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Development of Capital Markets in Member Countries of the South Asian Association for Regional Cooperation

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Contents

Foreword

The South Asian Association for Regional Cooperation (SAARC) is pleased to present this book in collaboration with the Asian Development Bank (ADB). It represents the culmination of a project and, we hope, the beginning of a move toward greater integration of South Asia's capital markets. The project, which was started in 2011, involved a deep and rigorous investigation of the barriers to greater integration among SAARC markets by external consultants with the assistance of market participants across the region. We hope that this publication will serve as a catalyst for the development of a more harmonized and integrated capital market in the South Asia region.

Capital markets are a key component of national development, improving the mobilization of savings by providing alternative sources of financing for productive investments and supporting the development of long-term savings channels. Capital markets in the SAARC region have made very considerable progress during the last 20 years. Most members now have functioning capital markets with structures and regulations based on international best practice. But, as the results presented in this book clearly demonstrate, there are considerable differences in the size and level of development of the region's markets.

In other regions there has been, and continues to be, a movement toward greater integration of capital markets. This process has always required moves toward harmonization of regulations and practices, which makes a market more attractive to participants from other countries both within and outside the region. Regional integration of markets brings further significant benefits, including access to greater liquidity, convergence toward higher standards, and reduced costs leading to greater capital market efficiency. But it can also disrupt existing arrangements and businesses, for example, increasing competition among intermediaries. It is therefore necessary to plan moves toward greater integration in a way that recognizes the differing needs and development levels of the various regional markets.

The SAARC region has a relatively low level of integration, both in terms of physical trade and capital markets. The reasons for the lack of capital market integration are many and varied, but what stands out is the lack of information and involvement in other SAARC markets combined with a lack of opportunities and structures through which the different markets can learn from each other's experience. A key recommendation of the study, therefore, is to address this point by encouraging and supporting interaction and awareness among all capital market participants, including the private sector, with a view to facilitating the development of a regional capital market as well.

As part of its remit, SAARC has lent its support to drive this study forward. We see the harmonization and progressive integration of the region's capital markets as a worthy aim and part of a wider commitment to greater economic and financial integration—an aim that SAARC is keen to continue supporting along with ADB. Therefore, we welcome the study as an important first step in a process. SAARC looks forward to assisting in the implementation of the recommendations of this study in partnership with its member states.

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Abbreviations

National Securities Regulators

BSEC	Bangladesh Securities and Exchange Commission
CMDA	Capital Market Development Authority (national regulator Maldives)
RMA	Royal Monetary Authority (national regulator Bhutan)
SEBI	Securities and Exchange Board of India
SEBON	Securities Board of Nepal
SECP	Securities and Exchange Commission of Pakistan
SECSL	Securities and Exchange Commission Sri Lanka

Stock Exchange Abbreviations

BSE	Bombay Stock Exchange, India
CSE	Chittagong Stock Exchange, Bangladesh
CSE	Colombo Stock Exchange, Sri Lanka
DSE	Dhaka Stock Exchange, Bangladesh
KSE	Karachi Stock Exchange, Pakistan
NEPSE	Nepal Stock Exchange, Nepal
NSE	National Stock Exchange, India

Other Abbreviations

ASEAN	Association of Southeast Asian Nations
ASX	Australian Stock Exchange
CMIG	Capital Market Integration Group
Consob	Commissione Nazionale per le Societa e la Borsa (Italian Securities and Exchange Commission)
CRA	credit rating agency
EU	European Union
FII	foreign institutional investor
GCC	Gulf Cooperation Council
GDP	gross domestic product
IAS	International Accounting Standard
IDR	Indian Depository Receipt
IFRS	International Financial Reporting Standard
IOSCO	International Organization of Securities Commissions
IPO	initial public offering
MiFID	Markets in Financial Instruments Directive
MOU	memorandum of understanding
NIT	National Investment Trust
OECD	Organisation for Economic Co-operation and Development
SAARC	South Asian Association for Regional Cooperation

SAFE	South Asian Federation of Exchanges
SCRA	Special Convertible Rupee Account
SGX	Singapore Stock Exchange
SMEs	small and medium-sized enterprises
UK	United Kingdom
US	United States
WFE	World Federation of Exchanges

Glossary

American depository receipt	An instrument issued against a holding of foreign shares, usually by a United States bank, to allow United States investors to gain foreign exposure without directly accessing foreign markets
ASEAN Common Exchange Gateway	A planned system of electronic links between stock exchanges in the Association of Southeast Asian Nations region
ASX–SGX link	Electronic link set up to allow cross-trading of stocks between the Singapore Stock Exchange and the Australian Stock Exchange
BATS Chi-X Europe	A multilateral trading facility licensed under the Markets in Financial Instruments Directive, an electronic marketplace offering access to most major European stocks
central counterparty	Settlement entity that guarantees completion of trades
closed-end investment fund	An investment fund in which the total number of shares (units) is fixed
common law	The legal structure used in the United Kingdom, the United States, and a number of other countries; common law is developed by judges through decisions of courts rather than through statutes
complex voting structure	Company voting structures under which some classes of shares carry more votes than others
contestability	A term used to describe the situation in a competitive market where the position of one commercial company as a supplier can be competed away by another
correspondent link	A link through which a foreign broker settles trades in a local market using a local broker hired for the purpose
credit rating agency	An agency that provides credit ratings for debt and debt securities; the ratings represent the likelihood of default
dematerialization	The process or state in which securities are held only in electronic form; there are no paper certificates
demutualization	The process that converts an entity (in this case a stock exchange) from an organization structure akin to a club to a normal commercial company with shareholders
depository	An entity that maintains records of holdings of dematerialized securities

derivative	A financial instrument, usually a future or option, based upon future delivery of an underlying asset; derivatives may be traded on an organized exchange or over the counter
electronic links	communication links between stock exchanges that permit shares listed on one exchange to be traded on another or the routing of orders from one stock exchange to another
exchange-traded fund	A security traded on an exchange that represents a predefined basket of securities
European Union directive	A law of the European Union, such as the Markets in Financial Instruments Directive, which governs investment services
foreign institutional investor	An investor designated by the Securities and Exchange Board of India and allowed to invest in Indian securities
Financial Services Authority	The national securities regulator in the United Kingdom at the time of the study—now renamed the Financial Conduct Authority
free float requirement	A requirement on a listed stock that a minimum proportion of the issued capital must be held by public shareholders rather than by the owners or strategic holders
funded (pension) schemes	Pension schemes where current pensions are paid from earnings on assets owned by the fund, in contrast to pay-as-you-go schemes where current pensions are paid from the contributions of those still in work
Gulf Cooperation Council	A political and economic union comprising Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates
global brokers	Firms of securities traders who operate on global basis, such as Goldman Sachs
gold-plating	Additional regulatory requirements that a government may choose to impose over and above the requirements of a minimum standard
harmonization	The process by which countries gradually align their regulatory structures
home country regulation	Regulation of a market participant by the regulator of the country in which the participant is licensed (and usually incorporated) irrespective of which country it is operating in
International Accounting Standards/ International Financial Reporting Standards	Principles-based accounting standards, interpretations, and the framework adopted by the International Accounting Standards Board

infrastructure providers	Entities that provide the infrastructure for a securities market, e.g., stock exchanges and securities depositories
integration	A process or state under which barriers between (capital) markets in a region are removed so that the individual markets become a single market
intermediary	A broker
internal matching systems	Systems within brokers that allow them to match buy and sell orders from their customers without using an organized exchange
initial public offering	A money-raising issue of shares by a company when it is first listed on a stock exchange
know-your-client rules	Regulatory requirement for a broker to be familiar with the client's circumstances and risk preferences before giving advice
legal immunity	A status granted in law to staff of a regulator that prevents them from being sued for their actions required for their function when carried out in good faith
market abuse	A range of prohibited activities in securities markets including insider trading and market manipulation
memorandum of understanding	An agreement between two entities, usually regulators, e.g., to exchange information about investigations
Markets in Financial Instruments Directive	A European Union law governing the securities markets
minorities	Shareholders who only hold a small proportion of the shares issued and are likely to be outvoted by larger shareholders
multilateral memorandum of understanding	An agreement between multiple entities, usually regulators, e.g., to exchange information about investigations the International Organization of Securities Commissions (IOSCO) operates a multilateral memorandum of understanding
mutual fund	An open-ended investment fund
net asset value fund	A mutual fund where the value of the fund units is strictly linked to the market value of the assets held
NYSE Euronext	A major global stock exchange group that owns the New York Stock Exchange, the Paris Bourse, the Amsterdam Stock Exchange, the Brussels Stock Exchange, and the Lisbon Stock Exchange as well as the London International Financial Futures Exchange—a derivatives exchange

offshore market	A market for a security or securities that is not located in the country where the company issuing the stock is normally domiciled
open-ended investment fund	An investment fund where the total number of shares (units) can be varied to meet purchase and sales by investors
over-the-counter trading	Trading not conducted on an official stock exchange
plea bargaining	A legal process whereby those charged with an offence can negotiate a settlement without actually admitting the offence and so incur a lesser penalty
price-sensitive information	Information which, if widely known, would be expected to influence the price of a security
real estate investment trust	A closed-end investment fund whose assets are exclusively real estate
securitization	A financial construct whereby assets are transferred from their owner to a special purpose vehicle and securities are issued backed by those assets
settlement	The process by which ownership of securities moves from seller to buyer and cash moves from buyer to seller
short-selling	The practice of selling securities one does not own in the hope of being able to buy them back at a lower price
special purpose vehicle	A financial vehicle in which assets are placed and against which securities are sold, much used in securitizations
stock collateral	Securities that are pledged as collateral for a loan
surveillance	The activity of monitoring trading of securities to identify possible evidence of market abuse
unit trust	An open-ended investment fund

Executive Summary

The purpose of the study is to examine the development and barriers to harmonization and integration among the capital markets of members of the South Asian Association for Regional Cooperation (SAARC) and to enumerate steps to achieving harmonization and integration. There are substantial benefits to greater capital market harmonization but also significant obstacles. Other regions, including the Association of Southeast Asian Nations (ASEAN) and the European Union (EU), are also making progress toward harmonization. This study represents a first step in a long process, to be controlled by SAARC members, toward greater harmonization.

Harmonizing capital markets is a crucial step toward greater integration of capital markets. An integrated, regional capital market describes a situation in which there are no obstacles to the movement of capital or the provision of capital market services. More specifically, an investor in one country can invest in another country in the region, an issuer from one country can raise capital in another country in the region, and suppliers of investment services can operate throughout the region.

Integrated capital markets encourage competition, enhance innovation, attract wider participants, and provide deeper liquidity. All of these benefits reduce the overall cost of capital and investment. Although greater integration offers opportunities for the majority of participants, some participants that are benefiting from the inefficiencies of a nonintegrated market could lose out from integration. Nonintegrated markets have many potential barriers to the flow of capital, including barriers that disadvantage some participants. These include regulatory barriers, such as exchange control and ownership restrictions; information barriers, such as lack of transparency in trading or corporate disclosure; and unequal treatment of nondomestic participants, such as mistreatment of minority shareholders. There may also be structural barriers, such as monopolistic structures, which restrict access for nondomestic participants; or taxation barriers, such as withholding taxes, which apply unequally to nondomestic participants.

The EU has pursued a model based upon treaties that define common standards as a basis for regional integration; whereas the proposed ASEAN integration model is based on electronic links between stock exchanges and mutual recognition. However, neither of these systems is appropriate for SAARC, where a bottom-up approach seems more likely to be accepted by participants.[1]

[1] A bottom-up approach is one in which progress is driven by the actions of individual participants, for example forging direct relationships across borders. In contrast, in a top-down approach regulators and governments take the lead role.

Methodology

Initial data for the study was collected from questionnaires completed by national securities regulators covering issues relevant to integration. This was followed by visits to all SAARC countries, except Afghanistan, to conduct interviews with regulators and a wide range of other market stakeholders.

While most of the countries in the SAARC region have considerable similarities, not least in their legal systems, there is currently very little economic integration. Economic integration as measured by intraregional trade is much higher in the EU (60% of all trade) and ASEAN (25%) than it is in SAARC (4%). Economic integration has been at the forefront of capital market integration in other regions. The obstacle within SAARC is that members do not see their own region as an attractive investment destination.

Key Findings

Some of the main conclusions of the study are as follows:

- SAARC countries show considerable divergence in their capital market development.
- In terms of basic structures, SAARC capital markets have requirements for prospectuses, corporate disclosure, and prohibition of market abuse. Most have governance codes and accountancy standards that comply with international standards. However, there are perceived to be significant differences in standards of monitoring and enforcement.
- Almost all SAARC markets are closed to foreign companies, and only locally incorporated subsidiaries can be listed.
- SAARC markets are open to foreign brokers, which are required to set up local subsidiaries.
- There are questions about the long-term viability of some of the very small markets in SAARC.
- Despite relaxation in some countries, exchange control remains a serious barrier to current market development and longer-term integration.
- There is limited interest among SAARC countries in the SAARC region as an investment destination.
- There is limited intra-SAARC contact and interaction in the area of capital markets.
- Few of the stock exchanges have demutualized, but most are at some point in the process.

The findings also suggest that the main barriers to integration, besides exchange control, are related to shortage of information and a lack of awareness of the benefits of integration.

The main barriers include

- lack of information on and interest in other SAARC markets, combined with a lack of opportunities and structures through which the various markets can learn from each other's experience;
- barriers to the movement of capital within the region caused by exchange control restrictions and the stifling effect this has on views on regional prospects for integration;
- the absence of any explicit policy objective of harmonization and common basic standards, leading to a failure of regulators to consider the extent to which their policies are congruent with those of other regulators in the region;
- perceived significant differences in the regulatory and enforcement capacity among the markets in the region, leading to a difference in regulatory outcomes, which are a deterrent to cross-border and external investment;
- the presence of small capital markets that may have difficulty in sustaining the expenditure on the systems and regulatory resources expected of a participant in a regional capital market;
- a low level of awareness of market developments and innovations in the region, including private sector initiatives; and
- lack of commercial imperatives, such as a requirement to cover costs; and lack of skills in some of the stock exchanges, leading to slowness to innovate and address strategic weaknesses.

General View and Recommendation

The following activities are agreed as essential for there to be progress in overcoming the barriers to integration:

- Initiate a program for information exchange, and development and formation of a capital markets lobby.
- Formulate a common policy on exchange control relaxation.
- Make harmonization a policy aim and set basic SAARC standards.
- Support improvements in enforcement capacity.
- Help small markets develop sustainable business strategies.
- Be aware of and support private sector initiatives.
- Improve commercial imperatives and skills in stock exchanges.

The coordinated and focused commitment of the members of SAARC is required to overcome the barriers to integration. It is important to recognize that the recommendations described will not be implemented unless an organization is specially tasked or mandated to implement them. There is a general view that a regional body should be set up within the SAARC Secretariat to promote the harmonization and development of the region's capital market.

I. Introduction

A. Background and Purpose

The proposal for the South Asian Association for Regional Cooperation (SAARC) Secretariat, with financial and technical assistance from the Asian Development Bank (ADB), to conduct a study on the variations in the degree of development of capital markets in SAARC member countries and assess the possibilities for harmonization was approved at the Standing Committee at its 38th session held in Thimphu, Bhutan, on 6–7 February 2011.

The purpose of the study was to examine the potential for harmonization and integration among the capital markets of SAARC members, i.e., Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka. The study looked at the benefits to be reaped from harmonization and identifies the major obstacles that need to be tackled. It identified lessons from other regional groups that are striving to enhance harmonization, such as the Association of Southeast Asian Nations (ASEAN) and the European Union (EU).

The study was presented to the joint SAARC–ADB workshop on Studies on Trade, Economics and Finance, held in Kathmandu on 21–22 June 2012. The findings represent the first step in a long process to be embarked upon by SAARC members if they are to achieve greater harmonization. The report covered all SAARC members, except Afghanistan, where it was not possible to collect data. This updated publication includes the latest available statistical data, and adds a summary table showing the main barriers to capital market integration and an assessment of the degree of readiness of SAARC members.

B. Scope and Methodology of the Study

The study encompassed all areas of the capital market, but emphasized those where greater harmonization would ease the flow of capital within the region. All SAARC members, except Afghanistan, have functioning equity markets, but India is the only country with a functioning derivatives or bond market.[1] Therefore, while not denying the potential longer-term importance of bond market development, the main emphasis of the study was on the equity market.

The study concentrated on three areas relevant to the integration of capital markets: market regulation, issuer regulation, and macroeconomic regulation. Market regulation

1 India has a corporate bond market, but it is largely a market for private placements among a limited number of investors rather than a market for public issues, which are relatively rare.

covers regulatory structure and independence, intermediary regulation and market abuse, and investor protection. Issuer regulation relates to ownership and location restrictions, issuer requirements, and corporate governance and accounting standards. Macroeconomic regulation addresses issues relating to currency flow regulation and taxation.

The original fieldwork and research for the study were carried out during November 2011–March 2012. The methodology of the study had three stages: a survey, fieldwork, and desk research.

Survey. The study team requested national regulators of the SAARC countries to complete a questionnaire relating to their own capital market. The questionnaire and covering letter from the SAARC Secretariat were drawn up by the consultants and agreed by ADB and the SAARC Secretariat. Dispatch of questionnaires, receipt of completed questionnaires, and follow-up on late returns was undertaken by ISC (International Securities Consultancy). It was originally intended that the questionnaires should be received before commencement of the fieldwork, but this was not always the case.

Fieldwork. The study team visited seven of the eight SAARC countries during November–December 2011. During visits of 2–5 days' duration, the consultant met with a wide range of market participants, including staff from national regulators, stock exchanges, brokerage firms, institutional investors, and listed or prospective listed companies.

The main purpose of the fieldwork was to clarify regulators' responses to the questionnaire, discuss barriers to harmonization and integration with market participants, and gather ideas and proposals for reducing the barriers to capital market integration—being mindful of the need to be realistic.

Desk research. The consultants conducted additional research on integration in other regions and on market development within the SAARC region. The Appendix discusses the collection of data on stock market metrics.

The questionnaire was critical for the research. It was designed to provide information on potential barriers to harmonization and integration, and in particular to highlight (i) important issues relating to the treatment of foreign investors in the country, (ii) the ability of foreign companies and brokers to participate in the securities market, and (iii) the treatment of SAARC investors wishing to invest more widely in the region.

The issues that were important for these groups fell into three areas: background structures, openness, and issuer regulation.

- Background structures include the effectiveness of the regulator and the quality of market regulation. This relates to the independence of the regulator and the robustness of the regulatory structure, how well market abuse is prevented, and the competence of intermediaries. Taxation is also part of the background structure, and an important consideration is whether taxation is discriminatory against foreign participants.

