Capital Market Development: Asian Experiences



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Capital Market Development: Asian Experiences



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Contents

Foreword 3
Messages 4
Speaking For ICC Bangladesh 8
About ICC - The world business organisation 9
Some Reflections on Bangladesh Capital Market 10
Risk Management and Surveillance 15
Role of Regulators in Improving Corporate Governance 18
Capital Market Transaction in Regional Emerging Economies 20
Cross Border Trade and Integrated Capital Markets 22
Bursa Malaysia Derivatives Berhad 23
Rules and Regulation of Valuation Methods: Buy-Back of Shares 25
Recent Trends in Global Capital Markets and the Role of Singapore Exchange in the Regional Economy 28
Asian Bond Market for Development of Regional Stock Exchanges 30
Demutualisation: Current Trend of the Stock Exchange Reform 32
Significant Milestones in the Development of Bangladesh Stock Market 34
Pension & Retirement Funds in Bangladesh 37
Bangladesh Country Profile 40
Major Economic Indicators 41
ICC Bangladesh Presidency 42
The Executive Board 43
Acknowledgements 45

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Disclaimer

The view expressed in the Articles contributed by the distinguished authors are their own and do not necessarily reflect the views of ICC Bangladesh.

Foreword



The 1997 Asian financial crisis points to the fact that weaknesses in the financial systems and free capital mobility have been crucial in aggravating and deepening the predicament. All the crisis-stricken countries had opened their market for free inflows of short-term funds and allowed foreign borrowing. It is well-known that the abolition of capital controls has often been followed by a large inflow of capital. Moreover, this inflow has typically been disproportionate in the form of short-term capital. As the crisis developed, domestic financial institutions found themselves unable to borrow, or even to roll over maturing loans.

In 1996, Bangladesh capital market also witnessed the biggest ever boom and as a consequence speculative trading gripped the market. DSE all share price index reached an all time high to 3648 points with the inflow of short-term foreign portfolio investments. In the absence of pre-emptive regulatory brake in an over-heated market, the inevitable happened and the market crashed and in a span of just a few months the index plunged to 650 points. The SEC established in 1993 came to the rescue and started the process of consolidation. Fundamentals and rationalities replaced speculations and rumours. Regulations become more comprehensive and as a result market started behaving more rationally and accountability has been put in place.

We in the International Chamber of Commerce (ICC) - Bangladesh, The world business organisation felt that through dialogues among the regulators, policy makers, capital market operators, financial institutions of the region, it is possible to identify the areas of mutual cooperation and avoid recurrence of such market disruption.

Keeping this in mind, Bangladesh National Committee of Paris-based ICC has organised a two-day "Regional Seminar on Capital Market Development: Asian Experiences" in Dhaka on September 27-28, 2005 which is the first of its kind arranged in Bangladesh. We are overwhelmed by the response from the regional regulatory commissions and stock market operators and other major stake holders for accepting our invitation to attend the Seminar at a very short notice. We believe that the two-day Seminar will provide a forum for sharing regional experiences and contribute significantly in setting up strategies for a sustainable capital market development programme that will reduce dependency for capital on the banking sector.

We are thankful to all our distinguished Moderators, Guest Speakers from home and abroad, multilateral agencies, Government of Bangladesh, esteemed participants, sponsors, supporters, advertisers, business community as well as ICC Bangladesh Secretariat to make the Event a success.



Mahbubur Rahman
President

Message from the Hon'ble President People's Republic of Bangladesh

بسم الله الرحمن الرحيم

রাষ্ট্রপতি



I congratulate the International Chamber of Commerce (ICC)-Bangladesh for organising the Regional Seminar on Capital Market Development : Asian Experiences. This Seminar, I believe, is quite an appropriate initiative particularly at a time when the Asian region is witnessing an increased spurt of growth driven by forces of globalisation and technological change. I hope, the capital market regulators and operators as well as experts coming from Asian countries will be able to draw up a plan of action on the basis of their deliberations for promotion and development of a regional capital market.

I am certain, ICC Bangladesh will continue to play its role in achieving our broader goals of economic growth and development, in times to come.

I wish the Seminar a grand success.

Allah Hafez, Bangladesh Zindabad.



Professor. Dr. Iajuddin Ahmed
President
People's Republic of Bangladesh.

Message from the Prime Minister
Govt. of the People's Republic of Bangladesh



I am pleased to know that International Chamber of Commerce (ICC)-Bangladesh is going to organize a regional seminar in Dhaka on 'Capital Market Development: Asian Experiences' on 27-28 September 2005.

Asia must strive hard to claim its rightful place as the leading force in the 21st century global economy. We should all work in unison to transform this century into an Asian Century. While many countries are already working together under the umbrellas of regional cooperation, we should make full use of every opportunity that comes our way. The seminar organized by ICC Bangladesh is, therefore, most befitting at this critical juncture of time.

I am optimistic that the ICC Seminar in Dhaka will provide all stake-holders with a unique opportunity to share each others' experiences as well as devise policies and strategies for mutual cooperation in capital market development. I hope, this forum will be helpful in designing a road-map for accelerated growth of the capital market in the Asia region.

I wish the Seminar all success.

Allah Hafez, Bangladesh Zindabad.

Khaleda Zia
Prime Minister
Government of the People's Republic of Bangladesh.

Message from the Minister for Commerce
Govt. of the People's Republic of Bangladesh



I am delighted to learn that International Chamber of Commerce (ICC) - Bangladesh is organizing a Regional Seminar on Capital Market Development: Asian Experiences in Dhaka on September 27-28, 2005.

This seminar, I understand, is bringing together regional stock market regulators, operators and other major stake holders from Asian region to identify areas of mutual cooperation.

I strongly believe that the two-day seminar will provide a forum for sharing regional experiences and contribute significantly in setting up strategies for a sustainable capital market development programme for countries of the region, in particular for emerging markets.

I congratulate all the members of ICC-Bangladesh for organizing such an important event and wish the seminar a grand success.

Air Vice Marshal (Retd.)
Altaf Hossain Choudhury, MP
Minister, Ministry of Commerce
Government of the People's Republic of Bangladesh

Message from the Chairman
Securities and Exchange Commission, Bangladesh



The world economy of the twenty - first century is characterized by the concurrent operation of the forces of globalization as well regional integration. Within the Asian region, several sub-regional and bilateral trading arrangements, already in operation or under negotiation, are the leading harbingers of economic integration. In contrast, efforts aimed at capital market integration are relatively muted. In part, this is due to infrequent contact among regulators and inadequate dissemination of information relating to the strengths and weaknesses of markets at different stages of development.

I am confident that the Regional Seminar on "Capital Market Development: Asian Experiences" organized by Bangladesh National Committee of International Chamber of Commerce will make an important contribution to the promotion of capital market integration in Asia. I congratulate the organizers for this laudable initiative and wish the Seminar every success.

Dr. Mirza Azizul Islam
Chairman
Securities and Exchange Commission, Bangladesh

Speaking for ICC Bangladesh



Bangladesh National Committee of ICC was established in 1994 with a view to bring world expertise to the local business and take priority issues of national concern to the global forum for expansion of trade and investment.

ICC Bangladesh is comprised of major Chambers of Commerce, Business Associations, Stock Exchange, Banks, Non-Banking Financial Institutions, Trans-national Companies, Law and Accounting Firms and large Corporate Houses having interest in international business.

ICC Bangladesh activities, therefore, include trade policy reviews, harmonisation of trade law and rules, legal reforms, updating businesses with the ICC rules and standards for cross-border business transactions.

It holds policy reviews, business dialogues, seminars and workshops on issues related to foreign trade and investment, market access as well as concerns of Bangladesh business at the international conferences, debates and dialogues including forums through ICC sponsored meetings of multilateral agencies.

The National Committee works closely with the government since its inception, in reforming laws and rules that govern business and liberalising trade to integrate Bangladesh with the global market place. ICC Bangladesh, among others, has been actively engaged in following legal and policy reforms including: Information Technology (IT) Act, modernisation of Arbitration Act, modernisation of Tax Laws & Customs Act, introduction of ATA Carnet System in Bangladesh, development of Bangladesh Foreign Trade Institute (BFTI) and establishment of Bangladesh International Arbitration Centre (BIAC).

In 2000, ICC Bangladesh organised a 2-day ICC Asia Conference in Dhaka. Policy makers, business leaders, economists and professionals from twenty five countries in Asia, Australia, Middle East and Europe participated in the Conference.

In 2004, ICC Bangladesh organised International Business Conference on Global Economic Governance and Challenges of Multilateralism in celebrating its 10th Anniversary in Bangladesh which was the largest international event ever organised in Bangladesh attended by a galaxy of leaders from both developed, developing and least-developed countries and heads of multilateral organisations including WTO and EU. More than 500 participants from 38 countries (3 continents) participated in this event.

The 2-day ICC Regional Seminar on Capital Market Development : Asian Experiences is yet another milestone in the road map of its programme and action plan. Needless to mention that organisation of such a seminar became possible by the endeavours and whole-hearted support of ICCB Member organisations and all our well wishers.



Mahbubur Rahman
President

About ICC- The world business organisation



ICC is the world business organisation; the only representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world.

ICC promotes an open international trade and investment system and the market economy. Its conviction that trade is a powerful force for peace and prosperity dates from the organisation's origin early in the last century. The small group of far - sighted business leaders who founded ICC called themselves "the Merchants of Peace".

Because its member companies and associations are themselves engaged in international business, ICC has unrivaled authority in making rules that govern the conduct of business across borders. Although these rules are voluntary, they are observed in countless thousands of transactions every day and have become part of the fabric of international trade.

ICC also provides essential services, foremost among them the ICC International Court of Arbitration, the world's leading arbitral institution.

Within a year of the creation of the United Nations, ICC was granted consultative status at the highest level with the UN and its specialised agencies.

Business leaders and experts drawn from the ICC membership establish the business stance on broad issues of trade and investment policy as well as on vital technical and sectoral subjects. These include financial services, information technologies, telecommunications, marketing ethics, the environment, transportation, competition law and intellectual property, among others.

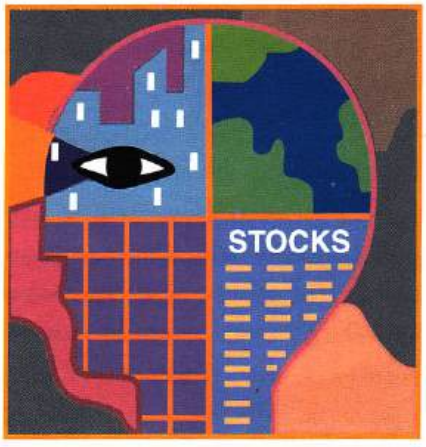
ICC was founded in 1919. Today it groups thousands of member companies and associations from over 130 countries. National committees work with their members to address the concerns of business in their countries and convey to their government the business views formulated by ICC.

Some Reflections on Bangladesh Capital Market

*— Dr. Mirza Azizul Islam**

Introduction

There is a considerable debate in the academic literature on development as to whether a soundly functioning capital market is a precondition for economic development or the former follows the latter. At the early stages of development in most countries, it is the banking sector which plays the leading role in intermediating savings into investment. However, it is generally acknowledged that excessive reliance on the banking system is fraught with serious risks for the financial sector. Such reliance over an extended period inevitably creates a mismatch between assets and liabilities as the banking system typically mobilizes short term deposits to finance long term projects. The risks faced by the financial sector can easily contaminate the real sector with deleterious consequences for economic development.



It is, therefore, an imperative that attention should be paid to the development of capital market as an alternative channel for intermediation function. Capital market is also beneficial for the entrepreneurial classes not merely because it provides access to surplus savings of investors, including many small ones, but also because they do not incur fixed repayment obligations, as is the case with bank financing. Besides an orderly and transparent capital market enables the small savers to participate in the fruits of economic development. Capital market is yet to play its potential role in Bangladesh. Against this backdrop, the article provides a brief description of the evolution of capital market in Bangladesh, where it stands now and the measures under way to enhance its role.

A peek into the past

The capital market of Bangladesh owes its origin to East Pakistan Stock Exchange Association Limited set up in 1954. The association was later converted into Dhaka Stock Exchange in which formal trading was started in 1956. The exchange was renamed as East Pakistan Stock Exchange in 1962 and underwent another name change in 1964 when it was renamed again as Dhaka Stock Exchange (DSE). Trading on the stock exchange was suspended during the liberation war. There was no trading in the immediate post - liberation years as the economic policies of the country during those years had a strong orientation towards central planning. Trading was resumed in 1976 with the shift of development strategy in favour of a greater role of the private sector. DSE has remained in continuous operation since then. Chittagong Stock Exchange (CSE) was set up in 1995.

Both Dhaka and Chittagong stock exchanges experienced a meteoric rise between July and November 1996. Average daily turnover increased by over 1000 per cent. The share price index of DSE jumped from 957 on 2 July 1996 to a record high of 3649 on 5 November in 1996. In CSE also the index rose dramatically from 411 on 2 July 1996 to 1417 on 2 November 1996. Then, started a process of catastrophic crash, particularly in DSE, with the index falling to 3065 in DSE by 30 November 1996. The index continued a downhill march thereafter with the lowest level recorded at 463 on 3 May 1999.

Since then the capital market in Bangladesh had been in a state of doldrum. However, the market has been showing unmistakable signs of resurgence from early 2004.

A bird's eye view of the recent past and the present

As already noted, the potential contribution of capital market in financing development is yet to be realized in Bangladesh. This is evidenced by the fact that market

capitalization as a proportion of gross domestic product (GDP) is of the order of six per cent of GDP. In contrast, the relevant orders of magnitude in India, Pakistan and Sri Lanka are respectively 47 per cent, 20 per cent and 15 per cent. Given the size of population of Bangladesh and steady growth of its GDP exceeding five per cent over the past one decade, considerable unrealized opportunities exist for utilizing the capital market as a vehicle for raising long term investment finance. The recent developments clearly suggest strongly positive developments in this regard.

Relevant data in support of positive developments are presented in table 1.

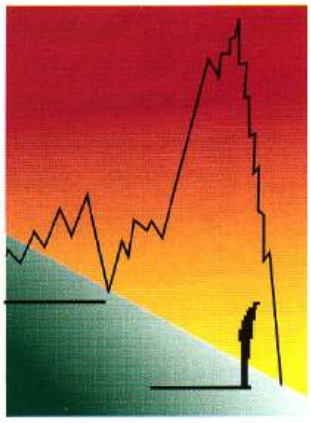
Table 1. Indicators of recent developments in Bangladesh capital market (based on performance in DSE)

	30/6/03	30/6/04	30/6/05
Number of listed companies	241	248	239
General index	830.5	1318.9	1713.2
Market capitalization (Billion taka)	73.0	142.4	222.0
Annual turnover a/ (Billion taka)	30.6	24.7	65.2

Sources : Bangladesh SEC, **Annual Reports,** 2003 - 2004 and 2004 - 2005 (draft)

a/ July - June fiscal year ending on the relevant date

Data for DSE only are used in this paper because it is a march larger exchange than CSE and the developments in the latter closely parallel those in the former. It will, be noted that the number of listed companies declined as of June 2005 relative to the previous year because a number of non - performing companies were delisted. Since then, the Securities and Exchange Commission (SEC) has given consent to initial public offering (IPO) for nine companies. A few more are in the pipe line. By June 2006, the number of companies listed on the stock exchanges will definitely exceed that of the pervious year. The general index and market capitalization have both increased substantially over the past two years. Perhaps, even more remarkable is the rise in turnover which indicates resurgence of vitality of the capital market.



