growing the listed sector - private sector development and improving market access, and
- Corporate governance in Asia.

The report contains some general conclusions and recommendations in respect to these common policy issues, as discussed in Part 2 of the report and the recommendations summarised below. It is emphasised however that these recommendations are general in nature and further detailed analysis will be required within the context of the each domestic listing regime to find solutions tailored to local circumstances.

General recommendation: De-mutualised exchanges and listing regulation

Comment
Within the SAFE region reform of exchange ownership and governance is currently under active consideration in **India, Pakistan and Sri Lanka**. The impact of demutualisation on SAFE exchanges which also currently undertake front-line listing regulation needs to be carefully assessed, drawing on international experiences and local market conditions. International experiences indicate that continuance by demutualised "for-profit" exchanges of a major front-line role in listing regulation is not necessarily impossible, if the right combination of checks and balances are provided for in the overall listing regime to ensure that conflicts of interest are properly addressed, but where multiple exchanges compete for market share the competitive pressures may well dictate the transfer of listing responsibilities to a centralised listing authority overseeing regulatory issues on suitability for listing.

General recommendation – Growing the listed company sector - private sector development and improving market access

General recommendations on growing the listed company sectors in SAFE countries
Growing the listed company sector is a major challenge for all of the SAFE countries. The SAFE exchanges and other key stakeholders in capital market development should **develop methods of gaining a greater understanding of the factors impacting companies decisions to list** or raise further capital through the capital markets. This market research and intelligence-gathering is essential to the formulation of relevant market development strategies. Central to these efforts are developing the exchange's professional market development expertise and consultation networks to gain a deeper understanding of companies financing alternatives and perceptions of the capital market. This work should be underpinned by **collaborative efforts to raise general awareness of the capital market as a capital-raising avenue for companies,** and as provider of investment options for citizens, and to encourage a favourable "enabling environment" for capital market development. SAFE exchanges should therefore seek opportunities to partner and consult with relevant stakeholder groups to ensure that they are able to factor in the needs and considerations of these stakeholders into exchange strategic polices and market development initiatives, and to be able to influence the policies of these parties which impact development of the listed company sector (e.g. taxation policies). SAFE exchanges are also encouraged to **develop "market-facing" listing operations**, by becoming more receptive to working in close co-operation with the financial intermediaries (such as exchange sponsor members and issue managers) and other professionals (such as reporting accountants and lawyers) to develop joint marketing initiatives targeting the corporate sector.

Development of "junior" markets – key considerations

Recommendation
In SAFE countries the design or re-trenchment of second markets is a "live" issue in **Sri Lanka, India, Pakistan, and Mauritius**. Given the experiences of second market development elsewhere, it is recommended that the SAFE exchanges considering establishing a junior market first conduct a thorough analysis of the market and business context, and carefully design the market structure to reflect these. In particular, feasibilty studies should examine the potential supply of companies, and the preferences of investors, particularly the views of venture capital providers and domestic institutional investors. Market design should be comprehensive with maximum possible engagement with potential market users on market design. Key areas for analysis are set out in Part 2 of the report.

Corporate Governance in Asia

Recommendation
Corporate governance standards are imposed and influenced through a variety of means, by company and securities laws, listing regulation, codes of practice, shareholder activism, and in some cases by a mixture of these methods. Listing regimes therefore play an important role in setting and applying standards of corporate governance for listed issuers, and all SAFE exchanges are recommended to study the findings and recommendations set out in the White Paper produced by the Asian Roundtable on Corporate Governance[2], (which covered *inter alia* **Bangladesh, India and Pakistan**). The Roundtable serves as a regional forum for the OECD corporate governance initiative, containing region-specific guidance and suggestions to assist policymakers, regulators (including stock exchanges), and other standard-setting bodies in non-OECD countries of the Asian region, as part of the ongoing development of their listing regimes.

Rationale for harmonisation of listing regulations and regional capital market initiatives

The TOR of the project also cover exploration of the scope for regional co-operation and harmonisation of listing regulations. Harmonisation of listing regulations across its constituent member's listing regimes is an important objective of SAFE for compelling reasons. Competition is effecting how exchanges organise themselves and forcing them to look beyond their domestic horizons, and to develop more appropriate ownership structures, new products and wider customer bases.

[2] The Roundtable comprises senior policymakers, regulators, and representatives of stock exchanges, private sector bodies, multilateral organisations, and non-governmental institutions.

How regional capital markets have emerged internationally

Regional markets are often characterised as being formed by the integration of some or all of the elements of national constituent markets, allowing securities to be traded across a number of markets in a region, investors to buy securities from throughout the region without restriction, and financial intermediaries to offer their services across national boundaries. Although regional market development initiatives often connote co-operation between market operators (e.g. through stock exchange trading platform linkages) and regulatory co-operation arrangements between jurisdictions (e.g. through MOU arrangements between securities commissions), there have been instances of market development through competition between exchanges, such as the London Stock Exchange's international equities market (IEM) and the Hong Kong exchange's "H" share market catering for mainland Chinese companies. Other examples of development projects to encourage and facilitate the emergence of regional markets are currently being promoted and facilitated by economic communities, such as the Southern African Development Community and the Eastern African Community.

However it must be emphasised that harmonisation of listing regulations is but one component of co-operative initiatives to facilitate regional market development, along with other types of regulatory and infrastructural development, such as those to address information dissemination (both corporate disclosure and trading information), order routing, trading systems linkages, and settlement and clearing arrangements.

Examples of regional market development and harmonisation initiatives internationally are set out in Annex 6.

SAFE's role in promoting regional market development within the SAFE region

The responses of the SAFE exchanges to the Questionnaire indicate general support for the concept of regional co-operation and efforts to harmonise listing regulations. In addition preliminary discussions with a number of the national securities regulatory bodies in the SAFE countries have indicated broad support for developing regional regulatory co-operation networks to address regulatory issues that would arise from cross-border listing and trading arrangements.

A key assumption of this project is that regional capital market development will be facilitated by co-operative arrangements between the market and regulatory institutions in SAFE countries. It is important to emphasise that this should not in any way preclude competition between all types of market participants, including stock exchanges, and that the emphasis on co-operation is to address the regulatory requirements supporting the quality of the capital market and to alleviate the regulatory barriers and implementation hurdles.

Additionally, the current SAFE initiative, in contrast to other co-operative initiatives internationally, such as those in southern and eastern Africa and the Caribbean, is not being undertaken under the auspices of a supra-national body, drawing its authority from international treaties between sovereign governments. It is being promoted by a voluntary association of stock exchanges, each of which is subject to its own peculiar circumstances. Despite the indications of support from the SAFE exchanges for

harmonisation of listing regulations, a wider consensus for developing harmonisation into a deeper form of regional capital market integration in the South Asia region is not yet clear, as the current project has not tested the degree of interest and enthusiasm among sovereign governments, or private sector-issuers, major domestic investors in the SAFE countries or international investors and capital market intermediaries. In particular, concerns may emerge that a regionally-focussed market may drain liquidity from some of the smaller and weaker markets and that certain interest groups, such as broker-dealers who have control of the exchanges in some markets, may oppose reforms because they perceive the costs of regional integration to be higher than the potential benefits.

Experience of capital market development has shown that the impetus for growth must necessarily come from the private sector – companies, financial intermediaries and investors - although regulatory co-operation structures are also an essential feature underpinning integration. This means that if SAFE is to succeed in promoting greater regionalisation of capital markets its action plans need to encompass engagement with stakeholders and other development partners to address the range of implementation hurdles faced, namely:

- Private sector issuer and investment groups domestically and internationally, such as national and regional Chambers of Commerce, and international institutional investment groups
- Sovereign governments
- Regulatory authorities (such as national securities commissions) responsible for capital market regulation and development, and
- Central Banks and other authorities responsible for exchange control regulation.

Recommendation
In addition to encouraging its member exchanges to strengthen and harmonise their listing regulations as recommended in this report, it is recommended that, as part of a planned programme of promoting understanding of the scope for regional capital market development SAFE should develop a series of Market Development Forums in the SAFE region, to further explore the scope and nature of development of a regional capital market. This should involve the following interest groups: o major listed companies with commercial interests across the region o Institutional investor groups with a focus on investment within the SAFE region o private sector representative groups such as local, national, and regional Chambers of Commerce o representatives of sovereign governments and agencies, such as central banks o regional co-operation organisations such as SARRC and SAFTA o the legal and accounting professions o representative of major broker-dealers in SAFE exchanges.

Reasons for promoting harmonisation of listing regulations in the SAFE region

This report concludes that SAFE should continue to promote harmonisation of listing regulations in the SAFE region, both to improve the quality of its domestic constituent markets, and also to contribute to efforts encouraging the development of regional capital markets. These efforts will:

- **Improve market quality of domestic markets**: Improve the overall quality of the domestic capital markets operated by SAFE members by providing benchmarks for listing standards and information and knowledge-sharing opportunities amongst its member exchanges, thus encouraging greater capital formation and investment opportunities within those countries.

- **Encourage greater intra-regional cross-border investment in the SAFE region:** Encourage greater investment by regional investors in the SAFE region through the greater exposure afforded by regional cross-listings.

- **Encourage more investment by FII's:** Encourage greater investment by overseas institutional investors in the economies of the SAFE member countries by encouraging adherence to international standards of listing regulations such as those espoused by IOSCO, overseas regulatory authorities and guidelines issued by industry representatives bodies[3].

- **Provide groundwork for regional capital market development initiatives:** Develop the ground for wider regional capital markets development initiatives that ultimately could allow free trading of investments across the region as economies continue to liberalise.

- **Take advantage of the commonality of legal traditions and heritage between SAFE countries:** All the SAFE countries have the same official legal language (English) and should draw upon this to help the ongoing process of shaping a legal and regulatory foundation for harmonisation and co-operative arrangements between SAFE exchanges.

Recommendations on listing harmonisation in the SAFE region

This project has taken the first steps in assessing the comparative position of the listing regimes of the seven SAFE countries, as a basis for exploring the scope for their harmonisation. However achieving full harmonisation[4] of listing regulations is not currently a realistic expectation in the SAFE region, especially given the absence of a supra-national economic and legislative body (such as the European Union), with the mandate to promulgate legislation and regulations. In addition, even if a model was to be developed this would be a difficult and time-consuming exercise as proven by the EU experience, and once achieved would require constant maintenance given that legal systems in separate sovereign states are dynamic and continue to evolve over time.

[3] Such as the Institute of International Finance (IIF).

[4] "Full" harmonisation would entail the development of identical regulations and regulatory processes in each of the listing regimes.

As an alternative to the full harmonisation of regulations therefore, it is recommended that SAFE, drawing on the information gathered on its member's listing regimes through this project, adopts a three-pronged approach to improving listing regulations within the SAFE region by:

- **Developing a set of SAFE listing harmonisation principles**, to act as benchmark for the setting of listing standards by its member exchanges
- **Encouraging mutual recognition of the listing regimes on a bi-lateral basis amongst its members**
- encouraging its members, as a first step in applying the "recognition" principle, to **make provision in their listing rules for the listing of the equity securities of other "recognised" SAFE listed non-domestic companies on a "secondary listing"** basis".

These recommendations are discussed in the following paragraphs.

Recommendation 1 - Developing a set of SAFE listing harmonisation principles

Recommendation
It is recommended that SAFE develops a set of listing harmonisation principles. The first draft of the principles could be based upon the model adopted by the Southern Africa Development Community (SADC) (see Annex 7), drawing upon the information on the SAFE exchanges listing regimes set out in this report. The SAFE principles would then be subject to a process of consultation with the SAFE exchanges and formal adoption by SAFE.

The benchmarking of listing regimes utilising the SAFE harmonisation principles would provide support for encouraging mutual recognition between SAFE exchanges, as a basis for allowing cross-listings, as well as encouraging the strengthening of the listing regimes in line with internationally accepted standards.

Recommendation 2 - Mutual recognition of listing regimes amongst SAFE members

Mutual recognition occurs when a jurisdiction or regulatory organisation "recognises" compliance with the regulatory regime in another as sufficient to constitute compliance its own territory.

Although mutual recognition in the context of listing regimes does require a certain degree of harmonisation between regulatory regimes, the underlying regulatory regimes and institutions only need to be comparable but not necessarily identical. International examples demonstrate that disparities may be addressed by the imposition of additional listing obligations by the exchange through specific listing agreements entered into between an exchange and a listed company, and through regulatory co-operation arrangements between exchanges and securities regulatory bodies.

The concept of "recognition" of listing regimes has been utilised widely by exchanges in capital market development to facilitate "secondary listings" and "trading-only" markets in international securities, most notably by the London Stock Exchange in its international equity market. Other examples of mutual recognition are the European Union's listing and public offerings directives, and the multi-jurisdictional disclosure arrangements between the United States and Canada for public offerings of securities.

It is to be anticipated that the assessment of other exchanges within SAFE for recognition purposes is most likely to be prompted by the application for listing by a non-domestic company on a SAFE exchange, possibly on a "secondary listing" basis (see also Recommendation 3 below). The recognition process would involve the SAFE exchange and its securities regulatory body (securities commission) assessing the listing and regulatory regime in the centre of "primary" listing to ensure that domestic investors are afforded a suitable level of protection, leading to the designation of that foreign exchange as "recognised" for the purpose of consideration of applications for listing companies with primary listings on that exchange.

Recommendation
It is recommended that SAFE adopts a policy of encouraging mutual recognition of listing regimes among its constituent members, supported by the establishment of SAFE listing standards harmonisation principles, as the next step in SAFE's efforts to promote a regional dimension to capital markets in its region.

Recommendation 3 - Providing listing facilities for "secondary listings" within SAFE

"Secondary listings" or "cross listings" are where a company is listed on an exchange outside its home jurisdiction, on the basis of recognition by the foreign stock exchange of its "primary listing". By providing for secondary listings SAFE exchanges would effectively broaden the investment options of their domestic investors to the securities of regional and international companies which choose to list in their jurisdiction, and thus take an initial step towards extending their market internationally.

Usual reasons for companies seeking secondary listings are to raise additional capital from foreign investors, broaden securities analyst's coverage, enable employees not employed in the country of origin to invest in the company through incentive share schemes, and for strategic commercial reasons such as increasing visibility and product brand awareness. Examples of companies form SAFE countries obtaining listings on foreign exchanges are apparent with some 131[5] Indian and 3 Pakistani companies having listed their securities in London and New York through depository receipt programmes in recent years, principally to raise additional capital from international investors.

An important policy issue that needs to be addressed to allow for cross-listing arises form the existence of currency exchange controls in many SAFE countries, and SAFE exchanges may therefore have to lobby and persuade their governments to relax exchange control regulations to allow of cross-border transactions on their exchanges.

[5] Source: BSE Annual Capital Market Review, 2002-03

This approach was adopted to facilitate cross-listings on the Caribbean exchanges of Barbados, Jamaica and Trinidad & Tobago in the Caribbean (see Annex 6).

Recommendation
It is recommended that, as a first step in encouraging cross-border investment in the region, SAFE member exchanges apply the "recognition" principle by making provision in their listing rules for the listing of the equity securities of other "recognised" SAFE listed non-domestic companies on a "secondary listing" basis".

Regulatory co-operation between jurisdictions

It is clear that as regional capital markets develop in the SAFE region will require SAFE members and their regulatory authorities to assess whether they have reached a sufficient level of confidence in each other's regulatory regimes and processes. In addition to the adoption of the SAFE standards outlined above, regional regulatory co-operation at the securities commission level will also support the quality of the cross-border market.

Among the areas that are typically covered by such agreements and forums are information sharing, multiple approvals and filings, although the precise nature of the co-operative arrangements required will depend on the characteristics of the regional markets that emerges.

It should be noted that in 2002 IOSCO endorsed a Multilateral MOU concerning consultation, co-operation and exchange of information, following the work of a special project team which explored the actions that securities regulators need to take in order to improve in these areas. It provides IOSCO members with a unique instrument to help combat cross-border fraud and to enforces securities market regulations worldwide. In order to be a position to sign the MOU, IOSCO member regulators must be subject to a review of the potential legislative, regulatory and institutional obstacles that would prevent a full exchange of information between regulatory agencies. An extensive list of MOU's entered into by securities regulatory bodies internationally can be found at IOSCO's website (www.iosco.org/library).

Recommendation
Formulation and agreement of the SAFE listing harmonisation principles, mutual recognition processes and the development of listing regulations for secondary listings will necessarily involve SAFE exchanges engaging closely with their national securities regulatory bodies. It is submitted that, given the central importance of regulatory co-operation structures to regional market integration, SAFE should encourage the formation of a regional forum of the SAFE country's national securities regulatory authorities to promote co-ordination and co-operation among regulators.

Action plans

- **Establish a SAFE Regional Markets Committee:** SAFE should convene a Regional Market Committee (RMC) comprised of representatives from each of its members to oversee its policy development and efforts to promote regional capital market development, including implementation of the recommendations in this report. The recommendations should be formally considered and approved to become SAFE policies, in accordance with its constitution.

- **Prepare SAFE listing standards harmonisation principles:** The RMC's initial task would be to prepare a first draft of SAFE listing standards harmonisation principles, based on the information gathered through this project, for consultation, and later approval, of SAFE members.

- **Prepare model exchange listing regulations for "secondary listings":** The RMC should also oversee the drafting of model listing regulations for "secondary listings" in the form of an additional chapter for integration into the regulations of each SAFE exchange, to be forwarded to the SAFE exchanges to commence their development of secondary listing facilities for their market.

- **Launching regional Market Development Forums:** The RMC should also plan and develop a series of Market Development Forums in the SAFE region, to further explore the scope and nature of development of a regional capital market with the following interest groups:

    - listed issuers with commercial interests across the region
    - Institutional investor groups with a focus on investment within the SAFE region
    - private sector representative groups such as local , national, and regional Chambers of Commerce
    - representatives of sovereign governments and agencies, such as central banks
    - regional co-operation organisations such as SARRC and SAFTA
    - the legal and accounting professions
    - representative of major broker-dealers in SAFE exchanges.

PART 1 – INTRODUCTION, PROJECT METHODLOGY AND PRESENTATION OF THE REPORT

Introduction

This report has been prepared as part of a SAFE project on strengthening SAFE member's listing regimes and exploring the scope for greater harmonisation of listing standards. The aims of the project are to:

- Review the nature and operation of their listing regimes,
- Make recommendations on how these could be strengthened and improved, and
- Explore the scope for regional co-operation and harmonisation on listing matters.

SAFE membership comprises the 12 major stock exchanges in the following seven countries:

- Bangladesh
- Bhutan
- India
- Mauritius
- Nepal
- Pakistan, and
- Sri Lanka.

The project has been supported by FIRST Initiative (FIRST) (www.firstinitiative.org), an organisation that facilitates technical assistance for capacity building and policy development in the financial sectors of low and middle-income countries. FIRST is a joint initiative of the World Bank, the International Monetary Fund and a number of national development organisations[6], concerned with providing focused, expert development assistance.

The project's terms of reference (TOR) are set out in Annex 8. The TOR require a number of key project outputs as follows:

- Report on the current listing regimes in the SAFE member exchanges produced.
- Strengths and weaknesses in national listing regimes diagnosed and assimilated.
- An action plan for addressing weaknesses of each national regulatory regime prepared and agreed, and
- List of areas and topics requiring further exploration (e.g. impact of local laws, tax regimes, etc).

[6] From Canada, the Netherlands, Sweden, Switzerland and United Kingdom.

Project methodology

The project has been carried out using a three-stage methodology, as follows:

Project team

Given the aims of the project, the approach taken has been of a highly interactive and co-operative nature. The project has been conducted by a project team consisting of Mr. Gerry Ritchie, an international consultant, and a number of representatives of SAFE member exchanges:

> **Mr. Wali-ul-Maroof Matin**, Secretary General, SAFE and Chief Executive Officer, Chittagong Stock Exchange, Bangladesh (maroof@csebd.com)
>
> **Mr. Rana Naveed Ahmed**, Joint Secretary, Company Affairs Department, Lahore Stock Exchange, Pakistan (rananaveed@lahorestock.com)
>
> **Mr. Joseph Bosco**, National Stock Exchange of India (jbosco@nse.co.in), and
>
> **Ms. Sonia Hossain**, Deputy Manager, Legal Affairs, Chittagong Stock Exchange, Bangladesh (sonia@csebd.com).

Stage 1 - Questionnaire to SAFE exchanges

A key element of the project methodology has been the use of a questionnaire, issued to SAFE exchanges to make a self-assessment of their current listing regimes and to canvass their views on the scope for regional co-operation and harmonisation on listing matters. The Questionnaire is set out in Annex 1.

The Questionnaire was comprised of three parts as set out overleaf:

***Part 1 - The nature and operation of the listing regimes*:** Part 1 of the Questionnaire sought to obtain a clear description of the features of SAFE Member's current listing regimes, in order to achieve a clear picture of the listing standards and practices across the SAFE region. To provide a source of reference for the type of information requested, and act as an international benchmark for their listing regime, each feature was discussed in more depth in the detailed notes under the same headings that accompanied the Questionnaire (see Annex 4 - Features of listing regimes and market environments)..

Part 2 - SAFE Member's views on strengthening and improving their current listing regimes: Part 2 of the Questionnaire sought to obtain each SAFE member's views on the strengths, weaknesses and opportunities and threats of their current domestic listing regime.

Part 3 - SAFE member's views on regional harmonisation: Part 3 of the Questionnaire sought to obtain the views of SAFE members on the scope and nature of greater harmonisation of listing standards among SAFE exchanges, including their views on the key implementation challenges, such as legislative, regulatory and business barriers that may obstruct or effect co-operation and harmonisation initiatives. To assist respondents, introductory notes on the development of regional markets, the key benefits associated with them and the main implementation challenges were circulated with the Questionnaire.

Stage 2 - Analysis of the responses to the questionnaires and follow-up meetings

Analysis of the responses to the questionnaire was augmented by a series of short country visits by project team members to personally meet the representatives of the SAFE exchanges to review and finalise their exchange's responses to the Questionnaire, and to gain a deeper understanding of their views on the areas for strengthening their listing regimes and the scope for regional harmonisation.

In addition during each country visit meetings were held with the respective securities regulatory bodies (typically securities commissions) to discuss their national listing regimes and seek their preliminary views on the TOR.

Stage 3 - Findings and recommendations

The findings and recommendations on strengthening of each SAFE exchange's listing regime and the scope for regional co-operation and harmonisation on listing matters are set out in the report.

Use of the terms "listing" and "listing regime"

The term "listing regime" is used throughout the report to denote the circumstances and environment for the raising of equity capital directly from the public, where the securities of the issuer are also listed on regulated markets operated by stock exchanges. It also includes the wider legal and regulatory framework, the regulatory institutions responsible for corporate and listing regulation, and the detailed legislation, regulations and rules covering listing.

It should be emphasised that most countries permit public issue and distribution of securities without their necessarily being listed on an exchange. The listing decision is a voluntary and often complex one, depending upon a number of factors *inter alia:*

- the capital-raising needs of the company and the relative costs of raising equity finance, compared to alternative sources (e.g. bank loans)
- investor demand for the securities of the issuer, and
- the willingness of current owners to dilute their holdings through the introduction of a large number of public shareholders and their willingness to submit to the enhanced transparency and prescribed governance provisions, including specific provisions relating to protection of minority shareholders, which listing status entails.

The term "listing" is also used in a number of different contexts throughout the world. “Listing” is used to refer to the eligibility of securities for trading on a stock exchange which has been authorised for such activities by a regulatory authority, but also to distinguish “formal” exchange listing in accordance with detailed listing rules or regulations (usually confined to the top tier or “main” market of a particular exchange), from the public trading of securities which do not meet the formal criteria for listing and are traded “off-exchange” on OTC (Over-the-Counter Market) markets, or are “quoted” and traded on exchanges on an “unlisted” second or “junior” market.

The term “listing” however generally connotes a certain recognised level of corporate regulation and investor comfort, and the efficient and effective operation of the listing regime is an important ingredient in achieving market quality[7]. This is illustrated further in the discussion on principles of listing regulation and features of listing regimes.

Principles of listing regulation

The prime motive for listing the securities of companies on stock exchanges is to raise capital from public investors to fund business expansion and, as a result, create economic value. This means that the essential challenge for policy-setters and the regulatory authorities is to ensure that the listing regime allows sufficient access to the market for the issuers of securities while effectively protecting investors.

A listing regime should aim to embody the following operating principles:

- **Balancing market access and investor protection** by seeking to achieve an appropriate balance between providing issuers with access to the market at the earliest opportunity and providing investors with protection and sufficient and

[7] Other criteria for measuring quality of capital markets, adopted by the former Emerging Markets Sub-Committee of the World Federation of Exchanges (WFE) in 1996, were as follows:

- exchange trading automation
- clearing and settlement systems and procedures
- investor protection schemes
- information dissemination
- trading regulations
- listing procedures
- human resources
- degree of internationalisation
- securities legislation, and
- organisational structure.

timely information for the purpose of enabling them to make informed decisions as to the value and prospects of listed securities[8].

- **Suitability of applicants** for listing as evidenced *inter alia* by their size, demonstrable track record, their governance arrangements and public exposition of their business plans.

- **Proper information and processes are adhered to** ensure that the distribution and marketing of securities is conducted in a fair, open and orderly manner and that potential investors are given sufficient information to enable them to make a properly informed assessment of the applicant company, and of the securities for which listing is sought.

- **Ongoing disclosure is made by listed issuers** to ensure that investors and the public are kept fully informed, and in particular that immediate disclosure is made of any information that might reasonably be expected to have a material effect on securities market activity in, and the prices of, the securities.

- **Probity of corporate governance standards and behaviour** to ensure that all holders of listed securities are treated fairly and equally, and that directors of listed companies act in the interests of its shareholders as a whole, particularly where the public represents only a minority of the shareholders.

Features of listing regimes

The nature and effectiveness of a listing regime can only be properly assessed by examining its main features, summarised as follows:

- Principles of listing regulation
- Historical development, quality of markets and listing standards
- Legislative and regulatory framework for listing
- Institutional responsibilities for corporate and listing regulation
- Listing rules
- Use of advisers in the listing process and due diligence procedures
- Requirements for company eligibility for listing
- Market segments: differential regulation of markets and product types
- Sources of information at IPO, IPO document approval and listing application procedures
- Continuing Obligations – on-going disclosure requirements
- Corporate Governance provisions, and
- Compliance monitoring and enforcement mechanisms.

These elements have formed the basis for:

[8] For example, the United Kingdom Listing Authority (UKLA), operated by the Financial Services Authority (FSA), expresses its purpose as providing “a cost effective regime which facilitates access to capital markets by a broad range of businesses, and to operate that regime so as to maintain market confidence and to protect investors.”

- the Questionnaire sent to SAFE exchanges (see **Annex 1**), and
- the summaries of the listing regimes of the SAFE exchanges generated by the Questionnaire and set out in the self-assessment responses (see **Annex 2**), and
- a summary of the main features, international practices and trends in listing regulation, contained in "Features of listing regimes and market environments", which has been used as a source of reference for the type of information requested by the Questionnaire, and for international comparisons of best practice (see **Annex 4**).