- Openness looks at the treatment of foreign investors, foreign companies, foreign intermediaries, and foreign investments. It also considers restrictions on cross-border movements of money, which may hamper investment or repatriation of funds.
- Issuer regulation focuses on standards of disclosure, including the presence of adequate disclosure regulation to ensure that foreign participants are not disadvantaged in relation to local participants, and the reliability of the numbers disclosed. Issuer regulation is also concerned with questions relating to corporate governance standards and standards of management in local companies, and the requirements for good governance and equal treatment of all shareholders.

Widely accepted international standards of best practice exist in the areas of regulation, corporate governance, and accounting standards, including the International Organization of Securities Commissions (IOSCO) Principles of Securities Regulation and the Organisation of Economic Co-operation and Development (OECD) Principles of Corporate Governance, International Accounting Standards (IASs), and International Financial Reporting Standards (IFRSs).

Where they were relevant to a discussion on harmonization and integration, these global standards were used to frame the questions. In addition, establishing that a national regulator had adopted standards from international best practice in governance and accounting standards is an indicator of their commitment to high standards of regulation.

II. Capital Market Integration

A. Meaning of Capital Market Integration

The focus of this report is harmonization. However, harmonization is most valuable as a step toward the integration of capital markets. Capital market integration describes a situation where there are no barriers to the movement of capital and the provision of investment services within a geographic region. For investors, integration implies that they can operate across borders; i.e., domestic investors can invest in other countries and foreign investors can invest in domestic securities knowing that they will encounter broadly similar regulations, information, trading systems, settlement systems, accounting standards, and governance standards throughout the region. For issuers, it implies that domestic issuers can raise capital in foreign markets and foreign issuers can raise capital in domestic markets, again knowing that they will encounter broadly similar regulations, information, trading systems, settlement systems, accounting standards and governance standards across the region. Finally, integration means that investment service providers can operate across the region without facing restrictions on their access.

A single country is the archetypal integrated capital market. Taking the United States (US) as an example of an integrated national market, an investor from Texas can invest in a company incorporated in New York using a broker incorporated in California as easily and with the same confidence as he can invest in a Texan company using a Texan broker. There are no restrictions on investment flows or provision of services within the US market. Similarly, the SAARC member countries have integrated capital markets within their own borders as there are no barriers to the movement of funds or the provision of services within each country. Within the country, integration is supported and assisted by a single currency and a single regulator. There are, however, barriers to the movement of funds and the provision of services between countries of the region.

B. Benefits of Integration

In its initial report on the regulation of European securities markets, the Committee of Wise Men stated that the integration of a region's capital markets should lead to the following benefits:[2]

- lower prices for all financial services, as competition lowers transaction costs and allows larger regional firms to exploit economies of scale; with the effects being evident in all forms of intermediation, investment, and other capital market activities;

[2] Committee of Wise Men. 2000. *Initial Report of the Committee of Wise Men on the Regulation of European Securities Markets*. Brussels. 9 November.

- more efficient, more liquid, and broader securities markets, with a likely increase in turnover;
- greater innovation in financial products and services;
- the transformation of all sectors of the capital markets industry;
- cheaper financing for companies, given lower transaction costs;
- more efficient allocation of capital arising from the fact that savings can flow more easily and cheaply to investment, and because barriers to investment are dismantled;
- higher returns on investments, given lower transaction costs;
- enhanced risk–return choices for investors who previously faced restricted opportunities, but who can now diversify their investments to a greater extent than before; and
- better macroeconomic performance of the region's economy, producing higher economic growth with positive effects on employment and productivity, possibly resulting in more inward investment; higher returns should also lower pension costs, with an attendant reduction in labor costs and enhancement of competitiveness.

In summary, integration increases competition, deepens capital markets, and widens the range of investments. These changes, in turn, lead to more efficiency and innovation in the provision of services to investors and issuers. They also lead to increased liquidity in the trading of financial assets. Enhanced efficiency leads to lower costs for investors and issuers, with a consequent reduction in the cost of capital. Greater liquidity also reduces the costs of trading with positive effects on the cost of capital. More innovation also extends the range of products to attract a wider range of participants, leading to greater financial inclusion.

However, the benefits of integration would not be equally spread among SAARC countries. The less developed and smaller markets, such as Bhutan and the Maldives, have more to gain from integration than the most developed markets, such as India, which have already realized many of the gains by developing their own internal capital markets.

C. Opportunities and Challenges

Opportunities and challenges exist for all types of market participants. It is likely that the more innovative and efficient participants will be most successful in the new environment. The likely impacts, both beneficial and less beneficial, will affect different groups of participants in different ways.

- Domestic institutional investors will gain access to a wider range of investment opportunities. This will bring gains through industry diversification, as they can invest in sectors that are not present in their home markets; currency diversification; and access to a wider range of intermediaries. They will also benefit from lower operating costs as competition drives down transaction costs. Finally they will gain from the improved standards of regulation, disclosure, and compliance that integration brings.

- Retail investors will benefit as costs are reduced and innovative providers compete for their business. These will include specialist retail brokers who, by virtue of specialization, are able to offer increased efficiency and lower charges. Cross-border collective investment schemes will be able to reach a wider investor base, leading to economies of scale. Increased competition will bring innovations and ensure that investment products more closely reflect the needs of retail investors.

- Issuers gain by being able to issue securities to a wider investor group. The reduction in risk for investors through greater diversification will be reflected in lower costs of capital for issuers. Issues by specialized companies will be able to attract more specialized investors within the wider market who will have a better understanding of their specialization. Stronger competition among intermediaries will drive down the costs of issuing and will increase the flow of information as intermediaries compete for advantage, leading to greater awareness of individual issuers. There will be challenges for smaller issuers who risk not being heard in the bigger market but, as in integrated capital markets elsewhere, specialists in small companies are likely to emerge to fill the market niche.

- Brokers have new opportunities to diversify their business across borders either by establishing links with other brokers or by opening branches. The larger market also gives them opportunities to offer a wider range of products. This attracts interest from investors and issuers from outside the region, which is a business opportunity for local brokers. Brokers that do not rise to the new opportunities will tend to lose out, but in other markets these losses have been more than offset by new business and gains in efficiency.

- Exchanges and other infrastructure providers gain potential new users from outside the country. They also have a wider range of possibilities for products to support cross-border business. The most successful will also have opportunities for mergers or other links with other infrastructure providers in the region, and the general growth of activity in the region will attract interest from infrastructure providers outside the region. Similarly, support service providers, such as corporate lawyers and accountants, will have wider opportunities and the prospect of links with cross-border counterparts.

- Individual countries will benefit from more efficient, more liquid, broader, and cheaper capital markets. Easier, cheaper capital raisings encourage companies to raise money for investment through public issues. More public issuances reduce reliance on bank borrowing. More equity issuance develops corporate profiles so companies can further diversify their issuance.

D. Barriers

There are many potential barriers to capital market integration. Among the most common ones, besides lack of political will and opposition from vested interests who profit from the fragmentation of the markets, are formal barriers and fairness barriers.

The principle types of formal barrier are regulatory, taxation, and monopolistic.

- Regulatory barriers prevent the movement of capital to its most efficient use, and so constrain development. Examples include exchange controls and rules that restrict foreign listings.
- Taxation barriers alter the economic comparison between different activities or participants. Thus they exclude some of them from the market, leading to narrower markets and higher costs. Examples include withholding taxes on foreign remittances, which deter foreign investors.
- Monopolistic structures prevent access to particular parts of the market, or restrict activities in the market by law or other means to a specified group. Monopoly deters or prevents other participants from joining the market, reduces competition, and increases costs for all users. Examples include limitations on the total number of stock exchange members, which acts as an entry barrier.

Fairness barriers deter investors through perceived or actual discrimination.

- Fairness barriers exist when there is explicit discrimination against certain participants or a perception that such discrimination exists. The effect is to deter them from entering the market. Examples include corporate governance structures that operate to the disadvantage of minority shareholders or nondomestic shareholders, and weak market abuse rules that allow local intermediaries and investors to operate with an advantage.
- Similar to fairness barriers, information barriers result when one group of participants is (or is perceived to be) better informed about asset valuations. The effect is to deter the less well-informed from participating in the market. Examples include significant differences in accounting standards or disclosure requirements, and lack of transparency of trading, which prevent nonlocals from seeing the state of the market.

E. Models of Capital Market Integration

1. The European Union

It is possible to have a significant measure of integration and gain most of the benefits without having a single regulator or a single currency. The European capital market is broadly integrated. There are no barriers to the movement of capital and, in particular, there are no exchange controls. Within the European Union (EU), regulations are harmonized on common, baseline standards to which countries can add if they choose. There is mutual recognition of intermediary regulations so that one license gives brokers the right to operate in all EU markets. There is mutual recognition of issuer regulations, so a single prospectus is valid across the region. Finally, trading system providers can enter the market freely and compete with each other without restrictions. By August 2013, 267 regulated markets, multilateral trading facilities, and systematic internalizers had been licensed.[3] In the EU there are also 13 currencies, 30 regulators, 20 central counterparties, and 28 depositories.[4]

While there is a measure of agreement in the EU that the ultimate goal might be full integration, for example with a single regulator, there is currently no likelihood of this happening. An important lesson for capital market integration is to set feasible goals. For the SAARC countries, with their significant national differences, this is a critical consideration that will inform the recommendations of this study.

2. ASEAN

Currently, the countries of the Association of Southeast Asian Nations (ASEAN) are planning for market integration. There is some movement toward mutual recognition, but the main thrust of activity has been the ASEAN Common Exchange Gateway, which aims to establish electronic links between the stock exchanges. This would enable, for example, an investor in Malaysia intending to invest in a Singapore stock to view prices on and enter an order through Bursa Malaysia, which is then routed to the Singapore Stock Exchange (SGX).[5] Recent announcements have suggested that the gateway will initially open for the more developed markets of the ASEAN region.

However, there are some doubts about this approach. Several electronic links that were set up or proposed in the 1990s have generated disappointing amounts of trading. The Australian and Singapore stock exchanges (ASX–SGX) link was set up and later abandoned.[6] There are a number of reasons for this which largely flow from the lack of incentives for any of the participants to share business. First, there was also little motivation for the management of stock exchanges to route trading to a competing stock exchange. If there is significant local demand for foreign stocks, then a stock exchange would prefer to establish its own offshore market for trading in foreign securities. Such offshore markets have not generally been successful, but the managements of a number of stock exchanges continue to try to attract

[3] Systematic internalizers are trading firms that register as such because they routinely execute customer orders by acting as the counterparty—i.e., they are dealers. In practice, relatively few have chosen to register as systematic internalizers.

[4] The Markets in Financial Instruments Directive (MiFID) is the EU law providing for harmonized regulation for investment services. Effective from 1 November 2007, it replaced the Investment Services Directive (ISD). It retained the ISD principle of a common EU "passport" and added provisions to increase competition and consumer protection in investment services. The MiFID has been implemented in the 28 EU countries, Iceland, Lichtenstein, and Norway.

[5] Under mutual recognition, a regulator in country A (host regulator) agrees to accept, without any further requirements, an entity subject to the regulator in country B (home regulator) and vice versa.

[6] In December 2001, the SGX and the Australian Stock Exchange (ASX) set up the SGX–ASX securities co-trading link (an electronic link between their trading and settlement systems). The link was abandoned by the ASX in 2005.

trading of foreign securities. Second, securities brokers did not use the link; if there is significant local demand, then brokers are likely to already have their own mechanisms for routing business into foreign markets either through their own branch network or through correspondent links. Third, settlement for business routed from a foreign stock exchange requires it to be through a member of the local clearing system. This has been problematic because of the high charges usually levied by the local clearing members. Finally, investors also gained relatively little from the link; as without harmonization of rules, such as on disclosure, national investors are unlikely to want to invest in the stocks of other countries in the region. Electronic links do not address their concerns. Global investors typically use global brokers, which tend to already have interbranch links.

3. Bottom-Up Harmonization

The approaches discussed so far could be described as de jure harmonization, where an agreement at the government level is the driving force or at least a major driving force.[7] An alternative approach, which could be described as de facto, is bottom-up harmonization. This contrasts with the top-down approaches described by progressing through localized initiatives toward the harmonization of standards and regulations. This has appeal in regions like SAARC, where there is little central drive for or interest in integration. Under this approach, regulators and other standard setters, such as the International Organization of Securities Commissions (IOSCO) and the Organisation for Economic Co-operation and Development (OECD), aim to ensure that their regulations are harmonized with those of their regional peers, or at least that they avoid setting regulations and standards that are inconsistent with those of their neighbors.[8]

Such harmonization does not address the issue of regional integration. However well harmonized the regional markets are, if major barriers remain, such as exchange controls, there will be no movement of investment capital within the region. Nevertheless, bottom-up harmonization has advantages. First, it prepares the ground for the time when the major barriers are removed. This may be relevant for cases where significant barriers, such as exchange control or barriers to foreign ownership, are being gradually relaxed. Second, it presents the markets of the region as more homogeneous for investors outside the region. This particularly benefits small markets that might not be able to attract international investors if they retain their local characteristics. Third, it can be achieved through low-level agreements between regulators and does not require intergovernment treaties. Finally, it raises standards because harmonized standards are more likely to be closer to international best practice than the preexisting ones. This has largely been the case in SAARC where members have adopted similar standards that approximate to international standards, although there remain significant differences in implementation and enforcement.

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7 In the EU the initial impetus was largely a consequence of various private initiatives to increase trading and raise awareness. The later stages were very much government led because of the need for intergovernment agreement on directives.

8 IOSCO publishes principles for regulation, which have become an international standard. Similarly the OECD publishes a standard for corporate governance.

F. Capital Market Integration and Stock Exchanges

There is an important distinction between the integration of capital markets and the integration of stock exchanges. Capital market integration is possible with multiple or single stock exchanges. The People's Republic of China, India, and the United States (US) are examples of countries with integrated internal capital markets but more than one stock exchange. In India and the US, various stock exchanges trade the same stocks. The market is integrated because capital can move freely and any discrepancies in prices on the stock exchanges are rapidly arbitraged away. In many countries, there is a predisposition favoring contestability or competition in the provision of trading services. It is argued that competition leads to lower costs, better service, and more innovation. The single European capital market explicitly recognizes and encourages a proliferation of trading venues competing for business in the same stocks. In August 2013, the EU had 267 licensed entities that offer some form of trading facility and, in addition, many investment firms have internal matching systems.[9]

Stock exchanges are increasingly complex businesses. They offer a combination of trading, regulation, data, information technology, settlement, and other services. They may also own other stock exchanges. Their activities can easily straddle markets, so the fact that the business is transacted on a particular stock exchange group does not mean that the market is integrated. An example is NYSE Euronext, operating in Europe and the US, which are not integrated into a single capital market. The European arm runs its business through a series of national subsidiaries to accommodate the sensitivities of national regulators, but the subsidiaries share a common technology platform, marketing, and management.

Capital markets allow users to choose from an array of financial structures to achieve an objective. Historically, company issuers have sought to gain access to a wider shareholder base by listing their shares on foreign stock exchanges. In the 1980s and 1990s, this was a major part of the corporate strategy of many large companies and was an area of competition for stock exchanges. However, it was found to be rare for an active, offshore market to develop in the country of the secondary listing. Usually, most trading, professional expertise, information, and liquidity remained in the home country. Foreign investors generally prefer to route their orders to the home market using the network of global brokers or correspondent links between local brokers.

Discussions on regional integration have often concentrated on cross-listing (and cross-platform trading), but the presence or absence of cross-listings does not give any indication of the level of integration. However, an absence of cross-listings along with other features such as restrictions on capital movements, as there are in SAARC countries, can indicate a lack of integration.

In conclusion, capital market integration and stock market integration are not necessarily linked. It is possible to have an integrated capital market with multiple stock exchanges and multiple regulators.

9 MiFID databases. http://mifiddatabase.esma.europa.eu/

III. Overview of SAARC Capital Markets

The capital markets of SAARC countries are varied. The most obvious dissimilarity is in size, with India being by far the largest economy in the region. This has had a significant effect on relative capital market development. India's sheer size has always meant that there would be international investor interest once the market overcame some basic weaknesses. Since the early 1990s, the Indian capital market has been transformed through a combination of sophisticated information technology, strengthened regulatory structures, rapid evolution of market structures, and willingness to accept foreign involvement. This encouraged foreign investors and intermediaries to enter the market which, in turn, led to higher standards. For example, Indian issuers wishing to attract global investors understood that they needed to conform to high standards of disclosure.

A. Legal System

Most SAARC countries have common-law-based systems that follow the English and US models. Therefore, many of the basic structures, such as the company laws, are similar.[10] The similarity of legal systems in the region is an advantage in harmonizing and integrating markets.

B. SAARC as an Economic Region

SAARC is not well developed as an economic region. Table 1 shows the comparative amount of intraregional trade of several of the regional groups. Figures 1 and 2 give the country breakdown of SAARC intraregional trade.

There is a general view that intra-ASEAN trade is too low at $615 billion in 2012 (24.9%); however, it dwarfs SAARC's intraregional trade figure of $41 billion (4.2%) in the same year. Figures 1 and 2 show that while the intraregional trade percentages are highest for the smallest countries, India is a much larger exporter to other SAARC members in terms of value.

The fieldwork revealed further facts about the SAARC region. First, despite its cultural links, the SAARC region is not generally seen as an investment destination by SAARC

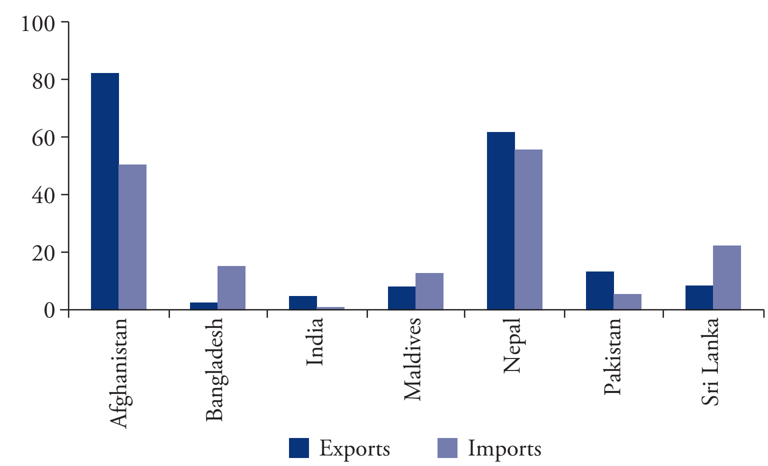
10 There are discussions as to which legal system is better for supporting capital market development and it is often said that the common law approach offers greater flexibility and is more supportive of financial innovation. For example, securitization in India did not require a special securitization law, unlike in most other Asian countries that have developed securitization.