Bangladesh has outperformed most other stock markets of the region in terms of change in index as of 17 August 05 relative to 31 December 04 (table 2). Furthermore, this notable gain has been achieved while maintaining a significant degree of stability. To illustrate this point, it can be noted that during the past six months, day - to - day variation in the DSE's general share price index was less than one per cent on overwhelming number of trading days (table 3).

There are also strong signs of confidence in the primary market. All IPO issues for which subscription closed between November 2003 and August 2005 numbering 18 were substantially oversubscribed. These positive developments have been induced by a number of measures taken by SEC in concert with other market actors to revive investors' confidence in the capital market and to ensure orderly and transparent trading on the exchanges. Some of these are presented below :

(i) The process of dialogue and communication between SEC and the exchanges has been institutionalized by constituting a consultative committee of which a senior SEC official is the convener and the Chief Executive Officer of the two exchanges are members. The committee invites representatives of other market actors, as needed to review market developments and recommend regulatory changes or administrative orders for appropriate action by SEC and / or the exchanges.

(ii) A regular system of inspection of brokerage houses by SEC and the exchanges has been put in place.

(iii) Automated trading system has been introduced by both exchanges. CSE has opened internet trading facility.

(iv) The central depository system (CDS) for electronic trading was operationalized in

January 2005. All new primary shares can be issued only in electronic form. The existing paper securities are being gradually dematerialized. As of now, shares of companies accounting for well over 70 per cent of market capitalization have been demated.

(v) The settlement cycle has been reduced with effect from 01 March 2005.

(vi) There have been considerable improvements in the regulatory framework since 1996. These relate to, inter alia, disclosure requirements for IPOs; right issues; qualifications of auditors, their retention by listed companies and standards of audit; insider trading; and eligibility criteria and codes of conduct of merchant bankers, stock dealers / brokers and their authorized representatives as well sponsors, trustees, asset managers and custodians of mutual funds.

Table 2. Comparative picture of stock market index

	Index as of 17 Aug 05	Percentage change over 31 Dec 04
China	1253.4	- 5.8
Hong Kong	15449.6	+ 8.6
India	7859.5	+ 19.0
Indonesia	1113.8	+ 11.4
Malaysia	926.4	+ 2.1
Philipines	1985.1	+ 8.9
Singapore	2280.2	+ 10.4
South Korea	1113.3	+ 24.3
Thailand	667.5	- 0.1
Bangladesh	1547.5	+ 17.3 a/

Sources : The Economist August 20th 2005, p.74 and Bangladesh SEC, unpublished daily trade reports

a/ Calculated with 30 June 04 as the base.

(vii) SEC has strengthened its monitoring and enforcement role with the result that there has been a considerable decline in the number complaints against market intermediaries as well as issuers. A particularly heartening fact is the fall in the incidence of issuers' default with respect to holding annual general meetings and submission of half - yearly / annual financial statements.

(viii) SEC is undertaking a more rigorous screening of the proposals for initial public offering. In consequence, the secondary market is pricing them well. The shares of nine companies for which public subscriptions closed between 15 November 2003 and 18 May 2005 are now being traded in the secondary market. The market price of all of them is well above the initial offer price excepting in two cases. In one case, the market price as of 31 July 2005 was Tk 99.75 and in the other case, it was Tk 90.75 against the initial offer price of Taka 100 in both cases. In contrast, out of 10 immediately prior issues, the shares of as many as four companies fetched market price well below the initial offer price (ranging from under 10 per cent to 60 per cent of the offer price).

Some ruminations about the future

SEC, in collaboration with other relevant agencies, is in the process of initiating several steps with a view to enhancing the confidence of the investors, increasing the quantity and variety of instruments, and improving the functioning of the market. Some of the forthcoming measures to accomplish these objectives are briefly mentioned below.

(i) As of now, enforcement powers of SEC are, after due enquiry and giving an opportunity to the violators to be heard, limited to cancellation or suspension of registration of market intermediaries, and imposition of penal measures which may involve levying of fines on or filing of cases in competent courts against issuers / market intermediaries. These is no legal provision for SEC to award compensation to shareholders or to file cases on behalf of shareholders. SEC is in the process of drafting amendments to the relevant laws so as to be able to better protect the interests of the shareholders.

(ii) The need for strengthening compliance by all market intermediaries is greatly felt. As present, the regulatory requirement for appointment of a compliance offer extends only to stock broker / dealer. SEC intends to extend the requirement to other market intermediaries laying down the qualifications of the concerned officials and specifying the issues to be addressed in implementing internal compliance procedures.

(iii) A sound capital market requires depth with a wide range of products and instruments to cater to varying risk - return - liquidity preferences of investors and also to ensure that the adverse effects arising from disturbance in some part do not assume systemic proportions. In this regard, SEC, in collaboration with Bangladesh Bank had made long - term government bonds tradable on stock exchanges. But, not much of trading has been actually taking place. SEC and Bangladesh Bank have formed a joint committee to suggest measures to activate trading in government bonds. Recently introduced asset - backed securities which are now being issued only on private placement basis need to be brought into the mainstream secondary market.

(iv) At the initial stages of capital market development, privatization of state - owned enterprises can make a signification contribution. In Malaysia, for example, the Privatization Master Plan resulted in many government - linked firms being listed with Kuala Lumpur stock exchange. Seven largest firms listed with the exchange belong to this category. Government - linked firms account for 34 per cent of total market capitalization. In Bangladesh also efforts are being made to progressively offload government shares through the stock exchanges. Hon'ble Finance Minister recently chaired an inter - Ministerial meeting at the request of SEC. The meeting took a number of decisions regarding off - loading of government shares and issuance of bonds by government agencies through the capital market. The implementation of these decisions will make a notable contribution to the depth of the capital market.

(v) A healthy capital market requires engagement of competent professionals by a wide range of market actors. Among the positions which require the services of people with adequate knowledge of the principles of corporate governance as well as security laws and regulations are the members of company boards, company secretaries, officials of the share departments of companies, authorized representatives of brokers, compliance officers of market intermediaries etc. Academic institutions or the professional bodies in the country do not produce enough people to fill up such positions. SEC has constituted a Steering Committee for preparing suggestions to set up a capital market training institute to bridge the gap. Asian Development Bank is expected to assist in this endeavour. SEC's investors' education programme has been intensified to enable investors to make informed decisions concerning their portfolio.

(vi) SEC is revisiting IPO and rights issue rules and drafting direct listing rules. The objectives are to reduce issue cost, simplify procedural requirements and shorten the time gap between submission of an application to and consent by SEC.

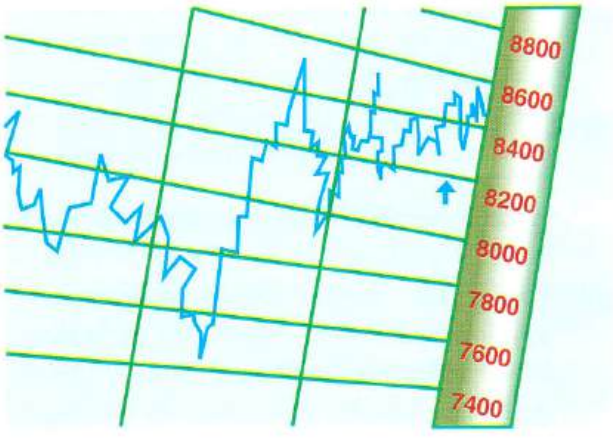
Table 3. Day - to - day variations in DSE general share price index

	Total trading days	Less than 1%	1%-2%	2%-3%	Above 3%
March 05	25	20	4	1	0
April 05	24	23	0	0	1
May 05	23	17	3	1	2
June 05	24	21	3	0	0
July 05	24	23	1	0	0
August 05 (Till 28 August)	22	19	3	0	0

Sources : Bangladesh SEC, unpublished daily trade reports.

Concluding Observations

Capital market in Bangladesh is yet to play its potential role as a vehicle for financing long term investment. However, the hangover of an unpalatable historical past which saw a dramatic upsurge in the second half of 1996 only to be followed by a drastic and prolonged downswing has been successfully overcome. Discernible signs of renewed vitality have emerged. A number of actions are in the offing to add depth to the market, increase the variety of instruments that can meet diverse investors' preferences, further promote orderly trading, enhance professional competence of market intermediaries and facilitate expeditious issuance of securities at reduced cost. In sum, Bangladesh capital market is now prepared to be harnessed in the service of the country's economic development. It is hoped that policy - makers, issuers of securities, market intermediaries and investors will all join hands in fuller realization of its potential.



* ***Dr. Islam*** *is the Chairman of the Securities & Exchange Commission of Bangladesh*

Risk Management and Surveillance

*— M. Damodaran **

Risk management is extremely complex to define in the context of securities market, though it is very vital for its growth. However, for the sake of easy understanding, it may mean identifying the possible sources of risk, reducing the potential of risk from the identified sources, noticing occurrence or likely occurrence of risk, preventing the likely occurrence, minimizing the impact of the risk, nullifying the remaining impact, and continuously upgrading the standards of these activities



based on experience and emerging circumstances. A risk management system at the regulatory level must be able to safe-guard the securities market from both systemic and non-systemic risks. While it is impossible to eliminate risk, the aim of a regulator is to minimize the possibility of a breakdown and to ensure that the market continues to function smoothly, fairly and efficiently.

In any environment there are three levers of risk management and surveillance - people, systems, and law. People are both a source of risk as also the key resource for managing risk. If their ingenuity is not regulated, they can manipulate the system in any direction. However, if they are regulated by way of appropriate systems and structures, and practices and standards, they can spur healthy growth of the market. Law is used to lay down and enforce rules and standards. Quite often these levers reinforce each other. The appropriate design and combination of these three levers, however, depends on the importance that the regulator attaches to objectives of risk management and surveillance, namely, pre-empting market failures and protecting investors.

People

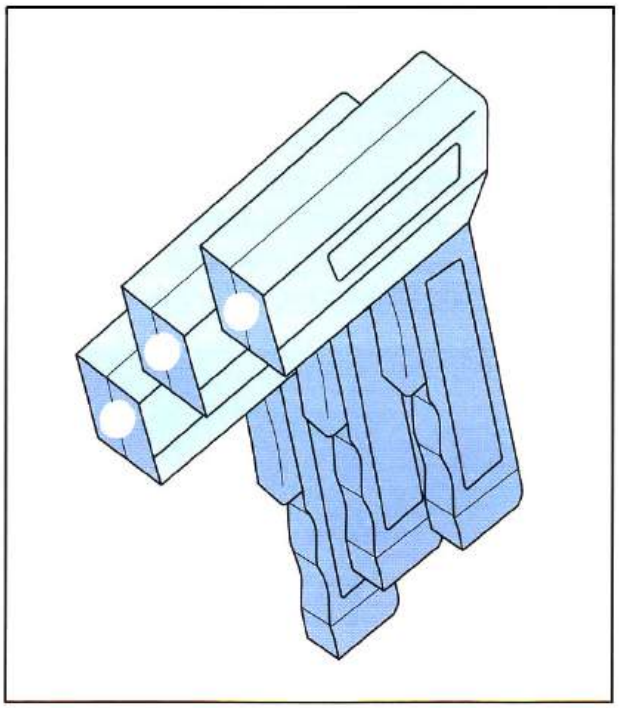
Of the three levers, the catalyst is people. The systems and the law can, at worst, fail to manage risk, but people may not only fail to manage risk, can also accentuate risk. The regulators around the world, therefore, perform some kind of gate keeping function by insisting on minimum standards in terms of conduct, capability, and resources of the participants and also the people working with them. Before authorization, the regulator determines if the applicant is a fit and proper person to participate in the market. In order to do so, it takes account of financial integrity, convictions or civil liabilities, competence, reputation and character, efficiency and honesty, etc. Regulations oblige participants to observe high standards of integrity and fair dealing and to act with due care and diligence. They also require them to frame and comply with standards for internal organization and operational conduct that aim to protect the interests of investors and to ensure proper management of risk. The participants must understand the requirements of the law, the market, the investors and the issuers. Otherwise they may be a hazard to the market. Keeping this in view, the regulations prescribe minimum requirements with regard to qualification and experience of participants operating in the market. In order to ensure that the participants have resources to put in place systems, the regulations generally specify capital adequacy standards in terms of net worth, base minimum capital, paid up capital and also minimum infrastructure required for

operations. The regulator monitors the conduct of market participants continuously to ensure that they are not contributing any risk to the market and in extreme cases, withdraws the authorization of the participants to operate in the market.

Systems

The securities market must have robust systems and market structures. Robust systems minimize the possibility of operational risk and reduce the possibility of manipulation. A few examples of such systems are: the screen based trading system, dematerialization of securities, T+2 rolling settlement, delivery vs. payment system, derivatives etc. The screen based trading system cuts down on the risk of error and fraud while reducing liquidity risk and price risk. Dematerialization of securities obviates the myriad of risks associated with paper based securities system, such as theft, forgery, loss in transit etc. T+2 rolling settlement reduces settlement risk. Delivery versus payment eliminates principal risk. Derivatives allow investors to hedge the risks of their portfolios. Extensive use of IT by market participants in all operations and implementation of business continuity plans and disaster recovery sites helps reduce operational risk.

To ensure market integrity, the market is so structured that the defaults by isolated participants do not lead to domino effect of successive failures and the system has slack resources to tide over the situation. For example, the market uses clearing corporations (CC) to assume the counter party risk of each broker on the strength of the settlement guarantee fund. To curb excessive volatility, which may put strains on CC, there is a circuit breaker system which brings about a coordinated trading halt in all equity and equity derivatives markets nation-wide, when the index moves either way by specified percentages. In order to reduce incentives for the participants to default, brokers pay daily margins comprising of mark to market margin and VaR-based margin on their positions. In order to prevent brokers from taking positions beyond their capability, the exchanges impose limits on turnover and exposure in relation to their base minimum capital. The brokers exceeding these limits are automatically and instantaneously disabled by the automated trading system.