Presentation of findings and recommendations

Findings and recommendations are presented as follows:

- ***Review of the nature and operation of their listing regimes*** - Summaries of the main features of the SAFE exchange's listing regimes, based on the responses to the Questionnaire, are set out in the individual exchange summaries in **Annex 2**

- ***Discussion of the strengthening of domestic listing regimes*** is set out in **Part 2** of the report and findings and recommendations, action plans and topics requiring further exploration on each domestic listing regime are set out in individual country summaries in **Annex 3**, and

- ***Regional co-operation and harmonisation on listing matters*** – A discussion of the scope for, and recommendations and action plans on harmonisation of listing regulations in the SAFE countries is set out in **Part 3** of the report.

Key comments and recommendations throughout the report are highlighted in the following format:

Recommendation
It is recommended that………………………………..etc,

PART 2 – STRENGTHENING OF SAFE EXCHANGE'S DOMESTIC LISTING REGIMES

Introduction

The project TOR require that a report on the current listing regimes of the SAFE member exchanges is produced and strengths and weaknesses in national listing regimes diagnosed and assimilated. This part of the report contains a summary of the project's findings on SAFE member's domestic listing regimes.

Specific findings and recommendations

Detailed findings and recommendations on the strengths and weaknesses of each of the individual SAFE exchange's listing regimes, including action plans and areas and topics requiring further exploration are set out under individual country sections in Annex 3 as follows:

- Note on scope of findings 52
- Annex 3.1 – Bangladesh 53
- Annex 3.2 – Bhutan 57
- Annex 3.3 – India 60
- Annex 3.4 – Mauritius 65
- Annex 3.5 – Nepal 70
- Annex 3.6 – Pakistan 73
- Annex 3.7 - Sri Lanka 80

In addition some common key policy issues and associated recommendations relevant to a number of SAFE exchanges are discussed in this part of the report.

The context of the recommendations on strengthening domestic listing regimes

Consideration of the nature and effectiveness of a listing regime must necessarily be assessed in the context of its market environment, how this has evolved and how policy-makers wish to see it develop. Setting regulatory standards for listing and developing them must therefore take into account the regime's historical and legislative origins, evolution of the market, its current characteristics and dimensions, as well as wider legal and socio-economic considerations.

The capital markets of the SAFE member's countries vary widely in their size, diversity and depth of market infrastructure, with implications for the scope and direction of development of their listing regimes domestically and regionally. These contrasts are illustrated in the following table, and some of the key factors generally effecting the development of listing standards in developing capital markets are set out in Annex 5 under the following headings:

- Levels of private sector support from issuers, investors, financial intermediaries
- The stage of development of the overall corporate sector
- Macro-economic conditions conducive to market development

- Supportive Government policies, and
- Legal and regulatory framework.

References to specific characteristics of the domestic capital markets of each SAFE country are set out in the self-assessments responses in **Annex 2.**

SAFE countries: relative sizes and extent of development of equity capital markets[9]

	SAFE member country	Bhutan	Bangladesh	India	Mauritius	Nepal	Pakistan	Sri Lanka
A	Country population (m)	0.782	136	1,000	1.2	26.8	150	19.7
	Year exchange first opened[10]	1993	1956	1875	1989	1994	1947	1985
B	Gross Domestic Product (USD Bn)	0.59	47.3	515	4.5	36	311	73.7
C	Market cap (official exchanges)[11] (USD Bn)	0.076	1.2	110	1.72	0.445	21.5	2.6
D	% Market Cap. Ratio (C/B)	12.8%	2.5%	21.3%[12]	38.2%	1.2%	14.5%	3.5%
E	Number of listed companies	15	237	9,644[13]	40	109	704	240
	Average market cap. (C/E) (USD m)	5.1	5.1	11.5	43	4.1	30.5	10.8
	% Institutional investors	0%	0%	17%	9%	Very low	Very low	40-60%
	% Foreign investors	0%	0%	13	5%	0%	2%	30%

[9] Statistics obtained from responses by SAFE exchanges to project questionnaires, attributed sources and other various sources.
[10] Where there is more than one exchange, date of the oldest is given.
[11] Based on the size of the largest exchange in that jurisdiction. Note: World Bank statistics state market capitalisation ratios as follows: High income countries = 120%; Middle income countries = 42%; South Asian countries = 27%; and low income countries as 23%
[12] NSE quote a figure of 32.2% for this measure.
[13] According to NSE statistics.

Some common policy issues relevant to a number of SAFE exchanges

Some key policy issues on listing regimes common to a number of the SAFE exchanges encountered through the project are:

- De-mutualised exchanges and listing regulation
- Growing the listed company sector - private sector development and improving market access, and
- Corporate governance in Asia.

The report contains some general conclusions and recommendations in respect to these common policy issues, as set out in the following paragraphs. It is emphasised however that these recommendations are general in nature and further detailed analysis is required within the context of the each domestic listing regime to find solutions tailored to local circumstances.

De-mutualised exchanges and listing regulation

A highly topical subject in regulation of capital markets is the challenge of dealing with conflicts of interest in the regulatory framework arising from the trend towards exchange demutualisation[14] and commercial operation of stock markets. In the SAFE region de-mutualisation has already taken place at the SEM in **Mauritius**, and is actively being considered in **India, Pakistan, and Sri Lanka**, In addition in **Nepal**, where the ownership of the NEPSE is shared between Government (Ministry of Finance responsibility), the Central Bank, Nepal Industrial Development Corporation and members of the exchange (who hold a very small stake), the Government is currently considering the privatisation and corporatisation of the exchange.

In the developed markets exchange demutualisation has mainly been driven by the increase in international competition among exchanges, which requires them to operate more efficiently and to have broader access to capital to finance investment in new technology. In the developing markets the benefits of demutualisation of exchanges is also increasingly being examined by policy-makers, who have observed that where broker-dealers are the sole owners and controllers of exchanges market development may be hindered.

The key regulatory issue arising from exchange demutualisation are the real and perceived conflicts of interests where a commercial exchange is also responsible for regulation of listed companies. The main concern is that the exchange may be less inclined to refuse listing applications, which are a direct source of income in the form of listing fees and securities transaction levies, and as a result less willing to commit the resources that rigorous self-enforcement would require.

[14] Demutualisation of a stock exchange is the process by which a non-profit member-owned mutual organisation is transformed into a for-profit shareholder corporation, and in some listed their securities on their own exchanges.

The Technical Committee of the International Organisation of Securities Commissions (IOSCO) has published an Issues Paper[15] on the subject of exchange demutualisation. The Paper observes that there is no single “right” regulatory path to follow in jurisdictions where stock exchanges demutualise and list their securities, and does not prescribe any solution that should be adopted, as that will depend on the particular market characteristics and circumstances.

Measures taken to address the conflicts of interest arising from an exchange’s roles as a regulator and as a commercial entity usually involve the setting up of a regulatory subsidiary under the exchange (Australia), the signing of an agreement between the exchange and the regulator to set out the procedure for handling conflicts (Singapore), or the transfer of the listing authority function to a new central listing authority within the the securities regulatory body (United Kingdom). In Hong Kong, were the mutually-owned securities exchange was demutualised, merged with the futures exchange and the clearing company to form HKEX in 2000, the decision that front-line listing regulation should continue to be discharged at exchange level has proven to a controversial one as illustrated in the following synopsis.

Synopsis

HONG KONG’S DEBATE ON LISTING REGULATION AND QUALITY OF ITS MARKET

In Hong Kong there is currently a concern that, notwithstanding the authorities stated objectives of strengthening the territory’s position as an international financial centre, the quality of new listings on the Hong Kong exchange (HKEX) has been seriously compromised. In Hong Kong very few of the initial public offerings (IPO) in recent years have:

- attracted interest from professional investors or international advisers
- achieved appreciable secondary market turnover
- had reasonable initial spreads of shareholdings among the minimum number of unassociated shareholders, or
- had an impressive post-listing performance.

Although these characteristics must necessarily be assessed within the context of the dramatic falls in market indices globally and deteriorating local economic conditions, there were 117 new listings on the HKEX in 2002, an increase of 33% over 2001, despite the 18% decline in the Hang Seng Index and a 17% decline in secondary market turnover. That period also saw a 36% decline in IPO’s globally and a net reduction in listed companies both in New York and London. At the end of February 2003, 60% of the 117 new listings were trading below their IPO price, some of them by more than 90%. Half were trading below HK$0.50 (US$0.06)[16].

In response to this situation the Hong Kong authorities are currently involved in reviewing various aspects of the listing regime, including initial and ongoing listing requirements, and institutional responsibility for the discharge of frontline listing regulation, currently discharged by HKEX, but proposed to be assumed by the Securities and Futures Commission (SFC).

Comment

It is clear that the impact of demutualisation by the SAFE exchanges which currently undertake front-line listing regulation needs to be carefully assessed, drawing on international experiences and local market conditions. International experiences indicate that continuance by demutualised “for-profit” exchanges of a major front-line role in listing regulation is not necessarily impossible, if the right combination of checks

[15] “Issues Paper on Exchange Demutualization: Report of the Technical Committee of the International Organisation of Securities Commissions”, June 2001.
[16] Report of the Expert Group on the Regulatory Structure, March 2003.

and balances are provided for in the overall listing regime to ensure that any conflicts of interest are properly addressed, but where multiple exchanges compete for market share the competitive pressures may well dictate the transfer of listing responsibilities to a centralised listing authority overseeing regulatory issues on suitability for listing approval and the enforcement of listing regulations.

Growing the listed company sector - private sector development and improving market access

The relatively small proportion of national economies represented by the equity market in SAFE countries (highlighted in the table earlier in this part of the report) is indicative of the need to adopt polices to raise awareness and use by the private sector of the capital markets, and in particular to explore innovative methods of providing access for companies to the market within the context of the particular economic conditions and stage of capital market development in each country.

Recommendations on policies aimed at growing the listed company sector and a specific type of market initiative, the creation of "junior" markets, are discussed further below.

Understanding the corporate sector's needs

In all the SAFE countries the exchanges and other key stakeholders in capital market development need to develop methods of gaining a greater understanding of the factors impacting companies decisions to list or raise further capital through the capital markets. This market research and intelligence gathering is essential to the formulation of relevant market development strategies. Central to these efforts are developing the exchange's professional market development expertise and consultation networks to gain a deeper understanding of:

- the dynamics of family-control of Asian businesses and how this may be effected by greater regional and global trade and the emergence of greater institutional ownership of equities in the region
- the terms on which other sources of business funding is available to companies in their countries (e.g. from the domestic banking sector) and internationally (e.g. through overseas listings of GDR programs)
- the impact of listing compliance costs on issuer's long term cost of capital, and how these costs are perceived by issuers, and
- the trends in private sector development in their countries and the likely long-term capital needs across the profile of their domestic industries.

Collaboration on raising awareness of the capital markets

Specific work by the exchanges on understanding companies needs should be underpinned by collaborative efforts with Government, other agencies and private sector representative groups to raise general awareness of the capital market as a capital-raising avenue for companies, and as provider of investment options for citizens, and to encourage an "enabling environment" for capital market development. SAFE exchanges should therefore seek opportunities to partner and consult with the following groups to

ensure that they are able to factor in the needs and considerations of other stakeholders in capital market development into their strategic polices and market development initiatives, and to be able to influence the policies of these stakeholders.

Key stakeholders include:
- Private and listed companies and their representative groups
- Investor groups, particularly those representing domestic institutional investors (e.g. an Investment Management Association)
- Financial intermediaries and their representative organisdations
- Government departments with responsibilities for encouraging business enterprises and economic management
- Other private sector representative groups such as Chambers of Commerce
- Educational establishments (e.g. schools and universities)
- Media outlets, including TV, radio, financial websites and newspapers.

Encouraging "Market-facing" listing operations

SAFE exchanges are encouraged to develop "market-facing" listing operations which, while focusing primarily on their regulatory responsibilities, also work in close co-operation with financial intermediaries (such as exchange sponsor members and issue managers) and other professionals (such as reporting accountants and lawyers) to develop joint marketing initiatives targeting the corporate sector. An example of a practical and readily achievable aim of all the SAFE exchanges should be to make widely available hardcopy and website materials which comprehensively describe the listing process to potential applicant companies, and describe their compliance responsibilities after listing.

General recommendations on growing the listed company sectors in SAFE countries
Growing the listed company sector is a major challenge for all of the SAFE countries. The SAFE exchanges and other key stakeholders in capital market development therefore should **develop methods of gaining a greater understanding of the factors impacting companies decisions to list** or raise further capital through the capital markets. This market research and intelligence-gathering is essential to the formulation of relevant market development strategies. Central to these efforts are developing the exchange's professional market development expertise and consultation networks to gain a deeper understanding of companies financing alternatives and perceptions of the capital market. This work should be underpinned by **collaborative efforts to raise general awareness of the capital market as a capital-raising avenue for companies**, and as provider of investment options for citizens, and to encourage a favourable "enabling environment" for capital market development. SAFE exchanges should therefore seek opportunities to partner and consult with relevant stakeholder groups to ensure that they are able to factor in the needs and considerations of these stakeholders in capital market development into exchange strategic polices and market development initiatives, and to be able to influence the policies of these parties which impact development of the listed company sector.

SAFE exchanges are also encouraged to **develop "market-facing" listing operations**, by becoming more receptive to working in close co-operation with the financial intermediaries (such as exchange sponsor members and issue managers) and other professionals (such as reporting accountants and lawyers) to develop joint marketing initiatives targeting the corporate sector.

Development of "junior" markets – key considerations

"Junior" markets, also known as "second boards" and "growth markets", have generally been established by exchanges to cater for the capital-raising needs of smaller or recently-formed companies, and are characterised, in particular, by having less onerous track record and other initial listing eligibility criteria (e.g size measured by expected market capitalisation or asset value), in an attempt to lessen the capital-raising and compliance cost burdens on smaller companies. Given these characteristics the development of such markets would appear to be a logical proposition in developing countries, where private sectors are under-developed and the need to promote entrepreneurialism and business growth are obvious.

The widespread development of junior markets internationally in the late 1990's saw the emergence of markets in many countries, including UK, Germany France, Hong Kong, Taiwan, and Malaysia. A recent study[17] noted that there are currently 22 such markets or market segments in Europe alone. However the experience of second market development internationally in recent years suggests care is needed in applying alternative models to new situations, as they have been designed in the context of the business and regulatory framework in their jurisdiction, generally tend to cater for domestic investors, and to be complementary to the role and nature of the main market in each jurisdiction. In addition assessment of the perceived success of second market development needs to be cognisant of the fundamental purpose of establishing the market. For example, is its primary objective to act as a "nursery" to assist fledgling companies to "graduate" to the more extensive exposure of the main board, or to develop unique characteristics of a distinct market in its own right?

Achieving the appropriate regulatory balance between providing issuers with access to the market and investor protection in the design of a second market presents additional challenges to exchanges and their regulatory authorities due to the higher business risk typically associated with smaller and more newly established companies and the lesser abilities of those companies to afford the costs of raising capital and additional compliance costs. Perhaps due to their focus on younger and growing companies, the life-cycle of seconds markets tends to be aligned more directly to economic cycles, with the result that their performances tend to exhibit an exaggerated picture. This can be observed in the experiences of many of the European new markets established in the late 1990's, where observers see closures and consolidations as increasingly inevitable[18] - the closure by Deutsche Borse's of its Neur Markt in September 2002 has become synonymous with the technology market boom and bust.

[17] By Grant Thornton (see below).

[18] The head of Grant Thornton's capital markets practice was reported in The Financial News (UK) in May, 2003 as predicting that a quarter of growth markets worldwide after launching during the 1999-2000 market boom, but failing to attract sufficient business.

A particular difficulty experienced by some of the second markets is that many of the listed companies on the existing or main board are of a small size, reducing the scope for a differentiated new market to be developed. In such cases it might be considered useful to develop a new junior market through re-trenchment of the existing market by hiving-off certain categories of existing listed companies into the new second board (e.g. based on a size threshold) and also recruiting new entrants to a regulated market from stocks traded on an existing OTC market segment.

Recommendation

In SAFE countries the design or re-trenchment of second markets is a "live" issue in **Sri Lanka, India, Pakistan, and Mauritius**. Given the experiences of second market development elsewhere, it is recommended that the SAFE exchanges considering establishing a junior market first conduct a thorough analysis of the market and business context, and carefully design the market structure to reflect these. In particular, feasibilty studies should examine the potential supply of companies, and the preferences of investors, particularly the views of venture capital providers and domestic institutional investors. Market design should be comprehensive with maximum possible engagement with potential market users on market design. Key areas for analysis are set out below.

Key areas for analysis include:

- Clarity of objectives of the market
- Legal framework for the market (e.g. amendments to securities legislation)
- Governance/management of the second market
- "Stepping stone" considerations (e.g. is the second board to form a nursery for companies to graduate to the main board?)
- Financing the market development
- Types of issuers anticipated
- Re-structuring of markets (e.g. incorporation of an existing market segment into the new market?)
- Market infrastructure/ trading mechanisms
- Extent of use of main market facilities
- Investor profiles anticipated
- Issuer's cost of capital
- Regulatory arrangements

- Market surveillance arrangements
- Listing and continuing obligations requirements
- Comparison with main board board listing requirements
- Role of Sponsors/ specialist advisers
- Investor protection features
- Takeover and merger requirements
- Disclosure of interest requirements.

Corporate Governance issues in Asia

An increasing focus on corporate governance standards has been a marked recent trend in international capital markets, driven by the corporate crises in the US and also by globalisation. As a result corporate governance policy has been high on the agendas of multilateral organisations such as the OECD[19], IMF and the World Bank, and the national regulatory authorities in most countries in recent years. The Asian Roundtable on Corporate Governance[20], which serves as a regional forum under the OECD corporate governance initiative, published a policy document in June 2003 containing region-specific guidance and suggestions to assist policymakers, regulators (including stock exchanges), and other standard-setting bodies in non-OECD countries of the Asian region. Of the SAFE countries, the report includes consideration of corporate governance in **Bangladesh, India, and Pakistan.**

The White Paper sets out six priorities for reform in Asia, as follows:

- Public and private sector institutions should continue to raise awareness among companies, directors, shareholders, and other interested parties of the value of good corporate governance.
- All jurisdictions should strive for effective implementation and enforcement of corporate governance laws and regulations.
- Asian Roundtable countries should work towards full convergence with international standards and practices for accounting, audit, and non-financial disclosure. Where full convergence is not possible, financial statements should disclose divergences from international standards and practices, and the reasons for these divergences.
- Boards of directors must improve their participation in strategic planning, monitoring of internal control systems and independent review of transactions involving managers, controlling shareholders and other insiders.
- Policymakers should ensure that non-controlling shareholders are protected from exploitation by insiders and controlling shareholders.

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[19] The OECD Principles of Corporate Governance, May 1999.
[20] The Roundtable comprises senior policymakers, regulators, and representatives of stock exchanges, private sector bodies, multilateral organisations, and non-governmental institutions.

- Governments should intensify their efforts to improve bank regulation and corporate governance.

Recommendation
Corporate governance standards are imposed and influenced through a variety of means, by company and securities laws, listing regulation, codes of practice, shareholder activism, and in some cases by a mixture of these methods. Listing regimes therefore play an important role in setting and applying standards of corporate governance for listed issuers, and all SAFE exchanges are recommended to study the findings and recommendations set out in the White Paper as part of the ongoing development of their listing regimes.

PART 3 – HARMONISATION OF LISTING REGULATIONS IN THE SAFE REGION

Introduction

The project TOR require that action plans are drawn up to harmonise the listing regulations of the SAFE region, and that these are discussed with SAFE members and other interested parties. Part 3 and Annex 6 (Examples of regional market integration initiatives) of this report discuss the rationale for harmonisation of listing regulations in the SAFE region, provide examples of regional market development and harmonisation initiatives internationally, discuss the benefits and implementation hurdles faced in establishing regional capital markets, and make recommendations on the way forward for SAFE in respect to promotion of harmonisation of listing regulations and regional capital market development in the SAFE region.

Rationale for harmonisation of listing regulations and regional capital market initiatives

Harmonisation of listing regulations across its constituent member's listing regimes is an important objective of SAFE for compelling reasons. Competition is effecting how exchanges organise themselves and is forcing them to look beyond their domestic horizons, and to develop more appropriate ownership structures, new products and to seek wider customer bases.

In particular the key drivers for a regional dimension in exchange strategies are:

- **Investors and companies widening perspectives:** Cross-border ownership is growing worldwide and developments in technology and increasingly global markets mean that greater number of investors are trading on exchanges outside their "home" jurisdictions. Stronger companies may prefer to list, directly or through depositary receipt programs[21], outside their home jurisdiction on a more established stock exchange
- **Technological development:** Technology is blurring the lines between competitors, customers and marketplaces, and
- **Increasing competition between trading platforms:** New market players, such as alternative trading systems (ATS's and ECN's), are competing with established exchanges in the developed markets and dealers are competing with exchanges for liquidity through off-exchange trading mechanisms.

How regional capital markets have emerged internationally

Regional markets are often characterised as being formed by the integration of some or all the aspects of national constituent markets, whereby securities may be traded across a number of markets in a region, investors can buy securities in the region without restriction, and financial intermediaries can offer their services across national boundaries. Although regional market development initiatives often connote co-operation between market operators (e.g. through stock exchange trading platform linkages) and

[21] For example, 131 Indian GDR/ADRs are listed in London and New York.

regulatory co-operation arrangements between jurisdictions (e.g. through MOU arrangements), there have been instances of market development through competition between exchanges, such as the London Stock Exchange's international equities market (IEM) and the Hong Kong exchange's "H" share market catering for mainland Chinese companies. Other examples of development projects to encourage and facilitate the emergence of regional markets are currently being promoted and facilitated by economic communities, such as the Southern African Development Community and the Eastern African Community.

Harmonisation of listing regulations is one component of co-operative initiatives to facilitate regional market development, along with other types of regulatory and infrastructural development, such as those to address information dissemination (both corporate disclosure and trading information), order routing, trading systems linkages, and settlement and clearing arrangements.

Examples of regional market development and harmonisation initiatives internationally are set out in Annex 6.

Benefits of establishing regional capital markets

Based on review of regional capital market initiatives internationally, the main benefits usually expressed for establishing a regional capital markets are to:

- **Boost investment in the region**: increase the attractiveness of the region as an area for investment and to stimulate increased economic growth and development
- **Increase capital-raising opportunities:** allow companies to tap a greater pool of investment in the form of equity capital and to obtain better prices for the sale of their shares
- **Regional competitiveness:** compete against overseas investment markets which offer investors diversification, liquidity, greater efficiency and a wider choice of investment products
- **Create a better market stock market:** achieve a larger and more liquid stock market with better opportunities for wealth creation for investors, and
- **Improve investor choice of financial advice and options**: provide investors with a wider range and improved quality of analysis and reporting of stocks by investment analysts and stockbrokers.

Implementation challenges

However the cross-border nature of regional market developments tend to present major implementation challenges, such as:

- **the relative size and, and longevity of each of the participant markets** e.g. the participant countries may have very different sizes and capacities of capital markets, and be at different stages of development e.g. higher liquidity, a greater number and size of listed companies, and more institutional investors.
- **differing national strategic aims for capital market development** e.g. a focus on increasing domestic liquidity may be paramount rather than encouraging greater inward international investment.

- **the presence of exchange controls and restrictions on inward investment in developing countries**, present major structural impediments to companies being readily cross-listed or traded other than on their "home" exchange**.**
- successfully implementing effective, standardised **regulatory oversight through a central regulatory agency or through regulatory co-operation arrangements**
- **harmonising adoption of international accounting standards**, to allow investors to be able to easily compare financial performances of companies from different territories
- **harmonising taxation policies, company legislation, disclosure standards and listing requirements**
- **co-ordinating securities settlement systems,**
- **agreeing ownership and co-operation structures for the market operation**, for example, where exchange merger is being considered, fast-tracking of the demutualisation of those exchanges not yet shareholder-owned, and
- agreeing on **the adoption of a common currency for securities trading and reporting.**

Regional capital market integration - the EU experience

Creation of a single market[22] in financial services is an important long-standing EU objective of an internal market which ensures the free movement of people, goods, services and capital. Experience of regional capital market development within the EU provides lessons of the difficulties and the implementation challenges and the benefits of regionalisation, and in particular the importance of regulatory frameworks in facilitating a cross-border markets.

In the EU, directives enacted by the European parliament provide the over-arching framework for the listing regimes and other securities regulatory provisions of member states. To date, EU policy has been to set core minimum standards including allowing for derogation on certain stipulated grounds, and not therefore to provide prescriptive requirements as to how individual member states should implement the standards. This has left substantial freedom for individual member countries to set additional listing requirements. However, the introduction of the Euro as the common currency in most EU member countries has forced changes in restrictions previously in place on foreign investments for entities in many member states and led to an increase in the volume of cross-border capital flows. The incidence of international mergers and acquisitions has also increased, and this has led to an increasing demand for standardisation and simplification of listing regulations and procedures.

These factors, and the EU's overall strategic objective of implementing a single market in Europe for financial services, has led to an intensification of efforts to achieve a more fully integrated capital market within the EU. In order to expedite its reform programme, with the ambition to complete this by 2005, the EU has adopted the Lamfalussy

[22] "A single market in financial services means that a financial services provider authorised to provide financial services in one Member State is able to offer the same services throughout the EU competing on an equal basis within a regulatory framework that is consistent across the Union. On the other side, the consumer would have access to a wider range of more competitively priced products and would be able to shop around with confidence and safety in the market place." Source: Select Committee on European Union, The United Kingdom Parliament, 2003.

approach to legislative change, which involves the casting of European Union Directives in broad terms, and allowing a committee of national supervisory authorities to fill in, and amend, the details, with the aim of being able to react faster and more flexibly to market changes, than the cumbersome process of constructing new directives.

SAFE's role in promoting regional market development within the SAFE region

The responses of the SAFE exchanges to Part 3 of the Questionnaire, set out in the exchange's response documents in Annex 2 and also collectively in Annex 9, indicate general support for the concept of regional co-operation and efforts to harmonise listing regulations.

In addition preliminary discussions with a number of the national securities regulatory bodies in the SAFE countries have indicated broad support for developing regional regulatory co-operation networks to address regulatory issues that would arise from cross-border listing and trading arrangements.

A key assumption of this project is that regional capital market development will be facilitated by co-operative arrangements between the market and regulatory institutions in SAFE countries. It is important to emphasise that this should not in any way preclude competition between all types of market participants, including stock exchanges, and that the need for a focus on co-operation arises form the need to alleviate the regulatory barriers and implementation hurdles.