Table 1: **Intraregional Trade Comparison, 2012**

Regional Group	Total Trade ($ billion)	Intraregional Trade ($ billion)	Intraregional Trade (%)
European Union (EU)	11,741	7,001	59.6
North American Free Trade Agreement (NAFTA)	5,562	2,216	39.8
Association of Southeast Asian Nations (ASEAN)	2,472	615	24.9
Southern Common Market (MERCOSUR)	665	137	20.6
South Asian Association for Regional Cooperation (SAARC)/South Asian Free Trade Area (SAFTA)	957	41	4.2

Source: United Nations Conference on Trade and Development statistics, World Trade Organization.

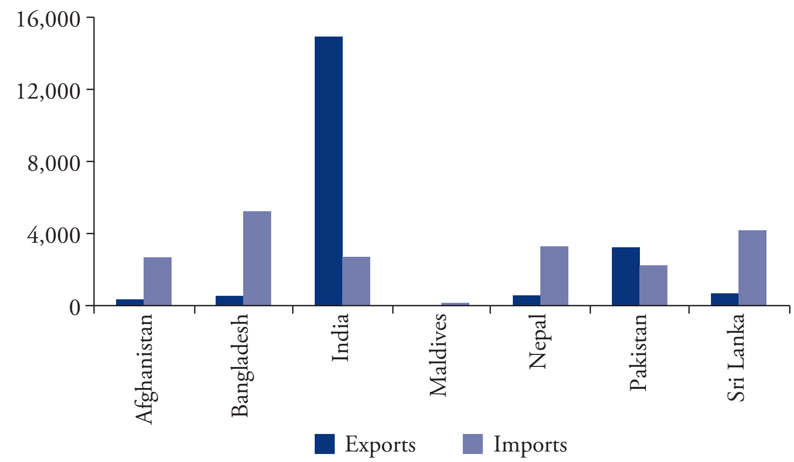
Figure 1: **SAARC Intraregional Trade, 2012**
(as a share of total exports, %)



Source: International Monetary Fund Direction of Trade Statistics.

countries. Interest in investing abroad is usually directed toward traditional investment destinations such as Europe; Hong Kong, China; India; Singapore; and the US. The limited interest in investing elsewhere in SAARC reflects the low interregional trade flows and the underdeveloped state of many of the markets. This is likely to change as the markets develop and should not necessarily be taken as a permanent feature. However, the lack of trade links remains a factor to consider when evaluating strategies for encouraging greater capital market integration.

Figure 2: **SAARC Intraregional Trade, 2012**
($ million)



Source: International Monetary Fund Direction of Trade Statistics.

Second, market participants are generally uninformed about the status of the capital markets in other SAARC countries. It is not surprising that participants lack even readily available information, because they are generally excluded from accessing other SAARC markets. SAARC regulators and stock exchanges are better informed, probably as a result of the efforts of international organizations such as IOSCO, the South Asian Federation of Exchanges (SAFE), and the World Federation of Exchanges (WFE) to foster relationships through which information can be exchanged.[11]

Third, there are barriers to movement of citizens between SAARC countries. In some cases, the visas required are no more than an entry tax, but in others they are a significant hindrance. SAARC has facilitated a waiver scheme for government officials, and it would be beneficial to extend this to finance sector professionals.

[11] SAFE was founded on the initiative of the Chittagong Stock Exchange. It is a voluntary body funded by subscriptions. Its headquarters are now in Islamabad, where it has a small permanent staff. Members include SAARC and other stock and commodity exchanges (e.g., Abu Dhabi and Kazakhstan), associated entities such as regulators and depositories, and other commercial entities (e.g., a systems vendor). SAFE has conducted some First Initiative funded projects on exchange-listing regimes, regional harmonization, and cross-listing.

IV. Country Results

Table 2 shows the key market size statistics for SAARC countries in 2012.

Table 2: **Equity Market Size of SAARC Countries, 2012**

SAARC Member	Number of Listed Companies	Market Value ($ million)	Number of Brokers	Number of Stock Exchanges	Equity Turnover Value ($ million)
Bangladesh	229	17,479	357	2	10,693.0
Bhutan	20	322	3	1	4.0
India	5,191	1,263,335	1,269	2	690,216.0
Maldives	6	504	4	1	0.1
Nepal	216	4,160	60	1	51.0
Pakistan	573	43,676	261	3	13,675.0
Sri Lanka	287	17,046	29	1	1,565.0
Total	**6,522**	**1,346,523**	**1,983**	**11**	**716,204.0**

SAARC = South Asian Association for Regional Development.

Notes:

1. India has other stock exchanges but only the Bombay Stock Exchange and the New Stock Exchange have significant trading. Consistent and comparable statistics are not easy to obtain for the SAARC region.
2. Exchange rates used for computation: Bhutan: $0.018/Nu, Maldives: $0.065/Rf, and Pakistan: $0.01/PRe. Exchange rates are end of period and from the International Monetary Fund International Finance Statistics.

Sources: World Bank Databank, World Federation of Exchanges Statistics, individual country stock exchanges, regulator websites, analyses compiled by ISC consultants, Capital Market Development Authority Annual Report (2012), and Maldives Monetary Authority Financial Stability Review (2012).

As the focus of the study was harmonization and integration of capital markets, the reporting concentrates on these aspects and is not intend to be a comprehensive study of the individual markets.

A. Bangladesh

1. Overview

Market size	The Bangladesh market is of significant size with 229 listed companies valued at $17.5 billion at the end of 2012 and a turnover of $10.7 billion in 2012.
Brokers, stock exchanges, and key institutions	There are 357 broking firms and two stock exchanges, the Chittagong Stock Exchange and the Dhaka Stock Exchange. Many firms are members of both stock exchanges. The stock exchanges are both mutual organizations.[12] There is a government-led initiative toward demutualization, but no legislation has been drafted.
Listed companies	The two stock exchanges cover the same stocks (issuers are required to list on both).
Investors	Mutual funds exist but penetration is not deep. Other conventional institutional investors are not important, but banks are permitted to invest up to 3% of assets, including margin loans. Foreign investors are permitted, but few have yet entered the market.
Settlement and margin trading	Stock exchange trading and settlement systems are not linked. Settlement is T+3, but currently not Delivery versus Payment.[13] The Central Depository of Bangladesh is the only central depository. Margin trading is permitted and margin loans can be up to 200% of collateral. In practice, firms have lent beyond collateral limits and moral suasion from the regulator has prevented them selling the collateral of defaulting clients.
Derivatives	There are no derivatives.
Corporate bonds	The corporate bond market is undeveloped. There are five licensed local credit rating agencies (CRAs). Foreign CRAs cannot be licensed, but local CRAs are required to have technical links with foreign CRAs.

[12] Traditionally, stock exchanges were structured as mutual organizations—not-for-profit companies owned and managed by their members. During the past 30 years, most major stock exchanges have restructured themselves as for-profit corporations (often with outside shareholders)—a process known as demutualization. Demutualization is said to improve the business focus and efficiency of stock exchanges.

[13] T+3 describes a situation in which transactions are settled by the close of the third business day after the transactions, e.g., a transaction on Monday is settled on Thursday. Similarly, T+2 transactions are settled two business days after the transactions. Delivery versus Payment describes a situation in which there is simultaneous exchange of money and the moment of settlement.

2. Market Regulation

Regulatory structure and independence	The Bangladesh Securities and Exchange Commission (BSEC) covers securities and mutual funds. It is attached to the Ministry of Finance and is mainly financed by government grants and listing fees for initial public offerings (IPOs). Staff have no legal immunity.[14]
Intermediary regulation	Foreign brokers are permitted to operate through a local subsidiary, which can be 100% foreign owned. There are currently no foreign-owned brokers. Brokers are restricted in the research they can offer. Until recently, brokers were prohibited from providing investment recommendations to clients. Draft professional standards qualification requirements for licensing of brokers are being considered by the SECB.
Market abuse and investor protection	Trading outside the stock exchange is permitted, but it requires BSEC permission. BSEC regulations prohibit market abuse.[15] The stock exchanges each have a surveillance system, although there is little coordination of investigations across the market. Recent events and practitioner comments suggest that abuse, particularly manipulation, is not uncommon. The BSEC is in the process of procuring a surveillance system. The market has been subject to sharp fluctuations in prices and volumes. The main regulatory response to date has concentrated on efforts to support the market by, for example, requiring directors to maintain minimum holdings. The BSEC has been involved in encouraging participants to support the market.

3. Issuer Regulation

Ownership and location restrictions	Subsidiaries of foreign companies operating in Bangladesh can be listed. Currently, 11 are listed. Listings of a foreign subsidiary must comply with free float requirements described below. There is no provision to list foreign companies as such. Local companies can be taken over by foreign companies.

[14] Legal immunity means that the staff members of the regulator, when doing their job in good faith, are protected from legal suits brought by those under investigation.

[15] Market abuse covers a range of prohibited activities designed to allow the perpetrator to unfairly take advantage of other participants. The most common forms of prohibition are those against insider dealing and market manipulation.

Information and disclosure	Issuers are required to release a minimum free float at IPO. For large companies, the minimum is 10%. Issuers are required to publish a prospectus. The BSEC can impose sanctions on issuers and their advisors and, as an extreme measure, cancel an IPO. Issuers are required to provide annual financial statements and unaudited quarterly statements. They are also required to provide monthly reports of shareholdings by sponsors and directors. Issuers are required to make prompt (e.g., within 30 minutes of board decision) announcements of a wide and comprehensive list of events that may affect the stock price. Disclosure compliance (and compliance with governance and accounting standards) is generally seen as poor, especially in companies outside the top 50. Companies can have complex voting structures with differing rights. Protection of minorities is generally regarded as weak and inadequate. Strategies to allow directors to overrule other shareholders at company meetings are common. Corporate bonds are required to be rated by a local CRA, but are not required to be listed.
Corporate governance	The stock exchanges regulate corporate governance. The code is not explicitly based on an internationally accepted code of governance, but is being developed locally. It is described as a work in progress and is at an early stage of development. Companies are required to publish their levels of compliance in the annual report.
Accounting standards	Bangladesh accounting standards conform to International Accounting Standards (IASs) with no substantive differences. Standards and accounting firms are currently regulated by the Institute of Chartered Accountants of Bangladesh. Foreign accountancy firms are not permitted to operate.

4. Macroeconomic Regulations

Currency flows	The capital account is nonconvertible for all types of domestic investor, so investment outflows are prohibited. Foreign portfolio investors can move funds into and out of the country without restriction.
Taxation	The tax system is neutral between foreign and domestic entities.

B. Bhutan

1. Overview

Market size	The market is very small, with 20 listed companies with a total market value of $322 million at the end of 2012. Trading is rare. The total trading value in 2012 was $4 million.
Brokers and stock exchanges	There are three broker firms. Two are subsidiaries of banks and one is a subsidiary of an insurance company. Securities trading is a minor activity within the conglomerates. There is one stock exchange, the Royal Securities Exchange of Bhutan, which is owned by the three broking firms.
Listed companies	Financial companies, including banks, are required to have a listing. Most significant nonfinancial companies are owned by the government and privatization is not seen as likely. Larger companies that might list see the market as too small to support their listing. Nonfinancial listed companies tend to be small and not in the major sectors of the Bhutanese economy.
Investors	There is only one significant institutional investor, the National Pension and Provident Fund. The fund is moving toward a funded scheme, but is constrained by the small size of the domestic market. The fund is permitted to invest abroad (and has done so in the past), but requires the approval of the central bank, i.e., the Royal Monetaty Authority (RMA) for each investment, which it is unlikely to get for exchange control reasons.
Settlement and margin trading	The settlement system and depository are run by the stock exchange.
Derivatives	There are no derivatives.
Corporate bonds	Bonds are required to be listed, but current conditions (bank interest higher than bond interest) mean that only the National Pension and Provident Fund—as the only institutional investors—invest. There is no trading. There is also no CRA.

2. Market Regulation

Regulatory structure and independence	The securities market is regulated by a department of the RMA, which also regulates insurance, banks, pensions, and nonbank financial institutions. The RMA's board is government appointed. The RMA levies charges on securities industry participants and is self-funded within the overall RMA budget. Staff have legal immunity.

Intermediary regulation	There is a prohibition on non-Bhutanese ownership of Bhutanese companies, including stockbrokers. Foreign brokers are not allowed to become joint venture partners with local brokers or to set up local subsidiaries.
Market abuse and investor protection	Trading is restricted to the stock exchange. The RMA and the stock exchange have joint responsibility for monitoring and enforcement.

3. Issuer Regulation

Ownership and location restrictions	Foreign companies cannot be listed in Bhutan, and are rarely allowed to operate in the country. Exceptions include the joint venture Druk PNB Bank. Companies with a track record of less than 3 years are required to issue at face (book) value. In the absence of a pricing process for IPOs (e.g., book-building or auction), shares or companies with longer track records tend also to be issued at book price. In both cases, the shares go to a substantial post-IPO premium, which deters listings.
Information and disclosure	Listing rules and companies law require accurate prospectuses. Noncompliant companies and their directors can be fined. Companies are required to produce semiannual financial statements for investors. Price-sensitive information must be published within 24 hours of the company officials or directors becoming aware of the information.[16] There are no provisions to protect the rights of minority shareholders.
Corporate governance	The RMA has issued a code of corporate governance with which companies are expected to comply, but there is no requirement to publish details in their annual reports.
Accounting standards	Bhutan has adopted Indian Accounting Standards but is developing Bhutanese standards, which will conform to International Financial Reporting Standards (IFRSs) and IASs. Practitioners are regulated by the Accounting and Auditing Standards Board of Bhutan.

[16] Price-sensitive information is information about the company that is likely to affect the share price. Some listing rules attempt to specify the types of information that might be price sensitive, e.g., information about sales or merger approaches. In English law countries, most regulators now favor a catch-all phrase that defines price-sensitive information as any information that a reasonably well-informed market participant would expect to have an impact on the share price.

4. Macroeconomic Regulations

Currency flows	There are no provisions for inflows or outflows of capital for portfolio investment purposes.
Taxation	As foreign companies are not permitted, the question of differential taxation does not arise.

C. India

1. Overview

Market size	India is by far the largest capital market in the region with more than 5,000 listed companies, a total market value of more than $1.3 trillion at the end of 2012, and a turnover of $690 billion. There are regional stock exchanges (17 at the end of 2012), but almost all the trading is conducted on the two stock exchanges that operate nationwide: the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). The total trading is split approximately 80/20 between the NSE and the BSE.
Brokers and stock exchanges	The two national stock exchanges are the BSE and the NSE. Both stock exchanges are private companies owned by major financial institutions. The BSE demutualized in 2005 and the NSE has always been a private company.[17] There are also 17 regional exchanges. There are a large number of licensed brokers. The NSE currently has 1,423 and the BSE has 1,376. Most brokers are members of both stock exchanges. The key institutions are the National Securities Clearing Corporation, the National Securities Depository, the Clearing Corporation of India, and the Central Depository Services (India).
Listed companies	It is not mandatory for companies to list on both national stock exchanges (although companies are required to list on their regional stock exchange), but most are listed on both.

[17] In 2008, Securities and Exchange Board of India (SEBI) mandated demutualization for all stock exchanges at the same time as it cancelled the licenses of four regional exchanges.

Investors	Mutual funds have developed with total assets of $138 billion (end of 2012). Some 30 private sector fund managers offer a wide range of funds covering different assets and risk categories. Private sector funds represent more than 80% of total assets under management. Other institutional investors are less well developed, with many pension schemes and insurance companies being restricted to government stock and bank deposits.
Settlement and margin trading	Each national stock exchange operates its own settlement system so there is not complete fungibility (stock bought on one stock exchange must be sold on that stock exchange).[18] Trading and settlement systems are of international standards.
Derivatives	India is the only country in the region to have a significant derivatives market. The NSE has almost all of the financial derivative market and trades a wide range of stock, stock index derivatives, and interest rate derivatives. Trading volumes are very high.
Corporate bonds	India has a large and active government bond market with a sophisticated electronic trading and settlement system. The corporate bond market is substantial, but few bonds are publicly issued. Most bonds are issued as private placement among a small group. Corporate bond trading is mainly over the counter but trades are reported and summary data is published by the Securities and Exchange Board of India (SEBI). Corporate bond holdings are dematerialized.[19] Ratings are required and there are five domestic CRAs. Securitizations were increasingly common before the global financial crisis of 2007–2009 but have not yet recovered to precrisis levels.
Other	Both the BSE and the NSE also offer a wide range of other products including indices, exchange-traded funds, stock borrowing, and lending.

[18] Fungibility means that one share in a company is identical with any other share. The practical implication is that a share bought on one exchange can be sold on another exchange in the country. This is not the case in India: shares bought on the NSE have to be sold on the NSE, and shares bought on the BSE have to be sold on the BSE.

[19] Dematerialized describes a situation where holdings of shares or bonds are maintained on an electronic register in electronic form (like money in a bank account). The electronic record is proof of ownership; there are no paper certificates.

2. Market Regulation

Regulatory structure and independence	India has a single securities regulator, SEBI. SEBI regulates securities markets, including mutual funds. Insurance and banks are regulated by other entities. The SEBI board is appointed by the Ministry of Finance and all of the (nonexecutive) members are government officials. SEBI is funded by fees on intermediaries and investment income. SEBI staff have legal immunity when carrying out their functions in good faith.
Intermediary regulation	Foreign brokers can and do operate in India. They are required to set up a SEBI-licensed subsidiary, which can be 100% owned by the foreign broker.
Market abuse and investor protection	Trading must be carried out on a licensed stock exchange. Securities law supplemented by SEBI regulations prohibits all forms of market abuse. Both SEBI and the stock exchanges have surveillance systems, with the stock exchanges responsible for real-time surveillance and SEBI responsible for off-line surveillance and for cases that are outside the regulatory jurisdiction of the stock exchanges. SEBI has direct access to bank accounts and can prosecute cases. There are a range of sanctions and SEBI is permitted to conduct plea bargaining. SEBI currently investigates about 80 cases a year. SEBI's annual report provides extensive information on initiated and completed cases.

3. Issuer Regulation

Ownership and location restrictions	Subsidiaries of foreign companies operating in India can be listed. They are required to comply with the same rules as domestic companies, including the requirement that 25% of the company must be issued to investors. There is also a provision for foreign companies to list as Indian Depository Receipts (IDRs). With an IDR, the whole company is listed, not just the part that operates in India. To date, only one company, Standard Chartered, has issued IDRs. To issue an IDR, a foreign company must have a track record of being listed and complying on its home stock exchange as well as complying with Indian listing rules. The benefits, from an integration viewpoint, have been weakened by the requirement to raise capital when an IDR is issued and the central bank's requirement that the IDRs must be kept separate from other shares of the company. There is no fungibility as there is with an American depository receipt.