Since the best systems and practices cannot eliminate the risks completely, a strong surveillance mechanism is necessary to detect the occurrence of risk and take remedial actions immediately. Surveillance mechanism gathers information from diverse sources and collates it to decipher the trend and patterns. It includes prudential surveillance to identify malpractices by intermediaries through inspections, financial surveillance to identify financial misreporting and fraud and market surveillance to identify market malpractices. The exchanges and the regulator have a variety of surveillance mechanisms, which generate various alerts on price/volume movement of securities not in line with expected patterns. Alerts are scrutinized to detect potential market abuses at a nascent stage and to minimize the ability of the market participants to influence the price of the security. In order to manage default risk, the exposure of the broker is closely monitored on a real-time basis to ascertain any excessive position compared to his normal business of the broker. Preventive actions taken as a result of surveillance include imposition of higher margins, imposition of circuit filters, shifting securities from rolling

settlement to a trade-for-trade settlement and suspension of trading, call for early pay-in, advice for reduction of exposure or trading restrictions. Suspected malpractices also lead to detailed investigations for taking appropriate enforcement action.

Law

The law lays down the minimum standards to be followed by market participants - issuers, investors and intermediaries to ensure free, fair and efficient markets. It prohibits insider trading, unfair trade practices, and any kind of price manipulation or market misconduct, which has the potential to threaten the market integrity. It provides the regulator with a range of disciplinary tools such as investigation, inspection, enquiry, adjudication, and prosecution for fraudulent, manipulative, and other illegal forms of conduct and also sanctions such as censure, monetary penalty, suspension or revocation of registration, etc. An effective enforcement system safeguards the integrity of the market by deterring the participants from violating Acts, rules and regulations. The law provides for protection mechanisms such as investor protection fund, insurance, ombudsman, etc. to compensate the victims of residuary risks.

The risk management and surveillance systems, if designed and implemented properly, may provide the comfort to the regulator in its area of responsibility towards healthy growth of the market, but not the luxury of sound sleep.

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* ***Mr. Damodaran*** *is the Chairman, Securities and Exchange Board of India*



Role of Regulators in Improving Corporate Governance

— *Dr. Tariq Hassan* *

More than two hundred years ago, Adam Smith, in his classic essay 'Wealth of Nations', wrote the following:

> *"The directors of such (joint-stock) companies, however, being the managers of other people's money rather than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private company frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company."*
>
> *(Adam Smith, The Wealth of Nations)*

It is evident from the passage quoted above, that corporate governance is neither a buzz word nor a new area of interest. The conduct of companies and its impact on stakeholders has been an area of active research and interest since a very long time. However, alongside the advances in communication, increases in volume of international trade and the phenomenon of globalization, the world has also experienced a spate of corporate scandals and economic crises like those in Asia in the 1990s. The combination of these factors has brought corporate governance into the lime light and it is now a leading policy agenda in the developed and developing world alike.

Adherence to the principles of good corporate governance serves to foster investor confidence and attract domestic as well as foreign investors. It is empirically tested that the extent to which a company is perceived to operate within the principles of good corporate governance largely affects its ability to attract investment. The need for corporate governance in South Asia is vastly recognized. The countries in the region have made a slow but positive response to corporate governance challenges. South Asian regulatory bodies have played a very active role in introducing corporate governance practices, and sustaining these efforts is now the key to developing the good governance paradigm.

Regulatory Responsibilities for Improving Corporate Governance

The regulator has a key role in implementing corporate governance requirements. Creation of a strong legal and regulatory fram ework that is adequately enforced serves to protect stakeholders' interests and engender investor confidence, as a first step. The second step is taking an iterative approach, and continuously improvising on the existent framework.

In implementing, promoting and improving good corporate governance framework, the regulatory role varies from consultative to administrative. Foremost, the introduction of a code of corporate governance requires the involvement of regulatory authorities and corporate sector representatives to ensure that it fulfills the fundamentals of transparency and accountability. Only a consultative process can ensure that such a framework objectively addresses the needs of diversified stakeholders.

Once the corporate governance code has been developed, it requires legal backing to allow a certain level of enforceability. The manner in which the framework is to be implemented varies according to the needs and circumstances of every jurisdiction. This can take the form of necessary amendments in corporate laws or incorporation in listing regulations of stock exchanges or encouraging voluntary adaptation through issuance as guidelines. Whatever may be the manner of introduction of a code of good governance, its effective implementation requires vigilant oversight by the regulatory body concerned.

It is also essential that the regulator maintains a regular dialogue with various stakeholders to allow them to understand and discharge their responsibilities in the corporate governance framework. This requires that compliance with good governance practices is

understood by companies to be in their own interest of enhancing business value. It also requires directors and managers to set strategic goals, establish financial and other policies, and run the affairs of the company while being accountable to shareholders for the performance and activities of the company and ensuring conformance with laws, rules and regulations. Furthermore, shareholders - particularly institutional shareholders - should play an active role in assessing the performance of management and exercising their rights. The regulator may need to create an enabling environment for improving participation of these various groups of stakeholders in implementing good corporate governance.

Improvement in corporate governance practices comes with the regulators' ability to reward those companies that display committed compliance with good corporate governance as well as take action against erring companies and their directors or managers.

Experience in Promoting Corporate Governance in Pakistan

Pakistan's frontline corporate regulator, Securities and Exchange Commission of Pakistan (SEC), has been proactively pursuing its agenda of instilling good corporate governance practices since 2002. Making a steady start to adopt and implement good governance practices, SEC issued the Code of Corporate Governance in March 2003. The Code was incorporated into the listing regulations of the stock exchanges. It is mandatory upon listed companies to comply with the Code and the stock exchanges ensure compliance therewith.

The Code of Corporate Governance seeks to establish a system whereby a company is directed and controlled by its directors in compliance with the best practices so as to safeguard the interests of diversified stakeholders. It proposes to restructure the composition of board of directors in order to introduce representation by minority shareholders and broad-based representation by executive and non-executive directors. It also emphasizes openness and transparency in corporate affairs and decision-making process and requires directors to discharge their fiduciary responsibilities in the larger interest of all stakeholders in a transparent, informed, diligent, and timely manner. Furthermore, it seeks to achieve the objectives of good corporate governance by recommending strengthening of corporate working, internal control system and external audit requirements.



Subsequent to the introduction of the Code, a number of measures are being taken to ensure that there is adequate awareness in the corporate sector of the need for and benefits of good governance. In this regard, a number of seminars and training workshops of directors and management of listed companies have been held under the auspices of the SEC as well as a number of private sector organizations.

Earlier this year, in partnership with notable private sector representatives, SEC established the Pakistan Institute of Corporate Governance to serve as the focal point for training and research on corporate governance in the country. It is expected that establishment of the Institute would provide an enabling environment for effective implementation of the Code of Corporate Governance.

Also, compliance with the Code of Corporate Governance has been incorporated into the criteria of awards announced by professional and industry associations. This has served to give due recognition to companies that follow better corporate governance practices.

Conclusion

Good corporate governance is now widely recognized as essential for establishing an attractive investment climate characterized by competitive companies and efficient financial markets. It is imperative that economies in the South Asian region develop necessary framework of corporate governance and achieve implementation through active participation of key stakeholders, in order to provide impetus to economic growth.

Good corporate governance is not about conformance in letter but in spirit as well. It cannot be measured by a box ticking exercise and companies therefore must be enabled to develop a corporate culture in which transparency and accountability are predominant features. Providing an enabling environment with a conducive regulatory framework is the foremost responsibility of the frontline regulators of every country. Once this job is well done, the rest falls into place more easily!

* ***Dr. Hassan*** *is the Chairman of Securities & Exchange Commission, Pakistan.*

Capital Market Transaction in Regional Emerging Economies

— *Rajnikant Patel* *

The topic of my speech - "Capital Market Transaction in Regional Emerging Economies" - is indeed, if I may say so, very relevant. Emerging economies are in the investment radar of investors worldwide chasing new growth opportunities. There are many drivers of this phenomenon. High personal debt in U.S., near saturated levels of personal consumption in the West, ageing population in the West etc. Thought leaders world wide are recognizing that this century is going to be the Asia century.

The action is here - in the emerging economies of Asia. China story has been told and retold and needs no repetition. Much is happening in this sub-continent as well.

In this context, I would like to touch upon the Indian experience. Indian Capital Markets have been doing exceptionally well. Since September 2003, when the bull ran started, our markets have more than doubled. Bombay Sensitive Index (SENSEX) is posting new heights and recently crossed the 8000 mark. In terms of market capitalization, India's market cap now stands around US $ 510 billion and has overtaken both Korea and Taiwan. In the regional sweepstakes, India is behind Australia, Hong Kong and Japan.



There is broad consensus that in the medium- and long-term, Indian story is going to strongly unfold. Indian economy is one of the fastest growing economies of the world and the stock market mirror this fundamental fact. Though relative valuations at PE multiple of around 16 make the Indian market fully priced (some will say expensively priced) if you factor in the projected growth of around 7% per annum, forward PE multiples look far more reasonable. Markets will typically upfront the economy, and as long as strong GDP growth and economic growth provide the underpinnings for a buoyant stock market, things are relatively safe.



Additionally, what is attracting foreign investors into India is the fact that the Indian markets are very clearly well regulated and have adopted over the years efficient trading, clearing and settlement processes comparable with the best in the world. I will like to touch upon a few of them.

The Indian equity market operates rolling settlements, with trades settled T+2. We have order driven markets, entirely screen based. The tick size of 5 paise (one-eight of a cent, yes, one-eighth of a cent) represents one of the finest (may be the finest spread) spreads in the world. T+1 is being discussed, and its introduction is awaiting reforms in banking settlement processes through RTGS (Real Time Gross Settlement).

Settlement risk issues have been addressed. Paper delivery is negligible and is as good as over. Electronic credit of dematerialized securities has meant that all the attendant problems of paper delivery - delays, conflicting corporate action entitlements, fake/forged shares, etc. are all things of the past. The load on both exchange back office and broker back office has considerably been eased, with settlement through electronic security credits.

The Settlement Guarantee Funds of the Exchanges, though seldom resorted to, have improved considerably the confidence of the players in the integrity of the market. From August the markets have adopted upfront collection of margins (based on VaR). This is a big step indeed in eliminating default risks. Additionally, EVR and mark-to-market margins are collected at the end of the day. This has considerably enhanced the safety climate, particularly in the context of buoyant conditions and new heights.

The Futures & Options markets have been very vibrant, with high level of investor and speculative interest in futures and specifically index futures. Options on individual stocks have seen rising participation, with NSE emerging as one of the largest players in the segment. The F&O market is till cash settled, and the regulator is addressing concerns relating to overnight risk. Towards this, the regulator is exploring ways and means to promote stock lending.

In terms of direct taxation, the Government of India introduced major changes in the last budget for capital gain calculations. Short term capital gains on shares (i.e. holding period of less than one year) attracts a low rate of 10% basic tax. Long-term capital gains arising out of transactions on stock exchanges attract no tax. Dividends are tax 'free in the hands of the recipients, making dividend yields attractive in as scenario of low interest yields that too taxable at the marginal rate of 33%.

Though India has been posting a high savings rate of 24%, only a small percentage of individual household savings have found their way into the capital markets (estimated at less than 1.5%). By and large individuals still seem to prefer the safety of bank deposits and high yielding government small savings programmes. However, with the withdrawal of tax benefits associated with some of these savings, and reduced interest yield on some of the small saving schemes, the relative attraction of the stock markets amongst the small savers is on the rise. Some of the investors are now taking the mutual fund route and are participating in high quality public issues of Public Sector disinvestments and other large offerings.

The mutual fund industry is still predominantly debt-oriented. It is estimated that the total assets under management of mutual funds in India is of the order of US $ 60 billion. Equity funds have been having exceptional years, with passive investment in index funds gaining popularity. Sectoral funds too have caught the fancy of investors, though by very definition they dilute the benefit of a broad based portfolio. More sophisticated offerings based on hedging have also made a beginning with more than passing interest from retail clients.

Markets are getting integrated. India imports more than US $ 140 million worth of gold every year and Indian private holding of gold is the largest in the world. Gold ETF is being discussed with the regulators and its launch will represent a significant watershed in the Indian capital markets.

Markets world over are integrated. India is no exception with larger and larger FII participation. Many of the leading Indian companies have their GDRs listed abroad, with the underlying equity listed on the Indian markets. The Vedanta group's shares were listed in London and is a pointer of things to come.



There is much happening in the sub-continent. A spirit of peace and cooperation is in the air. The governments are keen to increase trade and commerce. We have a very large market in the subcontinent and opening of trade between the countries will give a tremendous fillip to the economic growth.

I would like to conclude the speech with a significant event which happened during 2005. Indian Oil, a hydro-carbon major involved in refining and distribution of petroleum products, through Lanka IOC made a public issue in Sri Lanka which met with an overwhelming response. It is my wish and hope that we will see more of such regional cooperation in the capital markets of the sub-continent in the years to come.

* ***Mr. Patel*** *is the Managing Director & CEO of Bombay Stock Exchange Ltd.*

Cross Border Trade and Integrated Capital Markets - Role and Tasks of Tokyo Stock Exchange

— *Takuo Tsurushima**

With the capital that circulates in a second around the world, it is no wonder that the expectations from multinational companies that conduct global businesses and institutional investors that pursue asset allocation globally have risen. The capital markets are consequently expected to expand and enhance their functionalities more than before. It should be noted, however, that the capital markets can earn the confidence of these market users including investing public only through accomplishing their mission through the commonly accepted global market norms. Today's world is dramatically changed from the domestic-centric days of the past. As efforts are made to harmonize and standardize relevant rules across global capital markets, the traditional existence of "national borders" is diminishing.

Dramatically evolving environments that surrounds the capital markets have also greatly affected the management strategies and raison d'être of stock exchanges, or the capital markets as a whole. As one of the largest and most liquid stock markets in the world, Tokyo Stock Exchange (TSE) is expected to assume greater global responsibilities more. Some changes that TSE has experienced include a marked increase in foreign investment; non-Japanese investors recently account for more than 50% of TSE's daily trading volume. Additionally, in an effort to meet investors' needs, TSE has been promoting the listing of Asian companies in its market. TSE believes that its position as a premier financial center in Asia, can provide its listed companies with unique merits. TSE's invitation of a large variety of quality companies, both Japanese and Asian, will enhance its corporate value and allow it to stand still among other Asian markets. TSE is also expected to act proactively to provide more investing opportunities in the Asian markets to Japanese individual investors whose financial assets are over 1400 trillion Yen or 13 trillion US$. Japanese investors have already been active in investing in some of the Asian markets, most notably the Hong Kong market. It is easy to predict that this trend will continue to grow and Japanese investors will begin investing to a greater degree in other Asian markets as well in the near future. Therefore, it is a "must" for TSE to serve public by offering diversified alternatives to invest through collaborations and cooperation with other Asian exchanges, including direct market linkages.



There has already been significant progress on links in the ASEAN countries at the governmental level in the last few years. In 2003, the ASEAN Finance Ministers agreed on the Roadmap for Integration of ASEAN in the areas of capital market development, capital account liberalization, financial services liberalization and ASEAN currency cooperation. In particular, efforts have been focused on initiatives to foster greater cross border collaboration between capital markets in such areas as staff training networks, development of products and market linkages, and the harmonization of capital market standards.