In contrast to other co-operative initiatives internationally, such as those in southern and eastern Africa and the Caribbean, which have been undertaken under the auspices of a supra-national body, drawing its authority from international treaties between sovereign governments, the current SAFE initiative is being promoted by a voluntary association of stock exchanges, each of which is subject to its own peculiar circumstances. Despite the indications of support form the SAFE exchanges for harmonisation of listing regulations, a wider consensus for developing harmonisation into a deeper form of regional capital market integration in South Asia is not yet clear, as the current project has not tested the degree of interest and enthusiasm among sovereign governments, or private sector-issuers, major domestic investors in the SAFE countries or international investors and capital market intermediaries. In particular, concerns may emerge that a regionally-focussed market may drain liquidity from some of the smaller and weaker markets and that certain interest groups, such as broker-dealers who have control of the exchanges in some markets, may oppose reforms because they perceive the costs of regional integration to be higher than the potential benefits.

Experience of capital market development has shown that the impetus for growth must necessarily come from the private sector – companies, financial intermediaries and investors - although regulatory co-operation structures are also an essential feature underpinning integration.

These considerations mean that if SAFE is to succeed in promoting greater regionalisation of capital markets its action plans need to encompass engagement with other stakeholders and development partners to address the range of implementation hurdles faced, namely:

- Private sector issuer and investment groups domestically and internationally, such national and regional Chambers of Commerce, and international institutional investment groups
- Sovereign governments
- Regulatory authorities (such as national securities commissions) responsible for capital market regulation and development
- Central Banks and other authorities responsible for exchange control regulation

Recommendation
In addition to encouraging its member exchanges to strengthen and harmonise their listing regulations as set out in this report, it is recommended that as part of a planned programme of promoting understanding of the scope for regional capital market development SAFE should develop a series of Market Development Forums in the SAFE region, to further explore the scope and nature of development of a regional capital market with the following interest groups: o major listed companies with commercial interests across the region o Institutional investor groups with a focus on investment within the SAFE region o private sector representative groups such as local, national, and regional Chambers of Commerce o representatives of sovereign governments and agencies, such as central banks o regional co-operation organisations such as SARRC and SAFTA o the legal and accounting professions o representative of major broker-dealers in SAFE exchanges.

Reasons for promoting harmonisation of listing regulations in the SAFE region

This report concludes that SAFE should continue to promote harmonisation of listing regulations in the SAFE region, both to improve the quality of its domestic constituent markets, and also to contribute to efforts for the development of regional capital markets. In particular these efforts will:

- **Improve market quality**: Improve the overall quality of the domestic capital markets operated by SAFE members by providing benchmarks for listing standards and information and knowledge-sharing opportunities amongst its member exchanges and thus encourage greater capital formation and investment opportunities within those countries.

- **Encourage greater intra-regional cross-border investment in the SAFE region:** Encourage greater investment by regional investors in the SAFE region through the greater exposure afforded by regional cross-listings.

- **Encourage more investment by FII's:** Encourage greater investment by overseas institutional investors in the economies of the SAFE member countries by encouraging adherence to international standards of listing regulations such

as those espoused by IOSCO, overseas regulatory authorities and guidelines issued by industry representative bodies.[23].

- **Provide groundwork for regional investments trading initiatives:** Develop the ground for wider regional capital markets development initiatives that ultimately could allow free trading of investments across the region as economies continue to liberalise.

- **Take advantage of the commonality of legal traditions and heritage between SAFE countries**. All the SAFE countries have the same official legal language (English) and should draw upon this to help in the ongoing process of shaping a legal and regulatory foundation for harmonisation and co-operative arrangements between SAFE exchanges.

Recommendations on listing harmonisation in the SAFE region

This project has taken the first steps in assessing the comparative position on the various aspects of legislation and regulation relating to the listing regimes of the seven SAFE countries, as a basis for exploring the scope for their harmonisation. Through the questionanaire and response process detailed pictures of the listing regulatory frameworks and market development priorities have been drawn up and shared among SAFE members.

However achieving full harmonisation[24] of listing regulations is not currently a realistic expectation in the SAFE region, especially given the absence of a supra-national economic and legislative body (such as the European Union). In addition, even if a model was to be developed this would be a difficult and time-consuming exercise, and once achieved would require constant maintenance given that legal systems in separate sovereign states are dynamic and continue to evolve over time.

As an alternative to the full harmonisation of regulations therefore, it is recommended that SAFE, drawing on the information gathered on its member's listing regimes through this project, adopts a three-pronged approach to improving listing regulations within the SAFE region by:

- **Developing a set of SAFE listing harmonisation principles**, to act as benchmark for the setting of listing standards by its member exchanges

- **Encouraging mutual recognition of the listing regimes on a bi-lateral basis amongst its members**

- As a first step in applying the "recognition" principle, by encouraging its members to **make provision in their listing rules for the listing of the equity securities of other "recognised" SAFE listed non-domestic companies on a "secondary listing"** basis".

These recommendations are discussed in the following paragraphs.

[23] Such as the Institute of International Finance (IIF).
[24] "Full" harmonisation would entail the development of identical regulations and regulatory processes in each of the listing regimes.

Recommendation 1 - Developing a set of SAFE listing harmonisation principles

Recommendation
It is recommended that SAFE develops a set of listing harmonisation principles. The first draft of the SAFE listing standards harmonisation principles could be developed by drawing upon the approach to listing regulations harmonisation adopted by Southern Africa Development Community (SADC) (see Annex 7), drawing upon the information on the SAFE exchanges listing regimes set out in this report. This would then be subject to a process of consultation with the SAFE exchanges and formal adoption by the SAFE.

The benchmarking of listing regimes utilising the SAFE harmonisation principles would provide support for encouraging mutual recognition between SAFE exchanges, as a basis for allowing cross-listings, as well as encouraging the strengthening of the listing regimes in line with internationally accepted standards.

Recommendation 2 - Mutual recognition of listing regimes amongst SAFE members

Mutual recognition occurs when a jurisdiction or regulatory organisation "recognises" compliance with the regulatory regime in another as sufficient to constitute compliance its own territory.

Although mutual recognition in the context of listing regimes does require a certain degree of harmonisation between regulatory regimes, the underlying regulatory regimes and institutions only need to be comparable but not necessarily identical. International examples demonstrate that disparities may be addressed by the imposition of additional listing obligations by the exchange through specific listing agreements entered into between an exchange and a listed company, and through regulatory co-operation arrangements between exchanges and securities regulatory bodies.

The concept of "recognition" of the listing regimes has been utilised widely by exchanges in capital market development to facilitate "secondary listings" and "trading-only" markets in international securities, most notably by the London Stock Exchange. Other examples of mutual recognition are the European Union's listing directives and for public offerings, and the multi-jurisdictional disclosure arrangements between the United States and Canada with respect to public offerings of securities. It is anticipated that the assessment of other exchanges within SAFE for recognition purposes is most likely to be prompted by the application for listing by a non-domestic company on a SAFE exchange, possibly on a "secondary listing" basis (see also Recommendation 3 below). The recognition process would involve the SAFE exchange and its securities regulatory body (securities commission) assessing the listing and regulatory regime in place in the centre of "primary" listing to ensure that domestic investors are afforded a suitable level of protection, leading to the designation of the exchange of primary listing as being "recognised" by the SAFE exchange.

Recommendation
It is recommended that SAFE adopts a policy of encouraging mutual recognition of listing regimes among its constituent members (underpinned by the establishment of SAFE listing standards harmonisation principles), as the next step in SAFE's efforts to promote a regional dimension to capital markets in its region.

Recommendation 3 - Providing listing facilities for "secondary listings" within SAFE

"Secondary listings" are where a company is listed on an exchange outside its home jurisdiction, on the basis of recognition by the foreign stock exchange of its "primary listing". By providing for secondary listings SAFE exchanges would effectively broaden the investment options of their domestic investors to the securities of regional and international companies which choose to list in their jurisdiction, and thus take an initial step towards extending their market internationally.

Usual reasons for companies seeking secondary listings are to raise additional capital from foreign investors, broaden securities analyst's coverage, enable employees not employed in the country of origin to invest in the company through incentive share schemes, and for strategic commercial reasons such as increasing visibility and product brand awareness. From SAFE countries, some 131 Indian and 3 Pakistani companies have obtained listings of their securities in London and New York through depository receipt programmes, principally to raise additional capital from international investors.

Given the existence of currency exchange controls in many SAFE countries, SAFE exchanges may have to lobby and persuade their governments to relax exchange control regulations to allow of cross-border transactions on their exchanges. This approach was adopted to facilitate cross-listings on the Caribbean exchanges of Barbados, Jamaica and Trinidad & Tobago in the Caribbean (see Annex 6).

Recommendation
It is recommended that, as a first step in encouraging cross-border investment in the region, SAFE member exchanges apply the "recognition" principle by making provision in their listing rules for the listing of the equity securities of other "recognised" SAFE listed non-domestic companies on a "secondary listing" basis".

Regulatory co-operation between jurisdictions

It is clear that as regional capital markets develop SAFE members and their regulatory authorities will need to increasingly assess whether they have reached a sufficient level of confidence in each other's regulatory regimes and processes to permit cross-border securities listing and trading. In addition to the adoption of the SAFE standards outlined above, regional regulatory co-operation at the securities commission level will also support the quality of the cross-border market.

Among the areas that are typically covered by such agreements and forums are information sharing, multiple approvals and filings, although the precise nature of the co-operation arrangements required will depend on the characteristics of the the regional market that develop in the SAFE region. An extensive list of MOU's entered into by securities regulatory bodies internationally can be found at IOSCO's website (www.iosco.org/library).

It should be noted that in 2002 IOSCO endorsed a Multilateral MOU concerning consultation, co-operation and exchange of information, following the work of a special project team which explored the actions of securities regulators need to take in order to improve in these areas. It provides IOSCO members with a unique instrument to help combat cross-border fraud and to enforces securities market regulations worldwide. In order to be a position to sign the MOU, IOSCO member regulators must be subject to a review of the potential legislative, regulatory and institutional obstacles that would prevent a full exchange of information between regulatory agencies.

Recommendation
Formulation and agreement of the SAFE listing harmonisation principles, mutual recognition processes and the development of listing regulations for secondary listings will necessarily involve SAFE exchanges engaging closely with their national securities regulatory bodies. It is submitted that, given the central importance of regulatory co-operation structures to regional market integration, SAFE should encourage the formation of a regional forum of the SAFE country's national securities regulatory authorities to promote co-ordination and co-operation among regulators.

Action plans

- **Establish a SAFE Regional Markets Committee:** SAFE should convene a Regional Market Committee (RMC) comprised of representatives from each of its members to oversee its policy development and efforts to promote regional capital market development, including implementation of the recommendations in this report. The recommendations should be formally considered and approved to become SAFE policies, in accordance with its constitution.

- **Prepare SAFE listing standards harmonisation principles:** The RMC's initial task would be to prepare a first draft of SAFE listing standards harmonisation principles, based on the information gathered through this project, for consultation, and later approval, of SAFE members.

- **Prepare model exchange listing regulations for "secondary listings":** The RMC should also oversee the drafting of model listing regulations for "secondary listings" in the form of an additional chapter for integration into the regulations of each SAFE exchange, to be forwarded to the SAFE exchanges to commence their development of secondary listing facilities for their market.

- **Launching regional Market Development Forums:** The RMC should also plan and develop a series of Market Development Forums in the SAFE region, to further explore the scope and nature of development of a regional capital market with the following interest groups:

    - listed issuers with commercial interests across the region
    - Institutional investor groups with a focus on investment within the SAFE region
    - private sector representative groups such as local , national, and regional Chambers of Commerce
    - representatives of sovereign governments and agencies, such as central banks
    - regional co-operation organisations such as SARRC and SAFTA
    - the legal and accounting professions
    - representative of major broker-dealers in SAFE exchanges.

Annex 1 – Questionnaire

Important notes for respondents

- *Submissions should be sent by e-mail to the* ***SAFE Secretariat (info@safe-asia.com)*** *and copied to* ***Mr. Gerry Ritchie***(gritchie@grconsult.co.uk) *by* ***no later than 30 June, 2003.***

- *Respondents should carefully review the overall document of which this annex forms part, to ensure they fully understand the purpose and context of this questionnaire, and in particular the Terms of Reference for the project set out in* ***Annex 2*** *If you have any questions on what is required please contact the member of the Project Team who has been allocated to you (see above) or* ***Mr. Gerry Ritchie*** (gritchie@grconsult.co.uk).

- *Please supply written responses to each of questions on your exchange and jurisdiction set out in the questionnaire. When supplying your answer please indicate clearly by cross-referencing to the number of the question in the questionnaire e.g. Q2.1 is "Briefly describe the history and development of stock markets and listing of companies on your exchange". If the answer to a specific question please explain why this is the case.*

- *The questionnaire has generally been framed to gather information on the listing regimes for equity securities. Where information is sought on the listing requirements for other types of securities, this is specified.*

- *When answering please make specific reference to sources of information (e.g. pieces of legislation, regulations, rules or other documents). In cases where documents are accessible through websites, include URL references (e.g. securities commission, stock exchange's websites).*

No.	QUESTION
	Part 1 – Information on the nature and operation of the listing regime
1.	PRINCIPLES OF LISTING REGULATION
	Give an overall indication of the main characteristics of your listing regime.
2.	HISTORICAL DEVELOPMENT, QUALITY OF MARKETS AND LISTING STANDARDS
	1. Briefly describe the history and development of stock markets and listing of companies on your exchange. 2. Is your exchange the only official (regulated) securities exchange in your country? 3. If there are also other regulated exchanges, what is their relationship with your exchange e.g. do the exchanges compete for listings, and if so what form does the competition take e.g. lower fees, differential regulations etc ? Is there cross-listing / trading between the exchanges? 4. Provide statistical information on the profile of your market, including: ▪ the dimensions of the listed market e.g. number of companies, market capitalistion, breakdown between domestic and foreign companies (if applicable), sizes of company, industry type etc. ▪ the investor profile e.g. domestic and international institutional investors, retail investors etc. ▪ listing of domestic companies overseas (equity and depository receipt form) ▪ market performance and liquidity.

3.	LEGISLATIVE AND REGULATORY FRAMEWORK FOR LISTING
	1. Describe the legislative and regulatory context for regulation of public companies and exchange listing in your jurisdiction/ exchange. For example, is regulation provided for by company law, securities law and regulations, exchange listing rules, or a combination of these? 2. Summarise the main regulatory provisions relating to corporate and listing regulation.
4.	INSTITUTIONAL RESPONSIBILITIES FOR CORPORATE AND LISTING REGULATION
	1. Outline the responsibilities and roles in listing regulation of government departments, securities regulatory bodies (e.g., SEC) and/or the stock exchanges respectively. 2. Provide details of how regulatory responsibilities are discharged by the Exchange and how they are regulated by government or securities commission e.g. requirements for licensing and supervision of the Exchange. 3. Describe the arrangements for the delegations from the Exchange's Board (or governing body) for the discharge of its regulatory functions e.g. to a Listing Committee, or through delegation to executive staff, or a mixture of both ? 4. What is the ownership and governance model of your exchange, and how does this impact the Exchange's discharge of its regulatory functions? 5. Are there any plans to alter the ownership and governance structure e.g. by de-mutualising or broadening ownership of the Exchange?
5.	LISTING RULES
	1. Summarise briefly the main areas of coverage of your exchange's listing rules *(please note later questions will require further detail on specific aspects).*

6.	USE OF ADVISERS IN THE LISTING PROCESS AND DUE DILIGENCE PROCEDURES
	1. Describe the roles of the following financial and professional advisers in the listing process: – sponsors (see also 2. below) – corporate finance advisers – lawyers – accountants and auditors, and – valuers and other industry experts. 2. Does your exchange/ securities regulator require the appointment of sponsors (i.e. specialist the financial intermediaries such as investment bankers, that advise the issuers or underwrite the issues coming to the market) for initial listing and/ or ongoing listing? 3. If sponsors are required, what are their regulatory status, responsibilities and functions? 4. Describe the due diligence practices carried out for IPO's, and how they have developed.

7.	REQUIREMENTS FOR ELIGIBILITY/SUITABILITY FOR LISTING, MARKET SEGMENTS AND DIFFERENTIAL REGULATION OF MARKETS AND PRODUCT TYPES

1. Summarise the main qualitative and quantitative eligibility criteria for initial listing contained in your listing rules. Examples are:

   - ***Size***: minimum size of applicants in terms of net assets, shareholder equity or (expected) market capitalisation
   - ***Operating history:*** minimum period of existence and/or operating history
   - ***Audited financial track record:*** Existence of audited financial statements for the track record period to recognised accounting standards (e.g. GAAP/GAAS or IAS)
   - ***Profits history:*** minimum profit levels during that period
   - ***Sufficiency of working capital:*** working capital adequacy verification and disclosure
   - ***Minimum public float:*** minimum percentage or amount of shares to be held by public (non-associated) shareholders post IPO (e.g. 25%[25])
   - ***Placement and spread of shareholder base:*** minimum numbers of public shareholders
   - ***Capability of directors and non-executive directors:*** Requirements on experience of directors, their longevity with the company and presence of non-executive directors.

2. Are there explicit de-listing/ cancellation of listing criteria, and, if so, what are the procedures for de-listing?

3. Is differential regulation applied to market segments or product types e.g. is there a second market (also sometime called second board or development companies market) or other types of securities listed (e.g. debt securities)?

4. If so, please supply details of the regulatory standards and listing procedures applied to each separate market and product type.

5. Are differential regulatory requirement applied to any specialist types of issuers (e.g. property or technology companies)?

[25] Minimum threshold set by European Union directives.

9. SOURCES OF INFORMATION AT INITIAL PUBLIC OFFERING/ LISTING, IPO DOCUMENT APPROVAL AND LISTING APPLICATION PROCEDURES

1. **Prospectus and registration requirements**: Summarise the requirements from company law, securities law or other regulations and rules for the publication of a prospectus or listing document.

2. **Further issues:** Do further issues of securities require the publication of further information, and if so what are the specific requirements?

3. **Prescribed information disclosure**: What information is required to be disclosed in a prospectus or listing document? Please summarise the main areas of information required. Examples of areas are information on:
   - the persons responsible for the prospectus, auditors and other advisers
   - the shares to be listed
   - the company and its capital
   - the company's activities
   - the issuer's assets and liabilities, financial position and profits and losses for the track record period
   - the issuer's management, and
   - recent developments and prospects of the company.

4. **Financial information:** In particular what financial information is required to be published by an IPO company/ initial listing applicant? What accounting standards are required to be adhered to by reporting accountants/ auditors? Is there an explicit working capital requirement at the IPO/ initial listing stage?

5. **Forward-looking information:** Is the inclusion of forward-looking information in offering documents permitted? If so, how is this presented e.g. are there requirements for a forecast to be reported upon.

6. **Pro forma financial information:** Is the use of *pro forma* financial information permitted in offering documents?

7. **IPO/ initial listing approval:** What methods of assessment are used by the exchange and regulatory authority for the approval of IPO's and initial listings e.g. do the authorities pre-vet documentation, or is filing sufficient?

8. **Regulation of the marketing of securities**: What approach is taken to the regulation of marketing securities? For example are research analysts reports used for this purpose? Are "road-shows" used to encourage investor interest in an IPO?

10.	CONTINUING OBLIGATIONS OF LISTING – DISCLOSURE REQUIREMENTS
	1. Provide a summary of the main types of continuing disclosure requirements under the following categories: ▪ Disclosure of "price sensitive" information ▪ Disclosure of periodic financial information and the accounting standards this is required to be prepared to ▪ Specific prescribed disclosures of material information and actions on certain transactions e.g. acquisitions, disposals and related transactions ▪ Disclosure of director's and major shareholder's dealings, and ▪ Other prescribed disclosures and actions such a those set out in Annex 5. [Please us the categories in Annex 5 as a checklist] 2. What mechanisms are used to ensure wide dissemination of information to the market. Investors and the public? For example are company announcements published in the newspapers and/or on dealer- broker trading screens?
11.	CORPORATE GOVERNANCE PROVISIONS
	1. What role does your listing regime play in the overall regulation of corporate governance in your country? 2. In particular provide a summary of the main types of requirements under the following categories, cross-referring to other answers where the information has already been provided: ▪ Disclosure of "price sensitive" information ▪ Directors expertise and experience to manage their business ▪ Enshrinement of certain shareholder rights ▪ Takeovers regulation ▪ Proscription of insider dealing ▪ Adoption of corporate governance codes. ▪ Adoption of codes regulating of directors dealings, and ▪ Disclosures and action on certain transactions.

12. COMPLIANCE MONITORING OF CONTINUING OBLIGATIONS AND ENFORCEMENT

1. Summarise the compliance monitoring and enforcement mechanisms in your listing regime?

2. In particular, provide details of the approach taken in the following categories:

   - monitoring the content and timing of disclosures by issuers of information at initial listing and on an on-going basis
   - market surveillance, supervision and compliance monitoring of trading activities, including review of pricing of orders
   - monitoring the timely and orderly release of price-sensitive information
   - monitoring of the timing and content of quarterly review statements and half-yearly and annual financial statements
   - vetting of the initial suitability of applicant firms applying to act as Sponsors (i.e. corporate advisers such as investment banks) and ongoing review of continuing compliance with eligibility criteria
   - monitoring of adherence of Sponsors to their ongoing duties to the Exchange and instituting disciplinary proceedings against them, and
   - investigating suspected market abuses and liaising with other regulatory agencies.

3. Is suspension of listing or trading of a company's securities used as a regulatory device on your market.? If so, provide details of the situations where suspension takes place.

Part 2 – Views on how the listing regime could be strengthened and improved

All SAFE member exchanges are asked to make a submission expressing their views on the strengths, weakness, opportunities and threats of their current listing regime.

Part 3 – Views on the scope for regional co-operation and harmonisation on listing matters

All SAFE members are asked to make a submission expressing their views on the scope for greater harmonisation of listing standards among SAFE Exchanges, including their perspectives on the key implementation dependencies. Notes on the development of regional markets are set out in Annex 6.

Annex 2 - Reports on the current listing regimes of the SAFE exchanges – self-assessment responses to the Questionnaire [Contained in separate document]

[NOTE: due to its length Annex 2 is contained in a separate document]

[Annex 2 contents:

Annex 2.1 – CSE – Bangladesh

Annex 2.2 – DSE – Bangladesh

Annex 2.3 – RSEB – Bhutan

Annex 2.4 – BSE – India

Annex 2.5 – NSE – India

Annex 2.6 – OTCEI – India

Annex 2.7 – SEM – Mauritius

Annex 2.8 – NEPSE – Nepal

Annex 2.9 – ISE – Pakistan

Annex 2.10 – KSE – Pakistan

Annex 2.11 – LSE – Pakistan

Annex 2.12 – CSE – Sri Lanka]

Annex 3 – Findings and recommendations on SAFE exchanges domestic listing regimes

Note on scope of findings

Findings and recommendations on the strengths and weaknesses of each of the SAFE exchanges listing regimes, including action plans and areas and topics requiring further exploration are set out in this Annex. These have been drawn up by the SAFE project team based on the self-assessment responses of the SAFE exchanges to the Questionnaires (see Annex 2) and subsequent discussions with exchange management during a round of short country visits. The findings and recommendation do not therefore constitute a statement of the strategic policies of the exchanges concerned, but represent views on how the listing regimes of SAFE member exchanges can be strengthened. Given the short duration and the wide geographical scope of the project these recommendations are, in general, of a broad rather than a specific nature, and require further examination by the SAFE exchanges, their securities regulatory bodies and other interested parties domestically.

Annex 3.1 – Bangladesh

Overview – key dimensions of market

Country pop. (m)	Year exch. open-ed	GDP $US Bn.	Mkt cap. $US Bn.	Mkt. Cap. ratio	No. list-ed Cos.	Av, mkt. cap.	Instit. invs.	For. invs
136	1956	47.3	1.3	2.5 %	237	5.1	0 %	0%

Findings, recommendations, action plans and topics requiring further exploration

- ***Stage of capital market development***: The Bangladesh capital market is relatively immature and under-developed, comprised of mainly retail investors, with negligible investment by domestic institutional investors or foreign Institutional Investors (FIIs), and no shareholder associations or equity research houses. Listed companies are generally closely controlled by dominant family shareholders, who tend to maintain a "private company" mentality, despite the increased transparency and disclosure responsibilities they face when their company is listed. There are no fixed income or other debt instruments, and the high interest rates paid by government saving schemes discourages corporate debt offerings. There are currently around 50,000 private and public companies in Bangladesh, but the listed sector, with only 237 companies listed on the two stock exchanges, comprises only a small proportion of these. Although current and planned market developments such as the central securities depository will improve market quality, a range of co-ordinated capital market development efforts are needed to generally improve the quality of the capital market, and to increase its size by attracting more listed companies and investors.

Recommendation
In general there is a need for concerted capital market development in Bangladesh, with a need to improve the overall integrity and reputation of the market along with a carefully planned and implemented reform programme. The obvious priorities in this programme are: o Institutional strengthening of the SEC, as the lead regulator and authority with prime responsibility for capital market development o Co-ordination with private sector development efforts, such the current initiative in the field of corporate governance (see further below), as this sector both feeds the capital market, and the market seeks to serve its needs o Private sector development through privatisation of state-owned enterprises (SOEs) Development of the domestic institutional investment sector (e.g. the insurance industry).

- ***Exchange competition and listing regulation:*** The two stock exchanges are based in Dhaka and Chittagong respectively, the DSE having been established in 1947CSE having been established in 1995. Although the exchanges compete for new listings and trading, much of the trading volume is derived from local brokers to each exchange and therefore competition between the exchanges is not entirely direct. It is understood that applicant companies were required to list contemporaneously on both exchanges, although it is understood that this requirement was dispensed with, after pressure from the Asian Development Bank. Both exchanges have identical listing regulations (which were originally derived from the Karachi Stock Exchange), although CSE has a policy of discounting its fees in order to attract new listings, and both depend on substantial proportions of their income from listing fees. Regulatory responsibilities for listing regulation in Bangladesh are shared between the SEC and each of the two exchanges, who focus mainly on on-going market regulation of listed companies. There is evidence that the general quality of the capital market and the lack of a strong compliance culture among listed companies leads to threats by companies to de-list when they are confronted with their lack of compliance by the CSE market supervisory staff. There is also disturbing evidence of a certain degree of "regulatory arbitrage" by listed companies, whereby they play each exchange off against each other. The SEC appears to be under-resourced and lacking the enforcement zeal to support the exchanges in their listing regulatory roles. There is an urgent need for greater clarity of the respective roles of each of the SEC, DSE and CSE in administration of the listing regime in Bangladesh, and in particular for clear regulatory co-operation arrangements to be put in place between the SEC and the exchanges to ensure that their respective roles in listed company monitoring and enforcement.

Recommendation
It is recommended that in the interests of overall capital market quality, that the SEC, DSE and CSE consider devising an MOU on the arrangements for listing regulation. In particular it was also suggested by the CSE that the powers of the Registrar of Companies to enforce the Companies Act, 1994 should be transferred to the SEC, who would then have authority to bring any action against listed companies and/or their shareholders and directors for any alleged violation of the Companies Act, 1994. In addition it was pointed out that there is no special court for cases involving securities law, and that judges are not sufficiently expert on the securities law. It has been suggested therefore that a special bench of the High Court Division be designated as having original jurisdiction of all cases involving alleged breached of the Companies Act, 1995 and the securities laws.