	Companies listed in countries that are signatories to the International Organization of Securities Commissions (IOSCO) multilateral memorandum of understanding (MOU) can list an IDR with a simplified procedure under which the company's compliance with its home market requirements for continuous obligations are taken as being equivalent to compliance with India requirements (a form of mutual recognition). Many countries are signatories, but in the SAARC region only India, the Maldives, Pakistan, and Sri Lanka are signatories. Foreign investors are limited to a certain total percentage of ownership in some sectors. A general limit of 24% also applies, but this can be increased at the discretion of the issuer. There are no additional barriers to foreign takeovers. All listed companies are required to issue and maintain at least 25% of their shares in public hands.
Information and disclosure	Companies are required to provide detailed prospectuses to comply with the listing requirements. The company law proscribes misstatement or misrepresentation on pain of civil or criminal penalties. In addition, SEBI has powers to pass directions against any persons involved in the issue if the prospectus contains improper disclosures. Listed companies are required to provide quarterly updates to the stock exchanges. In addition, companies are required to disclose price-sensitive information immediately. Price-sensitive information is defined as "information likely to materially affect the price." SEBI regulations provide extensive protection for minorities in the event of a takeover or other event likely to affect minority holders. In general, companies are required to offer minorities the opportunity to participate in transactions at the same price and to have disclosed to them the same information relating to the company as other shareholders. Bonds are required to have ratings from a local agency. India has five domestic agencies. Bonds are not required to be listed and most are private placements. The prospectus requirement for a public bond issued by a listed company is less than that for an unlisted company.

Corporate governance	Listed companies are required to comply with the corporate governance requirements of the listing agreement. Noncompliance can lead to delisting or fines, although it rarely does. Companies must publish a detailed statement of compliance in their annual report and also quarterly updates. Auditors must issue compliance certificates. The current code is based on, and compliant with, Organisation for Economic Co-operation and Development (OECD) principles.
Accounting standards	Indian Generally Accepted Accounting Principles are the local standard. They are broadly consistent with international standards. India has adopted a convergence route for adoption of IFRSs, but the date of final implementation has yet to be announced by the Ministry of Finance. The Institute of Chartered Accountants of India has the statutory responsibility for standards subject to government oversight. Foreign firms can operate in partnership with local firms.

4. Macroeconomic Regulations

Currency flows	India retains a complex structure of exchange control administered by the Reserve Bank of India. This has gradually been relaxed, which has added to the complexity. However, most Indian market participants still regard exchange control as a major barrier to integration of the Indian market globally and with other SAARC countries. The main relaxations have been: • Foreign entities can be designated as foreign institutional investors (FIIs, of which 1,755 are listed by SEBI), although it is reputed to be sometimes a slow process, and they can trade in equities and derivatives without restriction. Investments in government securities and corporate bonds are restricted within an aggregate figure that has been steadily increased. • Indian residents are permitted to remit up to a total of $200,000 per annum for a range of purposes including investment in securities. However, the regulations specifically exclude remittances to three SAARC countries—Bhutan, Nepal, and Pakistan—and to Mauritius, which is not a SAARC country. • Indian mutual funds can invest abroad within an aggregate total of $7 billion.

Taxation	India has a complex taxation structure, which is beyond the scope of this study. However, main points that are relevant are: • corporate FIIs pay different rates to noncorporate FIIs; • domestic investors pay different taxes and different rates to all types of FII; and • foreign companies operating in India pay different rates to domestic companies.

D. Maldives

1. Overview

Market size	The market is small with six listed companies. Trading is infrequent, totaling more than $63,000 in 2012.
Brokers and stock exchanges	Stock trading commenced in 2002. The Maldives Stock Exchange, which was licensed in 2008, is a private company owned by its users.
Listed companies	Government policy favors further privatizations, although the current listed stocks include companies that have a majority state shareholding and these are not seen as particularly good in terms of compliance with disclosure and governance.
Investors	A national pension scheme, which is intended to be a fully funded defined-contribution scheme, has recently been instituted. However, the lack of investable assets in the local market is a serious difficulty for the pension fund's managers. In principle, the fund can invest abroad, but foreign exchange limitations render this impossible in the current circumstances of foreign currency shortage.
Settlement and margin trading	The central depository conducts clearing on a T+2 cycle. It was operated by the Capital Market Development Authority (CMDA), the regulator, until January 2008, and is now a private company sharing a chief executive officer with the stock exchange, which owns 90%. (The Maldives Stock Exchange is required by law to own at least 51%.)
Derivatives	There are no derivatives.
Corporate bonds	There are no corporate bonds, although there is some interest in issuing them. There is a series of Treasury bills of various maturities issued by the central bank on behalf of the Ministry of Finance. The Indian ratings agency CARE (Credit Analysis and Research) has a local office.

Other	There is an Islamic bank and an Islamic insurance company. The CMDA has a sharia advisory committee. The policy makers are looking at the possibility of amending the company law to facilitate incorporation of special purpose vehicles for developing new products.

2. Market Regulation

Regulatory structure and independence	The CMDA regulates the securities market. It is also tasked with supervising the Maldives Retirement Pension Scheme administered by the Maldives Pension Administration Office. Its regulation of the securities market encompasses dealers, dealers' representatives, CRAs, custodians, principal advisors, the stock exchange, and the securities depository. The current strategy for capital market development is to introduce new licensing categories such as asset managers, investment advisers, sharia advisers, collective investment schemes, and unit trusts. The regulator is structured to fund itself from industry fees, but at current levels of activity a government subsidy is required.
Intermediary regulation	Foreign-owned brokers are permitted to set up wholly or partially owned subsidiaries (although none have yet done so). Foreign brokers have higher capital requirements than domestic brokers. There is no restriction on repatriation of profits. There are no requirements for brokers to have professional qualifications.
Market abuse and investor protection	All trading of equities must be done on the stock exchange. Market abuse is prohibited by law, and the CMDA is responsible for monitoring and enforcement.

3. Issuer Regulation

Ownership and location restrictions	Foreign incorporated companies can list, although none have yet done so. Foreigners are generally permitted to own shares in domestic companies (unless specifically prohibited by, for example, the Land Act), and two listed companies have majority foreign ownership. Such companies are required to comply fully with local requirements.

Information and disclosure	Issuers are required to produce a prospectus that complies with the Companies Act, the CMDA's rules, and the stock exchange's listing rules. The CMDA has the power to suspend or cancel a noncompliant prospectus. Companies are required to provide quarterly and annual reports, as well as updates of price-sensitive information. Multiple voting structures are permitted and protection of minorities is not mandated but subject to each company's articles. While the Maldives has company and securities legislation, it lacks bankruptcy procedures, consumer protection laws, and trust laws. Corporate structures are complex with cross-holding structures. Listed companies have complex share structures and make frequent changes to their share structures, for example through large bonus share issues. Dividend payments are large and are the main reason shares are held. The shareholder base is mainly retail.
Corporate governance	Listed companies are required to conform to the CMDA's Corporate Governance Code and are required to publish their compliance. The code is modeled on the OECD principles of corporate governance. However, comments suggested that Maldivian companies tend to have complex ownership structures including cross-ownerships and pyramid structures. In addition, there are significant government holdings in some of the larger listed companies.
Accounting standards	The Maldives follows International Financial Reporting Standards (IFRSs) and International Accounting Standards (IASs), and there is no separate local standard. Supervision of standards is the responsibility of the Auditor General. Most accountancy firms operating in the Maldives are foreign owned.

4. Macroeconomic Regulations

Currency flows	There are no formal restrictions on outflows for portfolio investment. Individuals can invest abroad. There is widespread hoarding of foreign currency and many transactions related to the tourism industry are conducted in US dollars.
Taxation	The tax treatment of foreign and domestic companies is the same. Foreign investors are required to pay an administration fee as part of their approval and when the Foreign Investor Agreement is renewed or amended.

E. Nepal

1. Overview

Market size	The Nepalese market has a substantial number of companies listed—216 with a value of $4,160 million at the end of 2012. The market is illiquid and volatile. Turnover in 2012 was $51 million giving a turnover to market value ratio of 1.2%, which is very low compared with most other markets.
Brokers and stock exchanges	There are 60 brokers. Their activities are restricted to executing orders on the stock exchange. The Government of Nepal, Nepal Rastra Bank (the central bank), Nepal Industrial Development Corporation, and members are the shareholders of the Nepal Stock Exchange (NEPSE). The trading system was installed in 2007. NEPSE is looking for a replacement (funded by development assistance). The securities law now permits competing stock exchanges and it is reported that there are four applicants for licenses. There is a discussion about demutualization, but no progress. There are concerns among brokers that progress in developing the market is slow.
Listed companies	Most of the listed companies are financial companies, which are required by law to have a listing. Financial companies make up about 85% of the listed companies and about 75% of total paid-up value.
Investors	The government has recently enacted the Mutual Fund Regulation and the Securities Board of Nepal (SEBON) has provided licenses to two institutions for the operation of mutual funds. There is an inherent problem in that most of the listed companies are finance related with extensive cross-holdings, so mutual funds will, to a considerable extent, be investing in their parent companies.
Settlement and margin trading	Settlement was paper-based and slow, but a new depository (owned by NEPSE and developed with Indian assistance) has recently been established. Appropriate legislation has been passed and SEBON has approved the Central Depository System by-laws. However, the cash side of settlement will continue to be manual and so will lag behind the movement of stock.
Derivatives	There are no derivatives.
Corporate bonds	There were 16 government bonds listed and 13 listed corporate debentures at the end of 2012. ICRA Nepal in a joint venture with ICRA India (an Indian credit-rating agency) was granted a license to operate a credit rating agency in Nepal in October 2012.

2. Market Regulation

Regulatory structure and independence	SEBON regulates the securities market, including mutual funds. Board members are appointed by the government. SEBON is entirely self-financing, the grant from the government having ceased in 2010–2011. The Ministry of Finance has day-to-day involvement in the management and operation of the exchange.
Intermediary regulation	Stock brokers are limited in their activities. Their business is limited to executing client orders on the stock exchange. They cannot manage funds, trade for their own account, publish research, or advertise for business. Foreign brokers would be permitted to set up local subsidiaries if they desired, but repatriation of profits would be difficult or even impossible. SEBON is considering a professional education system for brokers.
Market abuse and investor protection	Trading must be carried out on the stock exchange. Both the NEPSE and SEBON have systems to detect market abuse, which is prohibited.

3. Issuer Regulation

Ownership and location restrictions	There are no provisions for the listing of foreign companies, but local subsidiaries of foreign companies can list. With the exception of banks, there are no restrictions on foreign ownership of domestic companies. Sponsors are required to hold 51% of their companies, which segments the market and the already small liquidity. New companies are required to have 500 shareholders at issue.
Information and disclosure	The pricing of initial public offerings (IPOs) is controlled so that the issue price cannot exceed net worth. IPOs are usually heavily oversubscribed and tend to trade at a sustained premium to the issue price. Prospectuses are regulated by SEBON, which can fine companies for noncompliance. Listed companies are required to publish quarterly updates, although a significant number do not comply. Companies are required to announce price-sensitive information within a week of the decision. The listed finance companies have no desire to attract investors and are generally poor in terms of compliance. Minorities receive some protection in the Companies Act, but there are no specific SEBON rules for takeovers and mergers. Corporate bonds do not have to be rated as there are no domestic rating agencies as yet. CARE is establishing a presence. Issuers of bonds must be listed.

Corporate governance	Corporate governance standards are contained in the Companies Act, but the provisions are weak and are not strongly enforced. Companies may report in their annual report but are not required to do so.
Accounting standards	The current Nepalese standards are not significantly different from international standards. Nepal is in the process of aligning financial reporting with international practice by adopting IFRSs.[20] The standards will be brought into conformity with IFRSs in a phased approach that will be completed by July 2017. The adoption involves the replacement of existing Nepal accounting standards with IFRS-compliant Nepal accounting standards by the Accounting Standards Board of Nepal. Regulation of audit is the responsibility of the National Accounting Standards Board and practitioners are regulated by the Institute of Chartered Accountants of Nepal. Only Nepalese firms can conduct audits. Some Nepalese firms have links to international firms.

4. Macroeconomic Regulations

Currency flows	There are exchange controls. In practice, it is not possible to move money outside the country for investment purposes, although expatriate Nepalese can invest their foreign earnings outside the country.
Taxation	This is not relevant as foreign companies cannot list in Nepal.

F. Pakistan

1. Overview

Market size	The Pakistan capital market is of significant size with 573 listed companies, a total market value of $43.7 billion at the end of 2012, and a turnover of $14 billion in 2012. Turnover is currently much depressed because of political uncertainty, but it is recovering.
Brokers and stock exchanges	There are three stock exchanges—the Karachi Stock Exchange (KSE), the Lahore Stock Exchange, and the Islamabad Stock Exchange. KSE is the largest. The stock exchanges are in competition for business and are mutually owned. A demutualization law was passed in March 2012, more than 12 years after the matter was first discussed.

[20] In April 2001, the International Accounting Standards Board adopted all International Accounting Standards (IASs) and continued their development, calling the new standards IFRSs. IFRSs are considered a principles-based set of standards in that they establish broad rules as well as dictating specific accounting treatments.

	At current volumes, the smaller stock exchanges are facing a business challenge and have responded mainly by trying to attract trade rather than through listing or developing new products. Each stock exchange has its own membership, although there is some overlap. The KSE has 134 members, the Lahore Stock Exchange has 74, and the Islamabad Stock Exchange has 53.
Listed companies	Companies are not required to list on all stock exchanges.
Investors	The mutual fund sector is dominated by the government-owned National Investment Trust (NIT). Equity funds only represent about 16% of the total assets of mutual funds; the rest are mainly money-market funds, which are used by corporate treasurers. The NIT represents 78% of the equity mutual fund assets. The NIT is now a net asset value fund. In 2008, the NIT, using government guaranteed loans, set up funds to support the stock market, and this remains part of their mission.
Settlement and margin trading	Settlement is centralized, dematerialized, and operated by the National Clearing Corporation and the Central Depository Company. The settlement period is T+3. The Margin Trading System allows margin trading (up to 400% of collateral) and stock borrowing.
Derivatives	There are index derivatives on the KSE, although trading has yet to become substantial.
Corporate bonds	Major companies are sophisticated users of multiple finance sources, including bond finance. Most bonds are issued as private placements and are not listed. However, there have been issues aimed at retail investors.

2. Market Regulation

Regulatory structure and independence	The Securities and Exchange Commission of Pakistan (SECP) has jurisdiction over the capital market, including mutual funds, insurance, and private pensions. It has considerable legal powers to do this, but is not permitted to prosecute cases. Banks, which are regulated by the central bank, also have some capital market activities. The SECP has legal independence, but there is a strong perception that there is external influence, evidenced by the length of time taken to appoint commissioners. SECP staff have legal immunity. The regulator is adequately funded by a combination of industry fees and levies, particularly fees associated with company registration.

Intermediary regulation	Licensed brokers must be incorporated in Pakistan. There are no limits to foreign ownership of licensed brokers, although currently no foreign brokers are active in Pakistan. A recent initiative by the SECP aims to substantially increase the net capital requirement for brokers. This is seen by brokers as a way of driving out weaker and less-compliant brokers, but the proposed high levels would exclude all but a few of the current licensed brokers.
Market abuse and investor protection	The market has experienced some challenges in recent years. It was effectively closed for 110 days in 2008.[21] Manipulation has been a problem, but the regulator believes it has diminished. The regulator has been active in trying to address manipulation, but industry sentiment suggests an excess of interventions that are not entirely thought through and are conducted without much industry consultation. Market abuse is prohibited and monitoring is split. The stock exchanges are responsible for frontline monitoring and applying sanctions to members or issuers, and the SECP takes cases that are more serious or involve entities outside the stock exchanges' regulatory remit.

3. Issuer Regulation

Ownership and location restrictions	Local subsidiaries of foreign companies can be listed, and several are listed. There are no requirements for subsidiaries to issue a minimum percentage to the local investors. There are no limits on foreign ownership of listed companies, nor are there barriers to takeovers of domestic companies by foreign companies.
Information and disclosure	Companies are required to publish a prospectus for an IPO. The SECP can impose sanctions for failure to make adequate disclosures. Listed companies are required to publish quarterly and annual results and financials. Companies are required to notify the stock exchange of any decisions or developments likely to affect the stock price before releasing such information to other persons or media.

[21] In 2008, there was strong downward pressure on the market with a one-third fall between April and July. In August, the regulator set a floor on stock prices below which they were not permitted to fall. There were repeated attempts to reopen the market, but on opening, the market immediately fell below the floor level and so the market was closed again. On 15 December 2008, the floor was removed and trading resumed. http://infoworldstock.blogspot.co.uk/2009/04/2008-karachi-stock-exchange-crisis.html

	Companies are permitted to have complex voting structures. There is protection for minority holders in the KSE's listing rules to ensure they are not disadvantaged when the company is sold at a premium to the current price. Bond issuers are required to have ratings above a minimum from a credit rating agency (CRA) that is registered with the SECP. Foreign CRAs can operate and be registered in Pakistan. Listing of bonds or their issuers is not mandatory, although it is normal for bonds issued to retail investors.
Corporate governance	The listing regulations of the stock exchanges contain a code of corporate governance. The code is based on the OECD code, and is currently being revised to bring it closer to international best practice. A revised Code of Corporate Governance was launched as part of the listing regulations of the stock exchanges in April 2012; and as part of the SECP's efforts to reach out to the stakeholders, awareness sessions were being conducted targeted at CEOs, CFOs, company secretaries, and international auditors of the listed companies. The stock exchanges are responsible for enforcement, but companies are also required to publish audited statements of compliance.
Accounting standards	Pakistan follows IFRSs with no significant variations. The SECP regulates standards, while the Institute of Chartered Accountants of Pakistan regulates practitioners. Foreign accountancy firms can operate through local affiliates and associates.

4. Macroeconomic Regulations

Currency flows	Domestic companies can remit payments to foreign shareholders without restriction, provided they are remitted to the investor's Special Convertible Rupee Account (SCRA). Inward portfolio investment is also unrestricted provided it is carried out through the SCRA. Any funds in SCRAs can be transferred to other accounts by the holder. Domestic investors are permitted to invest abroad through mutual funds. Mutual funds can hold up to 30% of their assets (to a maximum of $15 million) in foreign assets. However, each transaction requires the approval of the central bank. Approvals are very rarely, if ever, granted. Similar regulations apply to pension and insurance funds.
Taxation	There is no difference in treatment between foreign and domestic entities, although foreign investors face a 10% withholding tax.