At the exchange level, a regional federation of stock exchanges has been organized under TSE's leadership for more than 20 years. The federation, called the Asian and Oceanian Stock Exchanges Federation (AOSEF) was originally formed as a fraternal gathering of regional exchanges. This spirit still remains at the core of the federation. But, the member exchanges may be more ambitious to exchange information on their markets and enhance their cooperation toward further development of the regional capital markets. By fully recognizing ASEAN's initiatives, the most recent project which AOSEF has set up is the study and discussion of how the regional exchanges can harmonize the rules and practices of their markets and coordinate market surveillance and compliance. In order to help facilitate cross border trading among regional markets, the harmonization of rules and practices and coordination of market surveillance are both necessary and desirable.

We believe that although this AOSEF project may be a relatively long-term one, this will be of great help to increasing the level and standard of the markets both in terms of quality and quantity. It is essential for TSE to further enhance its regional leadership, so that both Japanese and Asian investors can gain access to expanded investment opportunities within our region.

* ***Mr. Tsurushima*** *is the President and CEO, Tokyo Stock Exchange, Inc.*

Bursa Malaysia Derivatives Berhad

*— Yusli Mohamed Yusoff **

As the capital market in Malaysia evolves further with more varied and customised investment instruments, the futures industry will play an increasingly significant role in the transformation towards a more dynamic capital market.

In Malaysia, Bursa Malaysia Berhad (Bursa Malaysia) offers a complete range of exchange-related services including trading, clearing, settlement and depository services for securities, derivatives and the off-shore markets. Bursa Malaysia Derivatives Berhad (Bursa Malaysia Derivatives), a wholly-owned subsidiary of Bursa Malaysia , offers futures and options contracts covering financial, equity and commodity related instruments on an electronic trading platform.



The following 8 products are currently traded on the Exchange:

- Kuala Lumpur Composite Index Futures (FKLI) contract
- Kuala Lumpur Composite Index Options (OKLI) contract
- Crude Palm Oil Futures (FCPO) contract
- Crude Palm Kernel Oil Futures (FPKO) contract
- 3-Month Kuala Lumpur Inter-bank Offered Rate Futures (FKB3) contract
- Three-Year Malaysian Government Securities Futures (FMG3) contract
- Five-Year Malaysian Government Securities Futures (FMG5) contract
- Ten-Year Malaysian Government Securities Futures (FMGA) contract

Bursa Malaysia Derivatives operates under the supervision of the Securities Commission and is governed by the Futures Industry Act (FIA) 1993. The Exchange also falls under the jurisdiction of the Minister of Finance of Malaysia, thus offering investors the security of trading on a regulated Exchange with infrastructure and regulations comparable to that of established markets worldwide.

It is Bursa Malaysia Derivatives' mission to be the catalyst in the development of the derivatives industry in Malaysia, by operating markets that serves the following major economic functions: for price risk management, or hedging; and as a pricing benchmark and price discovery tool. It also provides a liquid and safe market for investors seeking to trade in derivatives as part of their investment portfolio. Bursa Malaysia Derivatives has definitely established a reputation for being a derivatives exchange with the necessary capacity and capabilities for servicing the needs of both the local and international trading community.

Malaysia's position as the top global producer and exporter of palm oil and palm oil products allows Bursa Malaysia Derivatives to capitalise on providing price risk management solutions to traders and hedgers dealing in palm oil and its related products. Bursa Malaysia Derivatives offers the most actively traded crude palm oil futures in the world.

Bursa Malaysia Derivatives Berhad has shown robust growth in volume traded and open interest for its products. For the year ended 31st December 2004, total derivatives trading volume was an all-time record of 2.63 million contracts. This represented a growth of 31.6% over the previous year where 2.0 million contracts were traded. The Exchange total year-end open positions in December 2004 rose 33.53% from 49,296 contracts in 2003 to 65,824 contracts.

The significant growth in 2004 was attributed to the strong trading interest in FKLI and FCPO contracts, which contributed 41.3% and 52.3% respectively to the total trading volume. As at 30 August 2005, Bursa Malaysia Derivatives recorded a total volume of 1,652,821 contracts, with total open interest of 87,430 contracts.

Recent Developments

Recent developments at Bursa Malaysia include:

- The acceptance by the Clearing House of selected blue chip stocks as margin collateral for derivatives trading.
- In July 2005, the Deterioration of Bleachability Index (DOBI) was introduced as a quality criterion for the physically delivered FCPO.



- In August 2005, omnibus accounts were allowed to be opened with Malaysian futures brokers. Omnibus account holders are exempted from complying with the speculative position limits set by the exchange, as long as each individual underlying client registered under the omnibus account does not exceed these position limits. Position limits are set by the Exchange to prevent manipulation of the market.

The liberalisation of capital controls by Bank Negara Malaysia (the Central Bank of Malaysia) in September 2004 and the recent de-pegging of the Malaysian Ringgit in July 2005 would further enhance the attractiveness of Malaysia as an investment destination.

Moving Forward

Bursa Malaysia Derivatives will strive to introduce new products to meet risk management and investment needs of the local and global investing community.

Bursa Malaysia is in the process of implementing Bursa Trade (Bursa Malaysia's common trading platform) to replace the technology of its existing disparate trading platforms for securities and derivatives. This includes the introduction of both new hardware and application software that provide an integrated trading platform for all of Bursa Malaysia's securities and derivatives products. The new trading platform will allow Bursa Malaysia to introduce open Application Programming Interface (API), and pave the way for direct market access.

In meeting the challenges of increased globalisation and competition, Bursa Malaysia also intends to seek alliances and trading links with suitable strategic business partners. In pursuing this strategy, Bursa Malaysia seeks to grow its investor base, develop new products with an international flavour, and offer an increased range of investment tools to investors, both local and foreign.

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* ***Mr. Yusoff*** *is the Chief Executive Officer, Bursa Malaysia Berhad.*

Rules and Regulation of Valuation Methods: Buy-Back of Shares

— *Muhammad Yasin Lakhani* *

Protection of the interest of the minority shareholders has always been on the top priority of the Exchange, being the frontline regulator.

Unfortunately a considerable cross section of listed companies that availed public funds through Initial public offering for various reasons could not come up to the expectations of the shareholders. The minority shareholders as a consequence have been deprived of a reasonable rate of return on their investments coupled with sharply eroding values that has endangered precipitation of complete loss of confidence of investors in equity issues and thereby impeding growth of capital market.



1. Buy Back of shares from minority Shareholders by the Sponsors followed by delisting of Company from Exchange.

   The need for buy-back of shares of the minority shareholders by the sponsors of the company has arisen due to the persistent anemic financial position of a cross-section of public companies listed on the stock exchanges that are facing difficulties in their operations and as a result are unable to pay adequate return, or any return, to their shareholders. In such circumstances, the option of voluntary delisting through buy-back of shares by the sponsors of a company from the minority shareholders provides a relief mechanism within the regulatory framework to safeguard and protect the interest of shareholders and thereby instill greater confidence in the equity markets.

   Keeping view of the above, it was felt necessary to provide an exit route to the sponsors by-way of buy-back of shares followed by the delisting of companies. The Exchange with the prior approval of the Securities & Exchange Commission of Pakistan framed the Regulations relevant to Voluntary Delisting of Companies in 1999.

   The key element of the above option lies in determining benchmark price (buy-back price) to effectuate buy-back of shares keeping in view all exogenous factors.

   The benchmark buy-back price should invariably take into account exigency of the present and prospective environment and thereby ensure adequate protection of rights of all parties concerned and, in particular, the shareholders.

   The objective of the buy back of shares is to protect the interest of shareholders as the sponsors are at great advantage by having access to inside information pertaining to the company and its prospects. There are numerous scientific methods from very basic to highly complex to arrive at a buy back price some of which are included in the Listing Regulations of the Karachi Stock Exchange for the companies intending to seek voluntary delisting from the Exchange by purchasing all securities from minority shareholders by the majority security holders/sponsors with the purpose to de-list the security along with the reasons thereof. The minimum purchase price at which the securities are proposed to be purchased by the sponsors under the relevant Regulation of the

Exchange is determined on the basis of highest of the following:

a) Current Market Price as of the date the exchange receives the sponsors/ majority security holders intimation under 32-A (i).

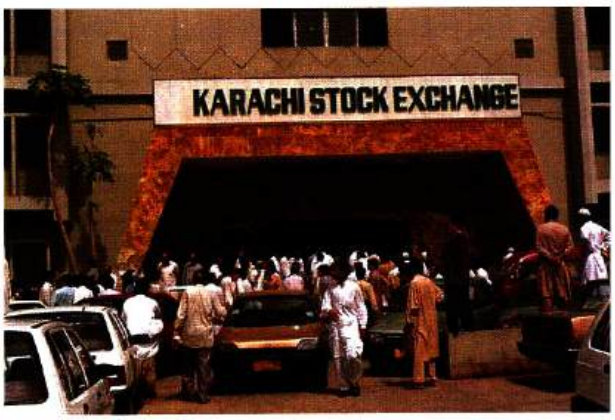
b) Average Market Price (Annualized)

c) Break-up Value based on historical cost

d) Earnings Multiplier approach (for profitable companies)

e) The maximum price at which the Sponsors had purchased these shares from the open market in the preceding one year

The final minimum purchase price of the securities to be delisted is fixed with the approval of the Exchange. At the same time the Exchange determine the minimum percentage of securities to be purchased by sponsors to qualify for delisting.



One of the criteria to arrive at the buy-back price is based on break-up value on historical cost. On various occasions the Exchange has very effectively used the reasoning of replacement cost/current market value of assets to persuade the sponsors of loss-making companies to buy back shares at a price significantly higher as compared to price arrived at using P/E valuation model, historical break up value, etc. The revaluation of assets is important in profit-making companies, it is more critical in loss-making companies having negative or negligible net-worth, negative earnings, and poor market value. The negative earnings add no value when incorporated in P/E valuation model. In such cases revaluation of assets is the only comfort for the shareholders, as is evident from the following:

Name of Company	Market Price In Rs.	Offer Price Sponsors In Rs.	Price Determined Exchange and Accepted by The Sponsors In Rs.
Kohinoor Oil Mills Limited	7	7	255
Shafiq Textile Mills Limited	103	110	200
Spencer & Co.	115	155	200
Universal Leather & Footwear Ind. Ltd.	48	50	125
Hamza Sugar Mills Limited	32	32	80
Zaman Textile Mills Limited	37	45	65
Hilal Tanneries of Pakistan Ltd	12	15	55
Pioneers Cables Limited	11	10	25
Elite Textile Mills Limited	7	7.40	15
Polypropylene Products Ltd.	13.50	23	29

In case of disagreement of sponsors on minimum percentage of securities to be purchased as determined by the Exchange, the sponsors may file an appeal with the Securities & Exchange Commission of Pakistan within 10 days of receipt of communication of such determination under intimation to the Exchange. The decision taken by the SECP is final and binding on both the sponsors and the Exchange.

2. Purchase of its own shares by the company followed by reduction in capital:

A listed company may subject to the provision of Section 95A of the Companies Ordinance, 1984 and the buy-back of shares Rules, 1999 framed by the Securities & Exchange Commission of Pakistan may purchase its own shares. The purchase of shares should be authorized by the special resolution which indicates the maximum number of shares, the maximum price and the period within which the purchase is to be made.

- The purchase is made in cash and out of the distributable profit and also that the company shall continue to operate as a going concern and capable of meeting its liabilities on time during the period upto the end of the immediately succeeding financial year.
- Where shares are purchased by a company on premium, the account of premium shall be charged

to Shares Premium Account of the company or in the absence of any balance therein, to the distributable profits of the company.

- Where purchase is made at a price lower than the nominal value of shares, the difference shall be credited to the reserve created.
- The company shall have debt equity ratio of 75:25 and current ratio of 1:1.
- The majority of the directors including the chief executive, shall at a meeting made a declaration of solvency verified by an affidavit to the effect that they have made a full inquiry into the affairs of the company, and that after having done so, they have formed the opinion that the company shall continue to operate as a going concern and that it is capable of meeting its liabilities on time during the period upto the end of the immediately succeeding financial year.
- The purchase shall be made through a tender system and the mode of tender shall be decided by the company in general meeting through a special resolution.
- The shares purchased under this section shall not be resold and shall be cancelled forthwith. The amount of the company's paid up share capital shall be diminished by the nominal value of such shares accordingly.
- The purchase shall be disclosed in the balance sheet as reduction of share capital and other necessary details including the mode and purchase price shall be provided in the explanatory notes of the accounts.

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* ***Mr. Lakhani*** *is the Chairman of Karachi Stock Exchange (Guarantee) Ltd.*



Recent Trends in Global Capital Markets and the Role of Singapore Exchange (SGX) in the Regional Economy

— *Swee Tian ANG* *

Efforts to build a resilient capital markets globally...

The development of capital markets is an important aspect of any modern economy. The direct correlation observed in economic development and the state of capital markets in many countries across the globe is telling that they progress in tandem. As the world becomes more integrated, capital markets play a critical role not just in providing liquidity and investment instruments, but also in maintaining global financial stability.



Therefore, building a thriving and healthy capital markets characterised by a robust regulatory and institutional framework, as well as efficient infrastructure for public information and trading/settlement remains a key priority globally. In particular, much emphasis has been placed on improving integrity of the marketplace through enhancing corporate governance standards.

... has helped create growth in recent years, albeit with guarded optimism in 2005

Along with the rest of the financial sectors, the global capital markets suffered tumultuous times during the Asian financial crisis in 1997, the burst of the dotcom bubble in 2000, and the aftermath of the terrorist attacks on the US in 2001. Recovery in the major global economies set the industry on a rally in 2002, which continued into 2003 where debt and equity underwriting experienced solid activity. Capital market's activity was further strengthened as international equity markets put on a generally healthy showing during 2004.

It was estimated by Mckinsey & Company that the total value of the global capital markets - including bank deposits, government and private debt securities, and equities - stood at US$119 trillion at the end of 2004. While this value is projected to grow beyond US$200 trillion by 2010, guarded optimism shapes environment for 2005 since potential disruptions such as the stubbornly high oil prices loom in the background.

In terms of market segmentation, the leading sector within the capital markets is bonds outstanding, which accounts for about 43% of the global value. Bank deposits and equity securities account for the remaining 30% and 27% respectively. Geographically, the US continues to dominate the market value, taking a share of about 37%. Europe is the second largest region with 31%, and is gaining strength through integration. Asia is a region made up of markets of vastly different sizes, with Japan dominating two thirds of the region's capital markets, and China and India driving growth.

Global IPO jumped sharply in 2004, roughly doubling over 2003 in transaction numbers and even more than that in dollars raised. In total, 1516 deals were concluded, raising US$124 billion. While North America and Europe reasserted themselves in the IPO scene, the centre of gravity continues to shift towards emerging economies such as China, India, Russia and Israel. The thirst for capital in these emerging markets has attracted increasing competition from many international stock exchanges, and has thus given rise to the number of cross-border listings.