- ***Cost of capital and market awareness***: Despite the cost of capital-raising through IPO's being estimated at 7-8%, compared with bank funding at rates of around 15%, corporate financing in Bangladesh is largely obtained by borrowing, mainly from banks, rather than through the equity markets. Often the main motivation for listing is not the desire to raise equity capital, but to obtain tax advantages and as a result of legal compulsions to go public (e.g. banks are

required by the Central Bank to list on the exchanges). In addition, due to the ready availability of funding from bank loans for higher quality companies, listing candidates may be of a relatively lower quality.

Recommendation
Growing the listed company sector is a major challenge for the Bangladesh exchanges and capital market authorities. In accordance with the general recommendations set out in Part 2 of the report the DSE and CSE should focus on : • developing methods of gaining a greater understanding of the factors impacting companies decisions to list • engage in collaborative efforts to raise general awareness of the capital market as a capital-raising avenue for companies, and • developing "market-facing" listing operations

- ***Exchange controls:*** Exchange Controls require Bangladeshi nationals to seek both Central Bank and Investment Board approval to invest abroad.

Recommendation
The DSE and CSE should, as part of their participation the SAFE regional harmonisation initiative, instigate discussions with these authorities on the implications for Bangladeshi investors of the exchanges broadening the range of investment choices of local investors through "secondary" listings of non-Bangladeshi companies on the local exchanges,

- ***Corporate Governance***: A project entitled "A Diagnostic Study of the existing Corporate Governance Scenario in Bangladesh"[26] (the BEI Study) has recently been undertaken which focused on corporate governance in the public listed companies sector. The study concluded that failings in institutions, government agencies, legal enforcement, and market behaviour have resulted in a weak corporate governance environment, and diagnosed that the current system in the country does not provide sufficient legal, institutional, or economic motivation for stakeholders to encourage and enforce corporate governance practices. The study proposes that targeted reforms in institutions and sectors can begin to provide the internal and external motivation for transparency and accountability that will lead to better corporate governance. In particular, a key aspect of this is further radical development of the private sector in the country. SOEs comprises approximately 35% of GDP, whereas the market cap ration amounts to only 2.5%. The BEI study recommends that corporate governance enhancement efforts should be focused through financial institutions that fund the vast majority of businesses, the banks, as that sector can serve as a motivator through enhancing its requirements and procedures for approving and monitoring loans. The capital market will ultimately benefit from these efforts through the

[26] Prepared as part of a wider project on "A Comparative Analysis of Corporate Governance in South Asia".

emergence of stronger candidate companies applying for listing. In addition it is understood that the an ADB capacity-building project has recently provided international technical assistance in the field of corporate governance practices of Bangladeshi companies, and that a comprehensive set of recommendation on legislative amendments, shareholders rights guidance, corporate governance guidelines and reform of the accounting and auditing processes have been put forward to the SEC.

Recommendation
The SEC, DSE and CSE should participate fully in corporate governance initiatives to improve the overall quality of the corporate sector in Bangladesh in order to improve the quality of the existing listed company sector, and to help develop conditions whereby a greater pool of potential candidates for listing on the exchanges is created in Bangladesh.

- ***International inward investment***: There is currently negligible IIF (international institutional fund) interest in the Bangladesh capital market, due to the overall relatively small size of the market compared to other emerging markets, the relatively small size of potential investee companies, and divergences from international regulatory standards, such as the lack of conformity with international accounting standards. For example, in relation to the corporate governance aspects of the regulatory regime the BEI study concluded that:

  "*the ultimate impetus for better corporate governance must come from domestic forces and institutions. Unlike some other developing countries, pressure from international portfolio investors or the hope of accessing international equity markets is not a realistic objective for a majority of corporate bodies in Bangladesh. Moreover, attracting international capital may prove to be an elusive goal until the domestic investor community itself shows confidence in the corporate sector*".

Comment
Attracting appreciable IIF to the Bangladesh capital market is unlikely in the short term. However the SEC and the exchanges should continue to develop their legal and regulatory structure and market facilities to the standards expected by international investors, and particularly in line with the regional standards of listing regulation being devised by SAFE.

Annex 3.2 – Bhutan

Overview – key dimensions of market

Country pop. (m)	Year exch. open-ed	GDP $US Bn.	Mkt cap. $US Bn.	Mkt. Cap. ratio	No. list-ed Cos.	Av, mkt. cap.	Instit. invs.	For. invs
0.782	1993	0.59	0.076	12.8 %	15	5.1	0 %	0%

Findings, recommendations, action plans and topics requiring further exploration

- ***Stage of capital market development***: The Bhutanese capital market is relatively immature and under-developed, and its size reflects the small size of the country and the newness of capital market activities in the country. Initially the RSEB was directly owned by the Government, although it is now an autonomous body co-owned by its four member broker firms, although these members are all subsidiaries of Government-owned financial institutions.

Comment
The evolution of the RSEB into a mutually owned self-regulatory organisation is to be welcomed. However the RMA and governmental authorities, will need to be mindful, as the market develops, that the individual and collective interests of the current broker-dealer members do not hamper the important development role of RSEB in the market.

- ***Shareholder spread requirements:*** A notable feature of the RSEB listing requirements is the requirement that a company must have only a minimum of 25 (previously 150) shareholders holding 25% of the issued capital to qualify for listing. The RSEB, while agreeing that this threshold is a low one for a public market, are of the view that the small shareholder spread requirement is needed in a relatively new market like Bhutan where stock market knowledge is low and private sector development limited. The RSEB stated that there has been an increase in interest IPO and listing process since the relaxation was made.

Recommendation
The RSEB should carefully monitor the impact of the reduction in shareholder spread on the number of new listings, and also its impact on market liquidity, and consider reviewing its minimum shareholder spread requirements as these do not conform with international norms for listing.

- ***Relevance of the capital market:*** Given the under-developed nature of the private sector in Bhutan, capital market development policies need to be closely

aligned with private sector development efforts, in order to ensure that the market is relevant to the financing needs of corporations.

Recommendation
Growing the listed company sector is a major challenge for the RSEB and the financial markets authorities in Bhutan. In accordance with the general recommendations set out in Part 2 of the report the RSEB should focus on: • developing methods of gaining a greater understanding of the factors impacting companies decisions to list, and • engage in collaborative efforts to raise general awareness of the capital market as a capital-raising avenue for companies. In particular RMA and RSEB should consider collaborating with relevant Government departments and private sector groups and initiatives on a market awareness campaign that widely promotes the benefits of the capital markets and reforms to improve the market in Bhutan. The campaign should be underpinned by detailed research into the financing needs and facilities for Bhutanese companies, to ensure that the right focus is brought to the campaign.

- ***Accounting standards***: Bhutan does not have its own accounting standard. Listed companies follow international accounting standards, and appoint statutory audit firms approved by the Royal Audit Authority of Bhutan, mainly comprised of Indian audit firms. It is understood that that the Royal Audit Authority is working on forming accounting standards for Bhutanese companies.

Recommendation
The efforts to develop national accounting standards should also encompass efforts to encourage the development a local accounting/auditing profession. In addition the setting of standards should be aligned to international accounting standards as far as possible, in accordance with the general trend in capital markets internationally.

- ***International inward investment***: The Royal Government of Bhutan has approved the Foreign Direct Investment Policy, (2002), but it is understood that the detailed legal framework has yet to be developed. It is recognised that the current market is too small to attract appreciable international portfolio investment, and is also hindered by the relatively small size of potential investee companies, the underdeveloped market infrastructure and divergences from international regulatory standards.

Recommendation
Attracting appreciable IIF interest in the Bhutanese capital market is unlikely in the short term. However the RMA and the RSEB should continue to develop their legal and regulatory structure and market facilities to the standards

expected by international investors, and particularly in line with the regional standards of listing regulation being devised by SAFE.

Annex 3.3 – India

Overview – key dimensions of market

Country pop. (m)	Year exch. open-ed	GDP $US Bn.	Mkt cap. $US Bn.	Mkt. Cap. ratio	No. list-ed Cos.	Av, mkt. cap.	Instit. invs.	For. invs
1,000	1875	515	110	21.3 %	9,644	11.5	17%	13%

Findings, recommendations, action plans and topics requiring further exploration

- ***Stage of capital market development***: Although the Indian capital market has grown rapidly in the last decade in terms of market turnover, size and infrastructure, given the size of the country and economy it still has a considerable capacity to grow and to also develop qualitatively. Reforms including the establishment of SEBI, which takes an effective lead in shaping market development and reform, screen-based national securities trading spurred by the emergence of the NSE, dematerialisation and electronic transfer of securities ownership, and the emergence of sophisticated risk management and derivatives trading have greatly improved the regulatory framework and the efficiency of the trading markets. However the surge in size of the market, evidenced by the growth in market capitalisation by a factor of 3.5 between the years 1990 and 2000 has seen a huge expansion in the number of listed companies, many of whom are proving to be of poor investment quality and lacking an adequate compliance culture. In addition the market is currently characterised by large number of stock exchanges in the country, totaling some 23 recognised exchanges. The historical role of the regional exchanges in admitting companies to listing and regulating them afterwards, has resulted in an unwieldly listing regime. This is currently being addressed pro-actively by the authorities and the major stock exchanges (see also Exchange governance and listing regulation below).

General comment & recommendation
After a period of rapid capital market growth, radically improving the listing regime and improving the quality of the listed company sector is now a high priority for the Indian capital market authorities and the BSE, NSE and OTCEI (the major Indian exchanges). It is in the interests of the major Indian exchanges to participate fully in efforts to reform and improve the listed sector and its regulation.

- ***Reforms of Exchange governance and listing regulation:*** Far-reaching reform of the exchange landscape is underway in India, principally driven by the lack of economic viability of most of its current 23 recognised exchanges. Despite the huge overall growth of market turnover in the country over the last few years, according to NSE statistics, the NSE and BSE, due largely to their technological

prowess, account for approximately 96% of the trading volumes, with 15 smaller exchanges responsible for less than 0.01% of trading in 2001-2 and 12 exchanges registering nil turnover during that period. The regional exchanges are therefore dependant upon non-business income (comprised of listing fees, interest on custodial monies and rents from property) for their survival. NSE analysis states that 68% and 65% of income of the Indian stock exchanges (other than BSE and NSE) was derived from listing fees in the last two years respectively.

Re-trenchment of the exchanges in India is progressing rapidly, in part prompted by the changes in regulations in April 2003 which abolished requirements for mandatory listings on regional exchanges. Prior to April 2003, any company wishing to list its shares had to be listed on its RSE, based upon the region where its registered office was located. With effect from April 2003, this preference is no longer insisted upon, with the result that the primary role of the RECs has been removed and competition is now based upon *inter alia* fee structures, the reach and coverage of trading terminals within the country, market depth and service differentiation.

Comment
The lifting of the requirements for mandatory listings on RSE's has removed a major distorting factor in the Indian listing regime, and should help contribute to efforts to improve the overall quality of the listed company sector in India.

- ***Establishment and operation of the Central Listing Authority:*** Reform of the stock exchanges in India is being accompanied by the centralisation of aspects of listing regulation through a new autonomous regulatory agency, the Central Listing Authority (CLA), with its authority to regulate companies delegated from SEBI. The SEBI (Central Listing Authority) Regulations 2003, notified on August 21, 2003, endow the CLA with the role of issuing or rejecting a listing application made by any body corporate, mutual fund or collective investment scheme, making recommendations as to the listing conditions and of discharging such other functions as may be specified by SEBI from time to time. Any exchange shall not consider any listing application which has not already been approved by the CLA. As of December 2003 the CLA was not yet operational.

  Currently the NSE and BSE adopt different listing procedures for new applications for listing. The BSE operates a "Listing Committee" (formerly known as "Prospectus Scrutiny Committee") to analyse draft prospectus/offer documents. The Committee also ensures that the issuer meets the eligibility criteria for listing new companies on the Exchange and is complying with the various SEBI guidelines issued regarding IPO's. The BSE committee also evaluates the promoters, company, project, financials statements and several other factors before taking decision in this regard. NSE adopts a case-by-case approach to assessing listing applications, with a listing advisory committee supporting NSE executives in non-routine issues.

It is not as yet clear how in practice the CLA's activities will effect the approach of the Indian exchanges to listing regulation. It is understood that both the NSE and BSE are represented on the CLA (committee), but other important matters which require clarification are:

- o The allocation of listing application and ongoing fees between the CLA and the exchanges
- o Clear de-lineation of the division of responsibilities between CLA and exchanges, and their communication to the market
- o In particular, the scope for the exchanges powers to reject listings, notwithstanding an approval of an initial application by the CLA, in the interests for maintaining the quality of their markets.

Comment and recommendation
Given the intense competition between stock exchanges in India, and the greater scope for conflicts of interest between commercial and regulatory operations when exchanges demutualise and become "for-profit" organisations, the establishment of an independent central listing authority in India is strongly endorsed. The independent status of the organisation will also be important in meeting the serious challenges faced in improving the corporate compliance climate in the country (see below). However, urgent and detailed clarification is needed from SEBI on the mode of operation of the CLA, and how this will interact with the continuing roles of the exchanges in listing regulation.

- ***Corporate compliance and quality of the market:*** The biggest issue facing the listing regime in India is the lack of a deep culture of compliance among listed companies, which has seriously eroded the overall quality of the market. For example, one commentator stated that about one third of listed companies are of a insufficient investment quality to maintain listed status due to their consistent failure to comply with corporate governance and disclosure requirements. Of particular concern are instances of "vanishing" companies, where promoters fraudulently abscond with cash, yet active market trading may still continue on the exchanges.

  The advancement of policies to facilitate greater scope for the de-listing by exchanges of companies which are performing badly, as indicated by consistently low market prices ad/or turnover or are in persistent breach of listing regulations often leads to contentious debate. One one side the arguments tend to centre on the view that the continuation of the trading facility should be maintained in the overall interests of investors notwithstanding the business performance or compliance record of the company. On the other side market operators tend to argue that where a critical mass of poor quality and /or delinquent companies has developed the exchange should be able to apply quantitative and qualitative criteria on which to assess the suitability of the company to continue its listing, and where companies fail to meet these standards the are automatically de-listed or relegated to an OTC or "junior" market.

De-listing criteria: The main de-listing criteria in the developed markets tend to include both quantitative and qualitative aspects including:

- **Sanctions:** Cancellation of listing can be used as the ultimate sanction where companies have transgressed their listing obligations
- **Failure to meet stated standards:** De-listing is triggered or considered where a company no longer meets the initial eligibility criteria, or certain stated continuing eligibility criteria, such as:
  - trading price
  - market capitalisation (relative to the overall market)
  - shareholders equity
  - total assets
  - revenue
  - minimum public float
  - profitability
  - market liquidity
  - number of market makers
  - market price
  - corporate governance
  - bankruptcy/ liquidation
  - qualified opinion on financial accounts
  - failure to file accounts on time
  - failure to follow good accounting practices
  - unsatisfactory financial conditions
  - in ability to meet debt obligations/ finance operations
  - abnormally low selling price or volume of trading
  - reduction in operating assets and/or scope of operations.]

Recommendation
In the interests of improving market quality and hence the long term attractiveness of the capital market to issuers and investors, SEBI and the Indian exchanges should urgently conduct a full review of the current SEBI regulations and exchange regulations covering de-listing, and consider extending the grounds for permitting the de-listing of listed companies,

Market segmentation and "Junior" market development: In India a degree of market segmentation of the market had been effectively put in place by SEBI at the time of the inauguration of the OTCEI by virtue of their requirements that companies with capital of less than 3 crores could only be listed on the OTCEI, and companies with higher capital could only seek listing on other exchanges. Subsequently the Rs. 3 crores ceiling was removed and currently companies with higher capital can be listed on OTCEI as well as on other the exchanges. The minimum capital requirement on OTCEI is Rs. 30 lakhs, whereas in NSE and BSE, it is Rs.10 crores. On OTCEI, a company should have a minimum paid-up capital of Rs. 30 lakhs and the minimum offer to the public should be 25% of the issued capital or Rs. 20 lakhs worth of shares in face value, whichever is higher. The concepts of Sponsoring an issue and Market Making are prevalent on

OTCEI. When the OTCEI was initially formed companies which were listed on Major Stock Exchanges like NSE and BSE, were permitted to trade on OTCEI in the permitted securities Segment, but any stock listed on the OTCEI cannot be listed or permitted to trade elsewhere until it is de-listed from the OTCEI. Subsequently this stipulation has been removed, allowing any company listed on OTCEI to also have a parallel listing on any other Exchange, (without being delisted from OTCEI) and vice-versa. The OTCEI has to date been regarded by the authorities as the providing exclusive facilities for the smaller and growth company sector. However, recently due to a lack of market interest the OTCEI has not been able to attract appreciable interest from start-up and growth companies and venture capitalists and high-risk investors, the stakeholders the exchange was established to cater for. A number of commentators have suggested that the OTCEI be reformed, including the suggestion that the OTCEI should be re-lanched as an unlisted market where qualified investors could directly interact with each other, without intermediation by brokers. Such a market would act as "nursery" allowing start-up companies to become acquainted with an information disclosure regime and to grow in size and reputation to a position where they can launch IPOs and broaden their investor base .

A further important potential development on restructuring the listed company sector in India in was announced by the BSE and the FISE (Federation of Indian Exchanges[27]) on 10 November, 2003. They have proposed the establishment of a new national market called Indonext, catering for the listing and trading of small and medium cap companies, being companies with capital of up to RS 20 crores. It is proposed that Indonext will would allow qualifying companies to be traded in a single national order book on the BSE's BOLT system, managed by the BSE, and that BSE and RSE members (amounting to approximately 7,000) would be able to access the market.

Comment
The Indonext proposal marks a further potentially important development in the current fundamental re-trenchment of the Indian listed company sector. However, this proposed development needs to be based on a thorough analysis of the market and business context, and especially in the light of the corporate compliance and market profile of the existing small and medium cap listed company sector in India. It is important therefore that design of the market structure is underpinned by studies on the nature of the listed companies targeted, and the preferences of investors, particularly the views of venture capital providers and domestic institutional investors, and maximum possible engagement with potential market users on market design. Key areas for analysis are set out in Part 2 of the report.

[27] FISE represents the 20 Indian regional stock exchanges (i.e. other than BSE, NSE and OTCEI).

Annex 3.4 – Mauritius

Overview – key dimensions of market

Country pop. (m)	Year exch. open-ed	GDP $US Bn.	Mkt cap. $US Bn.	Mkt. Cap. ratio	No. list-ed Cos.	Av, mkt. cap. $US	Instit. invs.	For. invs
1.2	1989	4.3	1.72	38.2 %	40	43	9 %	5%

Findings, recommendations, action plans and topics requiring further exploration

- ***Stage of capital market development***: The Mauritian capital market has developed steadily since the formation of the SEM in 1989, and can be characterised as having four distinct phases of development. The 1989-1992 period was an introductory phase, during which efforts were essentially geared towards the introduction of the regulatory and operational infrastructure of the market and the education of companies and investors. The 1993-1995 period constituted the take-off phase and was characterised by stronger investor participation, the setting up of collective investment vehicles and the listing of a few important companies, including two government-owned entities. The market was opened to foreign investors towards the end of 1994 and the 1996-1999 period saw important portfolio inflows from foreign investors, the establishment of central depository of securities and participation in African regional development through COSSE, the Committees of South African stock exchanges, under the auspices of the SADC (Southern African Development Community), The 2000-2003 period has seen major reforms of the regulatory and operational framework of the capital market, with the establishment of the Financial Services Commission (FSC) following the enactment of the Financial Services Development Act, which consolidates the regulatory oversight of the financial sector, the opening up of the ownership of the SEM to parties other than SEM broker members, the adoption of new Listing Rules by SEM and the introduction of the Automated Trading System." Currently new draft legislation covering the securities market (Securities Bill) and collective investment schemes is in the pipeline, and a number of market developments are being considered by SEM and the Financial Services Commission (FSC).

Recommendation
The experience of the Mauritius capital market provides a good example to many other small countries on how progressive capital market development can evolve, domestically, regionally and internationally.

- ***Legislative changes:*** The new Securities Bill amends the Securities Exchange Act, 1988 and the Companies Act, 2001, and provides for the assumption by the FSC of the regulation of IPOs, requirements for the publication of quarterly accounts, provisions concerning the role of and status of the Listing Committee

and licensing of financial intermediaries, which will facilitate the development of exchange "sponsors" for listing. Draft legislation concerning the regulation of mutual funds (collective investment schemes) is also under active consideration.

Recommendation
SEM should ensure that its listing rules are updated to reflect the rapid legislative and market developments that have occurred in recent years.

- ***IPO market and new listings:*** SEM operates two market segments, the Official List (main board) and the Over-the-Counter (OTC) Market. The listed segment is reserved for companies that meet the criteria set out in the Listing Rules regarding financial requirements, shareholders spread, and financial reporting. At the end of March 2003, there were 42 companies listed on the Official List, 39 of which have their equity capital listed. There are different regulatory requirements for some market segments, such as debt instruments, overseas issuers, and public sector issuers. SEM also operates an "unlisted" OTC Market (see below). The SEM main market grew during the 1990's through the use of tax incentives, which have now been removed. There have been no new listings on Official list since 1997, although there appears to be considerable capacity to extend the size of the listed market (currently measured as representing 32% of GDP), as there are approximately 18-20,000 registered companies in Mauritius, and about 200 large private companies which are largely under-capitalised, many of which are owned by Hong Kong and Indian investors and are involved in the textile industry. In addition there are 75 public companies whose equity securities are traded on the OTC market.

<table>
<tr><th>Recommendation</th></tr>
<tr><td>Extending the listed company market is a major objective for the SEM. In accordance with the general recommendations set out in Part 2 of the report the RSEB should focus on:

developing methods of gaining a greater understanding of the factors impacting companies decisions to list, focused on the currently unlisted corporate sector. and
engage in collaborative efforts to raise general awareness of the capital market as a capital-raising avenue for companies.

The focus of these efforts should, however, be linked in to market developments being considered (e.g. OTC market development).</td></tr>
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African regional capital market development Since 1997 the Committee of the SADC Stock Exchanges (COSSE) has been working on ways to develop regional Southern African capital markets[28]. The initial step in this process has been the agreement of a set of principles setting out minimum standards that the listing

[28] Members are Angola, Botswana, DRC, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

regulations of each member country should meet, in order to facilitate cross-listing between the southern African exchanges. A table setting out the agreed principles is set out in Annex 7 of the report. The aim of the harmonisation of listing regulations is to allow the participant markets to attract more foreign capital through cross-border investments and also through dual listings of companies on various exchanges within the SADC region. As yet there have been no instances of cross-listings involving SEM.

In addition it is understood that COSSE is considering proposals from the Johannesburg Stock Exchange to establish a regional market, based on the common listing of the companies currently listed on individual national exchanges (both within the SADC region and elsewhere in Africa) and allowing their existing members to trade, clear, settle on the new market. The suggested benefits of the proposal are that the autonomy of the existing exchanges would be maintained, the new market would provide a central access point for financial markets within Africa, provide a liquidity centre, and a focus for international inward investment in the region. It is understood that the JSE proposals are currently being discussed through Market Development Forums of interested parties.

Recommendation
It is recommended that SEM continue to participate actively in the SADC initiative as its relative highly developed capital market facilities (compared to other SADC countries apart from South Africa), it's familiarity to international investors (through its international financial centre's industry and reputation), place it well strategically to contribute ad benefit from African regional market development.

- ***Code on Corporate Governance:*** In the wake of a number of corporate scandals involving Mauritian companies, in September 2001, the Mauritian Government set up a Committee on Corporate Governance for Mauritius mandated to raise the level of corporate governance in Mauritius in line with so that it would compare favourably with international best practice. After a review of corporate governance practices in Mauritius, the Committee decided that it was appropriate to propose a Code of Corporate Governance for Mauritius, to be known as the Taylor Code. A draft Code was presented on May 26, 2003, following which, the Committee on Corporate Governance has invited the public to give their views on the draft code. The Code was finalised and published in late 2003 and under it listed companies although are required to "comply or explain" their position in relation to the Code. In order to give effect to the Code, SEM plans to amend its listing rules to require listed companies to make disclosure in two parts in their annual report and accounts, as follows:
    - A statement on how the company has applied the relevant principles of good corporate governance set out in the Code
    - A statement on whether or not it has complied with the relevant provisions of the Code in the case of non-compliance, this must be stated and reasons given.

This statement must be reviewed by the company's auditors prior to publication in so far as it relates to certain provisions of the Code.

Recommendation
SEM should ensure that its listing rules are updated to reflect the provisions of the Taylor Code.

- **"Junior" market development**: SEM also operates a "junior" market, the Over-the Counter market (OTC market) catering for trading in securities of 73 companies. The OTC market commenced operation in 1990, as an organised but unregulated SEM market. Trading of securities on the OTC is initiated at the request of shareholders of companies, rather than by the companies themselves. There are minimal prescribed initial entry standards, and no ongoing disclosure requirements. At its inception it was envisaged that the market would act as "stepping-stone" for companies to acquaint themselves with the capital market, and would later "graduate" to the SEM's main market. However this has not transpired to any appreciable degree. OTC quoted securities are traded utilising the same market infrastructure as main board companies, but are subject to minimal regulatory requirements and no fees are paid by companies for their access to the market. It is understood that SEM is currently reviewing the business and regulatory structure of its OTC market.

Recommendation
It is recommended that SEM conduct a thorough analysis of the implications of changing the regulatory and business requirements of its OTC market. In particular, the review should assess the likely reactions of current OTC quoted companies and other public companies to changes in the admission procedures and the likely more onerous ongoing disclosure requirements, and crucially their attitudes to the potential levying by the SEM of admission and annual charges for access to the market. In addition it is advised that any re-positioning of the OTC market should also be cognisant of the views of investors, and particularly the tendency of institutional investors to prefer "listed" securities, characterised by direct regulation of the companies by the listing authority and strong ongoing disclosure and governance requirements. By assessing fully the views of both companies and investors SEM will be able to make more informed judgments on the segmentation of its main and junior market.

- ***Mauritius as an international financial centre:*** In addition to its domestic equity markets, Mauritius also operates as an established international financial centre, catering for the needs of international investors and depositors. There has been a marked trend in recent years towards the design of innovative instruments catering for the needs of institutional and sophisticated investors, which has encouraged the development of stock exchanges in many of the smaller international financial centers. Luxembourg has traditionally been the leading stock exchange of choice for the listing of specialist debt issues and mutual funds. In recent years its pre-eminence has been strongly challenged by the LSE on debt issues and the ISE (Dublin) on mutual funds listings. LSE and Dublin made considerable efforts to compete directly with Luxembourg, particularly through rationalising their listing rules, and setting up a specialist

listing documentation vetting teams. The core business of many of the new "offshore" exchanges is the listing of mutual funds, asset securitisations and specialist debt issues, registered in their jurisdiction, or in competing centres. As the motive for listing on these exchanges is usually to increase the marketability of the investment vehicle, and to provide international institutional investors with trequired regulatory comfort and visibility, the listing aim for such issues has not traditionally been to seek access to secondary market liquidity.