G. Sri Lanka

1. Overview

Market size	Sri Lanka has a long-standing but small capital market with 287 listed companies and a total market value of nearly $17 billion at the end of 2012. Trading is illiquid, totaling $1.6 billion in 2012, and giving a turnover to market value ratio of less than 10%.
Brokers and stock exchanges	There are 29 licensed brokerage firms that are members of the stock exchange. Brokerage commissions are fixed. The Colombo Stock Exchange (CSE) is the only stock exchange. It is a member-owned mutual association. There has been discussion of demutualization for many years, but there are legal barriers. The Securities and Exchange Commission of Sri Lanka (SECSL) is currently in the final stages of drawing up a draft bill for demutualization.[22]
Listed companies	Sri Lanka has a large number of listed companies for the size of its economy. Sri Lanka has 287 listed companies and a gross domestic product (GDP) of $59 billion (2010 World Bank) compared to Bangladesh with 229 companies and a GDP of $112 billion, and Pakistan with 573 companies and a GDP of $210 billion.
Investors	Mutual funds are developing. Currently, seven companies are reported by the Unit Trust Association of Sri Lanka with 23 funds available. They have struggled to attract retail investors and much of the business is tax-avoidance trading by companies. The government pension fund mainly invests in government stock, as do the private provident funds. Insurance companies—there are about 20 life companies—are permitted to invest up to 33% in equities. They mainly invest in the 25 largest companies.
Settlement and margin trading	The CSE runs the settlement system, which has a settlement cycle of T+2 but is not Delivery versus Payment. A central counterparty is planned as part of an overall upgrading of information technology. Foreign investors are active participants in the market, representing about 20% of trading. Unregulated margin lending by brokers against stock collateral is widespread—estimates give a total of $6 billion. The SECSL has recently required brokers to set up separate subsidiaries to handle margin lending.

22 The SECSL announced in September 2012 that it was in the final stages of drafting a bill to demutualize. Lanka Business Online. 2012. Sri Lanka in Final Run to Demutualize Stock Exchange. 7 June. www.lankabusinessonline.com/news/sri-lanka-in-final-run-to-demutualise-stock-exchange/1480713174

Derivatives	There are, as yet, no derivatives.
Corporate bonds	The government bond market is significant with an active issuance calendar. Bonds are issued in maturities of up to 10 years. Corporate bonds are much rarer with only some bank issues having a maturity of 5 years.
Other	The CSE has developed exchange-traded funds.

2. Market Regulation

Regulatory structure and independence	The capital market is regulated by the SECSL. This covers markets, brokers, and fund managers. The commissioners are appointed by the Minister of Finance or by virtue of their government position. The SECSL has income sources, but most of its revenues come from government transfers to cover operating expenses.
Intermediary regulation	Licensed brokers must be incorporated in Sri Lanka. There are no barriers to foreign ownership and control of local broking subsidiaries. A number of brokers are foreign controlled, some by Indian firms.
Market abuse and investor protection	Trading must be carried out on the CSE. Market abuse is prohibited. The CSE has frontline monitoring responsibility and the SECSL has offline responsibility. The SECSL is empowered to make settlements in abuse cases. There are plans to permit civil actions.

3. Issuer Regulation

Ownership and location restrictions	There are no obstacles, except in banking, to foreign ownership of listed companies. Sri Lankan incorporated subsidiaries of foreign companies can be listed. All listed companies, including foreign subsidiaries, must have a minimum public float of 25%.
Information and disclosure	The CSE listing agreement specifies the requirements for prospectuses and quarterly reporting. The CSE is the regulator of corporate disclosures. Listed companies are also required to immediately notify the stock exchange of price-sensitive information including directors' dealing. Participants consider disclosure standards are quite good and above average for the region.

Corporate governance	Since 2008, it has been a requirement that listed companies should comply with the corporate governance rules, which are part of the CSE listing rules. Companies are required to publish their compliance or reasons for noncompliance in their annual report. The rules are based on the United Kingdom (UK) Corporate Governance Code.
Accounting standards	Accounting standards are regulated by the Sri Lankan Accounting and Auditing Standards Monitoring Board. The standards are partially compliant with IFRSs. A number of significant IFRSs will be adopted in 2013. Practitioners are regulated by the Institute of Chartered Accountants of Sri Lanka.

4. Macroeconomic Regulations

Currency flows	During 2010, the Central Bank announced some relaxation of exchange controls. In particular, Sri Lankan individuals and companies now have general permission to acquire, hold, and transfer shares of companies outside Sri Lanka. This is to be accomplished through special outward investment accounts held at commercial banks. Each person has an annual allowance of $100,000 for investment in foreign equities.
Taxation	The Sri Lankan taxation system is complex, although successful steps have been taken to simplify it. The issue of taxation of foreign companies or foreign-owned investments was not raised as a barrier in any of the fieldwork meetings.

V. Cross-Regional Findings

The following cross-regional analyses are based heavily on the fieldwork discussions with market participants.

A. Market Regulation

1. Regulatory Structure and Independence

The International Organization of Securities Commissions (IOSCO) principles place considerable importance on the independence of the regulator. Several of the core principles address the independence and hence effectiveness of the regulator; and those principles form the basis of the questions in this section.

Six of the seven SAARC countries have a single regulator for the capital market, with banking and insurance subject to different regulators. In all but two SAARC markets, regulators are protected from arbitrary dismissal, which thus strengthens their independence (Table 3).

Table 3: **Regulatory Structure and Independence**

SAARC Member	Structure	Dismissal of Senior Officials other than for Misconduct	Funding of Regulator	Legal Immunity of Staff
Bangladesh	Single regulator for capital market	No	Mixed, mainly government	No
Bhutan	Combined regulator for financial sector	Yes	Mixed, part of overall regulator	Yes
India	Single regulator for capital market	No	Industry	Yes
Maldives	Single regulator for capital market and pensions	Yes	Mixed, largely government	Yes
Nepal	Single regulator for capital market	No	Industry	Yes
Pakistan	Single regulator for capital market	No	Industry	Yes
Sri Lanka	Single regulator for capital market	No	Mixed, largely government	Yes

SAARC = South Asian Association for Regional Cooperation.

Source: Fieldwork discussions with market participants.

Funding of the regulator is difficult in several countries, partly because of the small size of the markets. Self-funding, whereby the regulator is funded by revenue derived from users of the market rather than from the government, is seen by IOSCO as an important support for regulatory independence.

Legal immunity for regulatory staff when carrying out their normal duties—another feature recognized by IOSCO—is the norm among the SAARC countries, with exception of Bangladesh.

2. Intermediary Regulation

Questions on intermediary regulation covered the qualifications of brokers, the ability of foreigners to enter the market, and the permitted range of brokerage businesses (Table 4).

In most countries, formal professional qualifications, such as examinations as part of a "fit and proper" requirement, are not required for the licensing of brokers. In all countries, except Bhutan, foreign brokers can operate but must set up a separate subsidiary, which can be wholly owned.

Broking activities are restricted in four of the seven markets. In the smaller markets, brokers are usually restricted to the execution of orders and they cannot offer advice. Some are prevented from soliciting business and most are prohibited from proprietary trading, although margin lending through brokers is common.

Table 4: **Qualifications of Brokers**

SAARC Member	Professional Qualifications Required for License as a Broker	Foreign Brokers	Role of Brokers
Bangladesh	No	As subsidiaries, up to 100%	Limited on research and advice
Bhutan	No	No foreign brokers allowed	Limited in practice to execution
India	No	As subsidiaries, up to 100%	Brokers offer all investment services
Maldives	Yes—examinations	As subsidiaries, up to 100%	Limited in practice to execution
Nepal	No	As subsidiaries, up to 100%	Limited to execution
Pakistan	No	As subsidiaries, up to 100%	Full service
Sri Lanka	Yes	As subsidiaries, up to 100%	Full service

SAARC = South Asian Association for Regional Cooperation.

Source: Fieldwork discussions with market participants.

B. Market Abuse and Investor Protection

These questions addressed prohibition of market abuse and over-the-counter (unregulated) trading, and surveillance responsibility (Table 5).

Table 5: Market Abuse and Investor Protection

SAARC Member	Prohibition on Market Abuse	Unregulated Off- Exchange Equity Trading Allowed	Surveillance
Bangladesh	Yes	Yes	The two stock exchanges with limited coordination Regulator currently procuring an online system
Bhutan	Yes	No	Joint—regulator and stock exchange
India	Yes	No	Joint—regulator and stock exchanges
Maldives	Yes	No	Regulator
Nepal	Yes	No	Joint—regulator and stock exchanges
Pakistan	Yes	No	Joint—regulator and stock exchanges
Sri Lanka	Yes	No	Joint—regulator and stock exchanges

SAARC = South Asian Association for Regional Cooperation.
Source: Fieldwork discussions with market participants.

All SAARC markets have prohibitions on a normal range of market abuses. In most cases, trading in an unregulated venue is prohibited. The usual configuration for monitoring and surveillance is for the stock exchange to have responsibility for real-time detection of potential abuse and the regulator to have facilities for off-line examination as well as wider powers over investors and other persons not regulated by the stock exchange.

C. Issuer Regulation

1. Ownership and Location Restrictions

The questions addressed the extent to which foreign issuers could access the domestic market, the limitations on foreign ownership, barriers to foreign takeovers, and the free float requirement (Table 6).

The regulations in five SAARC countries only permit listing of the locally operating subsidiaries of foreign companies. India allows listing of foreign company subsidiaries and has an additional provision for Indian Depository Receipts (IDRs), which allows the listing of an entire foreign company (i.e., the domestic and foreign operations). However, the IDR provision requires a set amount to be issued in IDRs, which means the IDR holdings are not fungible with the normal shares of the company.

Table 6: **Ownership and Location Restrictions**

SAARC Member	Listing of Foreign Companies	Limits on Foreign Ownership	Barriers to Foreign Takeovers	Minimum Public Float at Initial Public Offering
Bangladesh	Local subsidiaries only	None	None	40% (or 10% for larger issues)
Bhutan	No	Total prohibition	Not allowed	25%
India	Local subsidiaries and IDRs of foreign companies	Sector limitations	None subject to sector limitations	25%
Maldives	Local subsidiaries only	None except for land	Tax barrier of royalties in foreign companies	Must offer minimum of 250,000 shares to public
Nepal	Local subsidiaries only	Only in banking	None	No requirement
Pakistan	Local subsidiaries only	None	None	50% (or 25% for larger)
Sri Lanka	Local subsidiaries only	Only in banking	None	25%

IDR = Indian Depository Receipt, SAARC = South Asian Association for Regional Cooperation.
Source: Fieldwork discussions with market participants.

Six countries have no restrictions or only light restrictions on foreign ownership of domestic companies outside the banking sector. India has sector limits that set maximum foreign-owned percentages in companies in certain industries, but these are probably more of a problem for foreign direct investment than for portfolio investors.

It is common to have free float requirements for listed companies, including foreign subsidiaries. Companies that fail to maintain the minimum free float can be delisted, but this is rare in practice.

2. Information and Disclosure

These questions covered disclosures and the extent to which minority investors were protected against misbehavior by dominant shareholders (Table 7).

All countries require and regulate prospectuses, and all but one require quarterly financial updates. Treatment and definitions of price-sensitive information vary considerably from strict requirements for immediate reporting of any information likely to affect the price, to slower disclosure or disclosures limited to board decisions.

Table 7: **Disclosures and Protection of Minorities**

SAARC Member	Regulation of Prospectus Content	Regular Updates	Price Sensitive Information Disclosure	Complex Voting Structures Allowed	Protection of Minorities in Rules
Bangladesh	Yes	Quarterly	Board decisions made public within 30 minutes	Yes	Weak
Bhutan	Yes	Semiannual	Within 24 hours	Yes	None
India	Yes	Quarterly	Immediately	Yes	Regulations give protection
Maldives	Yes	Quarterly	Immediately	Yes	None
Nepal	Yes	Quarterly	Within a week of board decision	Yes	Limited
Pakistan	Yes	Quarterly	Publish on stock exchange before anywhere else	Yes	Protection against being excluded from advantageous price
Sri Lanka	Yes	Quarterly	Immediately	Yes	Anyone acquiring more than 30% of a company must make an offer for the remainder

SAARC = South Asian Association for Regional Cooperation.

Source: Fieldwork discussions with market participants.

Complex voting structures where investors have differing voting rights are permitted in all countries. Protection of minorities is generally weak and/or partial, except in India. It is commonly believed that dominant shareholders and sponsors are able to exploit their position.[23]

The responses to questions on corporate bond issues showed that all but two countries have a requirement for a rating. The exceptions are Bhutan, which does not have a ratings agency, and Nepal, which has only recently licensed an agency. Only the Maldives and Nepal require listing of corporate bonds.

[23] Sponsors are individuals who are involved in launching the company, but are not necessarily founders.

D. Corporate Governance

This section reports on the corporate governance standards, including whether there is a code and whether it is based on an international standard. In principle, noncompliant companies can be delisted, although this sanction is seldom applied. The main discipline in most markets is a requirement to publish levels of compliance (Table 8).

Table 8: **Corporate Governance**

SAARC Member	Rules or Codes on Governance	Companies Must Publish Compliance	Code Based on International Standard
Bangladesh	Yes, stock exchanges regulate	Yes, in annual report	No, local
Bhutan	Yes, by regulator	No	Modeled on OECD principles
India	Yes, stock exchanges regulate	Yes, in annual report	Compliant with OECD principles
Maldives	Yes, by regulator	Yes, in annual report	Modeled on OECD principles
Nepal	General provisions in Companies Act No code	No	No
Pakistan	Yes, stock exchanges regulate	Yes, audited statement of compliance required	Modeled on OECD principles
Sri Lanka	Yes, stock exchanges regulate	Yes, in annual report	Modeled on UK code, OECD compliant

OECD = Organisation for Economic Co-operation and Development, S AARC = South Asian Association for Regional Cooperation, UK = United Kingdom.

Source: Fieldwork discussions with market participants.

All SAARC countries have some form of corporate governance regulation except Nepal, which only has the minimal requirements of its Companies Act. In general, the codes are based on or approach the Organisation for Economic Co-operation (OECD) standard, with the exception of Bangladesh, which is at an early stage of governance regulation.

1. Accounting Standards

This section examines compliance with or convergence toward International Accounting Standards (IASs) and openness to foreign accountancy firms (Table 9).

Most countries comply with or are moving rapidly toward conformity with international standards. The exception is India, which has “adopted a direction,” but has not yet published a timescale. Foreign accountancy firms can operate in only four countries, and can operate only as joint ventures in all but one country.

Table 9: **Accounting Standards**

SAARC Member	Follow International Standard	Regulator of Standards	Foreign Accountancy Firms Permitted
Bangladesh	IFRS/IAS	Professional institute	No
Bhutan	Currently Indian standards but moving toward IFRSs/IASs	National board	No
India	Local standards but moving toward IFRSs	Professional institute	In partnerships with local firms
Maldives	IFRSs/IASs	Auditor General	Yes
Nepal	Local but adopting IFRSs in 2012	National board	No
Pakistan	IFRSs/IASs	Professional institute	In partnerships with local firms
Sri Lanka	Partially compliant with IFRSs	Professional institute	In partnerships with local firms

IASs = international accounting standards, IFRSs = international financial reporting standards, SAARC = South Asian Association for Regional Cooperation.

Source: Fieldwork discussions with market participants.

E. Macroeconomic Regulations

1. Currency Flows

Exchange control is a major barrier to greater integration in the SAARC region. These questions covered restrictions on inflows, outflows, and fund investments (Table 10).

Exchange control is a prevailing feature of the SAARC region. All countries, except Bhutan, accept portfolio inflows subject to other restrictions on foreign ownership. In practice, all countries have strict controls on portfolio outflows, but India has gradually relaxed its controls to a point where they are less restrictive and Sri Lanka has recently begun a similar process.

2. Taxation

This section looks at differences in tax treatment between foreign and domestic holders of domestic investments, and between treatment of foreign and domestic investments (Table 11).

Apart from Bhutan, all the SAARC countries treat foreign and domestic companies and foreign and domestic intermediaries the same. However, the Maldives has an additional royalty tax on foreign companies. India has a generally complex taxation structure, and this complexity extends to differential treatment of foreign and domestic investors. Most of the other SAARC countries have little experience of foreign investment and so the taxation issue has probably not arisen.

Table 10: **Currency Flows**

SAARC Member	Restrictions: Interest and Dividend Payments to Foreign Investors	Portfolio Investment Inflows	Outflows from Domestic Investors	Inflows to Domestic Investors	Foreign Investment by Domestic Investment Institutions
Bangladesh	No	No	Yes, not permitted	No	Yes
Bhutan	Yes, not permitted	Yes, not permitted	Yes, not permitted	Yes, not permitted	Yes, except through national scheme
India	No, through special account	No	Yes, annual limit $200,000	No, through special account	Aggregate limits on mutual funds Other funds generally prohibited by investment mandate rules
Maldives	No, but may not always be possible to exchange	No	No	No	National pension fund can invest in foreign assets
Nepal	Yes	No	Yes, but rules are imprecise	Yes, but rules are imprecise	Yes, but rules are imprecise
Pakistan	No, through special account	No	Yes, requires case-by-case permission	No, through special account	Yes, mutual funds subject to caps
Sri Lanka	No	No	Yes, annual limit	No	Case-by-case approval required

SAARC = South Asian Association for Regional Cooperation.

Source: Fieldwork discussions with market participants.

Table 11: **Taxation**

<table>
<tr><th rowspan="2">SAARC Member</th><th colspan="3">Differences in Treatment</th></tr>
<tr><th>Foreign and Domestic Investors</th><th>Foreign and Domestic Listed Companies</th><th>Foreign and Domestic Intermediaries</th></tr>
<tr><td>Bangladesh</td><td>No</td><td>Only local subsidiaries allowed to list, so treatment same</td><td>Only local subsidiaries allowed, so treatment same</td></tr>
<tr><td>Bhutan</td><td colspan="3">Not allowed, so not applicable</td></tr>
<tr><td>India</td><td>Yes</td><td rowspan="5">Only local subsidiaries allowed to list, so treatment same</td><td rowspan="5">Only local subsidiaries allowed, so treatment same</td></tr>
<tr><td>Maldives</td><td>No</td></tr>
<tr><td>Nepal</td><td>No</td></tr>
<tr><td>Pakistan</td><td>No</td></tr>
<tr><td>Sri Lanka</td><td>No</td></tr>
</table>

SAARC = South Asian Association for Regional Cooperation.

Source: Fieldwork discussions with market participants.

VI. Analysis of Findings

A. Diversity of Size and Development

The SAARC countries show wide divergence in their capital market development. This is most apparent in their market size, with India at one end of the scale, representing 93% of the total market value of listed equity in SAARC, and very small markets at the other, such as the Maldives with four listed companies and a total market value of $115 million at the end of 2012 and very few transactions. In addition to the size difference, innovation in exchange-traded products is low, except in India. Almost no markets trade any product other than basic equity shares. There are few exchange-traded funds; almost no derivatives except in India, which has a large market, and Pakistan, which has a modest market; no real estate investment trusts; and almost no corporate bonds.

The markets also show much instability—again with the exception of India. Most are undergoing or have undergone extremes of volatility, and several are in the throes of a volatility crisis. They do not have the resilience to withstand volatility, and their regulatory reactions may have exacerbated the already difficult situation.