SGX as the Asian Gateway continues to attract foreign listings...

Singapore is located at the heart of the exciting growth story of Asia, where there are tremendous investment needs. Companies within Asia are also fast expanding overseas, and capital is often a critical success factor. Against such a backdrop, SGX has been able to contribute by providing a platform for capital raising, and at the same benefit from it. Last year alone, 48 foreign companies were listed on SGX. For the first time last year, the number of foreign companies surpasses that of the local companies. On the whole, out of the 665 companies currently listed on SGX, 28% are foreign, making up 40% of the market

capitalisation. Such receptivity to foreign companies is a unique feature of Singapore market which foreign companies find comfort in when choosing to list on SGX.

In 2004, the Singapore bond markets saw the largest number of foreign issuers at 34, raising a total of S$3.5 billion. This included not only corporates and financial institutions such as General Electric and Citigroup, but also supranationals such as the Asian Development Bank (ADB) and U.S. Agencies like Fannie Mae.

Beyond raising capital, both Multi-National Corporations (MNCs) and smaller companies alike have found Singapore conducive for conducting business operations in areas like manufacturing, research & development, and distribution & logistics. Out of the 7000 MNCs located in Singapore, many have established their regional Headquarters here. This powerful MNC network, coupled with Singapore's extensive network of Free Trade Agreements (FTAs) and Double Tax Avoidance Agreements (DTAAs) must have helped attract the 1100 Chinese companies and 1500 Indian companies that currently have operations here.

... and strives to build our capital markets through partnerships and linkages.

SGX recognises the positive effects of exchange networks and by leveraging on its strengths in Asia, we are pro-actively forging alliances with like-minded institutions. On the securities front, SGX is currently in active discussion with Bursa Malaysia to establish a co-trading linkage similar to the one it had forged with Australian Stock Exchange a



We have also participated in a joint collaboration with four other ASEAN stock exchanges - Indonesia, Malaysia, Philippines and Thailand - to create an index of ASEAN stocks, which will be launched soon. It will be a tradable index that comprises many top names, and will facilitate the creation of exchange-traded products such as funds and futures targeted at investors who recognise the economic and investment prospects of ASEAN.

Through all these, we hope to pave the way for stronger growth in financial services activities between Singapore and our partners, to promote better market access and to enhance cross border flows of capital.

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* ***Mr. ANG*** *is the President of Singapore Exchange Ltd.*

Asian Bond Market for Development of Regional Stock Exchanges

*— Kittiratt Na-Ranong **

Introduction

The ASEAN+3[1] have launched the Asian Bond Markets Initiative (ABMI) since December 2002. Many efforts have been pursued under six working groups. Among these six working groups, the working group[2] is chaired by Thailand. There are a number of progresses. WG1 has continued to take a three-pronged approach toward its goal of creating new securitized debt instruments. At the same time, the efforts have also been put to increasing the supply of local currency bonds as well as the withholding tax issues.

In Thailand, the necessary amendments to the Royal Decree and Ministerial Regulations were made in order that the non-resident investors of Thai-baht Asian bonds will receive tax-free income from bond investment. The definition of the Asian bond for Thai environment has also been redefined to cover all types of government and quasi-government debt securities. Since the new definition of Thai-baht Asian bonds include both existing and newly-issued bonds, they account for large portion in Thai bond market. Thai-baht Asian bonds will be issued regularly and listed in the Bond Electronic Exchange (BEX)[3] to ensure the transparency and promoting the liquidity.



The securitization in Thailand has been developed using the Thai Government Complex project to be the pilot. A number of concerns have been put into considerations, for example, tax issues, public debt burden, etc. However, the progresses in the securitization are observed.

The Stock Exchange of Thailand and Asian Bond Market Initiative



To response to the ABMI tasks, the Stock Exchange of Thailand (SET) has set up the Bond Electronic Exchange (BEX) since November 2003 to perform the operations concerning fixed-income securities trading. Prior to the establishment of BEX, all bond trading transactions are done through the unorganized OTC. The retail investor has to rely on unobserved price-yield information if one wants to invest in bond. Liquidity of the bond trading through the unorganized is also one of the most crucial problems.

Since December 2004, the Ministry of Finance has set up the Thai Bond Market Steering Committee, chaired by the Minister of Finance, to look after the development of the Thai bond market according to the Thai Bond Market Development Master Plan: Stage II. The results from the first meeting of the steering committee, there are three main issues showing the remarkable moves of the Thai bond market. Firstly, it is agreed to promote the BEX to be the central electronic trading platform (Central ETP) for the Thai bond market. Secondly, the Thailand Securities Depository Co., Ltd, the subsidiary of the SET, was assigned as the depository center of all government and quasi-government bonds. Lastly, the Thai Bond Dealing Centre (ThaiBDC) was assigned to be the monitoring unit and information center for the Thai bond market.

BEX adopted the beta version electronic trading platform from the ThaiBDC. The FIRSTs (Fixed Income and Related Securities Trading system) emerges from the additional development to the adopted ETP. The FIRSTs is the electronic system for OTC bond market which complies to the regular practices of those institutional investors and dealers in the Thai bond market. The design of the FIRSTs intends to facilitate the Thai bond wholesale market. It is planned to launch by the last quarter of the 2005.

Besides to the FIRSTs, which is for the wholesale bond market, BEX also serves the retail bond investors through the automatic order matching (AOM) scheme. This AOM is the true exchange system with the pre-specified rules of matching, price-then-time. In the coming year of 2006, BEX plans to promote this AOM to the wide range of retail investors who are interested in bond investment.

Not only the developments of infrastructures, BEX also put extremely large efforts to educate both investors and professionals for the bond investment techniques. The Thailand Securities Institute (TSI), the business unit under SET, helps support the educational loads for BEX.

Conclusions

SET intends to help promote and support the ABMI in many ways. A number of tasks has been done and will be done in the future to strengthen the Thai bond market. It is expected to have strong and liquid Thai bond market as one of the unit of the Asian bond market. It is also believed that our Asian bond market, with Thai bond market, will ensure the stability of Asian economy in the near future.

1 Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam + Japan, China, South Korea

2 WG1-Creating New Securitized Debt Instruments, WG2- Credit Guarantees and Investment Mechanisms, WG3-Foreign Exchange Transactions and Settlement Issues, WG4-Issuance of Bonds Denominated in Local Currencies by MDBS, Foreign Government Agencies, and Multinational Corporations, WG5-Rating Systems and Information Dissemination, WG6-Technical Assistance Coordination.

3 BEX is the Thai bond market of the Stock Exchange of Thailand (SET).

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Demutualisation: Current Trend of the Stock Exchange Reform

— *Amir Khosru M Chowdhury, MP* *

The history of stock exchanges dates back to more than a century. Since its natural birth after institutionalization of large public limited companies, stock exchanges have continued to grow - from kerb market to current geographically neutral automated bourses. The changing features of the stock exchanges have always aimed, in the recent times as in the early days, to more transparency and efficiency. Transparency means equal access of information to all participants and right information on the right time to all. Efficiency refers to best use of resources required for effective operation. It looks at the quantum of recourses employed for the quantum of output.

The most active stock exchanges in the world are now, if they have not already, reforming to demutualisation. It is treated as an obvious development after trading systems have been automated worldwide. Demutualisation is a new jargon to us and may not be found in dictionary. In mutualised set up, the entities in the capital market form non-profit association to engender stock dealing and broking businesses. In the demutualised form stock exchanges are for-profit organisation run by the non-traders in the framework of the securities laws to provide services to traders. Demutualisation is the process of conversion of a not-for-profit entity into a for-profit entity owned by its shareholders. The reform results in a new company that operates like a business, which is customer-need-oridented and thus able to respond quickly to the changes in environment. As a profit oriented organisation, a professional management team runs it, which is accountable to its shareholders.

Stock Exchange involves basically three entities - Owners, Dealers and Management. Conflicts of interest among these groups may jeopardize the basic objectives of the organisation that is providing investors a transparent and efficient market place. The owners are trading dealers/brokers in the current scenario in Bangladesh. Stock Exchange shareholder members do not get any dividend from the Exchange. But they form the policy-making authority. A basic human instinct to maximise income from any business, no matter what the law permits, may provoke to utilise the right they possess as owner in their operation in dealing. It happened many times in the histroy - in all eras and in all countries. Managers hired and fired by the owner dealers receive some protection from the monitoring agencies, but dual accountability and reporting need may create dilemmas in delivery of managers' duties independently. There are representations of neutral persons in the governing board. But it is casual and the services are voluntary.

In the demutualised set up of a stock exchange, owners of for-profit corporate bodies in the financial sectors do not trade in securities. Brokers are licensees from the monitoring agency (SEC), and pay a very low amount of fees compared to the cost of a membership in the bourse for trading. They may have to pass professional exam. Management is responsible for providing a smooth trading system and running administration of the exchange in a profitable way. Managers do not trade or otherwise have any link to influence the brokers or be influenced by them.

Benefits of demutulised exchanges are enormous as have been experienced worldwide. Most of the major exchanges round the globe such as London Stock Exchange, Deutsch Borse, Singapore Stock Exchange, Australian Stock Exchange, Hong Kong Stock Exchange, Toronto Stock Exchange, Malaysia Stock Exchange, National Stock Exchange of India etc. have been demutulised and started reaping the benefits. Stock Exchanges such as Euronext, Nasdaq, Sydney Future Exchange etc. have started the process of demutualization. Even in the emerging markets, exchanges such as Chili, Hungary, Philippines already finished demutualization and Sri Lanka, China, Poland Pakistan etc. have started the process. Everybody irrespective of the region and nature of governance realized the need for demutualised stock market. It's time we think about the issue and quickly delve into the matter.

Traditional setup of exchange lacks focused strategic goals and business purposes and often has no clear accountability particularly because they are not-for-profit entity. Usually in a not-for profit company creating shareholders' value is not a priority and member-owners



are more concerned about their broking business than the whole exchange's profitability or development. Because they don't get direct benefit out of the surpluses that the exchange makes. However in demutualised setup the whole dynamics is opposite. Owners would put all out efforts to make the exchange profitable as in any corporate business enterprise.

Mutualised exchange does not have the opportunity to tap equity markets for capital, which might limit their ability to expand as and when the market warrants. They might have to tax the members for additional funds to cover expenditures or shortfalls. Demutualised exchanges may raise capital from the market even can list themselves in the same or other exchange for public trading of its shares.

There are lots of other benefits. Demutualised exchange will provide a new corporate governance structure that will be more effective in managing conflicts among market participants. Management would be more flexible and quick in decision-making. Brokers will be more professional and would concentrate in better service and resource creation. Market would be expanded through providing trading rights to thousands of brokers at low cost countrywide.

Current members are not getting any dividends out of the surpluses, if any, being made by the exchange. Their main income is from brokerage and other market activities such as merchant banking, issue management, underwriting etc. In demutulised setup they can sell their ownership as per the current value of their membership and still can retain their same trading rights with a very nominal fees and make same amount of money as they have been making. Whereas they can take back the huge amount of membership money in current price and can use it to expand their market and other useful purposes. Demutualisation process involves institution and amendments of many relevant laws, rules and regulations. Existing members will sell off ownership to a consortium of financial houses. If existing members want to discontinue as a broker and want to be among the new owner, share can be retained. The consortium of owners will form a governing board complying the need for best corporate governance. Members receive payment based on the valuation of the assets of the Exchanges. They can be a broker and retain right to trade and pay a periodical



fee to the exchange. New trading license can be issued to any company/individual meeting professional criteria. Stock Exchange can list on itself to providing liquidity of its share.

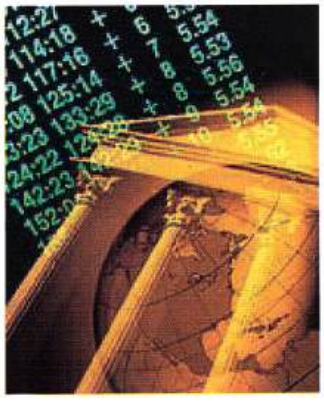
Demutualisation altogether is not risk free. It warrants set of pre-conditions and enabling environment in the economy. Given the pace of market expansion in our country and the state of regulations and market dynamics this is the right time we start the process. And also to keep the market expansion and advancement going, particularly when it was started successfully with the automation in the market, we need to start the process of demutualization at the earliest. Through demutualization we can keep up with the advancement in the region and eventually with the international trend.

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Significant Milestones in the Development of Bangladesh Stock Market

*— Prof. Imran Rahman **

The stock market of Bangladesh was born in the late 1950s with the establishment of the Dhaka Stock Exchange (DSE). In the early years, the market was characterised by a handful of listed companies, narrow shareholding base, and thin trading activity. Large manufacturing companies in the private sector met their capital needs mainly from banks and retained earnings. In certain sectors, like the jute industry, new entrepreneurs



received generous support from the government in the form of land, machinery and subsidised finance under an innovative scheme aimed at jumpstarting the manufacturing base of our country.

The government of the day formed the Investment Corporation of Pakistan (later Investment Corporation of Bangladesh) with the aim of encouraging greater public participation in the stock market through mutual funds and investors' accounts. From the issuers' point of view, ICP was the first institutional investor and investment bank, offering bridge finance and underwriting.

Primary market activity was overseen, not to any great extent, by a government department under the ministry of finance, archaically named the Controller of Capital Issues, an institution which had little concept of investor protection and disclosure needs. Secondary market activity was the under the purview of the Dhaka Stock Exchange, basically playing the role of a self regulating authority.

However, development activity in the fledgling market was put on hold following the independence of Bangladesh. As a result of whole-scale nationalisation of private manufacturing industry, banks and financial institutions, large-scale private sector activity ground down to a halt and the stock market entered a period of dormancy.

The thaw started in the late nineteen seventies, with greater focus being put on private enterprise, albeit in a limited way. Some nationalised industries were returned to owners, or privatised, and licences were issued for private banks. The stock market started waking up. In the late 1980s, some good companies (such as Beximco Pharmaceutical and Apex Tannery) floated shares and bonds.

At that time, regulations governing primary market activity were somewhat sketchy, with cursory oversight by the Controller of Capital Issues. In many case, issuing companies carried out most of the requirements and tasks leading up to floating shares. The quality of disclosure was not effectively monitored by any credible third party. Investment banking functions and distribution of new issues were carried out by the lone ICB, a handful of financial institutions, but mainly by the large brokerage houses of Dhaka Stock Exchange. The distribution base of new issues continued to be narrow, and a conservative approach ruled the pricing of new shares, a situation which persists to this day. The stock market appeared set to follow a slow but steady growth in activity.

Then in 1993, the Bangladesh market was "discovered" by some foreign brokerage houses based out of the Far-East (Smith New Court Hong Kong being one). Against the backdrop of high market valuations globally, the shares of a few DSE companies (large local corporates like Beximco and Apex and some MNCs) were on offer at bargain prices. The foreign brokers managed to persuade some fund managers, who had a taste for exotic and risky Asian stock, to include some of these stocks in their portfolio. This was a tur ning point in our market.