Recommendation
It is recommended that SEM should explore the feasibility of extending its product range to cater for international investors, drawing particularly on the new opportunities provided by the legislation on collective investment schemes currently being finalised.

Annex 3.5 – Nepal

Overview – key dimensions of market

Country pop. (m)	Year exch. open-ed	GDP $US Bn.	Mkt cap. $US Bn.	Mkt. Cap. ratio	No. list-ed Cos.	Av, mkt. cap.	Instit. invs.	For. invs
26.8	1994	36	0.455	1.2%	109	4.1	Very low	0%

Findings, recommendations, action plans and topics requiring further exploration

- ***Stage of capital market development***: The Nepalese capital market is relatively immature and under-developed, comprised of mainly retail investors. Although foreign direct investment is allowed in the market, there are very few foreign joint venture investors. There is one domestic mutual fund, but no institutional investment by pension funds or insurance companies, which invest solely in Government securities. The listed company sector currently measures just 1.2% of GDP, and is uneven in composition as it is dominated by financial institutions, comprising 70% of the sector. The manufacturing sector is in general under-developed. However a major privatisation issue, of the national telecommunications company, is expected and it is estimated that there are around 700/800 corporations that could in time have their securities traded. Major changes are needed to the legislative and regulatory framework, with the need for the Securities Exchange Act and other relevant financial sector legislation and regulations to be amended and the harmonised. In particular a planned revised Companies Act will allow the NEPSE to change its current ownership and governance regime, make it the listing authority and develop its bye-laws, and remove the current requirement of the mandatory listing of public companies. A draft Securities Act has also been drawn-up, but it has been subject to legislative delays. A major ADB-funded project is currently focusing on strengthening the institutional capacities of the securities regulator (SEBON), NEPSE and ROC, and developing a central securities depository.

Recommendation
Although these current and planned developments will improve the market environment, a range of co-ordinated capital market development efforts are needed to generally improve the quality of the capital market, and to increase its size by attracting more listed companies and domestic investors. In particular as much pressure as possible must be exerted on the Government to prioritise the consideration by the legislature of the proposed companies and securities acts, as the legislative log-jam is hampering development.

- ***Exchange reform:*** Ownership of the NEPSE is shared between Government (Ministry of Finance responsibility), the Central Bank and Nepal Industrial

Development Corporation and members of the exchange, who hold a very small stake. The Government have decided to privatise the exchange and the privatisation cell of the Ministry of Finance is preparing the model of privatisation.

Comment and recommendation

The decision to open the NEPSE ownership is strongly endorsed. It is recommended that ownership should be opened-up sufficiently to ensure that broker-dealer exchange members are not able to effectively control the company, as this has been demonstrated as resulting in the stifling of sustained market development in a number of developing capital markets.

In particular the plans to reform the NEPSE will facilitate the NEPSE being able to focus on market operation and development, and the planned devolution of responsibility for listing regulation into the NEPSE will allow a concentration of regulatory and market development expertise to be built-up at NEPSE, and help provide the necessary focus for ensuring the listed sector can both be expanded and improved over time.

- ***Cost of raising capital***: The cost of raising capital in Nepal, estimated at between 12 and 17% of funds raised, is relatively high, mainly due to the long period between allotment of securities and the first day of trading, with timing depending on the size of the issue. This deficiency in payments systems is proving to be a major deterrent to the establishment of an effective IPO market.

Recommendation

A priority for improving the IPO market is to upgrade payment systems and allotment procedures.

- ***Relevance of the capital market:*** Given the very low market capitalisation ratio (as a proportion of GDP) of only 1.2%, capital market development policies in Nepal need to be closely aligned with private sector development efforts, in order to ensure that the market is relevant to the financing needs of corporations.

Recommendation

Extending the listed company market should be a major objective for the NEPSE and the SEBON, and in accordance with the general recommendations set out in Part 2 of the report their efforts should focus on:

- developing methods of gaining a greater understanding of the factors impacting companies decisions to list, focused on the currently unlisted corporate sector, and
- engage in collaborative efforts to raise general awareness of the capital market as a capital-raising avenue for companies.

- ***Compliance and enforcement of listing regulations:*** Although the general regulation of the financial companies listed on the NEPSE is also supported by the efforts of the Ministry of Finance, there are deep-seated problems in corporate governance and compliance with listing regulations, with evidence of vote rigging at shareholders meetings, conflicts of interests of auditors, a lack of auditing standards and poor management accounting procedures. NEPSE have de-listed 25 companies due to failure to pay annual listing fees, failure to pay dividends, due to a lack of trading or accounting irregularities. These companies have mainly been operating in the wool importing business.

Recommendation
NEPSE needs to continue to focus on its efforts at monitoring and enforcing compliance with its regulations, and when responsibility for front-line listing regulation is devolved to it should conduct a full review of the listing regime and ensure that its experiences are fully reflected in a new set of listing rules which seek to achieve the appropriate balance between facilitating access to the market and providing adequate levels of investor protection.

- ***International inward investment***: Direct foreign investment into Nepal is permitted, subject to Central Bank approval, although inward portfolio investment is not yet permitted. It is understood that a Foreign Exchange Relations Act had been planned but was deferred due to concerns about repatriation of profits. It is recognised that even in an unregulated scenario, that the current market is too small to attract appreciable international portfolio investment, and is also hindered by the relatively small size of potential investee companies, the underdeveloped market infrastructure and divergences from international regulatory standards, such as the lack of conformity with recogniseable accounting standards.

Recommendation
Attracting appreciable IIF interest in the Nepalese capital market is unlikely in the short term. However SEBON and the exchanges should continue to develop their legal and regulatory structure and market facilities to the standards expected by international investors, and particularly in line with the regional standards of listing regulation being devised by SAFE.

Annex 3.6 – Pakistan

Overview – key dimensions of market

Country pop. (m)	Year exch. open-ed	GDP $US Bn.	Mkt cap. $US Bn.	Mkt. Cap. ratio	No. list-ed Cos.	Av, mkt. cap.	Instit. invs.	For. invs
150	1947	311	21.5	14.5 %	704	30.5	Very low	2%

Findings, recommendations, action plans and topics requiring further exploration

Stage of capital market development: The capital market in Pakistan is relatively immature and under-developed, comprised of mainly domestic investors, with negligible investment by foreign institutional investors (FIIs). The regulatory regime in Pakistan was considered to be quite weak in the past but recent reforms, spearheaded by the Securities Commission of Pakistan (SECP), and supported by technical assistance under the ADB's capital market development programme, have improved the regulatory framework and promoted rapid reform. Progress in recent years is evident from the following data:

Year	Listed Capital Rs in Billion	Market Capitalisation Rs in Billion	Average Daily Share Turnover Volume in Million
2000	236	382	187
2001	236	296	97
2002	291	595	167
2003	305	887	340
2004(up to 20.01.04)	356	1228	340

In particular the SECP has been focusing on improving investor education, information disclosure by the corporate sector, good governance at the stock exchanges and adequate regulations to counter market manipulation and market abuse, to encourage greater investor confidence and transparency in the market. Measures have included implementation of the Code of Corporate Governance through the exchange's listing regulations, improving the governance of the exchanges, ensuring adequate disclosure by amending law and making it mandatory for listed companies to issue quarterly accounts. The Companies were directed to issue all price sensitive information to all shareholders including the general public and effective enforcement action against violating companies. Registration of brokers has also been initiated and enforcement actions rule violation. A procedure has also been developed for expeditious resolution of investor complaints at SECP and the Exchange level.

Recommendation
In general there is a need for a continuation of the efforts being made in

concerted capital market development in Pakistan, to improve the overall integrity and reputation of the market along with a carefully planned and implemented reform programme. In respect to the listing regime, the priorities in this programme are:

- Expansion of the market by increasing the size and quality of the listed company sector
- Improving the compliance culture and performance of listed companies (see also below), and
- Possible centralisation of aspects of listing regulation to reduce duplication of regulatory effort and improve enforcement (see also below).

- ***Regulatory framework for listing:*** The SECP has in recent years taken a pro-active approach to imposing regulations on listed companies, by way of directives which impose requirements on listed companies through the exchange's listing regulations (e.g. the Code on Corporate Governance).

  The three stock exchanges in Pakistan are public companies limited by guarantee and incorporated under the Companies Ordinance, 1984. By virtue of being separate entities these exchanges have separate sets of rules/regulations, which are however fundamentally identical. However, the exchanges, in their capacity of self regulatory organizations (SROs), discharge their regulatory functions autonomously. The Listing Regulations of the three exchanges in Pakistan are therefore more or less identical, with some differentiation in the requirements for the minimum size of an initial listing and the scale of listing fees. Historically, the Securities and Exchange Ordinance, 1969 provided that applicant companies had to list on all "recognised" exchanges, although this has now been dispensed with, allowing issuers the freedom to choose their listing venue. The three exchanges in Pakistan discharge their regulatory functions in listing regulation largely autonomously. There is evidence of duplication of effort in the listing function, differing turn-around times on processing listing applications and a lack of appropriate regulatory liaison between the exchanges, where, for example, some companies appear on one exchange's default board but not another's. The exchanges also expressed concerns that their listing regulations do not provide sufficient penal provisions against listed companies, although these areas are generally within the powers of the SECP. There is evidence that stricter corporate regulation is improving compliance performance in the market, but all commentators stated that enforcement of regulations presented the major challenge in strengthening the listing regime.

Comment and recommendation

Given the competition between the three stock exchanges in Pakistan, and the evidence of duplication of listing regulation, the case for centralising the regulation of the listed company sector should be considered by the SECP and the exchanges.

It is understood that the SECP is currently in the process of setting-up an

Expert Committee, which will give its recommendations/report on demutualisation and integration of the national exchange's. It is recommended that the question of centralising the regulation of listing, either at exchange, securities commission or through an independent central authority, should be explicitly covered by the remit of this Committee.

- ***Cost of capital and market awareness***: A major challenge facing the exchanges in Pakistan is to expand the size of the market. As an indication of the scope for growth it is noted that the market capitalisation to GDP ratio is only 14.5%, but there are approximately 100,000 limited companies, of which just over 700 are listed. There have been very few IPOs in recent years, due mainly to structural issues in the economy, which is still predominantly agriculturally-based, and the situation has not been helped by the fact that interest rates have also been falling steeply, encouraging corporations to fund themselves through the banks. The main area where expansion of the market appear to be possible are through privatisation issues. Privatisation efforts commenced after the creation of the Privatisation Commission in 1991, and privatisations have taken place in the industrial, power, gas, transport (aviation, railways, ports, and shipping), telecommunications, and banking and insurance sectors. The other main sectors seen as potential sources for new listings are in IT, and service industries.

  The SECP encourages new listing of companies on the stock exchanges. The total capital listed at the Karachi Stock Exchange (KSE) stands at Rs. 313.267 billion as on December 31, 2003. With the listing of Rs. 43.009 billion capital of Oil and Gas Development Corporation Limited, the market has experienced a significant increase in its size. SECP is also encouraging demutualisation and integration of the exchanges which should make them commercially-driven, profit-making entities. This policy is aimed at promoting, efficiency and improved governance of the exchanges, and in turn create greater incentives for the exchanges to directly market the benefits of public capital-raising and trading to the unlisted corporate sector.

Recommendation

Extending the listed company market is a major objective for the stock exchanges and the market authorities in Pakistan. In accordance with the general recommendations set out in Part 2 of the report the RSEB should focus on:

- developing methods of gaining a greater understanding of the factors impacting companies decisions to list, focused on the currently unlisted corporate sector, and
- engage in collaborative efforts to raise general awareness of the capital market as a capital-raising avenue for companies.

Market development efforts should, however, be linked into specific market developments being considered (e.g./Second Board market development – see also below).

- ***Reforms of Exchange governance and listing regulation:*** Possible de-mutualisation and integration of the exchanges and its implications for the

structuring and regulation of the market are currently under active discussion in Pakistan, supported by the ADB through its Capital Markets Development Programme Loan.

The key regulatory issue arising from exchange demutualisation are the real and perceived conflicts of interests where a commercial exchange is also responsible for regulation of listed companies. The main concern is that the exchange may be less inclined to refuse listing applications, which are a direct source of income in the form of listing fees and securities transaction levies, and as a result less willing to commit the resources that rigorous self-enforcement would require.

Measures taken to address the conflicts of interest arising from an exchange's roles as a regulator and as a commercial entity usually involve the setting up of a regulatory subsidiary under the exchange (Australia), the signing of an agreement between the exchange and the regulator to set out the procedure for handling conflicts (Singapore), or the transfer of the listing authority function to a new central listing authority within the securities regulatory body (United Kingdom). In Hong Kong, were the broker-owned securities exchange was demutualised, merged with the futures exchange and the clearing company to form HKEX in 2000, the decision that front-line listing regulation should continue to be discharged at exchange level has proven to a controversial one, as illustrated in greater detail in Part 2 of the report.

These international experiences indicate that continuance by demutualised "for-profit" exchanges of a major front-line role in listing regulation is not necessarily impossible, if the right combination of checks and balances are provided for in the overall listing regime to ensure that any conflicts of interest are properly addressed, but where multiple exchanges compete for market share the additional competitive pressures may well dictate the transfer of listing responsibilities to a centralised listing agency overseeing regulatory issues on suitability for listing approval and the enforcement of listing regulations.

It should be noted that in India reform of the stock exchanges is being accompanied by the centralisation of aspects of listing regulation through a new autonomous regulatory agency, the Central Listing Authority (CLA), with its authority to regulate companies delegated form SEBI.

It is understood that the SECP is currently in the process of establishing an Expert Committee, which will *inter-alia* assess the impact of demutualisation on the role of the exchanges as frontline regulators with regard to the listings, in light of international experiences as well as keeping in mind the local market conditions.

Recommendation
It is understood that the SECP is currently in the process of setting-up an Expert Committee, which will give its recommendations/report on demutualisation and integration of the national exchange's. It is recommended that the potential impact of demutualisation and integration

by the Pakistan exchanges on their current roles in front-line listing regulation should be carefully assessed, drawing on international experiences and local market conditions. In particular, the greater scope for conflicts of interest between commercial and regulatory operations when exchanges demutualise and become "for-profit" organisations, should be factored into this review.

- ***Corporate compliance and quality of the market:*** The imposition of the requirement by the SECP, through its circular dated May 26, 2003, that all the listed companies are advised by the Commission to maintain a website where its shareholders, investors and general public can access financial information to make investment decisions, is a welcome one. In addition the practice of new companies coming for listing usually placing their prospectus on their website or their advisor/lead manager's website is also supportive of corporate disclosure culture.

  The present regulatory regime of the exchanges provides an exit-provision for listed companies which find it difficult, financially or otherwise to remain listed on the exchange through the mechanism of voluntary de-listing and buy-back/purchase of shares from the shareholders of the company. The SECP has recently approved the Regulations for the voluntary de-listing for the Karachi, Lahore and Islamabad Stock Exchanges. In addition section 9(5) of the Securities and Exchange Ordinance, 1969 ('the Ordinance') also provides for the de-listing of a listed security on application by the issuer to the Stock Exchange. In case of a refusal by an exchange to de-list a particular security, the Ordinance empowers the Commission to, direct the Stock Exchange to de-list the said security.

  The LSE expressed the view that the grounds upon which companies could be de-listed should be re-examined to ensure small investor's interests are protected. In particular the LSE cited the case that where the merger/amalgamation of defaulting companies to become unlisted companies occurs, through schemes of arrangement approved by the shareholders of the respective companies and approved by the Court, and in the cases of winding-up/liquidation of the defaulter companies, de-listing of such defaulter companies becomes binding upon the Exchange. Under such circumstances, the interests of small investors remain unprotected at the exchange level. The LSE suggest therefore that there should be some regulatory barriers to check such practices.

  The advancement of policies to facilitate and regulate de-listing by exchanges of companies which are performing badly, as indicated by consistently low market prices ad/or turnover or are in persistent breach of listing regulations often leads to contentious debate. On one side the arguments tend to centre on the view that the continuation of the trading facility should be maintained in the overall interests of investors notwithstanding the business performance or compliance record of the company. On the other side market operators tend to argue that where a critical mass of poor quality and /or delinquent companies has developed the exchange should be able to apply quantitative and qualitative criteria on which to assess the suitability of the company to continue its listing.

De-listing criteria: The main de-listing criteria in the developed markets tend to include both quantitative and qualitative aspects including:

- **Sanctions:** Cancellation of listing can be used as the ultimate sanction where companies have transgressed their listing obligations
- **Failure to meet stated standards:** De-listing is triggered or considered where a company no longer meets the initial eligibility criteria, or certain stated continuing eligibility criteria, such as:
  - trading price
  - market capitalisation (relative to the overall market)
  - shareholders equity
  - total assets
  - revenue
  - minimum public float
  - profitability
  - market liquidity
  - number of market makers
  - market price
  - corporate governance
  - bankruptcy/ liquidation
  - qualified opinion on financial accounts
  - failure to file accounts on time
  - failure to follow good accounting practices
  - unsatisfactory financial conditions
  - in ability to meet debt obligations/ finance operations
  - abnormally low selling price or volume of trading
  - reduction in operating assets and/or scope of operations.

Recommendation
It is recommended that SECP and the Pakistan exchanges keep under review SECP regulations and exchange regulations covering de-listing.

- ***Market segmentation / second board development:*** The development of an OTC/ second market catering for the needs of smaller and growing companies in Pakistan is currently being considered by the exchanges, following the SECP's approval of approval of the Regulations governing Over-The-Counter Market (OTC) in December 2002. In addition, it is understood that the SEC has advised the Karachi Stock Exchange to furnish a revised road map for activation of the OTC Market, which is expected to be become operational in the first quarter of 2004. The OTC Market Regulations include provisions for minimum capital size, minimum issue/offer size, disclosure norms, compliance requirements, screening and the market making mechanism. It also prescribes *inter alia* detailed eligibility criteria for listing, including requirements for minimum paid up capital, minimum size of offer, and certification by auditors. The Commission has also advised the exchanges to forward their proposals for the setting-up of a separate board for the trading of debt securities and draft regulations for the same.

Recommendation

> Second board development initiatives in Pakistan should be underpinned by a thorough analysis of the current market and business context, and careful design of the market structure to reflect this. In particular, feasibilty studies should examine the potential supply of companies, and the preferences of investors, particularly the views of venture capital providers and domestic institutional investors. Market design should be comprehensive with maximum possible engagement with potential market users on market design. Key areas for analysis are noted in Part 2 of the report.

- ***International inward investment***: Despite they considerable rises in market indices recently there is currently only an estimated 2% holding by foreign investors in Pakistan. This is largely due to perceived country risk as a result of the political tensions with India over the territory of Kashmir, but also due to the overall relatively small size of the market compared to other emerging markets, and the relatively small size of potential investee companies.

Recommendation
Pakistan has attracted appreciable interest of overseas institutional investors in the past, and as a large country with a market capitalization of $US 21.5 billion can be in the position to do so in the future. To encourage greater and sustained participation by overseas institutional investors the SECP and the exchanges should continue their efforts to develop their legal and regulatory structure and market facilities to the standards expected by international investors.

- ***Other suggested reforms***: During the project a number of other suggested reforms to strengthen the listing regime were put forward, as follows:

  - In order to improve a culture of compliance, there should be regulations providing for the protection of ‘whistle-blowers’ from within listed companies.

  - Whereas the penalties/surcharges/extension fees imposed for breaches of the exchange listing regulations are liable to be paid by the companies, the SECP has the power to fine/penalise the directors of the companies, which are in violation of statutory requirements. These powers should be extended penalise directors of listed companies for breaches by listed companies.

  - Listed companies should be required to hold their board meetings at which their financial accounts are to be considered and declaration of any dividend entitlements for the shareholders after closure of the market to ensure that the outcome of the meeting is made available to all stakeholders simultaneously, when the market re-opens.

Annex 3.7 - Sri Lanka

Overview – key dimensions of market

Country pop. (m)	Year exch. open-ed	GDP $US Bn.	Mkt cap. $US Bn.	Mkt. Cap. ratio	No. list-ed Cos.	Av, mkt. cap.	Instit. invs.	For. invs
19.7	1985	73.7	2.6	3.5 %	240	10.8	40-60%	30%

Findings, recommendations, action plans and topics requiring further exploration

- ***Stage of capital market development***: CSE listed companies are generally closely controlled by dominant family shareholders, who tend to maintain a "private company" mentality, despite the increased transparency and disclosure responsibilities they face when their company is listed. Although there are currently some 42,000 limited companies (including approximately 20,000 public companies) in Sri Lanka, only 240 companies are listed (including 18 on the Second Board). Banks are in the most powerful position in the financial markets. Economic growth and activity has increased in recent years, encouraged by the ongoing peace process, and the economic benefits of a $US 4.5 billion multi-donor aid package. Optimism has been manifested in the substantial increases in the CSE index, which rose by 38.7% and 31.2% in 2001 and 2002 respectively, although serious political uncertainties have recently returned and been reflected in dramatic falls in the index.

Recommendation
A range of co-ordinated capital market development efforts are needed to generally improve the quality of the capital market, and to increase its size by attracting more listed companies and domestic investors.

- ***CSE new listings:*** The CSE moved over to a disclosure-based approach to listing regulation in 2000, although the success of the change is difficult to assess as yet due to low number of new listings, with 9 new listings in 2002, and only one IPO in the first 8 months of 2003. In order to stimulate new listings, the CSE decided to target the considerable constituency of Sri Lankan non-listed public companies by abolishing initial listing fees, providing for listing by way of introduction (in contrast to public offering through an IPO) to, and to lower the shareholder spread requirements by abolishing the previous minimum free float requirement. As a result a listing applicant must only have a minimum number of 8 shareholders, the level required to qualify as a public company under the Companies Act, to satisfy initial listing requirements. The rationale for the lowering of the requirements has been to encourage public companies to familiarise themselves with the market, and then later to broaden their shareholder base through further issues. The existence of a minimum free-float

and initial listing fees were seen as deterrents to flotation, and founding shareholders were concerned at low valuations and loss of control. Concerns on the extent of free float also seem to relate back to the experience of the market in the mid 1990's, when a market bubble fuelled by foreign investor turnover levels of up to 60%, collapsed. For these reasons companies have been prepared to pay a premium to banks for business funding rather than access the capital market, even although the cost of equity capital is estimated at 3%, compared to interest rates of around 10%.

It is understood that the CSE and SEC have conducted a study of unlisted public companies which indicted a widespread lack of awareness of the use of the capital market.

Recommendations

Extending the listed company market is a major objective for the CSE. In accordance with the general recommendations set out in Part 2 of the report the CSE and SEC should continue their work on:

- developing methods of gaining a greater understanding of the factors impacting companies decisions to list, focused on the currently unlisted corporate sector, and
- engaging in collaborative efforts to raise general awareness of the capital market as a capital-raising avenue for companies.

In particular, the CSE should review its minimum shareholder spread requirements as these do not conform with international norms for initial main board listing.

- ***Market segmentation and proposed introduction of a "Superior Board":*** The CSE is considering the introduction of a Superior Board to differentiate companies on criteria relating to size, liquidity and adherence to certain corporate governance principles, drawing upon compliance with the Corporate Governance Code issued by the Institute of Chartered Accountants of Sri Lanka.

Recommendation

It is recommended that CSE conduct a thorough analysis of the implications of segmentation of their markets, ranging from the proposed "Superior Board" through their main board and second board/ OTC segments. In particular, the review should assess the likely reactions of current listed companies and other public companies to proposed changes, and also to consult the views of investors, and particularly the tendency of institutional investors to prefer "listed" securities, characterised by direct regulation of the companies by the listing authority and strong ongoing disclosure and governance requirements. By assessing fully the views of both companies and investors CSE will be able to make more informed judgments on the segmentation of its main and junior market.

- ***Exchange controls and inward foreign investment:*** Exchange Controls are still in place in Sri Lanka, although reform is rapidly taking place, with foreigners able to control up to 100% in most listed companies, with some restrictions on the maximum holdings in specific types of companies of national strategic interest (e.g. mass transport companies). Further changes to exchange control regulations expected soon, which will allow CSE to establish a USD board for free trading of securities between Sri Lankans and foreigners.

Comment
The experience of foreign inward investment in the listed company sector in Sri Lanka, encouraged by gradual restrictions on Exchange control regulations, provides a useful case study for other SAFE countries where more onerous restrictions are still in place.

Annex 4 - Features of listing regimes and market environments

Principles of listing regulation

A listing regime should embody the following widely accepted principles:

- **Balancing market access and investor protection** by seeking to achieve an appropriate balance between providing issuers with access to the market at the earliest opportunity and providing investors both with protection and with sufficient and timely information for the purpose of enabling them to make informed decisions as to the value and prospects of listed securities. For example, the United Kingdom Listing Authority (UKLA), operated by the Financial Services Authority (FSA), expresses its purpose as providing:

> **"a cost effective regime which facilitates access to capital markets by a broad range of businesses, and to operate that regime so as to maintain market confidence and to protect investors"**

- **Suitability of investments** by ensuring applicants are suitable for listing
- **Proper information and processes are adhered to** ensuring that the distribution and marketing of securities is conducted in a fair, open and orderly manner and that potential investors are given sufficient information to enable them to make a properly informed assessment of the applicant, and of the securities for which listing is sought
- **Ongoing disclosure is by made issuers** to ensure that investors and the public are kept fully informed by listed companies, and in particular that immediate disclosure is made of any information that might reasonably be expected to have a material effect on market activity in, and the prices of, listed securities
- **Probity of corporate governance standards and behaviour** to ensure that all holders of listed securities are treated fairly and equally, and that directors of a listed issuer act in the interests of its shareholders as a whole, particularly where the public represents only a minority of the shareholders.

Legislative and regulatory framework for listing

Historically, each regulatory environment has evolved in line with its host country's social and economic history and market experiences. For example, the United Kingdom (UK) has the largest and most highly developed capital market in the world outside the United States (US), and as result has developed a sophisticated regulatory environment reflecting an interaction of legislation, listing rules, guidelines and market practices. This environment has evolved gradually over a long period of time and through calamitous market events such as the South Sea bubble, the railway mania of the 19th Century to the Polly Peck and Maxwell corporate scandals in the early1990's.

However, the UK's membership of the European Union is continuing have legislative and regulatory implications for its listing regime. In the European Union, directives provide the over-arching framework for the listing regime, with the policy having been to date to set core standards and generally not to provide prescriptive requirements as to how individual member States should implement such standards, allowing individual jurisdictions to add additional requirements to there regulatory frameworks. The directives covering listing are currently being reviewed, with the strategic objective of implementing a single market in Europe for financial services. As a part of this process the Prospectus Directive, the Transparency Obligations Directive, the Investment Services Directive and the Market Abuse Directive (MAD) are being developed, and it is foreseen that these will have have a substantial impact on the approach to listing regulation in the UK, and in other European member countries.