B. Similarity of Standards, Diversity of Compliance and Enforcement

In terms of basic structures and regulations the markets show considerable harmonization. All have regulators tasked with supervising the market, and requirements for prospectuses and continuing disclosure. Most have some form of corporate governance standards and have adopted or are adopting a recognized IAS. In addition, the codes, disclosure requirements, and regulations are largely based on international practice.

However, discussions with practitioners suggested that enforcement standards in most SAARC countries are low. Some consistent themes were that markets were manipulated but the regulators had not been able to act, governance standards fell well short of any code, and corporate disclosures were not honest. Participants also suggested that those involved in abuse were powerful and influential, and that regulators sometimes lacked the confidence to act decisively against powerful interests. Generally, the larger and more developed markets, especially those where foreign intermediaries played a significant role, had fewer problems with abuse and better standards of compliance and enforcement. In most cases, the participants agreed that standards were improving but further improvement was needed.

This is a common observation among developing markets in other regions and it does not preclude progress on harmonization and integration. Even in regions where integration has progressed further, there are wide variations in the effectiveness of regulators. The Association of Southeast Asian Nations (ASEAN) may opt to integrate in two streams to reflect the differences in development among its members. However, weak enforcement of regulations is likely to be a barrier to further development of SAARC markets.

There have been a number of regional and local initiatives to increase cooperation between regulators in the SAARC region. For example, at the South Asian Federation of Exchanges (SAFE) annual general meeting in 2005, the South Asian Securities Regulators' Forum was established and a memorandum of understanding (MOU) was signed between the regulators of Bangladesh, Bhutan, Mauritius, Nepal, and Pakistan.[24] Efforts continue on bilateral MOUs: India and Pakistan signed an MOU in January 2008, and the Maldives is in discussions with the Securities and Exchange Board of India (SEBI) about an MOU. In addition, several SAARC members—Bangladesh, India, the Maldives, and Pakistan—are also members of International Organization of Securities Commissions (IOSCO). India, the Maldives, and Pakistan are signatories to the IOSCO multilateral MOU. However, contacts between the regulators are still not extensive, largely because there is little cross-border business and therefore limited practical need for regulator cooperation.

C. Markets Closed to Foreign Companies

No SAARC markets provide for listing of foreign companies, whether from within SAARC or from outside. All except Bhutan allow listing of subsidiaries of foreign companies. With one exception, it is only possible to list the subsidiary that operates in the country concerned, not the entire foreign company.[25] The Indian Depository Receipt (IDR) facility allows the entirety of a foreign company—Indian and non-Indian parts—to raise money and be traded on the Indian market. However, as already noted, the facility has been limited by the Central Bank and has so far only attracted one company.

The advantages of cross-listing have been reduced in developed markets. In the past, cross-listing allowed investors in one country to invest in foreign companies; but now it is relatively easy, and usually preferable, to invest directly through the foreign market. Listing in another market only brings significant benefits when the home market is too small or otherwise inadequate to support an issue. However, many less developed markets cannot support large issues and so the benefit to their companies of being able to issue into other markets may be substantial. Cross-listing gives companies in smaller markets an opportunity to raise capital without swamping their home market or moving their listing to one of the global financial centers.

The case of Druk Green, a state-owned hydroelectric company in Bhutan, illustrates the need for cross-listing. While privatization is not being considered, the company wishes to

[24] Mauritius is a member of SAFE but not of SAARC.

[25] This is not uncommon, but it tends to mean either (i) the subsidiaries do not list because they do not wish to raise capital locally, or (ii) they list with almost all the shares being held by the parent company and practically no free float.

fund some of its new projects privately through an initial public offering (IPO). However, the IPO would be larger than the Bhutanese capital market can absorb. The national pension fund is keen for assets and could possibly buy the issue, or a large part of it, but Druk Green would prefer an IPO that gives them a more diverse and broad shareholder base. The company would like to do an IPO in SAARC—ideally in India, because this limits the currency risk. However, none of the SAARC stock exchanges can list a foreign company operating outside their country; they can only list a subsidiary part that operates within their country. The only option for meeting Druk Green's needs is the IDR facility. However, a condition for issuing an IDR is that the company must have a track record of listing compliance over several years on another stock exchange. This precludes Druk Green from doing an IPO in SAARC. It could, however, do an IPO in Hong Kong, China; London; New York; or Singapore. The company has yet to decide on a course of action.

D. Markets Open to Foreign Brokers

The entry of foreign brokers into a market often leads to a general improvement in standards, greater compliance, and increased innovation. All SAARC countries, except Bhutan, permit foreign brokers to operate through a local subsidiary. This restriction is reasonable because the regulator needs to have some entity that it can license and de-license, and this must be located and legally incorporated within the country. The alternative is mutual recognition which, because it requires some form of intergovernment treaty, is seen by most participants as impractical. In most cases, there are no limits on the degree of foreign ownership of brokerages in SAARC countries.

The necessity of operating through a local subsidiary has not been a barrier so far. Several SAARC countries host subsidiaries of foreign brokers. However, it presents a difficulty for the smaller markets. If operating through a local subsidiary continues to be a requirement, then foreign brokers may be deterred by costs that may not be justified by the volume of business. Foreign brokers can access a market through correspondent relationships with local brokers, but this route would deny smaller markets the improvements that foreign brokers often bring.

E. Viability of Smaller Markets

The SAARC region contains some very small markets. These markets are well organized and have competent regulators. However, there has to be a question about their long-term viability. In the Druk Green case, the market was not large enough to absorb an IPO that was intended to fund an important development project. Several markets have been unable to generate sufficient revenues to fund the longer-term development of the intermediaries, regulators, and stock exchange. Finances are especially tight in the current circumstances, but the problem is long-standing. A number of markets were acquiring new systems with donor assistance, which suggests that they could not fund them from their business and that the new systems may not be well-suited to their needs.

To some extent, these markets are protected by artificial barriers such as exchange controls. Historically, small markets have tended to be subsumed into larger ones as the barriers that supported them have been reduced. For example, regional markets within a country have tended to be absorbed into the national market as communications have improved, such as in India, where trading has migrated to the national markets. In some cases, smaller regional markets have developed niches for themselves. For example, Vancouver developed a niche in trading mining companies, Osaka specialized in trading derivatives, and the Indian regional exchanges are developing businesses as portals for listing.[26] Some of the small SAARC markets have aspirations to develop their markets into regional financial centers. Taking a practical view, these aspirations are unlikely to be met.

It is important for national development that capital markets are adequate to support the funding and investment needs of the country. Therefore, markets in small economies need to take a strategic view of how they perform that development role. It may be that they are better able to serve that role by becoming integrated with larger markets in the region. Integration may involve the migration of some functions from a small national market, for example the provision of trading services. Consolidation of stock exchanges has been going on apace in developed markets. Equally, other capital market functions are best performed locally; for example, the provision of investment and corporate finance advice and accountancy services. As markets integrate and become more efficient, the local functions tend to expand as the total volume of activity increases.

F. Exchange Control Remains a Challenge

All the countries in SAARC have exchange controls. Only India and, more recently, Sri Lanka have relaxed controls to any significant extent. Most countries are concerned about possible outflows of reserves if they relax controls. At the same time, all countries, except Bhutan, are keen to attract portfolio investment inflows because they might easily be tightened at short notice.[27] However, foreign investors are wary of exchange controls, seeing them as a significant risk. Even where controls are benign toward portfolio investors, the risk remains. Malaysia in 1998 and Thailand in 2007 are examples of countries that radically changed their treatment of portfolio investments at short notice. Both faced a serious loss of credibility among international investors as a consequence.

[26] Vancouver, which acquired a reputation for lax regulation of listed companies, was taken over by the Toronto Stock Exchange at the behest of the national securities regulator. On 15 July 2013, the Osaka and Tokyo exchanges agreed on a merger.

[27] Even if the controls are tightened in areas that do not directly affect foreign investors, they can still spark a capital exodus. In August 2013, India tightened controls of foreign investment by Indian residents, which is said to have caused an exit of foreign investment even though inward investment was not affected by the new regulations.

G. Limited Interest in SAARC as an Investment Destination

There is only limited interest in SAARC as an investment target among regional investors. Although there is a desire to invest abroad, it is mainly directed at traditional financial centers and India. There seems to be relatively little interest in cross-border investment in SAARC. In part, this was because many saw investment overseas as impossible because of exchange control, so if an opportunity arose they wanted to get funds out of the region. This may change, but it is clear that there is no pent-up demand for intra-SAARC investments.

For global investors, the issue is that SAARC is mainly India, where they are already active, and the other countries are perceived as being "like India" but more risky. There may be excellent opportunities in SAARC outside India, but investors tend to see only the risks in settlement, risks of poor disclosure, risks of being disadvantaged by better-informed local traders, and the political risks that are certainly a factor in some SAARC countries. From a global investor's viewpoint, the correct strategy for other SAARC countries is to make themselves look more like India. Harmonization of standards and more effective enforcement are a key part, but far from the only part, of that process.

H. Limited Contact and Interaction within SAARC

There is little contact and interaction among SAARC capital markets. A few interviewees said that they had had interaction with the Indian market through Indian programs of assistance. Some interaction is also arranged through SAARC and SAFE, although interaction through SAARC is mainly between the ministries of finance. The overall picture is one of considerable lack of knowledge of other SAARC markets. Improving regional knowledge was seen by interviewees as a key part of the process of harmonization and integration within SAARC.

The lack of knowledge is often combined with a lack of interest in the developments in other SAARC markets. This is surprising, because most of the SAARC markets are facing similar issues such as low volumes, excessive volatility, and difficulties in enforcement. They are also often looking at similar solutions, such as demutualization. At the same time, the common view is that greater integration within SAARC was unlikely in the near term, so there is little to be gained by expending resources in learning about other SAARC markets. Most do not see SAARC as their source of growth. To the extent that they looked outside, they saw global investors as the main external driver of growth.

I. Demutualization

Apart from the Indian exchanges, all the larger stock exchanges in the region are run as mutual associations. Globally, the trend is toward demutualization of stock exchanges. Demutualized stock exchanges tend to be more efficient, better focused on business, less driven by sectional interests, and more innovative especially in terms of product development—all areas where SAARC stock exchanges are not strong. Even among small developing markets, the experience has been that commercially oriented stock exchanges, which in practice means demutualized stock exchanges, have been more willing and able to develop their markets. Such exchanges have been less constrained by vested interests, more likely to innovate with products, and better able to manage costs than mutually run exchanges. Based on the experiences of other markets, it is likely that development of the SAARC capital markets would be enhanced if more of the stock exchanges were demutualized.

The theoretical benefits of demutualization are widely accepted. There is a view that current market circumstances are not right for demutualization, and it is true that many stock exchanges that have made a success of it have benefitted from good timing. The contrary view is that it is impossible to judge the right time, and the gains from demutualization are so great that the timing should not be a barrier. Furthermore, the situation in some of the markets is partly a consequence of the stock exchanges' failure to address issues that a demutualized stock exchange would be best placed to resolve.

VII. Implications for Harmonization and Integration

This section draws out key factors affecting a market's readiness for greater harmonization and integration. It should be stressed at this point that, if the goal is wider economic integration and greater development of capital markets, harmonization is best seen as a step toward integration and not as a goal in its own right. Harmonization, meaning a high level of similarity of regulatory structures and standards, is undoubtedly a valuable step. This is because it usually has meant harmonization toward higher standards (e.g., IOSCO principles). Equally importantly, harmonization makes smaller markets more attractive to global investors because they will encounter familiar regulations and processes, which reduce the cost of accessing a market and so make accessing smaller markets viable.

But regional harmonization without regional integration tends to mean that investors from outside the region have easier access to the markets but that investors within the region have no cross-border access. Consequently, the regional markets tend to become dominated by investors from outside the region, as is arguably the case with some ASEAN markets, but the cause of greater economic integration and capital market development is not much advanced. A further point is that integration is the true test of harmonization. It is relatively easy to announce the adoption of common standards and best practice, but it is much more difficult to implement them. Harmonization means standards look the same; integration means there is mutual recognition and trust, which can only happen if standards are the same—both in form and implementation.

Table 12 summarizes the barriers to integration, areas of progress, and readiness for integration of the SAARC countries. In many cases, there are similarities in the standards and processes, giving an appearance of harmonization. However, during the interviews it became clear that the apparent similarities masked considerable differences in practice. Such differences will inevitably reduce the level of trust and mutual confidence that are essential for increasing integration.

Table 12: **Summary of Main Barriers to and Positive Factors for Integration**

SAARC Member	Main Barriers to Integration	Main Positive Factors	Readiness
Bangladesh	• Strict exchange control • Weak enforcement of market abuse rules • Poor enforcement of issuer disclosure rules • Lack of independence of regulator	• Regulation improving but many challenges remain • Some quality participants	Medium
Bhutan	• Strict exchange control • Complete barriers to foreign issuers and investors • Potentially nonviable national market • High level of government involvement in economy	• Effective regulator	Low
India	• Already a large market • Barriers to foreign listings remain • Complex and rigid tax structure • Fragmented settlement system	• Effective, well-developed regulator • Progress in reducing exchange control • Foreign institutional investor structure permits foreign investors	Medium
Maldives	• Weak disclosure enforcement • Potentially nonviable national market	• Effective regulator	Low
Nepal	• Strict exchange control • Patchy regulatory structure • Potentially nonviable national market • Weak disclosure by listed companies	• Relatively low barriers to inward investment	Low
Pakistan	• Weak enforcement of market abuse rules • Lack of independence of regulator	• Some relaxation of exchange control	Medium
Sri Lanka	• Weak enforcement of market abuse rules • Obsolete settlement system • Potentially nonviable national market	• Some relaxation of exchange control • Effective regulator • Disclosure fairly good	Medium

SAARC = South Asian Association for Regional Cooperation.

Source: Authors.

VIII. Ideas Leading to SAARC Capital Market Integration

During the course of the fieldwork, SAARC regulators gave suggestions for actions that would support greater integration. The broad consensus was that there were three major barriers:

- Exchange control generally remains a barrier even though it has been relaxed in some countries. Most regulators assume it is, and will remain, an absolute barrier, but the perception is probably worse than the reality.
- There is a lack of priority at the national level for greater capital market development and few seem willing to champion the idea. In contrast to ASEAN, there seems to be little drive for greater integration.
- There is a lack of investor enthusiasm within SAARC, but investors were keen to invest in the People's Republic of China, India, Singapore, the United States (US), and other more developed markets.

These findings led to the conclusion that the path to integration that Europe has engaged upon, and that ASEAN is working toward, is a distant prospect in South Asia. The European Union (EU) and ASEAN initiatives have required mutual recognition, and/or free movement of capital, and/or electronic links. Mutual recognition of regulators means that admissions to listing, prospectuses, and intermediary regulation by one national regulator are accepted throughout the region. Mutual recognition allows existing national institutions to be retained. Neither in ASEAN nor in the EU has integration required a single regulator, a single securities depository, or a single stock exchange. Free movement of capital is seen as essential because without it the discussion of integration is largely pointless. Harmonization has value in showing a common regulatory face to the world, which encourages and supports greater interest from investors outside the region. It has proved possible to have free movement of capital and an integrated market without having a common currency, although a common currency makes the integration stronger. Finally, electronic links are often seen as a critical part of integration.

In SAARC, none of these developments are present, planned, or thought likely in the foreseeable future. Therefore, it is necessary to emphasize softer steps toward harmonization and integration. A range of ideas emerged from the fieldwork. Some of the were unrealistic, but others might be feasible. The ideas fall into three broad groups: regional markets or instruments, setting and implementing basic common standards, and greater interchange of ideas. These are discussed in detail in the following paragraphs.

A. Regional Markets or Instruments

These proposals would rely on private sector initiatives. There are three strands: a regional market for trading stocks, an offshore derivatives market, and country and regional funds.

1. Regional Market for Trading National Stocks

The objectives of the proposals in this broad group are two-fold. The first objective is to develop a regional platform to attract the interest of global investors who are already familiar with the Indian market. If the other SAARC countries can be presented on a single platform, then they can benefit from the attractiveness of India. An alternative view is that a regional platform would allow the SAARC countries, excluding India, to present themselves to investors as a larger group of stocks than would be the case for each individual country. The second objective would be to develop a way for local investors to escape the constraints of exchange control. Two SAARC countries, India and Sri Lanka, have relaxed exchange controls to the extent of allowing their nationals to invest controlled but substantial amounts in foreign securities. The concept is that an entity, which could be a SAARC stock exchange, sets up an electronic platform on which stocks from the SAARC region can be traded. Successful examples exist (e.g., BATS Chi-X Europe, a privately owned multilateral trading facility offering access to the European market), but they are rare and have only achieved significant success in Europe and the US.[28] Several of these entities are attempting to gain footholds in major Asian markets.

The key issues in establishing a regional market for trading national stocks relate to settlement, regulation, exchange control, competition, and liquidity.

Settlement. To settle transactions in underlying stock, a SAARC platform would need a clearing facility or access to a third-party facility and links to national depositories. For example, European law requires that settlement entities, clearing houses, and depositories give access on an equal and fair basis to all trading venues. A number of independent, privately owned clearing agencies exist in Europe and these have access to national depositories.[29] A SAARC stock exchange could probably develop its own clearing function, but links to national depositories would be difficult because in the SAARC region many depositories are owned by stock exchanges or governments.

An alternative approach would be for the SAARC stock exchange to trade depository receipts. However, unless the depository receipts were fungible with the underlying shares, which requires a link to the depository, there would have to be a pool of underlying stock held at the expense and risk of the SAARC stock exchange in order for trades to be settled.

Regulation. Investors would not be willing to trust an unregulated market, so the SAARC stock exchange would need to be regulated. There are, or have been, some examples of such offshore markets; for example, Dubai and Qatar. They have not been successful to

[28] BATS Chi-X Europe offers various types of electronic order books—a dark pool (no order display) and a transparent order book—for potentially any European equity. It has gained a substantial market share in equities of the larger European markets (BATS Chi-X Europe regularly transacts 20%–40% of the market trading in French, German, Italian, and United Kingdom [UK] shares).

[29] BATS Chi-X Europe currently allows users to choose from a list of four clearing entities (including LCH.Clearnet, which is partly owned by exchanges with which BATS Chi-X Europe competes; and Six Clearing, which is owned by the Swiss stock exchange, and is also a competitor.)

date, but remain interested in opportunities to trade nondomestic stocks. The problem has been that brokers from the countries where the stocks originate are prohibited by their own regulators or by the offshore regulators from accessing these markets, and brokers from the offshore market do not have the natural business flow in the stocks that the national brokers have.