Soon other foreign brokers and funds followed. In the scramble for shares, good judgment went out of the door. Foreign investors started picking up whatever was

available. Local investors shook off their lethargy, and spurred by the avid appetite of foreign investors, started buying with new vigour. The spurt of activity drove valuations and PE ratios up and soon the market ran short of shares.

Taking advantage of the unmet demand for shares, new companies came to the market, many with little or no track record. Existing companies used the opportunity to make seasoned issues. The period from 1993 to 1995 saw a spurt of primary issues, a substantial chunk of which were placed with foreign investors, with the balance being offered to local investors though public offerings.

At the peak of this international interest in Bangladesh's stock market, an investors' conference was organised by Euromoney in January 1995. This was attended by several international fund managers, brokers, and investment banks. The government rolled out the red carpet and highlighted the various incentives that were available for inward portfolio investment.

However, local investors were somewhat aggrieved at being offered the remnants of new issues after foreign investors' appetite had been sated. The authorities agreed and imposed a one-year lock-in on foreign investment in primary shares. This move was not welcomed by the foreign investors who only a month ago were being wooed by the government at an international conference. Foreign interest in primary shares waned and the foreign investors seemed content to sit on their holdings for the time being. Fortunately, there was sufficient interest from local investors to keep the primary market ticking.

Around this time, the newly formed Securities and Exchange Commission was still getting its act together. The transition from a bureaucratic government department (CCI) to an independent watchdog body with a new mandate and powers is rarely a smooth one. For whatever reason, the relationship between DSE and its regulator SEC got off on the wrong foot. SEC enacted a new law regulating primary market activities through the formation of a new entity called a merchant bank. Interestingly, there was no significant role in the regulation for broker-dealers who had so far been carrying out investment banking activities.

In such a vibrant market, DSE was not in a mood to pay much heed to the new ideas coming out of SEC -- transparency of transactions, investor protection, responsibilities of a self regulatory organisation. Perhaps with the intention of bringing DSE into line, the government supported the formation of a new stock exchange in Chittagong. The idea was to introduce competition in the stock market and to allow local Chittagong companies to raise capital through a home-grown exchange.



The year 1996 will be remembered as a watershed in our stock market's history. The election of a new government after a year of political turmoil was apparently welcomed by the market, as evidenced by a healthy jump in the market index. But the index kept on rising - exponentially. So did trading activity. DSE's manual "open outcry" trading system failed to cope with this increased volume and trading activity spilled onto the streets. One side of Motijheel Road turned in to one long kerb market. New investors - professionals, government employees, housewives, students, small businessmen, traders - flocked to this market, attracted by the money-making machine called the Dhaka Stock Exchange.

Amidst this mad rush of activity, the DSE seemed to lose focus on its regulatory responsibilities. The DSE council, entrusted with the responsibility of regulating the activities of broker-dealers, was composed of some of DSE's biggest brokers. There was a surge in proprietary trading. SEC appeared uncertain as to what action it should take to cool the market down. To quell price increases of 10 percent and above a day, SEC imposed circuit breakers. But this seemed to fuel the fire further. Public notices warning new investors of the dangers of buying shares in a bull run went unheeded. The DSE index rose from around 600 points in June to over 3,600 in October.

And then the inevitable collapse began. But it still took another two months for the market to

return to the June level. It seemed that some people were still buying. New investors who had travelled all the way from distant town and cities after cashing out their land and other assets were not going to go away empty handed, no matter what others were saying about the market's collapse. Predictably, these newcomers took the biggest hit. The clever ones, including the proprietary traders, baled out long ago. Remember the foreign investors? Well they quietly offloaded their holdings and repatriated their winnings, all quite legally.



After the storm, one question was on everyone's lips "who engineered the bull run?" An embarrassed government hurriedly constituted an investigation into the alleged scam. The report, which was completed in a surprisingly short time, found circumstantial evidence of wrong-doings by some brokers and listed companies, against whom the government subsequently framed charges. A quick resolution of the share scam cases would have gone a long way towards restoring the credibility of the market, the players and the regulators. Sadly this was not to be. These cases are still pending today.

The consequences of the 1996 bubble were not all negative. For one, it focussed the minds of the regulators on the need for more relevant laws and effective implementation of the same. The SEC enacted a string of laws relating to primary issues, secondary market transactions, broker/dealer responsibilities, insider trading, and private mutual funds. To avoid the resurgence of kerb trading, all agreed that the trading capacity of the stock exchanges needed to be significantly increased. The two exchanges installed computerised trading systems and a central share depository was set up.

It has taken a while for the public's confidence on the stock market to return. Thanks to a spate of successful primary issues over the last couple years, the ghost of 1996 seems to be almost buried. However, most of these new issues were not voluntary. They were offered by banks and insurance companies in line with the terms of their operating licence agreements. There have been few issues made by good quality manufacturing or service companies.

A possible reason for this could be that issuers are not being able to sell shares at prices that they desire. New issue price premiums have to be justified with reference to net book value and endorsed by a rating agency. Whatever is the wisdom of such tinkering with valuation, the end result is that issue costs have gone up, and good companies seem unwilling to sell their shares cheaply. Furthermore, when new issues are grossly underpriced, the temptation to acquire large chunks of primary shares by dubious means would be great. The recent incident with the Premier Bank IPO is a case in point.

Today our stock market has more or less recovered from the protracted after-shocks of the 1996 turmoil. The regulators and market participants have quite rightly focussed their attention on removing supply and demand side constraints. However, one has to remember that a stock market is a free market, implying that it is not, and should not be, wholly controllable. The market's vibrancy and activity will in the end be determined by the underlying fundamentals in the economy.

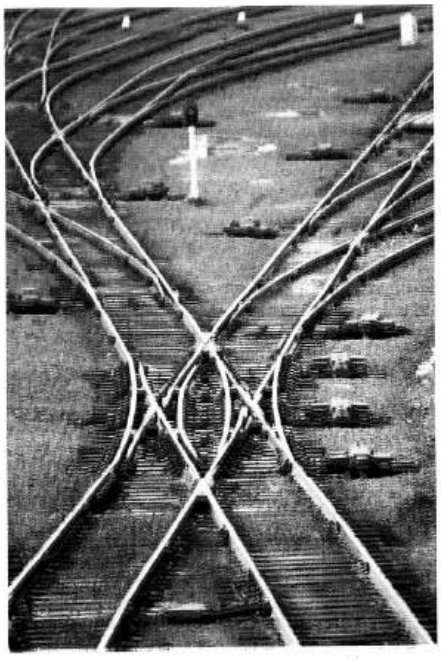
* ***Mr. Rahman*** *is an Associate Professor, Institute of Business Administration, University of Dhaka*

Pension & Retirement Funds in Bangladesh

— Yawer Sayeed *

Pension and provident fund system in Bangladesh is in force mainly with the civil services and armed forces, along with some other semi-government and autonomous bodies and SoEs. There are provident fund systems in most multinational companies, private and public banks and financial institutions and some large private industrial conglomerates, though pension system is not prevalent in the private sector.

It is estimated that roughly about only 2.5 percent of the entire working age population of around 65 million are covered under any retirement benefit scheme and that the present pension and provident fund system provides comparatively high benefits in relation to generally low wages. At present there are about 800,000 pensionable government employees. The government simply pays pension and the commuted portion out of current revenue as they fall due for payment. This, however, is not strictly in accordance with the generally accepted accounting principles, which requires that a pension liability should be recognized during the working life of the respective employee and not on retirement. The pension benefit is a function of the number of years of service and salary on retirement. It is not regarded as a good financial practice to defer financial recognition of a current liability.



The rules governing the public pension scheme are not consolidated in one document but are scattered in various executive orders issued by the Ministry of Finance and the Ministry of Establishment. The Office of the Comptroller and Auditor General (C&AG) is the parastatal for pension and other social benefits provided by the government to the public servants, though approval for pensions comes from the respective ministry or division or commission. However, the pension, provident fund and other social benefits of the civil servants are managed by a single wing of the office, the Controller General of Accounts (CGA). Functionally, the office is now under the Ministry of Finance (MoF) since June 30, 2002 and not sovereign. All decisions on pension and provident funds are made directly by or in close consultation with MoF, Ministry of Defense (MoD) and Ministry of Communication (MoC). None of the offices decides any policy term as well.

Numerous small government offices under various ministries, divisions and commissions maintain individual accounts on pensioners, which supply only an estimated budget to the MoF for payment of pension benefits during the fiscal year prior to the preparation of the national budget. The CGA office, which collects information from 523 civil government offices (excluding military, railway and telephone), is not in the practice of asking for the actual number of pensioners to be retired in a year, and hence does not maintain any or prepare a consolidated figure of the total number of pension receivers or are to be receiving benefits in a year. Even though the National Board of Revenue (NBR) grants approval to gratuity (superannuation) funds and provident funds for those to qualify for tax-exempt status, they also do not maintain any consolidated data on the number of employees under pension, provident fund and gratuity schemes or the accumulated amount of assets of such funds. Respective district offices might have such an estimate but any central authority does not ask them for consolidation, thus no total figure have been reached in this regard by the government. Data are not available at the office of the CGA, CGDF or DGRA as to how many people retired at old age or ceased to be employed, for invalidity or for death.

The commutation rate appears to be quite on the higher side. It would appear that the actual pay and benefits in the public sector in Bangladesh could be higher than the private sector in reality. However, government pensions are usually not

revalued or indexed against inflation or any other parameter. But the financial impact of such a generous commutation basis effectively increases the pension benefit to over 95 percent of last drawn salary. Unlike in developed and welfare states, the government of Bangladesh does not fund pension liabilities for civil servants. Pensions are not financed during employee's working career as well. It is paid out of revenue budget, as it is a PAYG system.

Aggregate amount needed to fund the current government provident fund obligation at June 2003 was around $870 million and pension for existing pensioners was about $325 million. Accumulated pension obligation is however much larger, and there is no good estimate available with CGA or any other government office as to what extent this might reach. During the past four years (2001-04) on average pension benefits were equivalent to almost 40 percent of the total salary paid to the public servants. This is likely to increase over the years as new pensioners participate in the scheme, and few exhaust from the list, since benefits are passed over to the immediate heirs after the principal beneficiary dies. An earlier (July-August 1999) actuarial study of the ADB estimated that the annual cash outlay for pension and commuted pension would reach to about Tk 22 billion by 2005.

The General Provident Fund (GPF) is a noncontributory provident fund for only pensionable employees, and an employee's minimum rate of contribution depends on respective income bracket. The government, however, does not make any contribution in to the scheme. A Contributory Provident Fund (CPF) is required for all public servants in non-pensionable employment.

Both CPF and GPF receive interest from the government (or the employing agency), generally over or at the rate of the government savings bonds. All calculations of contribution and interest are made on the basis of basic pay. The return in effect is almost double the actual average yield in the country's stock market. The interest rate is also quite high compared to the present rate of interest on bank FDR. The MoF usually reviews it annually, but without any explicit regard to inflation index. The interest burden gets heavier every year, as it is compounded. During 2001-02 interest on GPF was more than 13.6 percent of the gross salary paid to the public servants. Deposits are kept with the Government Treasury, and therefore, there is no explicit funding of provident fund liabilities, and annual benefit payments are met regularly from the revenue budget.

There is no organized social security system for the private sector in Bangladesh. Private sector companies, by practice, have no pension obligations to employees. However, many companies establish, administer, and manage their own retirement benefit schemes suiting



their own human resources policy. For the private organizations there is no legal obligation to provide any retirement benefits for their employees. Setting up a provident fund arrangement for employees is voluntary; payment of gratuity benefits is also not mandatory. However, almost all multinational corporations and some large reputed local companies, including banks and financial institutions, have on-going provident funds and gratuity system. There is no government or privately managed superannuation funds where an employee can participate voluntarily at his/her discretion.

Though the affiliates and subsidiaries of multinational companies (MNCs) offer generous severance pay, it is not a practice for the local companies. None of the local corporate bodies has reportedly offered any pension schemes for employees in Bangladesh so far. Pension schemes in the private sector are not prevalent in Bangladesh. However, only three MNCs do offer pension benefit to the employees and almost every MNC has attractive funded gratuity schemes. The MNCs usually apply internationally accepted practice, norms and terms

and conditions as well as actuarial standards in determining employee benefits and generally those are recognized as funded liabilities, as could be gathered from the published accounts of such listed companies. It can be inferred that the non-listed MNCs also do follow similar practices.

Provident funds in the private sector are usually contributory, with equal contribution by employee and employer. Unlike in public service, it is funded and the assets were mainly invested in government securities as is/was required by law and practice. With amendment to the relevant section of the Trust Act 1882, the trustees of provident funds can now invest up to 25 percent of assets in approved capital market ins truments, such as listed equities and debentures, but it is rarely done, in absence of requisite expertise as well as risk and responsibility aversion mentality of the trustees.



Usually such funds are invested in bank fixed deposits and government savings certificates or securities and now to some degree in privately placed debentures and newly introduced government bonds. Employees themselves manage the fund under a sort of management committee or trustee, and hardly any external entity is engaged to professionally manage the funds.

Provident fund balances are paid on termination of service to employees completing specified minimum number of years of service. There is no provision in the country's legal system whereby a provident fund account can be transferred to another enterprise once the accountholder moves there. Though provident funds are subject to internal audits, few of the companies appoint external auditors, as this is not mandatory by any law. Incidentally, none of those funds are in fact subject by law to regular independent actuarial valuations.

Unlike government pension, provident fund and gratuity schemes, the gratuity scheme in some of the sector corporations and some of the unit enterprises are reported to be funded. Gratuity finance comes from the corporations' own income. When a company goes into liquidation with unfunded retirement benefits, then, not only do the employees lose their jobs but also lose their accrued retirement gratuities. But, if the retirement payments and benefits are financed through an NBR-approved trust fund and the company goes into liquidation, then the accrued retirement gratuities are protected for the employees. However, there are perceived barriers to financing gratuity and pension schemes through an NBR-approved trust. Getting NBR approval is usually difficult and obtaining an actuarial valuation to determine the plan costs is an obstacle. At present there are only one or two qualified actuaries resident in Bangladesh, while foreign-based actuaries charge high rates.

The Institute of Chartered Accountants of Bangladesh (ICAB) has only recently adopted the International Accounting Standards as far as pension and gratuity schemes are concerned. Earlier there was no requirement for employers to make an appropriate accounting reserve to reflect their emerging liabilities to deferred compensation plans. This enabled companies to in fact conceal true liabilities. Therefore, there was no pressure on companies to consider the optimum method to finance these liabilities and in discovering the taxation advantages in funding the arrangements by means of an NBR approved trust fund.