In the United States the development of the current regulatory regime arose from the aftermath of the 1929 Wall Street crash which was, in part, blamed on securities fraud. The dominant characteristics of the US regulatory approach are the tendency to provide strong enforcement for securities laws and a highly litigious atmosphere. These were evident in the responses by the authorities to the recent corporate scandals involving Enron, Worldcom and others which have deeply shaken public confidence in the corporate sector and the role of the capital markets in IPO's. The responses have been the swift enactment of far-reaching legislation, the Sarbanes-Oxley Act, 2002, and the high profile legal actions brought by the New York Attorney-General, Eliot Spitzer[29]. The Spitzer action led a recent financial settlement with major US investment banks totalling over USD1.4 billion, and agreements *inter alia* on:

- insulation of research analysts from investment banking pressure
- a ban on the spinning of IPO's
- an obligation to furnish independent research
- disclosure of analysts' recommendations, and
- publication of ratings and price target forecasts.

The Continental European capital markets have developed much more recently, due the traditional reliance for business funding on bank lending, rather than equity markets, and have not evolved the same levels of detailed level of regulation necessary in larger markets such as the UK and United States. Due to their British colonial heritage the Australian and Hong Kong models have their origins in the UK model.

The developing countries and transitional economies (previously command economies) have also been rapidly developing their capital markets during the period of rapid international economic and trade liberalisation experienced during last two decades. As a measure of progress, emerging market capitalization as a percentage of GDP grew within that period from 1% in 1980 to 13% in 1990 and 20% in 2000[30]. The listing and regulatory frameworks adopted in the developing countries have tended to draw on

[29] The SEC, the NYSE, the NASD and other regulatory agencies co-ordinated their various investigations with Spitzer into alleged abuses surrounding analysts' research and IPO allocations.

[30] From "Thirty Years of Emerging Securities Market In Perspective" speech by Rudolf van der Bijl, at the World Federation of Exchange's Forum on Managing Exchanges in Emerging Economies, Kuala Lumpur, December, 2002.

approaches of the developed markets, adopted for local market conditions, particularly in the areas of corporate governance, information disclosure and listing procedures.

Institutional responsibilities for corporate and listing regulation

Institutional responsibility for the discharge of corporate and listing regulation is carried out in a number of different ways, with responsibilities often shared between a number of different governmental, regulatory bodies and market operators. For example there may be a multiplicity of corporate regulators including the stock exchange, a securities commission, a companies registry and an official receiver's office, as well as law enforcement agencies responsible for detecting and enforcing commercial crime and corruption cases involving listed companies. In most countries prime responsibility for listing regulation is held by the securities commission, stock exchanges or is shared between them, with a system of checks and balances to ensure that potential conflicts of interest are controlled or eliminated put in place through legislation, memorandum of understandings, special corporate governance provisions and regulatory oversight through senior regulator's approval of new listng regulations and regulatory audits,

In most countries, such as the United States, France and Germany, the stock exchange is responsible for assessing the eligibility of an issuer to be listed whilst the senior regulatory authority (typically a securities commission) is responsible for information disclosed to the market by the issuer at he point of first public offering (IPO) and subsequently. In contrast, since the demutualisation[31] and listing of the London Stock Exchange (LSE), the British Government now places all responsibility for listing regulation with its main securities regulator, the Financial Services Authority (FSA).

A topical subject in regulation of capital markets is the challenge of dealing with conflicts of interest in the regulatory framework arising from the trend towards exchange demutualisation and commercial operation of stock markets. This has been largely driven by the increase in international competition among exchanges, which requires them to operate more efficiently and to have broader access to capital to finance investment in new technology.

The key regulatory issue arising from exchange demutualisation are the real and perceived conflicts of interests where a commercial exchange is also responsible for regulation of listed companies. The main concern is that the exchange may be less inclined to refuse listing applications, which are a direct source of income in the form of listing fees and transaction levies, and less willing to commit the resources that rigorous self-enforcement would require.

The Technical Committee of the International Organisation of Securities Commissions (IOSCO) has published an Issues Paper on the subject of exchange demutualisation. The Paper observes that there is no single “right” regulatory path to follow in jurisdictions where stock exchanges demutualise and self-list, and does not prescribe any solution which should be adopted, as that will depend on the particular market characteristics and circumstances.

[31] The conversion of the traditional not-for-profit member-owned exchange to a shareholder-owned for-profit organization, possibly listed on its own market.

Measures taken to address the conflicts of interest arising from an exchange's roles as a regulator and as a commercial entity usually involve the setting up of a regulatory subsidiary under the exchange (Australia), the signing of an agreement between the exchange and the regulator to set out the procedure for handling conflicts (Singapore), or the transfer of the listing authority function to the securities regulatory body (United Kingdom).

The regulatory approaches of national regulatory authorities also vary in style, with some adopting a more interventionist and pro-active approach than others. The SEC in the United States, the FSA in the UK and the COB in France are perceived as taking a strident approach. Hong Kong's regulatory approach has developed based on the UK model, both in terms of securities regulation and responsibilities of the regulator. Holland, Germany and Luxembourg could be characterised as adopting a less interventionist approach. The regulator in Australia, ASIC, whilst not directly active in the regulation of securities offerings, significantly influences the behaviour of the Australian capital markets through its powers of oversight.

Listing rules

The main prescriptive requirements governing listing tend to be set out in listing rules, published by a stock exchange of other regulatory body. These tend to contain requirements covering *inter alia* the following matters:

- the listing process (e.g. listing approval by an exchange Listing Committee comprised of a range of market users)
- compliance and enforcement provisions
- criteria for initial and continuing listing
- disclosure in listing documents (prospectuses)
- disclosure in periodic reports (such as interim and annual financial statements)
- disclosure of price sensitive or material events and information
- duties of directors and advisers of listed issuers (e.g. sponsors)
- dealings by directors in their company's securities
- certain categories of defined transactions by listed issuers with third parties or with parties connected to the company or its directors, and
- certain corporate activities of listed issuers, including secondary issues and placements, rights issues, and granting of share options,
- prescribed corporate governance standards and practices.

Use of advisers in the listing process and due diligence practices

The use of professional advisers, including auditors, accountants, lawyers, financial advisers and valuers, is central to the efficacy of the listing process. Some jurisdictions use advisers as a support mechanism of their regulatory model. For example, in the UK and Hong Kong regulatory frameworks have the most defined and extensive role for an advisor to a listed company to act as an intermediary between the company and the regulator, discharging a "sponsor" role. The requirements for a sponsor and their responsibilities are prescribed in the UKLA listing rules, although the role is also defined in law and by market practice. In Hong Kong the requirement for, and role of, the sponsor is also set out in the HKEX's listing rules, which also include a code of conduct for sponsors. In France, the COB requires all Nouveau Marché (second board) and

foreign companies to retain an advisor for a period of three years after listing. There is no equivalent role to the UK sponsor in Germany, where the main role of the lead bank is to ensure market liquidity post-IPO. The Australian market has no defined sponsor role, relying instead on the market participants such as the banks and lawyers to ensure appropriate procedures are carried out.

Due diligence practices also vary widely internationally. Due diligence procedures derive for the requirements legislation covering public offering, which generally tend to provide that, where a person who takes responsibility for all or part of a prospectus can demonstrate that they undertook “due diligence” in its preparation, they have a potential defence against litigation for omissions or errors in a prospectus for which they were in whole or in part responsible. However, the manner in which due diligence is demonstrated tends to vary widely between jurisdictions, due to the perceived risk of litigation in that country, by the standards set and responsibility for prospectuses imposed by law on directors, other officers, reporting accountants, valuers and other experts, and market practices.

The focus on obtaining a due diligence defence is most apparent in the United States. In contrast, in Germany, for domestic offerings, the lead bank has some responsibility for the accuracy of the prospectus but there is little litigation experience and there are no specific local responsibilities imposed. Consequently, less focus is placed on due diligence, as the perceived risk of litigation, particularly to parties such as the investment banks, is generally limited. The effect of local regulation is evident in the UK listing rules, which explicitly require a “sponsor” to confirm that it has undertaken due diligence. The due diligence defence adopted by an underwriter in the United States is very much legally-driven, and includes attendance by the underwriter’s counsel and investment bankers at due diligence meetings with the issuer’s management. The result is a letter from counsel to the underwriter, known as the “10b-5” letter. The role of other parties in broader commercial or financial due diligence is typically limited to focused verification work. The increasing prevalence of securities being offered globally, particularly those in the United States under Rule 144A, has led to United States due dligence practice being applied in other countries, regardless of the size of the United States element of the offering.

Due diligence practices in the UK have evolved differently from those in the United States. There is an important distinction between US due diligence practices, which is typically more hands-on by the lawyers and accountants (e.g. checking physical assets, agreements, etc.), as compared with the traditional UK verification questionnaire approach whereby UK sponsors will instruct third parties, such as the reporting accountants and lawyers, in respect of every statement in the draft prospectus, but place more reliance on paper-based evidence and directors/officers' responses. The contrast in approach may be explained by the fact that due diligence practices have been developed in the UK to investigate the company for the purpose of assessing eligibility for listing, whereas in the United States the emphasis is more on providing a defence mechanism to protect the company and investment banks against any liability arising from disclosures omitted from the prospectus.

There are no formal due diligence requirements in Germany, although, as elsewhere in Continental Europe, market practice typically involves extensive due diligence being carried out by lawyers on prospectuses and the lead bank carrying out commercial or

financial investigations to the extent they deem necessary. Market practice in Australia is that a due diligence committee comprising, amongst others, the underwriters, lawyers and auditors, together ensure that the prospectus has been verified. Whilst maintaining a sponsor regime, Hong Kong practices have, especially since the advent of international offerings of mainland China companies through Hong Kong since the early 1990's, increasingly been influenced by the adoption of US investment banking and legal practices.

Requirements for company eligibility for listing

The question of initial and ongoing issuer suitability or eligibility for listing of securities arises in every capital market, although requirements and practices in making these assessments differ markedly. In addition, as markets have become more sophisticated, the incidence of differential regulation has also increased with different regulatory requirements being applied to distinct products and market segments.

Contrasts in methods of assessing eligibility: The United States has adopted a disclosure-based approach, with the SEC playing no part in assessing or vetting eligibility and the stock US stock exchanges assessing eligibility against verifiable, largely quantitative, eligibility criteria set out in their listing rules. The United States model is based on the principle of "buyer beware" (caveat emptor), with emphasis on disclosure of prescribed information in the prospectus rather than a qualitative assessment of issuer suitability, based on pre-vetting of listing documentation by regulatory officials. The involvement of an associated investment bank supporting the issue of securities is central to the US model.

Regulatory bodies in continental Europe do not generally assess the qualitative suitability of an issuer for listing. In those markets where an assessment is made, it is carried out by the stock exchange, against measurable quantitative criteria. However, in Continental Europe the lead investment bank is usually locally-based and has a strong interest in being associated with successful IPO's, and their involvement includes an implicit assessment of the suitability of a company for listing.

In contrast to elsewhere the FSA in the UK conducts an assessment of the suitability of an applicant for listing which includes both qualitative and quantitative criteria, and the exercise of judgment by expert FSA regulatory staff. Certain Continental European regulators carry out interviews and conduct site visits to applicant issuers, and also seek to highlight to investors the limitations in their role in relation to prospectuses by requiring explicit disclaimers to be prominently displayed on documentation.

Initial eligibility: The main initial listing criteria in the developed markets tend to include both quantitative and qualitative aspects including:

- ***Size***: minimum size of applicants in terms of net assets, shareholder equity or (expeed) market capitalisation
- ***Operating history:*** minimum period of existence and/or operating history
- ***Audited financial track record:*** Existence of audited financial statement for the track record period to recognised accounting standards (e.g. GAAP/GAAS or IAS)
- ***Profits history:*** minimum profit levels during that period

- ***Sufficiency of working capital:*** working capital adequacy verification and disclosure
- ***Minimum public float:*** minimum percentage or amount of shares to be held by public (non-associated) shareholders post IPO (e.g. 25%[32])
- ***Placement and spread of shareholder base:*** minimum numbers of public shareholders
- ***Capability of directors and non-executive directors:*** Requirements on experience of directors, their longevity with the company and presence of non-executive directors.

Sufficiency of working capital: The UKLA requirements on sufficiency of working capital have been in existence for many years and, apart from Hong Kong, are unique amongst the major markets. These requirements are relevant to assessing eligibility for listing, supported by information being disclosed in listing documents and needing to be reported upon by sponsors. In Australia a working capital adequacy statement is required to be included in an IPO prospectus. Continental European markets do not have explicit requirements on working capital positions, although in practice it is usual that an issuer's sponsoring bank is also its corporate lending bank, with knowledge its clients financial position and needs. Although in the US there is are no explicit rules requiring sufficiency of working capital, there are a number requirements which are of relevance to the topic. As the requirement for an audit in the United States is only mandatory for listed companies, reliance is placed upon the audit opinion to provide assurance with regard to a company's working capital at the time of listing. In addition the US SEC requirement for a Management's Discussion and Analysis section to be set out in prospectuses ensures that a commentary on a company's financing needs is provided publicly.

De-listing criteria: The main de-listing criteria in the developed markets tend to include both quantitative and qualitative aspects including:

- **Sanctions:** Cancellation of listing can be used as the ultimate sanction where companies have transgressed their listing obligations
- **Failure to meet stated standards:** De-listing is triggered or considered where a company no longer meets the initial eligibility criteria, or certain stated criteria, such as:
    - trading price
    - market capitalisation (relative to the overall market)
    - shareholders equity
    - total assets
    - revenue
    - minimum public float
    - profitability
    - market liquidity
    - number of market makers
    - market price
    - corporate governance
    - bankruptcy/ liquidation
    - qualified opinion on financial accounts

[32] Minimum threshold set by European Union directives.

- o failure to file accounts on time
- o failure to follow good accounting practices
- o unsatisfactory financial conditions
- o in ability to meet debt obligations/ finance operations
- o abnormally low selling price or volume of trading
- o reduction in operating assets and/or scope of operations.

Market segments: differential regulation of markets and product types

A major trend in capital market development in recent years has been the increasing incidence of differential regulation of markets and products types. This is evident in the emergence of junior markets or second boards in many countries, and the segmentation of markets by exchanges developing products targeted at certain types of professional investors (e.g. specialist debt securities) or types of issuers (e.g. information technology and biotechnology companies).

Junior markets (second boards): The late 1990 saw the development of second markets in many countries, including UK, Germany France, Hong Kong, Taiwan, and Malaysia. A recent study noted that there are currently 22 such markets or market segments in Europe alone. Second markets, also often known as junior markets, second boards and growth markets, markets are generally established to cater for the capital-raising needs of smaller or recently-formed companies, and are characterized, in particular, by having less onerous track record and other initial listing eligibility criteria, although in some markets additional disclosure requirements and specific additional requirements are imposed over and above those required on the main market.

For example the UK second market, the Alternative Investment Market (AIM), operated by the LSE since 1995, imposes a high standard of self-regulation through the role of sponsors known as Nominated Advisors, although, unlike with main board listing in the UK, the UKLA does not pre-vet GEM IPO prospectuses. In France and Hong Kong the junior markets are in some ways more heavily regulated than their main markets. In France Nouveau Marché companies to operate the “document de reference” system, report quarterly, and have prospectuses attested by an investment bank and approved by the COB. HKEX’s Growth Enterprise Market (GEM) market, established in 1999, requires quarterly financial reporting requirements and imposes additional corporate governance obligations to those of its main market.

Care is needed in assessing the success of second markets established in recent years, as they have tended to be designed in the context of the business and regulatory framework in their jurisdiction, generally to cater for domestic investors, and to be complementary to the role and nature of the main domestic securities market in each jurisdiction (i.e. their main board). Perhaps due to their focus on younger and growing companies their life-cycle also can be observed to being aligned more directly to the economic cycles, and as a result their performances tending to exhibit an exaggerated picture. This can be observed in the experiences of many of the European new markets established in the late 1990’s, where observers see closures and consolidations as

increasingly inevitable[33]. The closure by Deutsche Borse's of its Neur Markt in September 2002 has become synonymous with the technology market boom and bust.

Markets catering for professional investors: Many developed markets permit securities to be offered to "professional" or "sophisticated" investors with minimal regulatory oversight. For example, the US SEC's Rule 144A and the various exemptions under the European Union's Public Offers Directive permit "international" offers to be made based on the existence of a listing and recognition of the regulatory provision in one country without further regulation in other countries where the targeted professional investors are located.

There has been a marked trend towards the design of innovative instruments catering for the needs of institutional and sophisticated investors. This trend has also led to the development of stock exchanges in many of the smaller international financial centers (offshore) in recent years[34]. Luxembourg has traditionally been the leading tock exchange of choice for the listing of specialist debt issues and mutual funds. In recent years its pre-eminence has been strongly challenged by the LSE on debt issues and the ISE (Dublin) on mutual funds listings. LSE and Dublin made considerable efforts to compete directly with Luxembourg, particularly through rationalising their listing rules, and setting up a specialist listing documentation vetting teams. The core business of many of the new "offshore" exchanges is the listing of mutual funds, asset securitisations and specialist debt issues, registered in their jurisdiction, or in competing centers. As the motive for listing on these exchanges is usually to increase the marketability of the issue, and to provide international institutional investors with the necessary regulatory comfort and visibility, the listing aim for such issues has not traditionally been to seek access to secondary market liquidity.

Sources of information at initial public offering, (IPO) document approval and listing application procedures

Prospectus and registration requirements: Company and securities legislation tend to require:

- the publication of a prospectus (offering document) where a substantial amount of securities are to be offered to the public, and
- that the prospectus is the sole source of information and that it contains all the information necessary for an investor to assess the issuer and its securities.

However the practices adopted by regulators overseeing these requirements tend to differ. The US information disclosure model is based on a concept of registration whereby a company files an initial registration document which is then updated by subsequent quarterly reports, transaction circulars and is fully refreshed each year by an annual filing, with the subsequent document being incorporated by reference. The SEC reviews all initial registration statements prior to them being declared effective and subsequent filings are reviewed on a selective basis. In France, the COB has adopted an approach based on the registration concept, whereby listed issuers are required to prepare an annual "document de référence" which is similar in form to a prospectus.

[33] The head of Grant Thornton's capital markets practice was reported in The Financial News (UK) in May, 2003 as predicting that a quarter of growth markets worldwide after launching during the 1999-2000 market boom, but failing to attract sufficient business.
[34] For example in The British Overseas Dependent Territories of Bermuda, the Cayman Islands, Channel Islands (Guernsey) and the Malaysian Federal Territory of Labuan.

Although the registration statement and annual update approach is gaining ground, beyond the US and France, in most other jurisdictions material further issues of equity securities must be supported by the issue of a prospectus containing information equivalent to that at an initial offering. Under European Union directives prospectuses for listed companies must be approved by the national regulator (as competent authority) before they can be used. The Australian regulator no longer approves any prospectus before it is issued, although it does have the power to order a prospectus to be withdrawn in a short period after its issue.

Prescribed information disclosure: The extent and nature of information prescribed to be disclosed in prospectuses and listing documents varies throughout the world. For example, in Australia there are few prescribed disclosures, whereas in Europe detailed information content requirements are prescribed by the Consolidated Admission and Reporting Directive. Most prescribed disclosures relate to the current and historical position of the issuer and its business, although forward-looking and pro forma (for illustration purposes) information may also be included on a carefully considered basis.

- **Main areas of information required**: Listing rules require disclosure of detailed information in the prospectus or initial listing document on the following areas:
  - the persons responsible for the prospectus, auditors and other advisers
  - the shares to be listed
  - the company and its capital
  - the company's activities
  - the issuer's assets and liabilities, financial position and profits and losses for the track record period
  - the issuer's management, and
  - recent developments and prospects of the company
- **Specific provisions for specialist issuers**: In the UK specific additional disclosures are required by the UKLA listing rules for specialist industry issuers, such as property companies, mining companies, bio-technology companies, and investment companies, and in Hong Kong there are additional disclosures for specialised industry issuers, People's Republic of China companies, and different security types.
- **Summary documents;** Summary short form prospectuses are not used in the US, whereas they are widely used for marketing of securities in Holland and Germany, and extensively for widely distributed offerings of formerly nationalised companies and demutualised building societies.
- **Forward-looking information:** Due to the perceived threat of litigation most listed companies do not publish explicit forward looking information or forecasts, although such information is potentially the most valuable for investors. In the US the threat of litigation is probably the highest, and this acts as a deterrent to the disclosure of any forward-looking statements. As a result, offering documents include extensive disclaimers covering the use of words which could be construed as being forward-looking. In France, the COB requires any profit forecast made as part of the IPO process to be included in the prospectus, and covered by an accountants' attestation certificate. UK companies tend to avoid the inclusion of explicit profit forecasts in prospectuses, but where they occur they are expressed in euphemistic language in a prospectus, supported by analysts' research, to communicate a view of the issuer's prospects.

- **Use of pro forma financial information:** The UK has relaxed its previous limited acceptance of pro forma (for illustration) financial information in prospectuses in recent years ago to allow information relating to the most recent financial periods to be adjusted to show the effect of a transaction, as long as the relaxation was subject to detailed disclosure requirements as well as public reporting by the issuer's reporting accountants. The SEC has specific rules requiring pro forma financial information to be presented, illustrating the effect of major transactions.

Vetting of information documents: Regulators adopt a range of methods of reviewing prospectuses and listing documents. The US SEC conducts an extensive review process at initial registration. The FSA conducts detailed pre-vetting of draft listing documents, whereas the Australian securities regulatory body (ASIC) does not pre-vet or formally approve IPO prospectuses, relying instead on self-regulation by the issuer and its advisors, underpinned by the ability of ASIC to require changes in a prospectus, or even suspend an offering, if major omissions are discovered.

Regulation of marketing: Approaches to the regulation of marketing of securities offerings also varies. In the US, any advertising which could be construed as promoting an offering is not permitted in the pre-IPO period, including the publication of research by analysts connected to the issuer. "Roadshow" presentation of information to potential investors is permitted in the US, as long as it is not published in printed form or distributed. In France, the COB attends roadshows to ensure that no additional information is imparted beyond that contained in the prospectus. Roadshows are also a feature of the UK primary market and may contain additional detail to information set out in prospectuses and elaborated upon by management in response to questions raised by attendees. Analyst research reports are also used to convey additional analysis. As these are usually prepared by the research departments of the investment bank sponsoring the new issue, and typically tend to be subject to the review by the issuer's management, concerns have been expressed by investors that the objectivity and independence of such analysis could be tainted. The FSA is currently consulting market participants and the public on measures to address these concerns.

Continuing obligations – ongoing disclosure requirements

Continuing Obligations listing rules tend to cover the following key areas of the activities of companies, and their directors and major shareholders (and in some cases other related parties):

- Disclosure of "price sensitive" information
- Disclosure of periodic financial information
- Specific prescribed disclosures of material information
- Prompt disclosure of directors dealings, and
- Other prescribed disclosures.

An insistence upon a high level of disclosure is necessary because information is critical to the support of analysts and investors and this in turn is essential to supporting market liquidity, and the information is the best assurance of a fair market and the best safeguard against market manipulation, insider trading and other harmful practices.

Disclosure of "price sensitive" information: In most markets there is a general ongoing listing requirement to disclose information likely to affect their share price as soon as it is available, augmented to varying degrees by a range of specific financial and other prescribed disclosures depending on the market concerned.

In the European Union basic continuous disclosure requirements derive frrm the EU Admissions Directive, although the UK is widely perceived as having both a more extensive range of disclosure requirements and a more proactive regulatory approach to monitoring compliance by issuers with its requirements, focused on encouraging listed companies to respond to market rumours and price movements. The UK's has evolved with its market, reflecting its scale, maturity, and relative sophistication as indicated by the widespread presence of institutional investors and research and investment banking industries associated with the market.

In the US the SEC requires listed companies to make prescribed disclosures on a quarterly and annual basis within defined time limits within specific time limits of completion of major transactions, rather than applying a continuous requirement, as in the UK.

Detailed guidance to listed companies and their advisers (such as lawyers, accountants and public relations firms) on guidance on the dissemination of price sensitive information and dealing with media interest is published by the FSA. The guidance highlights the need for equitable disclosure of information to investors and the public, in terms of both content and timing. The US has introduced similar fair disclosure rules in SEC's Regulation-FD. These are arguably less strict than those in the UK, for example, in that they accept that providing a journalist with information can constitute, in some circumstances, fair disclosure.

Disclosure of periodic financial information: Markets require the timely publication of audited annual and interim financial results, as a key indicator of company performance. A company's accounts provide a framework against which to judge the performance of the company's directors and managers and reflect the company's viability and financial health.

Historically most markets, other than US did not require the publication of quarterly financial a statements. However, an active debate on the value of quarterly reporting continues internationally.

Quarterly reporting requirements are increasingly being imposed in Europe, especially in respect of specialist markets and segments catering for growing and technology companies. Similarly in Hong Kong, the HKEx's second board the Growth Enterprise Market requires quarterly reporting of financial statements as part of its "disclosure-based" approach. The latest draft proposals from the European Union on transparency obligations advocate that quarterly reporting should be required of all listed companies and that such quarterly reports should be subject to auditor review. An argument put forward by proponents of quarterly financial statements is their familiarity and hence attractiveness to US-based investors.

On the other side of the debate, some commentators in the developed markets are opposed to the imposition of audited quarterly report requirements, citing the extra

compliance costs of supporting formal reporting, especially where continuous disclosure requirements are already in place. It is argued that the interpretation of continuous disclosure requirements requires intermediate updating (e.g. at an Annual General Meeting) in relation to sales, margins and gearing.

Specific prescribed disclosures and actions on certain transactions: Continuing obligations listing rules also tend to include a range of specific disclosure requirements on material information, and on corporate governance matters (discussed further below)

UK listing rules require comprehensive disclosure of major acquisitions, disposals and related party transactions, an approach is also adopted mirrored in US, Australia and Hong Kong. FSA listing rules require specific disclosure of information (and in some cases a shareholder vote) on corporate transactions, dependent on the relative size of the transaction, and require related party transactions[35] to be covered by an independent advisor's fair and reasonable opinion.

The FSA may be involved in detailed pre-vetting of disclosure announcements and shareholder documentation. Hong Kong and Australia also prescribe similar transaction requirements to those in the UK. The US SEC requires companies to disclose by way of Form 8-K filing (publicly available) prescribed details of material events or corporate changes, including details of major acquisitions and disposals. Although the SEC does not require to itself pre-vet transactions or impose shareholder consideration of transactions, US state law or the company's charter documents may impose specific particular shareholder and/or director approval requirements.