Exchange control. Controls would continue to be a barrier for SAARC investors in a SAARC stock exchange. As noted, some countries have relaxed controls to a limited extent. Investors from those countries could access an offshore SAARC stock exchange, but they would see no advantage in doing so as they could more easily access the national stock exchange. For example, a Sri Lankan investor wishing to invest in the stock of another SAARC country could ask his Sri Lankan broker, who would establish a relationship with a broker in the target country. That broker would then execute a trade on the national stock exchange, assuming foreigners are allowed to own domestic stock. If this is not permitted, as with Bhutanese stock, then there is no way for a SAARC stock exchange to settle any transaction executed through its system.

Competition. For global investors, there are already two liquid platforms for trading SAARC stocks: the BSE and the NSE. India represents some 93% of total SAARC market value, so any portfolio with a wider range of SAARC stocks would not be very different from an India-only portfolio. There is no suggestion at present that global or SAARC investors have much interest in investing in SAARC outside India, but it would be a desirable policy aim to encourage this. In the current situation, it is not clear that a SAARC stock exchange could offer anything to compete with the Indian stock exchanges or generate sufficient liquidity to attract global investors.

An alternative approach is to have a "SAARC-excluding-India" stock exchange. This would, however, be equally unlikely to attract significant investor interest. The ability to access the market is only one, and probably the most minor, of the issues that might deter an international investor from using a SAARC-excluding-India stock exchange. Many SAARC countries already have established stock exchanges, so they are not starting from nothing. Therefore, a SAARC stock exchange would have strong competitors in all the countries. In other areas of the world, for example parts of Africa, where the local stock exchanges are much less developed, some sort of transnational stock exchange might gain traction.

Liquidity. It is difficult to establish a successful offshore stock exchange (i.e., a market trading in stocks outside the home country). There have been a few recent examples: Canadian, Mongolian, and Russian stocks are traded in London; and the Singapore stock exchange (SGX) is trying to attract nondomestic companies and has been successful, for example with Thai Breweries. But in general, the home market needs to be particularly bad or difficult to access in order for an offshore stock exchange to capture significant business. In most situations, the home market retains the major advantages, particularly in expertise and information, and is generally the most liquid market.

2. Offshore Derivatives Market

An approach that circumvents settlement constraints is to replace the stock with a cash-settled derivative. The SAARC stock exchange then becomes, in effect, a place for the trading of bets on prices of underlying stocks. Transactions would be settled in cash with no movement of underlying stock and margin collateral would be in cash or other assets, so there is no need to link to depositories.

The key issues for the offshore derivatives market relate to exchange control, loss of control, competition, regulation, and lack of involvement.

Exchange control. While there would be no movement of stock, settlement payments would require movement of cash. To function properly, this would require links to banks where the users have deposits. Exchange control would remain an obstacle for countries that retain strong controls. Others that have relaxed their controls have generally done so for purchases of securities.

Loss of control. If the market gained liquidity, then it might permit substantial exposures to be built up in SAARC stocks, which are entirely outside the reach of the national regulator. Given the small size of many SAARC markets, this might make them vulnerable to being driven by the offshore market.

Competition. Just as there is a liquid stock market in India for global investors, there is also a liquid derivatives market. So it is not obvious why investors who want exposure to SAARC should not just trade the Indian derivatives, given that India makes up more than 90% of the total SAARC listed market value.

Regulation. Only India and Pakistan have derivative exchanges for securities derivatives, and only India has good liquidity. Like the offshore cash market already discussed, the offshore market would be regulated outside the SAARC region. It is unlikely that regulators of most SAARC countries would be enthusiastic about their regulated entities participating in an offshore derivatives market.

Lack of involvement. While a derivatives market might attract investors—or speculators—it is not usually the type of involvement that companies or governments want. Derivatives are a valuable hedging tool, but they do not carry an involvement with the company other than in the short term. Holders of derivatives would, therefore, not be concerned with the longer-term prospects of the company or its compliance with regulations and standards of governance. Thus, it is unlikely that a derivatives market would do much to develop genuine investment interest and so raise standards compared to direct involvement through share ownership, which for many investors involves longer-term commitment and participation in management through the use of voting rights.

3. Country and Regional Funds

Country and regional funds are private sector initiatives requiring little or no involvement from governments or national regulators. Fund managers would offer conventional mutual funds, if they do not already exist, in each SAARC country. Not all countries in SAARC would need to be involved. A fund-of-funds is then set up to hold a portfolio of the country funds. The fund-of-funds could be marketed as a regional fund to allow exposure to the wider region. However, some SAARC countries, for example, Bhutan, do not permit foreign investors to own shares of domestic companies and so could not be included in the fund of funds. The fund of funds would be located and regulated in an offshore venue. This might be regarded negatively by national regulators in the SAARC region.

Such a fund might be attractive to global investors that are too small to invest directly in the countries of the region. However, such funds may be constrained as to which foreign countries they can invest in. They may, for example, be limited only to countries in one of the emerging market indices, and so might be excluded from the fund of funds; although there could be a sub-fund-of-funds version that meets those needs.

The fund might also attract investors from countries in the SAARC region whose exchange controls permit capital outflows for investment. Governments might even consider some relaxation of exchange controls for investment in a regional fund. The Gulf Cooperation Council (GCC) has such an arrangement, which makes it easier for GCC nationals to invest in other GCC countries. However, any such relaxation brings risks of abuse. The lack of investor interest in most SAARC countries might be changed by the availability of a simpler, cheap vehicle.

Funds of funds invest in country funds according to fixed algorithms that are often based on market values. However, although this would give more than 90% of the fund to Indian investments, it would provide other SAARC countries with valuable exposure. The alternative of using an algorithm that does not correspond to market value incurs the risk that investors might not be attracted to a fund that appeared, to them, to be overweight in smaller countries. The South Asian Federation of Exchanges (SAFE) has already produced an index that gives greater weight to smaller countries.[30]

The final configuration is a private sector matter. It would not be wise for regulators, government bodies, or nongovernment organizations to become involved in such a venture. There are already private firms interested in this idea, and they suggest that a venture of this type might be launched soon. However, the attitude of regional regulators might be important in determining the success of a regional fund. It seems to be a potential approach that might work, and the experiment should be encouraged by local regulators.

[30] Based on a press release dated 17 March 2009, the Dow Jones SAFE 100 Index will measure the performance of the 50 largest Indian stocks and the 50 largest stocks trading in Bangladesh, Mauritius, Pakistan, and Sri Lanka. In July 2013, Dow Jones published a methodology for the index. www.djindexes.com/mdsidx/downloads/meth_info/Dow_Jones_SAFE_Indices_Methodology.pdf

B. Setting and Implementing Basic Common Standards

The integrated capital market in the EU is underpinned by common regulatory standards. The common standards are defined by EU directives. The directives are, in effect, international treaties under which governments agree to cede sovereignty to a regional body and to bind themselves to the laws agreed upon at regional level. The current structure is the culmination of many years of work. Discussions on the first directive covering investment services began in the late 1980s.

The Prospectus Directive is an example of such a directive. It lays down common standards for the content of prospectuses. EU members are obliged to adopt the Prospectus Directive into their national laws.[31] The directive is the minimum standard. Members are free to add requirements over and above those of the directive, so-called "gold-plating." However they are not allowed to implement lower standards.

At the same time as a directive is implemented, EU members agree to recognize each other's jurisdiction, so-called mutual recognition. For example, a company that is listed in Finland can be traded throughout the EU without additional regulatory documentation. Similarly, a broker licensed in Italy is able to operate in any EU country without additional regulatory documentation. The same is true for mutual funds and other investment products.

However, there are no EU regulations on enforcement standards. Every state that is subject to the directives has similar standards of, for example, disclosure; but in practice there are significant differences in enforcement and consequently in the quality of information disclosed.

The principle of home country regulation prevails. If an Italian broker misbehaves in the United Kingdom (UK), then the investigatory and enforcement responsibility rests with Consob, the Italian regulator, rather than with the UK's Financial Services Authority. There were concerns that this might lead to a "race to the bottom," with regulated entities opting to gain access to the European market by getting their license or listing in the country with the least demanding regulatory requirement. Greece was usually cited as an example. In practice that has not happened, and most regulated entities have chosen to be regulated in the largest markets where the regulators are the most demanding.

In contrast, SAARC is at a much earlier stage of capital market integration, and a model based on an EU-style regime based on commonly agreed directives may not be the right approach. Such a structure is generally regarded by market participants as an unlikely prospect, mainly because of the high-level intergovernment treaties or agreements that would be required. However, there is a considerable degree of regulatory similarity among

[31] Non-EU members may also adopt EU directives. For example, MiFID—the directive governing provision of investment services—has been adopted by Iceland, Lichtenstein, and Norway. These countries are not EU members, but have agreed to subject themselves to this EU law.

the SAARC members, at least in terms of structure. The general model for SAARC countries includes

- rules requiring prospectuses and similar requirements on the contents of prospectuses,
- corporate governance codes based to a considerable extent on international best practice,
- prohibitions on most of the normal types of market abuse,
- requirements for brokers to know your customer and act in their best interests,
- rules on trading transparency,
- standards for clearing and settlement,
- accounting standards that are approaching international standards,
- rules on capital adequacy of broking firms, and
- rules on fit and proper persons for companies and for brokers.

There will be significant variations in standards of monitoring and enforcement between SAARC countries, as there are in Europe. Typically, markets that have sought to attract international investors have standards that are closer to global best practice than those that have not sought foreign involvement in their markets.

Accepting such differences, which also exist in Africa, the Association of Southeast Asian Nations (ASEAN), the EU, and every other region where there are moves toward market integration, SAARC has a sound foundation for establishing common standards. The approach would be different to that of other regions because of the unique characteristics and history of the SAARC countries. In particular, there could be a valuable role for one or more of the regional agencies, such as SAARC and SAFE, to

- gather detailed data on existing structures, regulations, and codes from existing studies by making further enquiries;
- analyze the results to determine what could become minimum common standards;
- encourage awareness of the common standards so that the regional standards become well-known;
- conduct or facilitate detailed assessments of implementation standards; and
- support efforts to improve implementation of standards, especially in the less developed markets.

C. Greater Interchange of Ideas

The participants in the SAARC national markets have little information about or perception of the other SAARC markets. This could be explained in part by the perception that there are few capital market opportunities in the SAARC region because of barriers and a general lack of enthusiasm among local investors. However, given most of the capital markets in the region are facing essentially the same business challenges, such as demutualization and managing volatility, there could be significant gains from greater exchange of information.

There are at least three regional bodies with an interest in capital markets:

- SAARC itself, given that it has jointly commissioned and assisted with this project;
- SAFE, which is a voluntary body that includes most of the regional stock exchanges as well as others outside the region, and has been the executing agency for funded projects on the harmonization of listing standards and cross-listing; and
- ADB, which has sponsored many projects aimed at developing capital markets in the region (as have other development agencies).

In the mid-1980s most European stock exchanges had little knowledge of each other. The Federation of European Exchanges and the World Federation of Exchanges (WFE) organized a network of meetings, committees, and working groups to foster greater interaction. At the same time they were seeing increasing overlaps in their business, as well as competition, which gave them an incentive to learn more about each other. The result was a sharp improvement in knowledge and availability of data.

The capital markets of the SAARC region would be benefit from greater interaction, and this should be fostered by the organizations already involved. The participants in such groups should be those involved directly in the capital markets rather than high-level government officials who have little direct market involvement. The groups should focus on specific issues rather than generalities, ensure accountability by having proper agendas and action points to follow up, and possibly be facilitated with outside assistance.

The topics that could be addressed in such groups include the following:

- **Managing volatility.** Many of the markets have seen damaging levels of volatility; and the others, because of their small size, are vulnerable. The regulatory responses have not generally been well thought through, and regulators have not learned from the experiences of other markets.
- **Demutualization.** Stock exchanges in the region are considering demutualization and are facing difficulties in making progress.

- **Pension fund investments.** Most are moving toward funded schemes, but lack the assets to support such schemes.
- **Common standards.** Most have adopted standards close to international best practice, often as a result of development projects, but there is no sense of a coherent set of SAARC standards. There are also large differences in enforcement standards, which could be addressed through capacity building workshops.
- **New products.** New products that have led to substantial development and growth of markets in other regions are lacking in SAARC, aside from India. For example, derivatives and exchange-traded funds have been widely adopted in other regions. Islamic finance has been a major area of growth and could be developed by the SAARC countries.
- **Capital-raising at the regional level.** Some of the markets are too small to support initial public offerings (IPOs) by their major companies. A regional method of spreading IPOs across more markets would help smaller markets to survive without denying their companies access to finance.
- **Bond markets.** Bond markets are underdeveloped throughout the SAARC region, as are related techniques, such as securitization and structuring, despite the acute need for novel methods of infrastructure finance in the region.

IX. Conclusions

A. Capital Market Integration Is Likely to Bring Overall Benefits

The analysis has shown that while there is wide diversity in size and development level of the various SAARC capital markets, there is considerable structural similarity. This suggests that harmonization and integration are feasible and would potentially lead to significant benefits. The experience of integration both within countries and across regions is generally positive. The Indian example is relevant. Until the early 1990s, the Indian capital market was very underdeveloped, similar to the current situation of the other SAARC markets. At that time, there were many local stock markets, which made the capital market fragmented and inefficient.[32] From the early 1990s India undertook a transformation of its capital market (mainly but not exclusively its equity market) infrastructure, market structure, and regulation.

The result is that the Indian equity market is now world-class in terms of infrastructure and regulation. There are two national stock exchanges and the market is now fully integrated.[33] Results show that the cost of transacting business, which affects the efficiency with which savings can be mobilized and allocated, has fallen substantially. In addition, the Indian national exchanges have been innovative in developing new products which, as well as increasing the revenue of the exchanges, has given Indian investors a wider range of possibilities for investment and risk management. Furthermore, foreign investors have been attracted into the Indian market. As a large and growing economy, India would have attracted foreign inflows irrespective of the state of its capital market, but the quality of its capital market has widened the range of foreign interest and given that interest greater stability.[34]

India's experience has not been completely positive.

- The local exchanges and some of the more traditional local brokers have lost ground and have had to find alternative market niches to survive. The demise

[32] Capital market inefficiency is different to other types of inefficiency. Industrial inefficiency, for example, is taken to mean that too many inputs are required to produce a given volume of output. A capital market is said to be inefficient when the same or equivalent asset has different prices in different parts of the market. Capital market inefficiency usually arises from artificial barriers and costs that restrict the flow of capital that would otherwise arbitrage away the price differentials. Usually, removal of inefficiencies is a consequence of greater integration.

[33] It is entirely possible to have a nonfragmented market with multiple stock exchanges as long as there is a high level of transparency and an absence of barriers.

[34] Typically, growing economies will attract foreign inflows of portfolio investment and foreign direct investment. However, the more risky the capital market is in terms of poor regulation, poor infrastructure, and poor governance, the more those inflows will be (i) from more speculative investors rather than long-term investors, and (ii) volatile and prone to rapid withdrawal.

of local exchanges has been a frequent consequence of national integration; but where the markets of several countries have become integrated, the national stock exchanges of the countries have always survived, although often with a different business model.

- Small and medium-sized enterprises (SMEs) may not have fared as well as large companies. The greater breadth of the market and focus on national companies has meant that, to some extent, SMEs have probably been less able to raise capital or have probably had to pay higher yields. This is a perennial and global problem as markets develop. The Indian national exchanges are exploring structures to better support SMEs. It is quite possible that the cost of capital for SMEs was artificially depressed before integration by the barriers between regions, and SMEs were therefore being overpriced to the disadvantage of investors and larger issuers.
- Capital flows are more volatile than they were, but the net inflow is substantially larger, so India has more capital but more challenging currency management.

On balance, Indian policy makers see the result as substantially positive, and India is better off as a consequence of integrating its local capital markets into a national market. Similar benefits are expected to flow to national capital markets in the SAARC region if it moves toward regional integration. Inevitably, the gains will not be evenly spread. India, as the largest and most developed capital market, has already achieved most of the gains through national integration. So, for India, the incremental gain from regional integration will be less, although there is still some advantage in the form of further broadening the options open to Indian investors. Small capital markets in the region face specific challenges discussed elsewhere in this report, although national exchanges have always retained a role in regionally integrated capital markets.[35] But the potential gains for their issuers and investors are perhaps the greatest.

The focus of this report has been mainly on equity markets. This is because those markets are most developed in the SAARC region, with every country (except Afghanistan) having a functioning equity market. [36] Corporate bond markets do exist in many SAARC countries, but they are rarely public markets. In SAARC, even in India, the corporate bond markets are mainly markets for private placements rather than for public offerings.[37] Derivative markets are also less well-developed in most SAARC countries. Greater integration of capital markets is expected to lead to conditions and incentives for developing a wider range of products in the SAARC region, including corporate bonds, collective investments, derivatives, and sharia-compliant financial instruments.

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[35] In the EU, all the national stock exchanges continue to trade, although some have been subsumed into larger exchange groupings. ASEAN has no plans to reduce the role or number of national exchanges.

[36] The Afghanistan Central Bank plans to develop a capital market and intends to start with a stock-exchange-based equity market.

[37] The laws of most countries allow bonds (and shares) to be issued through private placement for issue to a small group of professional investors with a substantially reduced documentation requirement.

B. Different Starting Points, Different Speeds, One Goal

Two features of SAARC capital markets are important in determining the steps toward integration. First, while the SAARC capital markets display structural and regulatory similarities, they are all at very different stages of development and their progress toward integration varies (Table 12). Second, while the capital markets are generally keen to move toward greater integration, they each face different challenges that will affect the speed at which they can progress.

Therefore, it is not feasible to adopt a strategy for integration that commits all the markets to move toward integration in lockstep or to a fixed timetable, so the Euopean Union (EU) approach is not suitable for SAARC. The ASEAN approach, which is pragmatically moving toward two streams of integration, is more relevant, but it is not clear that even a two-stream approach will suit the diversity within SAARC because

- some markets are relatively less developed but are able to move toward integration more rapidly,
- some markets are relatively less developed but face internal constraints that will prevent them moving rapidly toward integration,
- some markets are more developed and are able to move toward integration more rapidly, and
- some markets are more developed but face internal constraints that will prevent them moving rapidly toward integration.

In conclusion, SAARC markets should each move toward integration at a pace that suits their individual levels of development and the obstacles they face; ie., from different starting points, at different speeds, with a common goal. It is not practical to draw up a rigid plan for capital market integration within SAARC in which all member countries arrive at the same point at the same time. However, much can be done to mitigate the barriers, increase awareness, harmonize standards, and assist the less developed markets. The recommendations of this study are designed to allow the SAARC countries to move toward the integration goal in a way that recognizes the different starting points and differing speeds with which they can progress.