Adoption of such standards means that there will be a need for actuarial valuations of pension or gratuity arrangements, whether or not they are funded. However, implementation and compliance to the relevant IAS 19 would still remain a far cry in absence of practicing professional actuaries in Bangladesh. The county needs to develop expertise in this particular area on immediate Provident fund balances are paid on termination of service to employees completing specified minimum number of years of service. There is no provision in the country's legal system whereby a provident fund account can be transferred to another enterprise once the accountholder moves there. Though provident funds are subject to internal audits, few of the companies appoint external auditors, as this is not mandatory by any law. Incidentally, none of those funds are in fact subject by law to regular independent actuarial valuations.Unlike government pension, provident fund and gratuity schemes, the gratuity scheme in some of the sector corporations and some of the unit enterprises are reported to be funded. Gratuity finance comes from the corporations' own income.

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Earlier, the NBR-approved trust funds were required to invest only in government securities. Section 20B of the Trusts (Amendment) Act, 2000 now allows private pension and provident funds to invest up to 25 percent in any security listed with the stock exchanges of Bangladesh. However, because the capital market has been sluggish for quite a number of years since the 1996 crash, the opportunity to earn higher yields for a trust fund through security investments has not been attractive.

Many employers also do not see the advantage of financing their liabilities by means of an NBR-approved trust fund and does not have the required skills to run such funds professionally. There is only one state-owned (ICB Asset Management Company) and another private (AIMS of Bangladesh Ltd) SEC approved asset management company in Bangladesh. Unfortunately though, the SEC (Mutual Fund) Rules 2001 does not qualify any Provident or Pension Fund, established as Trusts, to Sponsor any mutual fund in the country.

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Bangladesh

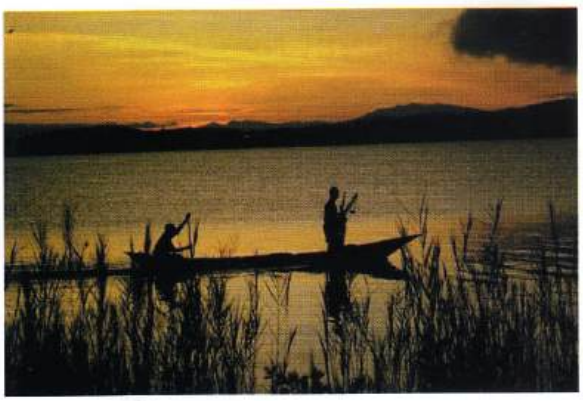
Official Name	The People's Republic of Bangladesh
Capital City	Dhaka
Location	South Asia, between 20°34' and 26°38' north latitude and between 8801 and 9241 east longitude, consists of flat fertile alluvial land.
Boundaries	North - India (West Bengal and Meghalaya) West - India (West Bengal), East - India (Tripura and Assam) and Myanmar, South - Bay of Bengal
Area	1,47,570 Sq. KM (Territorial water 12 nautical miles in the high seas measured from the base line).
Standard Time	GMT + 6 Hours
Climate	Sub-tropical monsoon. Winter (Nov. - February) temperature - average max. 29°C, average min. 11°C; Summer (March-June) temperature - average max. 32°C, average min. 21°C; Monsoon (July - October)
Rainfall	1194 mm to 3454 mm (average during monsoon, July - October)
Humidity	Highest: 99 per cent (July), Lowest: 36 per cent (December and January)
Vegetation	Grassland, mixed evergreen and evergreen
Population	150 million
Density	765 per Sq. KM
Growth Rate	1.67%
Mortality Rate	62.6 per 1000
Literacy Rate	64%
Ethnic Groups	Predominantly mixed group of Proto Austroloids/Dravidians, Mongoloids and Aryans
Language	95 per cent Bangla and 5 percent other dialects. English is widely spoken and understood.
Religion	Muslim (88.3%), Hindu (10.5%), Buddhist (0.6%), Christian (0.3%) and others (0.3%)
Food	Rice, Vegetables, Pulse, Fish and Meat
Principal Crops	Rice, Wheat, Jute, Tea, Tobacco, Sugarcane, Pulses, Oilseeds, Spices, Potatoes, Mango



	Vegetables, Banana, Coconut and Jackfruit.
Principal Rivers	Padma, Buriganga, Brahmaputra, Jamuna, Meghna, Karnaphuli, Shetalakha, Teesta, etc. Total 230 rivers including tributaries.
Mineral Resources	Natural gas, lime stone, hard rock, coal, lignite, silica sand, white clay, radio active sand, etc. (There is immense possibility for oil deposit).
Human Resources	A substantial manpower reserve , trained and skilled engineers, technicians, physicians, economists, accountants, administrative and managerial personnel, abundance of low cost, easily trainable and adaptable, hard working, intelligent and youthful labour force.
Form of Government	The country has a Parliamentary Form of Government headed by the Prime Minister. The President is the constitutional head of the country.
Principal Industries	Jute, tea, textiles, garments, paper, newsprint, fertilizer, leather and leathergoods, sugar, cement, fish p rocessing, pharmaceuticals, chemical industries, raw jute, jute manufacturers (hessian sacking carpet backing, carpets), frozen shrimps, other fish products, newsprint, paper, naptha, furnace oil, urea and ceramic products.



Principal Exports	Readymade garments, frozen food and shrimp, tea, raw jute, jute products, leather and leather products, chemical, fertilizer, ceamic tableware, etc.
Principal Imports	Wheat, oil, seeds, crude petroleum, raw cotton, edible oil, petroleum products, fertilizer, cement, staple fibers, yarn, iron and steel, capital goods, etc.
Households	1,47,85,048
Divisions	6
Districts	64
Thana	495 (???)
Unions /Words	4,472
Villages	85650
Intl. Airports	Zia International Airport, Dhaka, Chittagong Shah Amanat International Airport, Chittagong and Osmani International Airport, Sylhet.
Domestic Airports	Dhaka, Chittagong, Sylhet, Cox's Bazar, Thakurgaon, Syedpur,



	Rajshahi, Rajshahi, Jessore and Barisal.
Sea Ports	Chittagong and Mongla
Inland River Ports	Dhaka, Chandpur, Barisal, Khulna, Bhairab, Narayanganj and Sirajganj
Television Stations	Dhaka, Chittagong
TV Sub-Stations	Sylhet, Khulna, Natore, Mymensingh, Rangpur, Noakhali, Brahmanbaria and Saidpur.
Radio Stations	Dhaka, Chittagong, Rajshahi, Khulna, Rangpur, Sylhet, Rangamati, Comilla and Thakurgaon.

Sources : 1. CIA The World Factbook
2. Bangladesh Economic Review

Major Economic Indicators

	FY 02	FY 03	FY 04	FY05*
National Accounts				
GDP (in Billion Tk)	2732.0	3005.8	3329.7	3684.8
GDP (in billion US$)	47.57	51.90	54.75	60.47
Growth Rate (%)	4.4	5.3	6.3	5.4
Per Capita GDP (US$)	361.0	389.0	418	445
GDI (% of GDP)	23.2	23.4	24.0	24.4
GDS (% of GDP)	18.2	18.6	19.5	20.1
GNS (% of GDP)	23.4	24.9	25.4	26.5
Inflation (annual average)	3.6	5.0	5.6	7.4
Major Sectoral Contribution to GDP				
Agriculture	24	23.5	22.1	21.1
Sectoral Growth (%)	0.0	3.1	4.1	0.3
Industry	26.5	25.9	26.6	27.4
Sectoral Growth (%)	6.5	7.3	7.6	8.6
Service	48.7	48.8	47.2	47.8
Sectoral Growth (%)	5.4	5.4	5.7	6.6
Fiscal Operations (% of GDP)				
Revenue Earnings	10.1	10.4	9.8	10.1
Revenue Expenditures	15.0	13.8	12.9	12.8
Budget Deficit	-4.8	-3.5	-3.2	-2.7
ADP	5.9	5.6	5.0	3.7
Balance of Payments				
Export (f.o.b.)	5929	6492	7521	8573
Import (f.o.b.)	-7697	-8707	-9840	-11870
Trade Balance (deficit)	-1768	2215	-2319	-3297
Remittance	2501	3062	3372	3848
Current A/C Balance	157	176	176	-518
FDI	391	376	385	540
Overall Balance	408	815	171	161
Gross Forex Reserve	1583	2470	2705	3024
Average Exchange Rate (Tk/US$)	57.42	57.90	60.43	63.70
Monetary & Credit Development (in billion Taka; end June)				
Net Foreign Assets	95.9	140.9	163.3	192.3
Growth (%)	28.2	46.9	15.9	17.75
Net Domestic Assets	890.2	999.0	1134.4	1323.3
Growth (%)	11.7	12.2	13.6	16.65
Domestic Credit	1014	1097.2	1255.5	1472.5
Growth (%)	12.9	8.2	14.4	17.3
Broad Money	986.1	1139.9	1297.7	1515.6
Growth (%)	13.1	15.6	13.8	16.7
Reserve Money	235.3	243.1	262.6	299.8
Growth (%)	24.3	3.3	8.0	14.2
Time Deposit	744.6	872.5	992.7	1160.4
Growth (%)	14.9	17.2	13.8	16.9
Capital Market Development				
Listed Securities in DSE	257	260	267	259
Market Cap. (billion Tk)	64.7	72.2	141.9	212.4
Turnover (billion Tk)	34.9	30.6	24.8	74.8

Notes: * FY 05 data on National Account, Sectoral Contribution and fiscal Operations estimated

Sources: 1. CIA The World Factbook
2. Bangladesh Economic Review
3. Bangladesh Bank Quarterly: April-June 2005

ICC Bangladesh Presidency



Mahbubur Rahman
President, ICC Bangladesh
Chairman & CEO, ETBL Holdings Limited

ETBL Holdings and its affiliates are active in banking, insurance, housing and financing companies, newspaper, international trading, investments, stocks and securities, warehousing, cold storage and specialised construction in marine and infrastructure building.

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Vice President, ICC Bangladesh
Chairman & CEO, Transcom Group

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Former President of Metropolitan Chamber of Commerce and Industry (MCCI), Dhaka and Bangladesh Employers' Federation.



Samson H. Chowdhury
Vice President, ICC Bangladesh
Chairman, Square Group

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- Office of the Hon'ble Prime Minister of the Government of the People's Republic of Bangladesh
- Office of the Minister for Commerce, Government of the People's Republic of Bangladesh
- Securities and Exchange Commission, Bangladesh
- Securities and Exchange Board of India
- Securities and Exchange Commission of Pakistan
- Bombay Stock Exchange Ltd.
- Bursa Malaysia Berhad
- Chittagong Stock Exchange Ltd.
- Dhaka Stock Exchange Ltd.
- Karachi Stock Exchange (Guarantee) Ltd.
- Korea Exchange Ltd.
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- Tokyo Stock Exchange Inc.
- The International Securities Consultancy Ltd., Hong Kong
- Citibank N.A., Bangladesh
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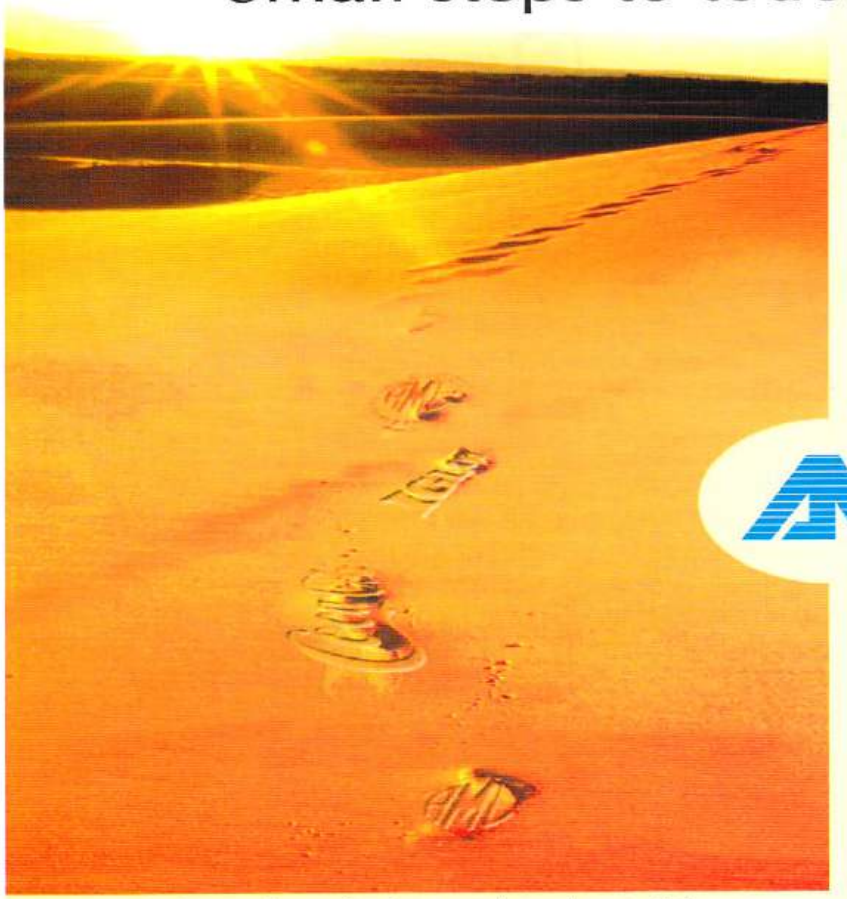
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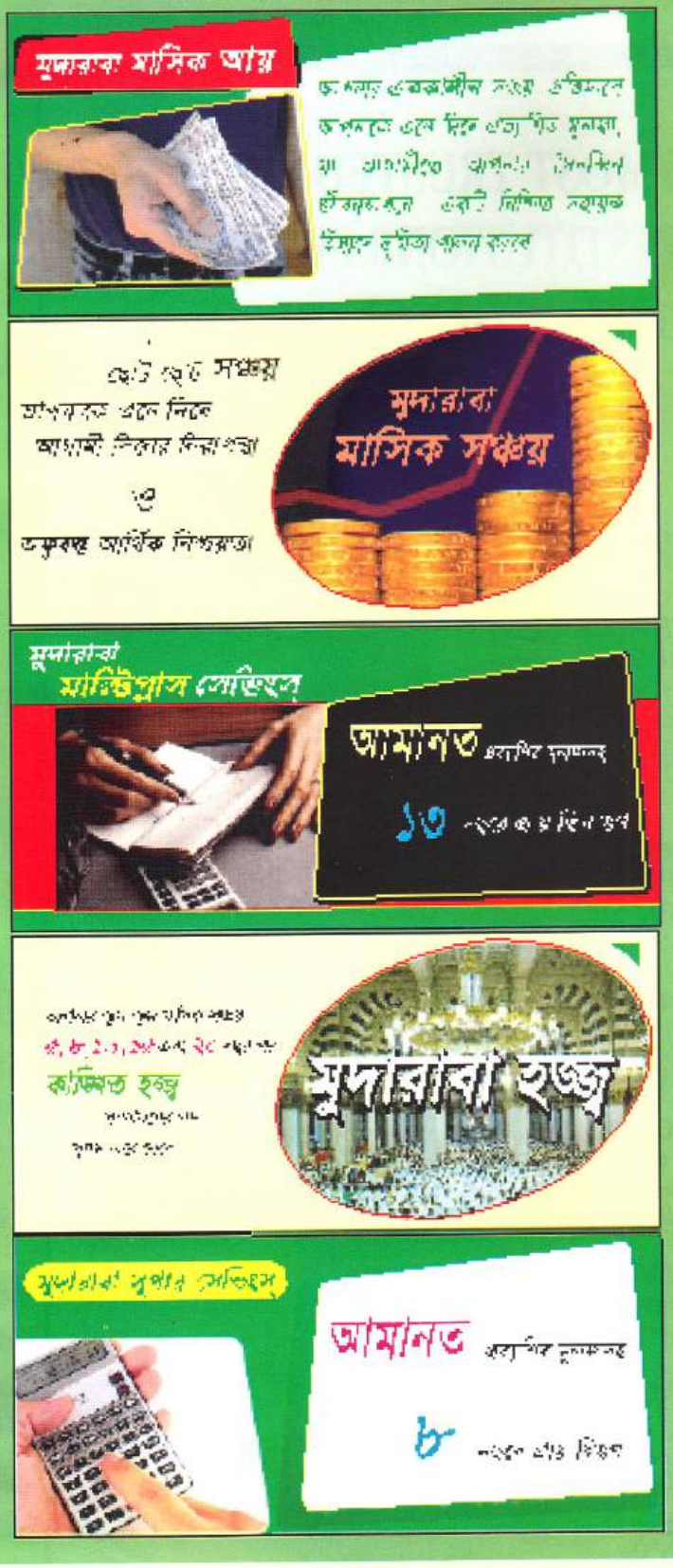