In contrast requirements for disclosure of corporate transactions in Continental Europe are not as highly developed, tending to be limited to the continuous disclosure requirements, or where a transaction involves further issues of securities, and the European Commission's recent transparency proposals do not advocate comprehensive disclosure. However, the proposals for shelf registration with an annual filing document would require disclosure of details of major acquisitions, including financial histories, albeit somewhat belatedly in the annual filing. A notable indication of developing international thinking is the inclusion in the OECD's Code on Corporate Governance that shareholders should be explicitly informed by companies on major acquisitions and disposals of substantially all of a listed company's business or assets.

Regulation and disclosure of director's major shareholders dealings: Regulation and disclosure of director's dealings is well-established in the UK market. Listed companies are required to adopt a code of dealing no less exacting than the FSA's Model Code set out in the listing rules. The purpose of the Model Code is largely preventative one of seeking to ensure that directors and persons connected with those directors do not abuse, and do not place themselves under suspicion of abusing, price sensitive information, especially in periods leading up to the announcement of results. Company law and listing rules also combine to ensure that directors dealings are reported promptly to companies and the companies in turn publicly disclose details to

[35] For example in many Asian countries listed companies are still controlled by either one, or a small number of related shareholders, often by family members of the founding shareholders. As a result, listing regimes often seek to redress the inherent balance of power by prescribing various minority shareholder protections in their regulations.

the market. A similar approach is taken to the reporting and disclosure of dealings by major shareholders (holding at least 3%).

In the United States director and major shareholder dealings disclosures are required to be filed 10 days after the end of the month in which the dealing occurs. The United States also has provisions precluding directors from making gains by buying and selling shares within short periods, so called "short swing" trading. There is no equivalent to the Model Code in the United States although there is the deterrent effect of insider dealing legislation.

In contrast to the UK, director or major shareholder reporting and disclosure requirements in Continental Europe tend to be limited to the minimum standards contained in the red by the Major Shareholdings Directive which require reporting and disclosure of holdings of 10% or more.

Other prescribed disclosures: Listing rules may also contain specific prescribed continuing obligations, requiring *inter alia* regular disclosures and notification of information to shareholders, and obtaining shareolder consent to certain proposed transactions. A number of examples are set out in the table below.

Dividend declarations: Any decision by an issuer to declare, recommend or pay any dividend or to make any other distribution on its listed securities and the rate and amount thereof must be made, and reported to the relevant authority for dissemination to the investing public.
Changes in directors of the company: There occurs any significant changes to the composition of the board of directors or senior management personnel of the issuer (including any change in the chairmanship).
Changes in the nature of the group: Any material change to the business policies or business projects of the issuer.
Material contracts: The agreement of the terms of a material contract or agreement with another person, where such contract or agreement will have a significant effect on the issuer's assets, liabilities, rights or one or more of the products manufactured, supplied or traded by it.
Material investments: The making of any material investments outside of the ordinary and usual course of business of the issuer (being any investments equal to or greater than twenty (20) % of the book value of the existing net assets of the group) or the purchase of long term assets for a significant amount.
Significant losses; There occurs any significant (e.g. greater than twenty (20) % of the book value of the existing net assets of the group) trading or non-trading losses.
Change in regulations: Any newly promulgated laws and regulation, policies, directives, or systems announced by the Government having a significant impact on the trading and production of the issuer.
Litigation: Any involvement in significant litigation proceedings.
Purchase of own securities: The issuer shall inform the Exchange immediately, for dissemination by the Exchange, of any repurchase, drawing or redemption by the issuer or any subsidiary, of its listed securities
Alteration of company's articles and association: Any proposed alteration of the issuer's constitution
Change in rights of shareholders: Any change in the rights attaching to any class of listed securities and any change in the rights attaching to any shares into which any listed debt securities are convertible or exchangeable
Change in company's administration: Changes of company secretary, auditors or registered address

Winding-up and liquidation: (a) the presentation of any winding-up petition, or equivalent application in the country of incorporation or other establishment, or the making of any winding-up order or the appointment of a provisional liquidator in respect of the issuer, its holding company or any major subsidiary; (b) the passing of any resolution by the issuer, its holding company or any major subsidiary that it be wound-up by way of members' or creditors' voluntary winding-up; (c) the entry into possession of or the sale by any mortgagee of a portion of the issuer's assets which in aggregate value represents an amount in excess of fifteen (15) % of the book value of the existing net assets of the group; or (d) the making of any judgment, declaration or order by any court or tribunal of competent jurisdiction whether on appeal or at first instance, which may adversely affect the issuer's enjoyment of any portion of its assets which in aggregate value represents an amount in excess of fifteen (15) % of the book value of the net assets of the group.
Minimum required public holdings: The issuer shall inform the Exchange immediately if it becomes aware that the number of listed securities which are in the hands of the public has fallen below the relevant required minimum percentage (e.g. 25%),or the number of shareholders has fallen below the prescribed minimum.
Registration of transfers: The issuer shall register transfers and issue definitive certificates arising out of a registration of transfers or the splitting of certificates within a stipulated number of business days (e.g. 5) of receiving properly executed transfer documents or the date of expiration of any right of renunciation (as appropriate).
Registrar: If the issuer does not maintain its own register, appropriate arrangements must be made with the registrar to ensure compliance with the listing requirements.
Subsequent listings: The issuer shall apply for the listing of any further securities which are of the same class as securities already listed on the Exchange, prior to their issue, and shall not issue such securities unless it has applied for the listing of those securities and the relevant authority has approved the application.
Proxy forms: The issuer shall send with the notice convening a meeting of holders of listed securities to all persons entitled to vote at the meeting, proxy forms, with provision for two-way voting on all resolutions intended to be proposed at the meeting.
Equality of treatment: The issuer shall ensure equality of treatment for all holders of securities of the same class who are in the same position.
Response to enquiries form the Exchange: The issuer shall respond promptly to any enquiries made of the issuer by the Exchange concerning unusual movements in the price or trading volume of its listed securities, or any other matters, by giving such relevant information as is available to the issuer or, if appropriate, by issuing a statement to the effect that the issuer is not aware of any matter or development that is or may be relevant to the unusual price movement or trading volume of its listed securities.
Additional obligations: Exchange shall be entitled to require the publication of further information by, and impose additional continuing obligations on, the issuer where it considers that circumstances so justify, but will allow representations by the issuer before imposing any additional obligations on it which are not imposed on listed issuers generally.

Corporate governance provisions

An increasing focus on corporate governance[36] standards has been a key recent trend in international capital markets, driven mainly by the corporate crises in the US and also by globalisation. As a result corporate governance policy has been high on the agendas of multilateral organisations such as the OECD[37], IMF and the World Bank, and the national regulatory authorities in most countries in recent years.

Corporate governance standards are imposed and influenced through a variety of means – by company and securities laws, listing regulation, codes of practice, shareholder activism, and in some cases by a mixture of these methods.

Listing regimes generally play an important role in setting and applying standards of corporate governance for listed issuers. Listing rules and regulations may contain provisions covering the following areas:

- Directors expertise and experience to manage their business
- Enshrinement of certain shareholder rights
- Takeovers regulation
- Adoption of corporate governance codes
- Adoption of codes regulating of directors dealings (see above), and
- Disclosures and action on certain transactions (see above).

Director's expertise and experience: UKLA listing rules require the directors and senior management of listed companies to have appropriate expertise and experience to manage their business but, unlike firms regulated by the FSA in its other capacities, the competent authority does not approve the directors of listed companies. A company's Articles of Association determine the manner of appointment of directors; in almost all cases, the Articles of a listed company will give the company power to make and confirm the appointment of directors at its general meetings.

Enshrinement of certain shareholder rights: A number of shareholder rights are enshrined by some listing regimes as follows:

Share allocations to retail investors: Traditionally a number of jurisdictions have had specific requirements aiming to ensure minimal allocations of securities issues to retail investors. In France the COB mandates that a minimum of 10% of an IPO must be offered directly to retail investors, and limits are placed on range of prices permitted in a price range offering and on the extent to which pre-IPO share issues can be offered at a discount to the IPO price. In Hong Kong, the HKEX regulates the placing and

[36] "The structure and processes of the governing body, typically the board of directors in a joint stock limited liability company, is central to corporate governance. The relationships between the board and the shareholders, the auditors, the regulators and other stakeholders is also crucial to effective corporate governance, as is the linkage between the board and top management. Effective corporate governance ensures that long-term strategic objectives and plans are established and that the proper management and management structure are in place to achieve those objectives, while at the same time making sure that the structure functions to maintain the corporation's integrity, reputation and accountability to its constituencies." Source: Progressive Corporate Governance (www.pcgworldwide.com).

[37] The OECD Principles of Corporate Governance, May 1999.

subscription of shares, requiring that a minimum of 25% are offered to retail investors. In contrast in the UK and the US there are no preferential requirements in favour of retail investors.

Shareholder pre-emption rights: In the UK and in much of Continental Europe, company law provides shareholders with a pre-emptive rights over further issues of the same class of securities, subject to waiver by shareholders in general meeting. In the US pre-emption rights for shareholders of public companies are not enshrined in legislation, although shareholders are generally required by local state legislation to vote on significant increases in capital, usually in excess of 20%.

Takeovers Regulation: Once a company's securities are freely traded amongst the public it is possible for new shareholders to build up their interests. In order to regulate such potential changes in control and to protect the position of minority shareholders, securities laws or regulations, listing rules or codes of conduct tend to provide regulatory controls over the build-up of substantial stakes in public companies, and to require offerors to inform and purchase the securities of other shareholders in takeover situations. The extent of and approach to takeover regulation varies widely internationally.

Adoption of corporate governance codes: In addition to the legal framework, and the provisions of the UKLA listing rules, UK listed company corporate governance is regulated by a code of best practice which is appended to the listing rules, the "Principles of Good Governance and Code of Best Practice" (the Combined Code). The Code's principles of corporate governance are recommended to be applied flexibly, with common sense and due regard to companies' individual circumstances, and that the annual report should explain the application of the principles. The Combined Code contains 14 corporate governance principles and 45 provisions applicable to listed companies. Although the Combined Code is appended to, it does not form part of the listing rules. However, the listing rules do require listed companies to include in their annual report and accounts a narrative statement explaining how the principles have been applied together with a statement setting out in detail the extent of compliance and reasons for any non-compliance. A company's external auditors are also required to review aspects of the compliance statements in relation to a number of specified provisions.

Following the corporate scandals of recent years the UK Government appointed a leading investment banker, Derek Higgs to undertake a review of the effectiveness of non-executive directors, and amendments to they Combined Code are expected during 2003.

Recent reform of corporate regulation US: Traditionally the approach of the US regulatory authorities to shareholder rights has been non-prescriptive and non-interventionist. Instead reliance has been placed on the largely disclosure-based regulatory system providing shareholders with sufficient information to take action by buying or selling shares, and this is supported by legislation providing punitive remedies for fraudulent behaviour. However the regulatory response to the US corporate scandals crisis has been far-reaching.

The Sarbanes-Oxley Act came into law on 30 July 2002. Many of the provisions are effective immediately, while others will into force when final regulations are issued by the

SEC with an implementation horizon of 2004. The primary purpose of the Act is to increase the reliability and accuracy of corporate reporting, improve accounting and auditing practices, and ensure the independence of advice and recommendations of securities analysts, and as a result aims to help restore the loss in trust and confidence in US corporations and capital markets. The Act establishes more stringent practices for accountability and lays down much tighter penalties for corporate wrongdoing. Company executives, specifically the CEO and CFO are now personally liable for the completeness and accuracy of the information contained in the filings[38] that their organisations make to the SEC. Extreme cases of failure to comply can result in long prison sentences and large fines for directors and executives.

In addition in May 2003 the SEC announced a review of rules that currently hinder shareholders from nominating directors to US companies, the result of which could greatly enhance the abilities of shareholder activists to influence corporate governance in the US.

Compliance monitoring and enforcement regulations mechanisms and experiences

The nature of the compliance monitoring and enforcement regimes vary among jurisdictions.

Compliance in listing regimes: Exchange's compliance monitoring regimes usually include the following activities:

- monitoring the content of disclosures by issuers of information at initial listing and on an on-going basis
- market surveillance, supervision and compliance monitoring of trading activities, including review of pricing of orders
- monitoring the timely and orderly release of price-sensitive information
- monitoring of the timing and content of quarterly review statements and half-yearly and annual financial statements
- vetting of the initial suitability of applicant firms applying to act as Sponsors, and ongoing review of continuing compliance with eligibility criteria
- monitoring of adherence of Sponsors to their ongoing duties to the Exchange and instituting disciplinary proceedings against them
- undertaking investigations into suspected market abuses and liaising with other regulatory agencies.

Enforcement: Generally those countries where a securities commission takes the leading role in listing regulation tend to have stronger enforcement backing for their compliance work, as the commissions have been directly established and empowered by national securities legislation. Where stock exchanges discharge the front-line responsibility for listing regulation, the contractual nature of their relationship with listed companies has tended to pre-dominate, with direct consequences for the effectiveness of their ability to enforce their requirements. As rules imposed contractually by means of listing rules can only be enforced upon parties with which an exchange has a direct relationship, in the case the of listing rules the listed company as a corporate person, the scope for targeted and effective enforcement is often regarded as limited. The most

[38] Including forms 10K, 10Q, 8K and other publicly disclosed documents.

common forms of sanctions, focused on suspension and cancellation of listing, are also regarded as clumsy and blunt, tending to penalise shareholders by denying them access to the market, rather than targeting those responsible.

For regulations to be generally applicable, and therefore to apply company directors, officers, principal investors, and sponsors, primary or secondary legislation is required. Moreover, legislation is required to create criminal sanctions. Some jurisdictions endow securities commissions and stock exchanges with powers to impose criminal penalties on issuers and their directors for breaches of disclosure requirements and market abuses, principally through the imposition of fines and imprisonment. In Malaysia, for example, the Securities Industry Act empowers an exchange to fine issuers and their directors for breaches of exchange listing requirements. In Canada, the Ontario Securities Act codifies disclosure responsibilities of listed companies, which imposes criminal penalties on issuers and their directors for failures to publicly disclose material information and for misrepresentation. In Hong Kong The Securities and Futures (Stock Market Listing) Rules, 2002 provides for a dual-filing system, which effectively provide an element of statutory backing for the listing rules, allowing the SFC (securities commission) to effectively extend its investigatory and enforcement powers provided by securities legislation to listed companies, their controlling shareholders and directors in respect to the provision of providing false or misleading information.

Suspension and cancellation of listing: Listing rules generally provide that listing status has been granted subject to the condition that where the Exchange considers it necessary for the protection of investors or the maintenance of an orderly market, it may at any time suspend dealings in any securities or cancel the listing of any securities in such circumstances and subject to such conditions as it thinks fit, whether requested by the issuer or not. Typical grounds are:

- an issuer fails, in a manner which is considered material, to comply with the listing rules
- there are insufficient shares of the issuer in the hands of the public
- the issuer does not have a sufficient level of operations or sufficient assets to warrant the continued listing of its securities on the Exchange; or
- the issuer or its business is no longer suitable for listing.

Cancellation of listing is used both as a sanction, but also increasingly as a strategic tool to improve overall market quality. However, the use of suspension and cancellation of listing as compliance tools and sanctions is that the device punishes shareholders by denying them liquidity, and in the case of cancellation relinquishes any remaining influence the exchange may have on a recalcitrant board.

Annex 5 - Factors relevant to domestic capital market development

Introduction

A number of factors that directly impact the nature and scope for development of listing standards in developing capital markets are discussed in this annex. These are set out below under the following headings:

- Levels of private sector support from issuers, investors, financial intermediaries
- The stage of development of the overall corporate sector
- Macro-economic conditions conducive to market development
- Supportive Government policies, and
- Legal and regulatory framework.

Levels of private sector support

Most importantly, the facilities of the capital market need to be relevant to the needs of companies seeking to raise capital, investors, and financial intermediaries. How conditions influence these key market users are discussed below:

Issuer interest

The willingness of companies to raise capital through the market may be impacted by:

- the availability of sources of capital from private sources and the banking sector on more favourable terms than the public market
- reluctance of many small and/or family-controlled businesses to dilute ownership- for example in Asia, approximately 75% of listed companies remain family-run[39].
- the generally under-developed state of the private sector in many developing countries
- costs and bureaucracy in public offering processes, and
- reluctance to incur additional compliance costs and transparency obligations.

[39] Source: "Asian Corporate Governance White Paper", June 2003.

Note on IPO costs

Costs associated with IPO's can be considerable when professional advisory fees, compliance costs and demands on a company's management are taken into account. Internationally these have been estimated at between 3 and 7% of IPO value, these costs can be divided into professional charges, brokerage fees and exchange listing fee costs.

A lead manager, often an investment bank, will usually act as overall adviser in bringing its client company to market. The lead manager's tasks may involve analysis of the industry and advising on such matters as the value of listing. A key variable is whether or not the company elects to have its securities offering underwritten, depending on judgments on the perceived risk of the listing, pricing of the offer and on the importance of achieving a fully taken-up offer. Underwriters fees tend to be in the region of [2]% of the issue value.

Legal costs tend to be based on the time involved and vary with the complexity of the transaction, with most of the legal work concentrated in the weeks prior to registration of the IPO prospectus. Exchange listing fees tend to comprise a relatively minor element of the IPO costs. They usually comprise initial listing fees and annual fees, set on either on a fixed fee basis or on a graduated basis related to the size of the company's (expected) market capitalisation.

Investors

Domestic investor demand for equities in developing countries may be limited, due to low-income levels or low propensities to save among the general population, or the lack of developed institutional investment vehicles such as mutual funds and pension funds. Policies encouraging pension reforms involving the creation of the provident funds and the mandatory professional management of pension funds can have the effect of boosting demand for equities. Similarly development of the insurance industry, especially the life insurance sector where liabilities are longer term and which therefore facilitating investment of funds in the capital market, can also provide a source of long-term investment capital.

Further discussion on the relevance of listing standards to the encouragement of inward foreign investment is set out below under "Encouraging inward foreign investment – international recognition and benchmarks for listing regulation".

Financial intermediaries

Financial intermediaries are essential to the established methods of market operation, but low issuer activity and trading volumes due to a small or inactive investor base will restrict the scope for profitable intermediaries such as broker-dealers to flourish. A lack of activity puts upwards pressure on transaction charges to investors, and in turn increases the entry costs to market usage. A small number of participating market intermediaries may also distort competition and lead to higher costs to investors.

Stage of development of the overall corporate sector

The listed company community typically comprises the most highly regulated and prestigious market segment in an economy, and in a fully developed capital market sits at the apex of a range of other segments of the private corporate sector ranging from sole traders, family-owned and operated companies, public companies which are closely held, joint ventures, and developing companies which may be partly funded by strategic investors such as venture capitalists. The securities of some of these companies may be traded outside the exchanges at significantly higher transaction costs and with little market information available, with investors needing to search for potential buyers on their own.

In many developing countries therefore there is an acute need to consider the development of OTC and venture capital arrangements, alongside the formal listing regime, in order to better meet the needs of the private sector and to contribute to the much-needed growth of that sector. In the developed economies exchanges have tended to address the needs of "growth" companies exchanges by creating "junior" markets or "second boards" catering for the trading of companies which do not yet qualify for listing and which require additional capital and liquidity to facilitate their growth. The use of exchange facilities for this sector is a "live" issue in a number of the SAFE exchange markets, as discussed further in Part 3 of the report specifically in relation to a number of the SAFE markets in Annex 3.

Macro-economic conditions conducive to market development

Given the commercial nature of the decisions to list and to invest in listed securities, prevailing macro-economic conditions are an important factor impinging on the effectiveness of a listing regime and development strategies. For example, some conditions which might affect healthy progress in capital market development are:

- **Inflation rates** - high inflation rates discourage investment in long-term financial assets.
- **Economic growth rates** - low growth dampens demand for equities and hence productive investment of risk capital
- **Interest rates** - relatively high real short-term interest rates can reduce the demand for capital market instruments, with substantial domestic savings being diverted into short-term government securities, and
- **Low savings rates** – due to poverty or low savings propensities will lower demand for investment products.

Supportive Government policies

Strong Government support and commitment to capital market development is essential in developing economies. Examples of supportive policies are:

- **Fiscal and other incentives** put in place to encourage capital market activities. For instance, making issuing costs tax-deductible or imposition of a low withholding tax on dividends.

- **Encouraging inward foreign investment**, and where exchange controls are in place amending exchange control regulations and easing restrictions on inward investment by international investors. Easing of restrictions on inward investment can also potentially improve the capital formation potential in the economy and increase market liquidity. For example, a favoured approach to limiting exposure of domestic securities markets to foreign parties has been the imposition of ceilings on foreign investments in all or specific sectors either by imposing a limit for each individual investor in a listed company or an aggregate limit for foreign investors in each listed company, and
- **Privatisation of Government-owned enterprises:** A major catalyst to capital markets growth in many emerging markets has been the privatisation of government-owned corporations.

Legal and regulatory framework

A suitable legal and regulatory framework which has been developed in line with national strategic economic policies, is necessary for investor confidence, particularly to encouraging domestic institutional and international inward portfolio investment. International recognition issues are discussed further below.

Encouraging inward foreign investment – international recognition and benchmarks for listing regulation

International investor interest in developing countries tends to be shaped by a number of factors including:

- the presence and extent of restrictions on inward foreign investment
- assessments of country risk, especially currency risk
- the size of the target market and target companies within the market. For example, based on anecdotal comments, international institutional investors tend to limit their investments to not less than USD 50 million in any company and in countries where the market capitalisation is at least $US 20 billion, and
- levels of confidence in the protections provided to investors by the securities market infrastructure[40] and legal and regulatory frameworks.

The desire to attract international investment has contributed to the gradual opening up of domestic capital markets in recent years, and although there is no definitive single benchmark for listing regulation internationally, there has been movement towards some convergence of standards as developing countries have sought international recognition for their maturing markets.

In particular international acceptance and recognition of the legal and regulatory framework and market mechanisms are important to attracting inward portfolio investment by international institutional investors. These institutions are often subject to regulatory requirements set by their "home" regulatory authority or by virtue of their investment policies, requiring investment in securities "listed" on a "recognised exchange".

[40] As evidenced by the success of national central securities depositories (CSD's) in satisfying due diligence exercises undertaken by international custodians, thus facilitating links with local custodians.

Published international standards relevant to exchange listing regimes

Convergence of standards has been encouraged by the emergence of international standards relevant to exchange listing regimes, as follows:

- **Formal recognition criteria and lists of approved exchanges** published by national securities regulatory bodies in the major international asset management centres (e.g. the US SEC and the UK FSA). These may dictate the permitted investment policies of publicly offered mutual funds and other regulated investment institutions such as insurance companies in these centers, and cover a range of characteristics of the overseas market (e.g. local settlement and custody arrangements) as well as the legistaive and regulatory provisions.
- **OECD Principles of Corporate Governance,** issued in May 1999, and which have come to serve as a worldwide benchmark for policy dialogue on corporate governance reform. They also constitute one of the 12 core standards adopted by the Financial Stability Forum to promote stability of the global financial system. The Asian Roundtable on Corporate Governance[41], which serves as a regional forum under the OECD corporate governance initiative, published a White Paper (consultative document) in June 2003 containing region-specific guidance and suggestions to assist policymakers, regulators (including stock exchanges), and other standard-setting bodies in non-OECD countries of the Asian region. Further comments on the Asian Roundtable on Corporate Governance are set out below.

- Relevant **IOSCO standards,** as follows:

    - International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers, Report of IOSCO (September 1998).
    - Adapting IOSCO International Disclosure Standards for Shelf Registration Systems, Report of the Technical Committee (March 2001).
    - Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities, Statement of the Technical Committee of IOSCO (October 2002).
    - General Principles Regarding Disclosure of Management's Discussion and Analysis of Financial Condition and Results of Operations, Report of the Technical Committee of IOSCO (February 2003).

- **Investment industry guidelines** such as the corporate governance and information disclosure standards required by international institutional investment houses as promulgated by bodies such as the Institute of International Finance[42].

[41] The Roundtable comprises senior policymakers, regulators, and representatives of stock exchanges, private sector bodies, multilateral organisations, and non-governmental institutions.

[42] For example the code proposed in the IFF report "Policies for Corporate Governance and Transparency in Emerging Markets, 2002". The IIF is a leading representative group of international institutional investment institutions.

Annex 6 - Examples of regional market integration initiatives

Regional capital markets internationally have typically been developed and designed through:

- ***expansion***: by national exchanges extending their businesses to international companies and investors through provision of listing and trading facilities to issuers from other countries, and
- ***co-operative projects***: between nations and exchanges in a region sharing a common economic interest, usually facilitated through the auspices of an economic community.

Markets established through expansion

There has been a trend, more marked before the TMT boom[43], of the larger established stock exchanges seeking to expand internationally, encouraged by their ability to raise finance as commercial entities (post de-mutualisation), and as result of changes in European Union legislation which have expanded their business horizons. Examples of international markets developed through exchange expansion are Euronext, the integrated platform formed by the national exchanges of France, Belgium and Holland, the London Stock Exchange's International Equity Market, catering for the trading of shares of non-UK companies either listed directly in London or listed on other "recognised" exchanges throughout the world, and Hong Kong Exchange's (HKeX) "H" share market, catering for mainland China companies[44].

LSE's International Equity Market (IEM)

London has historically been a major centre for international securities listing and trading due to the United Kingdom's economic heritage and its role as a major international banking centre. The London Stock Exchange's (LSE) International Equity Market (IEM) developed rapidly in the late 1980's with trading in international securities coming "on - Exchange", following the merger of the International Securities Regulatory Organisation ("ISRO") with the Exchange and the development and success of the Exchange's SEAQ International price collection screen-based price quotations system.

The scope of the IEM is essentially defined by the securities eligible to be traded on it i.e. overseas securities directly listed on the LSE or securities listed on overseas exchanges which the Exchange and the FSA have "recognised" as having a suitable regulatory framework in place, and the involvement of LSE member firms in carrying out transactions in overseas securities. Overseas exchanges which have met assessment criteria principally relating to listing regulation, but also including free movement of capital between borders, are defined in LSE rules as "approved organisations". A distinguishing characteristic of the IEM is therefore the inter-relationship between the Exchange and the "home" exchange of issuers whose shares are listed and traded

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[43] The boom in stock markets largely caused by listing of new technology, media and telecommunications (TMT) companies, which led to a severe downturn in international stock markets in 2000.

[44] This market was first established in the early 1990's in co-operation with the mainland Government, prior to the change in sovereignty of Hong Kong in 1997. The market can be characterised as an regional market due to the fact that mainland companies are constituted in a separate legal system (mainland China) to that where they are listed (Hong Kong), under the "One Country – Two Systems" arrangements.

there. This interest takes the apparently conflicting form of competition for business on the one hand and, for many securities traded on the IEM, a reliance on the discharge of regulatory responsibilities by the "approved organisation" on the other.