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খাদ্য এবং পানীয় সামগ্রী প্রস্তুতিতে নেস্‌লে বিশ্ব সেরা এক নাম। নেস্‌লের প্রস্তুতকৃত খাবার মান এবং পুষ্টিতে সবার সেরা–আর তাইতো প্রতিটি পরিবারের নেস্‌লের উপর রয়েছে অটুট আস্থা। আমাদের বিভিন্ন পুষ্টিকর খাদ্য ও পানীয় সামগ্রী প্রস্তুত করা হয়েছে যে-কোনো বয়স, সময় এবং পরিবারের প্রতিটি সদস্যের কথা ভেবে। আমরা আপনার জন্য যা কিছুই প্রস্তুত করি না কেন, স্বাদ ও পুষ্টির বিবেচনায় সেটি সর্বোচ্চ মানসম্পন্ন। কারন আমরা বিশ্বাস করি সুন্দর জীবন নির্ভর করে যথাযথ পুষ্টির উপর এবং যথাযথ পুষ্টি নির্ভর করে সঠিক খাবারের উপর।

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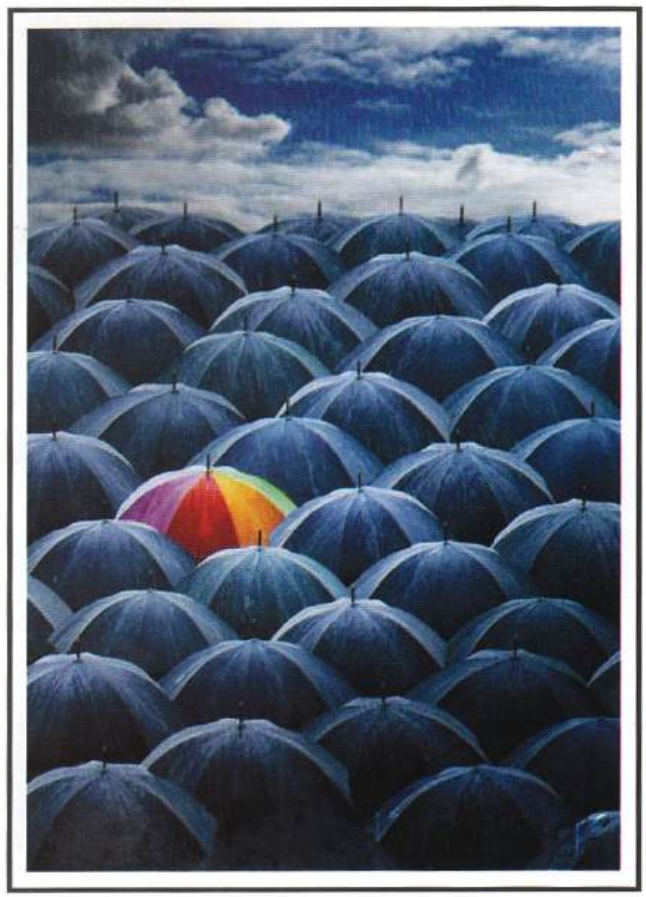
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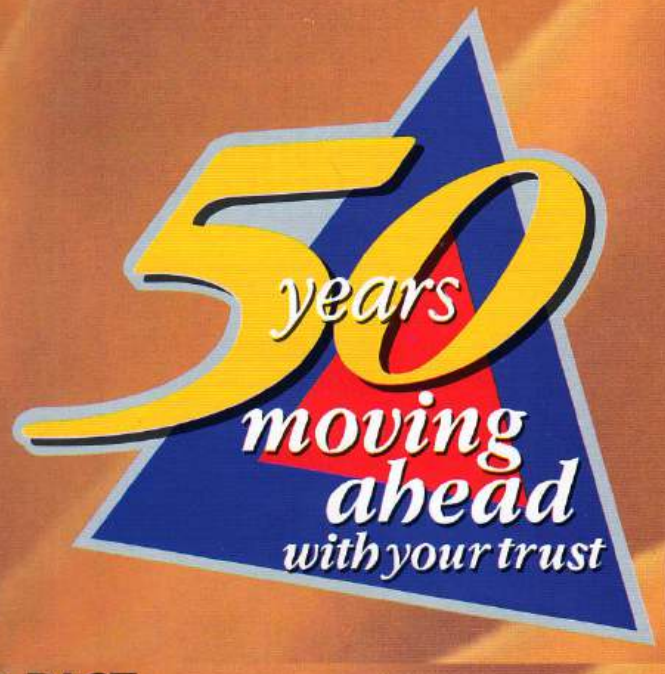
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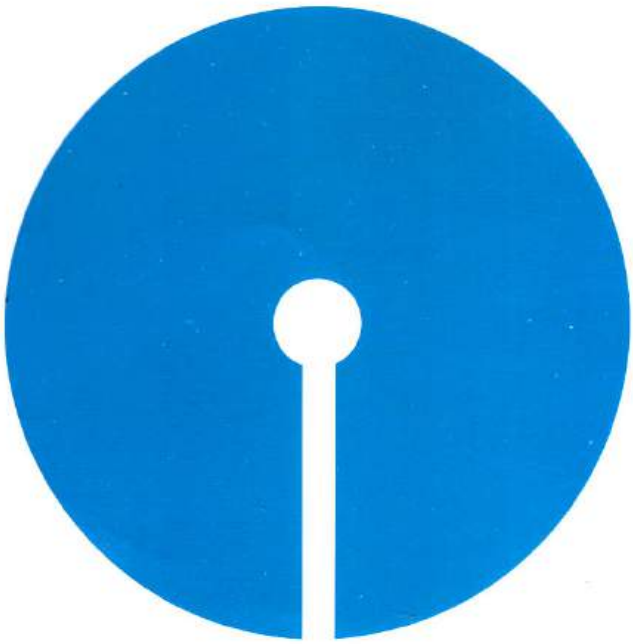
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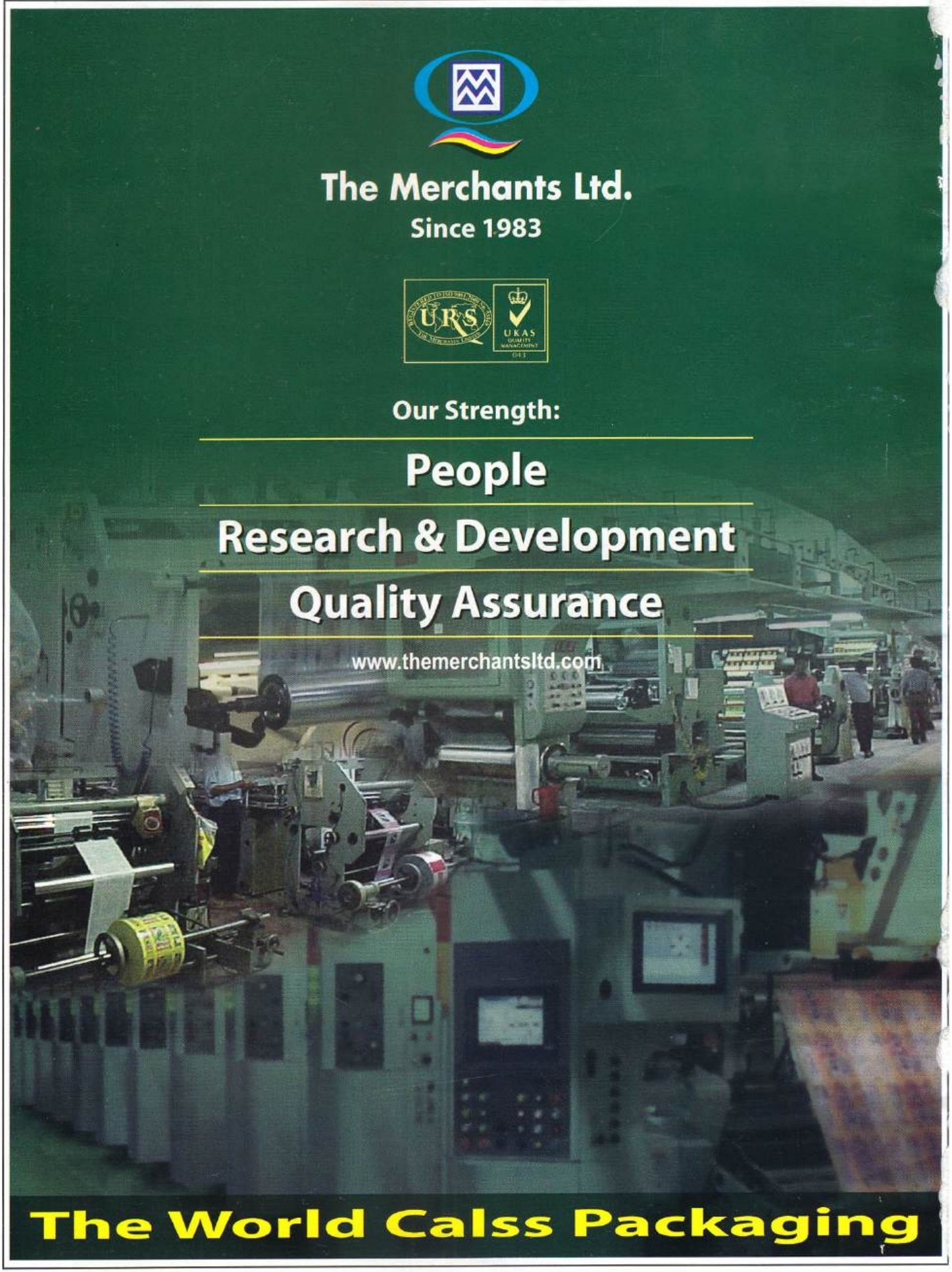
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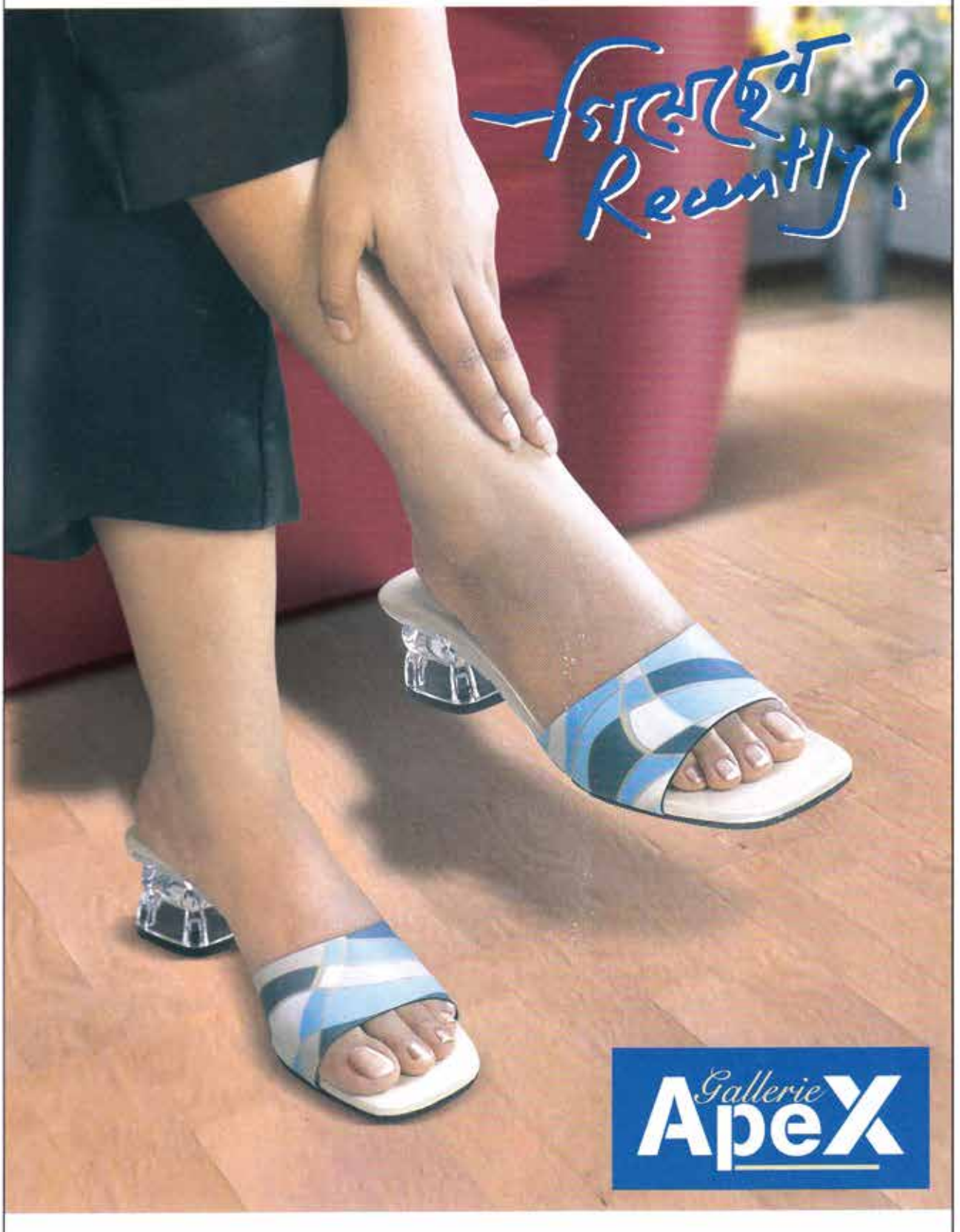
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