The main regulatory features of the IEM are:

- The regulatory arrangements for the market are founded on the fact that the IEM caters mainly for professional investors, and as result is regulated with a “lighter touch”, in line with the principle that professional investors require a lesser level of protection than private investors due to their greater knowledge of investment matters.
- The FSA’s conduct of business rules govern the obligations of financial intermediaries to their client investors, and the rules concerning suitability of investments and customer understanding operates to ensure UK investors receive pertinent advice in relation to purchasing international securities.
- In particular, a feature of the “trading-only” segment of the IEM is the lack of a direct “listing” relationship between the Exchange and the issuing company. In the case of such securities the Exchange "assumes" that the proper flow of information is taking place from issuers to the market by virtue of its continuing obligations to the "approved organisation" on which it is formally listed and that the requirements to inform the market are being monitored and enforced to a reasonable standard by that exchange.

Hong Kong’s “H” share market

HKEX’s “H” share market caters for the listing and trading of the securities of some 81 mainland Chinese incorporated companies (state-owned enterprises). The Chinese mainland company market sector represents 24 per cent of Hong Kong's listed companies and 28 per cent of its market capitalisation. The mainland companies have raised HK$100 billion in Hong Kong since 1993, when the “H” share concept was introduced[45].

In designing the market the Hong Kong authorities addressed the stark differentials in regulatory framework and business practices between Hong Kong and China by requiring “H” share companies to undertake additional listing obligations, which sought to address the differentials between the two jurisdictions, and the entering into of a regulatory Memorandum of Understanding between the Hong Kong Securities and Futures Commission (SFC) and The China Securities Regulatory Commission (CSRC).

Co-operative projects facilitating regional capital market development

Initiatives have also been launched to develop regional markets through the facilitation of economic communities of nations. Some examples are:

- East African Community (EAC),
- CARICOM’s Caribbean initiative, and
- Southern Africa Development Community (SADC), and

Each of these are discussed briefly in the following paragraphs.

[45] Source: South China Morning Post, 6, August 2003

Eastern African Community (EAC) regional capital market development

The EAC was established under the *Treaty for the Establishment of the East African Community*, signed in November 1999. Formally launched in January 2001, the EAC succeeded the *East African Cooperation*, set up in 1996 to revive regional cooperation which had ended following the 1977 collapse of the original East African Community.

The gradual development of the regional capital market in the EAC is being spearheaded by the cross-listing and trading of some major companies. In March 2001, the Kenyan-listed East African Breweries Limited (EABL) made history by pioneering cross-listing of its shares on the Ugandan Stock Exchange (USE). Kenya Airways also listed in March 2002. Because of capital controls in Tanzania, cross-listing has only been possible between the Nairobi Stock exchange (NSE) and USE. EABL intends to apply for a cross- listing on the DSE when the Tanzanian government ends current restrictions on foreign investors.

Synopsis – World Bank views on EAC regional capital market development

EXTRACT FORM WORLD BANK REPORT[46]

"The member countries of the East African Community[47] (EAC), Kenya, Tanzania and Uganda, have committed to the creation of an enabling environment within which the private sector can flourish and generate faster growth in individual countries. One of the pillars of this effort is the pursuit of financial development, with a view to maximizing the ability of financial sectors to mobilize resources and efficiently allocate them to the most productive sectors of the respective economies.

A major gap in the provision of financial services to the EAC private sector is the lack of long-term finance. Financial systems in the EAC are dominated by commercial banks, which typically have not been reliable sources of long-term capital. Non-bank sources of medium to long-term financing (e.g. leasing, mortgage, and contractual savings) are also underdeveloped. Hence, a principal component of financial sector development efforts in the EAC is the expansion of capital markets in the Community with the objective of developing long-term debt and equity capital for the private sector.

To date, capital markets in the region have not been able to provide effective support for the private sector because they are small, underdeveloped and have limited activity. Although there are ongoing efforts in individual countries to alter this situation and expand capital markets, all the EAC countries have recognized the limitations of a country-focused approach and have placed substantial emphasis on the pursuit of a regional approach. It is expected that a regional market will ensure that capital markets fulfill their potential in providing long-term finance to support private sector activities in the EAC."

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CARICOM's Caribbean initiatives

In 1989 CARICOM, the regional economic community in the Caribbean region, adopted a policy of encouraging an integrated capital market through the gradual development of Caribbean regional stock exchange, on the basis that the free movement of capital was crucial to CARICOM's aim of creating the CARICOM single market and economy. The regional initiative was seen as allowing companies access to a wider market for fund-raising at competitive rates and therefore allowing industry to become more competitive regionally and internationally, and providing investors with opportunities to diversify their portfolios regionally and thus reduce portfolio risks.

Recognising the many implementation hurdles faced in establishing a regional capital market, CARICOM's initial approach involved the participation of the national exchanges of Barbados, Jamaica and Trinidad and Tobago in arrangements facilitating cross-listing and trading, which led to the cross-listing of 9 companies among the three exchanges. It is noteworthy that to address the effect of exchange controls in place in Barbados the Central Bank of Barbados issued guidelines in 1996 for the Barbados exchange (SEB) in relation to the handling of cross-border transactions on SEB. The guidelines *inter alia:*

- confirm a delegation to the SEB to approve transactions in cross-listed securities up to a stipulated value limit of BD$2 million
- define residential status
- require re-patriation of dividend income and sale proceeds by residents to Barbados
- permit CARICOM nationals to purchase and trade securities listed on the SEB provided that settlement is made in a foreign currency
- allow repatriation of dividend income and sales proceeds by non-residents up to the BD$2 million limit, and
- require the SEB to report in an agreed form details of purchases and stakes by Barbadian residents on the exchanges of other CARICOM exchanges and those of other residents of other CARICOM countries on the SEB.

Cross-border trading in the Caribbean, although commencing briskly, has hitherto been constrained by *inter alia* inadequacies in the legal and regulatory framework, the lack of supporting infrastructure and the relatively under-developed nature of the constituent national markets, a marked home-country investor preference and in particular the reluctance of many of the larger companies with regional businesses to listing even on their national exchanges.

In 1998 the Inter-American Development Bank supported a "Harmonization of Caribbean Capital Markets Project" which largely achieved its objectives of providing a common technological platform for securities trading, settlement and clearing, and has set up a Central Securities Depository in some of the countries.

The next policy steps that were being contemplated by CARICOM to further develop the Caribbean regional market were:

- devising a system for integration of all member states into the regional market, including those which do not have a national stock exchange

- linking regulatory efforts throughout the region by way of a Memorandum of Understanding between securities exchanges
- establishing an authoritative regional arbitration body in respect to cross-border trades
- developing a system of certification for industry participants,
- devising a regional investors protection scheme[48].

The SADC listing harmonisation initiative

Since 1997 the Committee of the SADC Stock Exchanges (COSSE) has been working on ways to develop regional Southern African capital markets. SADC has 14 member countries as follows: Angola, Botswana, DRC, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

The initial step in this process has been the agreement of a set of principles setting out minimum standards that the listing regulations of each member country should meet, in order to facilitate cross-listing between the southern African exchanges. A table[49] setting out the agreed principles is set out in Annex [6]. The aim of the harmonisation of listing regulations is allow the participant markets to attract more foreign capital through cross-border investments and also through dual listings of companies on various exchanges within the SADC region.

It is understood that COSSE is currently considering proposals from the Johannesburg Stock Exchange to establish a regional market, based on the common listing of the companies currently listed on individual national exchanges (both within the SADC region and elsewhere in Africa) and allowing their existing members to trade, clear, settle on the new market. The suggested benefits of the proposal are that the autonomy of the existing exchanges would be maintained, the new market would provide a central access point for financial markets within Africa, and providing a liquidity centre, and a focus for international inward investment in the region. It is understood that the JSE proposals are currently being discussed through Market Development Forums of interested parties.

[48] Source: Presentation by CARICOM at "A Symposium on A Regional Stock and Securities Exchange", held in Trinidad & Tobago, April 2001.
[49] Supplied by STOCK exchange of Mauritius (SEM), which is a COSSE participant.

Annex 7 - SADC's 13 PRINCIPLES FOR LISTING RULE HARMONISATION

SADC'S 13 AGREED PRINCIPLES FOR THE HARMONISATION OF LISTING RULES		
	Recommended Principles	**Comments**
1	**Form of the Listing Requirements** The structure of listing requirements of the SADC stock exchanges must be harmonized. The format of the JSE Listing Rules should be the standard.	• The form and not the content should be harmonized • Enhances clarity of the SADC listing requirements • Increases familiarity on the requirements of the region
2	**General Principles** The listing requirements of the SADC stock exchanges should at least include the following general principles: There should be full, equal and timeous public disclosure of all significant matters relating to listed companies. Holders should be given full information, afforded adequate opportunity to consider in advance and vote upon substantial changes in operations, constitution and shareholder rights. All parties involved in the dissemination of information must observe the highest standards of care in doing so. All holders of the same class of securities must enjoy fair and equal treatment.	• The listing requirements can never cover every circumstance that may arise in practice- they are essential guidelines of good market practice. • General principles facilitate interpretation • Attempts to avoid vagueness and uncertainty in application of listings requirements across the SADC region.
3	**Criteria for Listing** The listing requirements of the SADC stock exchanges should have the following criteria for listing: Minimum number of securities in issue Minimum percentage of equity capital held by the public Minimum number of public shareholders Minimum subscribed capital Minimum profit history Minimum audited pre-taxed profits	• SADC stock exchanges have agreed that the criteria (but not the thresholds for each criteria) for listing should be the same • Enable applicants to be at least familiar with the criteria on which applications are judged • Should facilitate dual listings. Attempts to avoid vagueness and uncertainty in application of listings requirements across the SADC region.
4	**Disclosures by new applicants for Listings** The listing requirements of the SADC stock exchanges should prescribe the disclosure requirements for documentation relating to the introduction, placing and public offers.	• Disclosure requirements and content of documentation for each method of listing should not differ • Disclosure requirements should be

	As far as possible they should confirm to those of the JSE	consistently applied • Disclosure should be sufficient to enable investors to make a properly informed decision
5	**Methods and Disclosures in respect of raising additional capital by Listed Companies** The listing requirements of the SADC stock exchanges should, as far as possible harmonise minimum content for press announcement and circulars and similar timetables for: o Rights offers o Claw back offers o Capitalisation Issues o Issues for cash o Vendor consideration issues o Vendor consideration placings	• SADC stock exchanges should prescribe the minimum contents for press announcements, circulars and the timetables relating to such issues. • Disclosure requirements and time tables should be consistently applied and sufficient to enable investors to make a properly informed decisions
6	**Continuing Listing Obligations** The listing requirements of the SADC stock exchanges should, as far as possible, conform their continuing obligations with those of the JSE and consolidate such obligations in a separate chapter or section.	• Consolidation of the continuing listing obligations into one section avoids/reduces likelihood that companies will ignore them
7	**Financial Information** The content and timing of interim and preliminary reports and annual financial statements should be sufficiently detailed in the listings requirements. Financial information and accounting standards should conform to the GAAP	• Full and proper disclosure of financial information is of paramount importance to investors • Where the required disclosures (say the Companies Act) are not sufficiently detailed, the listing requirements can prescribe additional disclosures
8	**Corporate Governance** The SADC Stock exchanges should make it a listing requirements that companies should state in their annual reports the extent of their compliance or non-compliance with the relevant aspects of the Code of Corporate Practices and Conduct contained in the King Report.	• Investors generally and international investors in particular are paying increasing attention to corporate governance (the way in which companies are managed) • SADC stock exchanges are urged to endorse the relevant codes on corporate governance
9	**Contents of Prospectuses/pre-Listing Statements** The listing requirements of the SADC stock exchanges should require the production of pre-listing particulars in the case of major issues and as far as is possible conform with required disclosure with those of the JSE	• Companies Act and listings requirements prescribe the contents of prospectuses and pre-listing statements but the extent of disclosures required differs considerable • Some countries do not require pre-listing statements (particulars)

		• These inconsistencies should be addressed to facilitate dual listings on SADC stock exchanges
10	***Transactions*** The listing requirements of the SADC stock exchanges should use the same criteria as the JSE for determining the size of "transactions" entered into by listed companies and should require press announcements, circulars and shareholders' approval when such transactions trigger the same thresholds as those of the JSE.	• When a listed company enters into a transaction, the size of the transaction dictates the extent of the disclosures and whether or not shareholders approval is required • Different criteria are used to determine the size of the transaction. This inconsistency and any other should be addressed.
11	**Related Party Transactions** The listing requirements of the SADC stock exchanges should adopt the same definition as used by the JSE in respect of related party transactions and, as far as possible, conform the disclosure and other requirements with those of the JSE relating to such transactions.	• There is a need to protect shareholders when a listed company enters into a transaction, which is not at arms length • Therefore SADC stock exchanges should define "related party transactions" entered into by listed companies and the disclosure and other requirements that apply in relation to such transactions.
12	**Pre-emptive Rights** The significance and necessity of provisions on pre-emptive rights should be reviewed and discussed. (Specific to the JSE)	• It is crucial that shareholders' rights and percentage holdings are not arbitrarily diluted without strict compliance to specific requirements • Companies should be enforced to attain a shareholders approval in these circumstances
13	**Low/Voting Shares and Pyramid Companies** Each SADC stock exchange should make its own decision with regard to the listing of low/high voting shares and pyramid companies	• The merits or otherwise of listing low/high shares should be discussed. • *NB: In line with international best practice, JSE has last year decided that the listed of new pyramid companies will not be allowed.*

Source: "SADC Stock Exchanges Harmonisation of listing requirements", by Mumba S Kapumpa, Secretary and Chief Executive Securities & Exchange Commission, Zambia. (Nov 1999)

Annex 8 - Project Terms of Reference and reporting

Background

The South Asian Federation of Exchanges (SAFE) was formed in January 2000. Its members comprise 13 stock exchanges from Bangladesh, Bhutan, India, Mauritius, Nepal, Pakistan and Sri Lanka. The convener bourse, the Chittagong Stock Exchange, acts as the SAFE secretariat.

SAFE's key objectives are to strengthen its member stock exchanges and their regulatory and supervisory environment.

To achieve these objectives, SAFE undertakes the following activities: facilitate exchange of information and promote mutual assistance among its members; encourage co-operation among the members in order to promote and to develop their respective securities markets; work towards common standards including International Accounting Standards and best business practices in securities markets; represent the members in related international forums; encourage cross border listing and trade in the region; co-operate in human resources development and transfer of technology; and address other issues of common interest as and when they arise.

To date SAFE has organised a number of conferences covering topics such as: cross border listing and trade; globalisation and deregulation: issues and challenges for exchanges; and globalisation and challenges to the small exchanges.

To further develop member capital markets, SAFE is keen to strengthen listing requirements in its member stock exchanges, by drawing on best practice within its membership and internationally. The strengthening of listing requirements will also contribute to SAFE's long-term goal of achieving harmonisation of regulation among capital markets in its member countries.

SAFE has requested FIRST's support for assessing the listing regulations of the member exchanges in comparison with international and regional best practice in order to identify strengths, weakness and development needs and disseminate the findings and expert's recommendation to the member bourses and concerned national regulators.

SAFE member stock exchanges

SAFE member exchanges vary greatly in terms of size and development of market infrastructure, ranging from National Stock Exchange in India, with over 1,000 listed companies and market capitalisation of over US$25bn, to the Nepal Stock Exchange, with less than 100 companies (only half of which are actively traded) and capitalisation at less than US$500m, with Bhutan even smaller. Also, the level of development of each member country stock exchange's infrastructure varies greatly, along with the effectiveness of regulations and capacity of stock exchange staff and regulators.
The regulatory regimes in the countries of the SAFE member bourses have been developing independently and thus differ substantially. In Nepal and Bhutan, for example, the bourses are directly owned and regulated by the Government. In other countries, stock exchanges are regarded as self-regulatory organisations. The degree

of self-regulatory power varies widely. International Accounting Standards are adopted in the relevant countries. Similarly, there is a trend to strengthen corporate governance standards. Nevertheless, the degree of enforcement and the requirements and procedures for listing vary widely.

The need for the project

Effective listing rules develop confidence in stock exchanges by enhancing transparency and improve the quality of investments available by creating quality hurdles for companies. These rules are therefore an important foundation for developing broad and deep capital markets. Conversely, poorly designed rules increase the cost of transacting and act as a barrier to companies tapping capital markets.

The project is aimed at meeting two needs: a) the strengthening of listing regulations in individual SAFE member countries; and b) facilitating progress towards harmonisation in the region.

Various weaknesses in listing regulations within the SAFE countries are apparent. Further, numerous peculiarities exist both between country members and within countries themselves which further exacerbate existing weaknesses.

For example, in Bangladesh there exist two stock exchanges - competing for market share - with approved identical listing regulations. In practice, however, the two exchanges behave differently. Companies delisted in one exchange for non-operation for more than three years are still being traded on the other exchange. The Bangladesh SEC, however, cannot address these differences as the bourses obtain their authority from statutes. Consequently, investors face high unfair competition costs.

Another example is in India where there is a move to establish a central listing agency. The present situation is such that securities not suitable for listing in one exchange may still be listed in other exchanges due to differing criteria and standards for listing. Investors suffer as the consequence.

In addition to removing such anomalies and weaknesses, a key benefit of the project will also be awareness generation among regulators of the costs of poorly-designed listing regulations.

With respect to the need for harmonisation of listing rules within the region, there is already considerable intra-region trade and investment. The present difficulties between India and Pakistan notwithstanding, there is also strong political will in the region - styled SAARC and SAFTA - to create a free trade zone. Strengthening of listing regulations in the first instance and harmonisation in line with international standards will be imperative in the near future to ensure the efficient flow of capital through the stock exchanges.

In the longer term, the capital markets of the region lend themselves very well to regionalisation. There is already a trend to this effect within India, which has some of the most advanced stock exchange infrastructure (although some weaknesses in enforcement of regulation). Many of the other countries have relatively small economies, with illiquid exchanges that are performing poorly and would benefit considerably from the efficiencies that regionalisation would offer.

Nevertheless, there remain a number of political and economic barriers to regionalisation in the short-term and SAFE is taking a step-by-step approach toward this objective.

Listing rules strengthening and harmonisation effort will be aimed at meeting international standards. As seen with other regional initiatives, eg, SADC, divergent levels of development in financial markets can be harnessed for the benefit of everyone, with the more developed markets acting as examples. It becomes easy for one country to adopt rules that neighbours have adopted.

We are aware that some work has already been done in this area by USAID (in India) and the AsDB (in most of the other countries). We have consulted both organisations and they feel the project will indeed be beneficial. The TORs build on the work that has been done.

Project goal and purpose

The project goal is developing more effective and consistent regulations in the SAFE member countries.

The purpose of the project is strengthening and making more consistent listing regulations in SAFE member stock exchanges.

Key project outputs

The key outputs of this project will be:

Report on the current listing regimes in the SAFE member exchanges produced.
Strengths and weaknesses in national listing regimes diagnosed and assimilated.
An action plan for addressing weaknesses of each national regulatory regime prepared and agreed.
List of areas and topics requiring further exploration (e.g. impact of local laws, tax regimes, etc).
An action plan to harmonise the listing regulations in the region, prepared and discussed.

Project risks

Implementation risks include:

The outcome of the study may not be adopted by the individual stock exchanges and/or regulators. SAFE has held various conferences in Bangladesh, Pakistan, India, Bhutan and Sri Lanka, which have included chief regulators from member countries. All participants explicitly support the SAFE venture. Whilst confidence exists that this risk is low, further mitigation will be achieved by involving regulators in the final workshop where study results will be presented.
Political risks – such as the exacerbation of political difficulties between India and Pakistan.

Idiosyncrasies may exist within member countries which require major changes to allow the harmonisation of listing regulations - for example, major changes in legislation or in the capacity of domestic supervisory agencies. We believe that this risk is low.

Terms of Reference

A small task force, with the international consultant supervising SAFE representatives will cover 4-7 stock exchanges each.

The international consultant, who will be a capital markets specialist (approximately 45 person-days), will concentrate on:

- Attending SAFE's Executive Committee meeting to receive comments on and agree TORs for the project.
- Developing questionnaires and terms of reference for SAFE Team Members and providing them with initial briefing. The questionnaires will focus on matters such as:
- Listing procedures
- Compliance with International Accounting Standards, GAAP and G30 recommendations
- Improved transparency
- Disclosure policy re price sensitive information
- Dividend distribution
- Analysis of information on penalties on companies or the managers, etc
- Corporate governance
- Prospectus requirements
- Capacity building needs within regulators
- Analysing the information collated and determining follow-up questions.
- Commenting on the current plans for developing regional co-operation in harmonising the regulation
- Developing action plan for SAFE member exchanges
- Drafting report in conjunction with SAFE team members
- Participating in final SAFE workshop

The main responsibility of the SAFE Team Members (between 2 and 3) will be to assist the international consultant in:

- Information gathering from member stock exchanges.
- Analysing the information and assisting the International Consultant in drafting the main report.
- Everyday logistics.

In addition, SAFE will take primary responsibility for organising the final workshop.

The kick-off meeting for the project will coincide with SAFE's 18-19 April meeting in Lahore. Discussions will be held to review the TORs for this project, the proposed outputs and the support needed from the stock exchanges.

Phase I will include the design of questionnaire and collating information from each member country.

During Phase II, when information is being gathered from the individual stock exchanges by the SAFE Team Members, the international consultant will provide such support as necessary.

Phase III will involve the collation of information and the preparation of the draft report.

Phase IV would involve the workshop to discuss the report and the preparation of the final report.

Reporting Requirements

The international and local consultants shall provide jointly:

- Report on the current listing regimes in the SAFE member exchanges produced.
- Strengths and weaknesses in national listing regimes diagnosed and assimilated.
- An action plan for addressing weaknesses of each national regulatory regime prepared and agreed.
- List of areas and topics requiring further exploration (e.g. impact of local laws, tax regimes, etc).
- An action plan to harmonise the listing regulations in the region, prepared and discussed.

Project timetable

The kick-off meeting will be held on 18-19 April 2003 in line with SAFE's April meetings. Phase I of the project will then commence during May 2003 in either Chittagong or Colombo. The high-level workshop in Phase IV is expected to take place during July 2003. AsDB representatives and other interested donors/IFIs will be invited to attend. The final report will be presented one week after the workshop.

Management arrangements

SAFE will be FIRST's counterpart and will assist in obtaining any permission required to enable this project to occur in the 7 countries involved. The Secretary General of the Federation, who may also work as a team member, will be the main point of contact for all the team members including the International consultant.

Subhrendu Chatterji, FIRST MU Director, is designated FIRST MU's Project Technical Officer, assisted by Angela Bell, Project Officer.

UK Value Added Tax

The consultant is to supply the services above to SAFE.

Annex 9 – Comments by SAFE exchanges on regional co-operation and development

Exchange's views
The Questionnaire requested all SAFE members for their views on the scope for greater harmonisation of listing standards among SAFE Exchanges, including their perspectives on the key implementation dependencies. The replies were: • ***CSE, Bangladesh wrote*: "**There are companies in Bangladesh who are willing to list cross border for raising larger fund and to ensure wider liquidity. Similarly, we understand that there are companies in other neighbouring countries having similar will. Fulfilment of this intention will require, among others, a harmonized listing regime.There are other factors, e.g., foreign currency convertibility etc. But SAFE can certainly work for compare and suggest a harmonized listing regulation acceptable for all the regimes." • ***RSEB, Bhutan wrote*: "**Regarding the cross border listing RSEB opined that the Government policy is very important to decide on this issue in their Exchanges. The existing rules do not permit them to allow cross border listing. If the Government allow the Exchange to do so they have to educate the investor as well as the listed companies about the market and the Exchange also require to restructure the organization by increasing the manpower and also to develop themselves enough to deal with the cross border listing." • ***OTCEI, India wrote: "***To begin with, there should be continuous and regular sharing of information among all the member exchanges of SAFE. The globally acceptable practices prevalent in one exchange may be considered for implementation in other exchanges also. The establishment of a regional capital market will definitely boost the growth of trade, industry and commerce, and hence the economy of the member countries. It will be an additional step towards globalising the products of member exchanges. Such a regional capital market will automatically provide for cross-listing and cross-trading of securities listed in the member exchanges on one platform. The challenges in establishing a regional capital market can be resolved by initiating the following steps: - There should be a dialogue among the governmental departments of the member countries in this regard, because without the co- operation of the governments of all member countries, it will not be possible to establish a regional capital market. - A common currency similar to Euro should be worked out for the member countries to facilitate the trading and settlement A committee may be established, consisting of stock market experts from the member countries, in order to formulate the listing requirements, disclosures standards, International accounting standards and best practices to be adopted in the regional capital market." • ***KSE, Pakistan wrote***: "Harmonisation of listing regulations across SAFE stock exchanges would remove impediments in cross-border listing. It will also benefit the regional countries from each others experience on emerging issues like development of OTC market, index futures, warrants and options trading, listing of scrip other than ordinary shares, ease of rating of cross-border scrip, standardisation of accounting

standards and ultimately paving the way for an effective regional trading block."

- ***ISE Pakistan wrote***: "The SAFE is playing an effective role for the regional co-operation and harmonisation of trading and allied affairs. The SAFE is bringing the stock exchanges closer to each other whereby the management of the stock exchanges can share the experiences with each other. The recent project on the harmonization of the Listing Regulations with the collaboration of foreign donors is of great significance. At present, different practices are being followed by different Exchanges even the bourses of one country are adopting distinct practices. The strengthening of regulatory regime is on top of the agenda of every Exchange irrespective of its geographical location. Therefore, the recommendations of the consultants would be given due weight by us.

  We also hope that SAFE would not only limit its tasks for the strengthen of Listing Regulations but a series of programme would be initiated to upgrade and harmonize other Rules and Regulations of the Exchanges."

- ***LSE Pakistan wrote***: "Although it would be very difficult to adopt a complete set of identical listing regulations in all the SAFE member Exchanges, the member Exchanges can identify and adopt the common principles and thereafter, uniform clauses can be incorporated in their respective listing regulations, if their corporate laws so permit.

  Necessary amendments in the regulatory framework can allow the cross-boarder listings. There can be standard criteria for cross-boarder listings. However, issues such as enforcement and monitoring of compliance of listing regulations under such cases need to be evaluated in detail. It is suggested that a SAFE committee comprised of member exchanges, should be convened to make recommendations on cross-border listings, and to prepare/update the guidelines for monitoring and enforcement of such listed securities by the member Exchanges.

  Regional cooperation on listing matters can be improved through:
  - Dissemination of changes in listing regulations and listing procedures to SAFE members.
  - Discussion of common challenges faced by the corporate sector of the countries at a SAFE forum in order to find out joint strategy to meet them through coordinated efforts.
  - Performance and activities of the member exchanges should be reflected at SAFE website.
  - Formation of Steering Committee of member exchanges to recommend SAFE on harmonization on listing matters."

- ***CSE, Sri Lanka wrote:*** "CSE is of the view that greater harmonisation of listing standards should pave the way for cross-listing and trading securities within the SAFE region. However the current Exchange controls applicable in almost all SAFE countries would have to be released if this objective is to be achieved."