X. Recommendations

The recommendations follow from an acceptance that greater harmonization and integration of the SAARC markets would be beneficial for the countries of the region. They comprise a set of actions that have a reasonable prospect of being implemented. The analysis has identified seven significant barriers to greater harmonization and integration of SAARC capital markets:

(i) lack of information and interest in other SAARC markets, combined with a lack of opportunities and structures through which the various markets can learn from each other's experience;

(ii) barriers to movement of capital within the region as a result of exchange control restrictions and the stifling effect this has on views about prospects for regional integration;

(iii) absence of any explicit policy objective toward harmonization and of common basic standards, leading to a failure of regulators to consider how far their regulatory policies are congruent with those of other regulators in the region;

(iv) perception of significant differences in the regulatory and enforcement capacity of the markets in the region, which are a deterrent to cross-border and external investors;

(v) small capital markets that may have difficulty sustaining the expenditure on the systems and regulatory resources expected of a participant in a regional capital market;

(vi) low awareness of market developments and innovations including private sector initiatives in the region; and

(vii) lack of commercial imperatives and skills in some of the stock exchanges leading to slowness to innovate and address strategic weaknesses.

The following recommendations address these barriers. There is an overarching need, which is reflected in all seven barriers, for a regional entity charged with responsibility for developing the regional capital market. The final recommendation proposes and describes the role of such an organization.

A. Initiate a Program for Information Exchange, and Development and Formation of a Capital Markets Lobby

Three features are a notable lack of (i) awareness of developments in other SAARC markets, (ii) regular contact between the participants in the markets, and (iii) political impetus for greater harmonization and integration. The recommendation is to institute a program of contacts with the aims of increasing information exchange between SAARC capital markets; encouraging greater information exchange between different types of participant including regulators, practitioners, and policy makers; and developing a regional policy on key development issues leading to a "SAARC capital market viewpoint."

The program would consist of a series of regular contacts between the SAARC capital markets. An effective and straight-forward way of starting such a program would be to initiate regular meetings of regulators. However, the process of integration must involve a wide range of stakeholders in consultation and decision making, including regulators, central banks, governments, market practitioners, and infrastructure providers; so a regulators' forum, while very helpful, is only a first step. The regular regulator and wider group contacts would be theme-driven, i.e., they would assess policy issues, make recommendations, and agree and follow up on action points. The participants in the group should include a mix of regulators, policy makers, and practitioners. The participants should not change frequently to allow a level of stability within which regional relationships can be built up.

The program should be used to produce evidence-based material and clearly thought-through policies that can be used in each SAARC market to influence policies and champion capital markets as a valuable part of economic development. Such a forum would bring significant benefits in increased understanding and could be initiated quickly.

B. Formulate a Common Policy on Exchange Control Relaxation

Although exchange control is gradually being relaxed in India and Sri Lanka, it remains a significant barrier to market integration. Without some relaxation of exchange control, SAARC capital market integration is probably impossible. Its very existence imparts an air of impossibility to any discussions and so has stifled discussion of integration.

Exchange rate policy is an important determinant of the exchange control stance of the country because it is closely linked to macroeconomic conditions and policies. Smaller markets are concerned about capital flight related to capital market flows. However, there should be a two-way interaction, with capital market integration policies being drawn up in a way that is mindful of the requirements of monetary and exchange rate policy, and exchange control policy being drawn up in a way that is mindful of its impact on capital markets.

Central banks are responsible for exchange control and use it to achieve their specific policy objectives, in particular, protection of the exchange rate against capital flight and protection of domestic industry. The capital market will only ever be one of many interest groups wishing to change exchange control policy. This makes it incumbent upon the capital markets to work with the central bank to relax controls where possible and to mitigate the negative effects on controls when relaxation is not possible. The forum should take a leading role in managing these discussions and supporting the capital market case. It should draw upon the experiences of other SAARC countries, as well as the policies that have been tried, so as to help the central bank to pursue its goals in ways that minimize negative impacts on the capital market.

C. Make Harmonization a Policy Aim and Set Basic SAARC Standards

There is already harmonization in terms of structure, rules, and standards. However, the appearance to an investor who does not investigate the situation in detail is of an uncoordinated set of disparate rules. The European approach of writing and legislating minimum standards through directives is not appropriate for SAARC because it would require intergovernment cooperation leading to international treaties. An alternative approach is to use the proposed regulators' forum to write baseline SAARC standards in key areas of capital market regulation—prospectuses, disclosures, market transparency, market abuse, and corporate governance.

Initially, these would be based on what is already in place—a lowest common denominator approach; but gradually the standards could be raised. The existence of common standards would encourage national regulators, who should include a harmonization objective in their regulatory actions, to strive to ensure that new regulations conformed to the harmonization objective.

D. Support Improvements in Regulator Capacity

While there is some harmonization in structural terms, there are thought to be wide variations in the standards of enforcement. Market participants believe there is pervasive market abuse and generally poor disclosure. Most markets are now equipped with the basic technology to allow them to regulate their markets and enforce rules to an acceptable standard. If they do not carry out proper enforcement, the likely reason is that they lack the staff capacity to do so.

Two activities are recommended. First, provide further capacity building assistance. India, in particular, has supported regional markets with capacity building and other assistance. This has been provided through the Securities and Exchange Board of India (SEBI) and the major Indian exchanges, and has focused on strengthening regulatory skills and developing market systems. Second, measure the effectiveness of enforcement through statistical measures that could be used to report on the enforcement performance of each of the SAARC markets. In the initial stages, the results should not be published. However, the results, including a anonymous comparisons, would form a valuable benchmark for regulators wishing to raise performance.

A further area where capacity needs to be greatly enhanced is financial literacy. If the population of the SAARC region is to make use of the opportunities that capital markets provide for better investment of their long-term savings, it is important that they understand what they are entering into. Encouraging involvement of the population without providing for financial literacy has often proved to be a disaster, as unsophisticated participants are drawn into market which they understand poorly, and where they suffer unsustainable losses. Ensuring financial literacy is, in many countries, a statutory responsibility of the national regulator; and that is generally accepted as the correct place for that responsibility. National regulators often delegate some part of the implementation of financial literacy to, for example, the stock exchange, although the regulator remains accountable for seeing that implementation is effective. Most SAARC regulators are at a relatively early stage in developing financial literacy, and there is considerable scope for assistance through capacity-building regional workshops on financial literacy.

E. Help Small Markets Develop Sustainable Business Strategies

SAARC has some very small markets and it is unlikely that these will become large. Smaller markets face particular risks in moving to integrate with regional markets, such as migration of investment business to larger markets. But equally, integration offers opportunities for smaller markets, such as the ability to broaden their offering through links with larger markets. There are no examples of national markets being abolished or failing to survive as a consequence of regional integration. However, the ongoing challenge for smaller markets, which is independent of the degree of regional integration, is that they may be unable to generate adequate revenue to cover the costs of essential regulation, trading facilities, settlement, and other infrastructure. If stock exchanges fail to develop adequately because of lack of revenue, then they may be unable to meet the investment or fund-raising needs of their countries, which will lead to slower development.

Some functions in capital markets benefit from economies of scale. In addition to the cost savings, larger markets have higher liquidity. Small markets will only have low trading volumes, so transaction costs will be higher. There is an argument that those functions where there are economies of scale gains and/or liquidity gains should be provided in a way that allows those economies to be captured. This might mean outsourcing or sharing a trading or settlement function.

A clear and realistic examination is needed to establish whether there are the opportunities for outsourcing some of the activities of smaller markets without compromising their independence. There should be assessments of the potential for smaller markets to combine some of their activities with those of larger markets while still retaining operational, commercial, and regulatory independence. There should also be an examination of the problem of large issuers and investors located in countries with smaller markets. This must allow them to access the regional capital market while retaining a sustainable role for the local market. There should be an investigation of alternative business opportunities to increase the sustainability of stock exchanges in smaller markets, such as developing niche positions or diversifying their product range. There are many viable small exchange models outside the region and a study of these would provide indications of development paths. Finally, plans should be drawn up detailing the assistance that can be given within the region to sustain smaller markets and maintain diversity while being consistent with the commercial needs of larger regional markets.

F. Be Aware of and Support Private Sector Initiatives

Much of the development of capital markets is driven by private sector initiatives. This is as true of integration as it is of other developments. Earlier discussion of the country funds and fund of funds provides an example of how integration could be driven almost entirely by private sector initiative.

Regulators must attempt to understand the needs of the private sector and should not to act in an excessively cautious way that crushes any such ideas before they can be developed. This is one of the reasons why it is so critical to have market participants involved in the proposed regulators' forum. It is hoped that greater understanding will support a flexible approach to novel proposals of benefit to the market.

G. Improve Commercial Imperatives and Skills in Stock Exchanges

Commercial imperatives and skills in stock exchanges need to be improved by privatizing them or, if that is not feasible, imposing commercial discipline. The track record of stock exchanges has demonstrated that the more commercially driven a stock exchange is, the more likely it is to serve its users well by innovating, regulating firmly, and controlling costs. Demutualization or privatization can achieve this, but some of the SAARC exchanges may not be large enough to support themselves at this stage in their development.

In some of the exchanges there is a shortage of fundamental commercial skills and knowledge of the stock exchange business in the wider world. This is undoubtedly slowing the process of demutualization and, unless remedied, is likely to lead to problems in the longer term.

H. Set up a Regional Body to Support Capital Market Harmonization and Development

If the harmonization and integration goals are to be achieved, then an independent capital market body is required to champion and support this. It is proposed that the regional body should be called the SAARC Capital Market Integration Group (CMIG).

It is further proposed that it should be set up as part of the existing SAARC Secretariat in the same way as the Financial Integration Division for the Association of Southeast Asian Nations (ASEAN) is incorporated as part of the ASEAN Secretariat. The remit of the CMIG would be to support actions leading to capital market integration across the SAARC region and it would be specifically accountable for the work streams. The remit of the SAARC Secretariat would need to be broadened to incorporate this new activity. It is unlikely that the resources could be generated within the region. Therefore, support from an external development assistance agency could be required. Funding would be for a pre-agreed period based upon a plan drawn up by SAARC to achieve specified work streams. The CMIG would be accountable to the SAARC Board, and the SAARC Board would report on progress to the development assistance agency.

The CMIG's activities would center on the following work streams based on the recommendations of this study:

- Initiate and maintain a program to exchange information between market participants in the SAARC region. The main feature would be a series of regular contacts involving a wide range of market participants, including those from the private sector, to discuss issues of common interest. The discussions would be managed and structured in a way that ensures that actions are agreed upon and followed up. The regional body would act as a lobbyist to promote agreed-upon policies.
- Work with central banks and other authorities in the SAARC region to draw up a strategy to reduce the damaging effects of exchange controls on the regional capital market. Such a strategy would address the needs of the authorities to protect their currencies and reserves. Part of the task would involve championing the cause of relaxation and building up support.
- Encourage regulators to adopt objectives that recognize the benefits of harmonization. The task would involve drawing up common standards and codes of practice to be adopted by SAARC regulators. These would be a voluntary version of the kinds of directives adopted in the European Union (EU).
- Develop capacity building programs for regulators involving exchange of staff and specific assistance. The programs should cover the basic regulatory activities, such as market surveillance; the more general skills, such as consultation with users; and the setting up of financial literacy programs.
- Assist the smaller exchanges in drawing up viable and sustainable business models involving, where appropriate, outsourcing and sharing of facilities, but not compromising their independence.
- Develop links to private sector participants in the capital market through including them in the information exchange programs described with the aim of involving the private sector in the decisions affecting the regional markets and gaining knowledge of current thinking among practitioners.

- Set up an information exchange on privatization or demutualization of stock exchanges, and assist stock exchanges in developing sound business practices and business models.

The CMIG would, under the purview of the SAARC Secretariat, work to produce a road map with milestones appropriate to each country's capital market development aspirations.

The CMIG would require staff resources to achieve the tasks described. It would draw upon resources from other entities in the region, including the South Asian Federation of Exchanges (SAFE), the regional trade association whose objectives of harmonization and regionalization are congruent with the objectives of the CMIG, as well as stock exchanges and regulators. Some such assistance already takes place within the region and it is proposed to continue such assistance in a way that is targeted toward the goal of integration.

The staff of the CMIG would be mainly engaged in project management, management of working groups, and public relations activities to drive forward the integration agenda, in particular promoting the agreed programs and policies. Organizations such as the World Federation of Exchanges (WFE) fulfill these activities with small permanent staffs: the WFE has a staff of 9 and a membership of 70. The secretariat for SAARC capital market integration should be of a similar size.

XI. Final Remarks

The purpose of this report was to examine the level of harmonization among SAARC capital markets, identify barriers to greater integration, and propose recommendations that could ease the path to greater integration. Integration of capital markets—a situation where there are no barriers to movement of capital or barriers to cross-border provision of investment services within a region—brings considerable benefits, including lower costs, higher standards, more choice for investors, greater liquidity, and faster innovation. Capital markets that are generally more efficient are better able to support the mobilization of savings and national development.

Harmonization of capital market regulations and structures is an important step toward integration, but it does not bring the same benefits. Developing markets have made considerable strides toward harmonization, which has generally meant harmonization toward international best practice. The effect has been to make them more attractive to investors from developed markets. However, it has not led to an increase in intraregional capital flows. This is true in ASEAN and SAARC, and was the case until relatively recently in the EU. Recognizing the benefits, the EU has substantially integrated its capital markets, the ASEAN nations have embarked on a program leading to integration, and there is progress among African nations toward regional integration.

The research and fieldwork carried out for this report identified key features of the SAARC markets. First, it was quickly apparent that there is considerable divergence among the SAARC capital markets in terms of their level of development and size. This feature will clearly affect the path toward integration and the speed of progress. Most of the markets are largely closed to foreign involvement, including that of other SAARC countries. It is possible, in most cases, for foreign investors to invest in domestic stocks, but it is not possible for domestic companies to access foreign capital markets or for foreign intermediaries to operate in domestic markets. Combined with exchange controls, which are prevalent, although some have relaxed somewhat in recent years, the result is that other SAARC countries are not seen as feasible investment destinations for SAARC investors. Therefore, foreign investment has come almost exclusively from outside the region, and when SAARC investors look abroad they look to developed markets. The closed nature of many of the markets has led to a slowness to innovate and to develop high standards of regulatory enforcement, despite the adoption by most markets of regulatory models based on international best practice. This, together with exchange rate controls, has led investors from outside the region to view SAARC investments as marginal to their portfolios and liable to be withdrawn at short notice.

One consequence of the closed nature of SAARC markets is the absence of a strong drive for integration. It is widely regarded as something that is impossible to achieve because the barriers are too strong. There are also vested interests that benefit from the status quo or that fear the impact of integration on their business. The report makes seven recommendations to address the barriers to integration, ranging from formulation of a nonthreatening policy to reduce exchange control barriers to encouraging a more market-focused approach for stock exchanges. However, these recommendations are unlikely to be implemented unless there is a change in thinking among market participants and they come to believe that integration is likely to benefit the markets and is achievable.

One thing is clear is that the diversity within SAARC means that integration cannot go forward at the same pace for all member countries. This has been recognized in ASEAN, where a two-speed solution is proposed, and for SAARC the diversity suggests the need for a multispeed approach. However, it is also clear is that there is a lack of common understanding among market participants and a lack of drive for a policy of greater integration. A key recommendation is for the creation of a regional body with a specific mandate of working to reduce barriers to integration, increase understanding between the participants in the SAARC capital markets, and champion a drive for integration. Without this, integration will remain in the "too difficult" pile; but with proper drive progress is possible and the SAARC countries can reap the benefits of far more effective capital markets.

Appendix
Note on Stock Market Metrics

A. Data Sources

The basic metrics collected for stock exchanges are the (i) number of listed companies, (ii) total market value of the listed companies at year end, (iii) turnover or trading value of the listed companies during the year, (iv) number of brokers in a country, and (v) number of exchanges in a country.

There is considerable difficulty in gathering basic data (number, market value, and turnover of listed companies) on stock exchanges in the South Asian Association for Regional Cooperation (SAARC) region. The four possible data sources are the exchanges, the regional exchange organization, the World Bank, and the World Federation of Exchanges. Some of the data presented are not completely reliable or wholly consistent. However, they represent an estimate of the order of magnitude of each market. The problems associated with each data source as follows:

- **The exchanges.** Many of the exchanges do not provide historical statistical information.
- **The regional exchange organization.** Unusually for a regional organization, the South Asian Federation of Exchanges does not provide statistical data.
- **The World Bank.** World Bank statistics are based on data supplied by Standard and Poor's. The data are often inconsistent with other sources and are subject to major revisions. For example, the market value for Bangladesh at the end of 2010 was recently revised from $47,000 million to $15,683 million.[1] The World Bank no longer provides turnover figures in US dollars but as a turnover ratio, i.e., the total value of shares traded as a percentage of market value. Thus, turnover value (in US dollars) has to be estimated using the ratio and the market value. There are also no data available on Bhutan and the Maldives, and on the number of brokers.[2]
- **The World Federation of Exchanges.** World Federation of Exchanges (WFE) data are sourced directly from the exchanges. The WFE has set standards for calculation that the exchanges are expected to follow to ensure consistency. Only 3 of the 11 SAARC exchanges are members of the WFE (the National, Bombay, and Colombo stock exchanges). Overestimation of listed companies and market values is a possibility for countries, such as India, that have multiple exchanges and stock listed on more than one of the exchanges. The WFE does not give data on number of brokers.

[1] Data from the Chittagong Stock Exchange suggest that $47,000 million was closer to the actual total.
[2] There are also no data on Afghanistan, where there are currently no data to collect.

The preference is to use World Bank figures for the basic data, provided that they do not deviate significantly from other data sources. Table A.1 summarizes the available data sources for each of the SAARC members (excluding Afghanistan). Tables A.2–A.4 provide information from the three sources used, and tables A.5–A.7 provide a comparison of the data.

Table A.1: Sources of Capital Market Data for SAARC

SAARC Member	Exchange	Exchange Website	Regional Organizations	WFE	World Bank	Notes
Bangladesh	Chittagong Stock Exchange	2012 data available	No	No	World Bank gives Bangladesh figures	Companies are required to list on both exchanges so number and market value should be same
	Dhaka Stock Exchange	2012 data available	No	No		
Bhutan	Royal Stock Exchange of Bhutan	2012 data available	No	No	No	
India	Bombay Stock Exchange	2012 data available	No	Yes	World Bank gives India figures	Major companies are listed on both exchanges (by choice); BSE lists many more of the smaller companies
	National Stock Exchange		No	Yes		
Maldives	Maldives Stock Exchange	Market value and turnover value from annual reports of CMDA and MMA.	No	No	No	The number of companies is small so data can be estimated
Nepal	Nepal Stock Exchange	2012 data available from monthly reports	No	No	No	Nepalese months start from approximately the middle of conventional months
Pakistan	Karachi Stock Exchange	No historical data	Yes—FEAS[a]	No	World Bank gives Pakistan figures	Karachi lists the most companies. Few, if any, stocks are listed solely on the other exchanges
	Lahore Stock Exchange	No historical data	Yes—FEAS	No		
	Islamabad Stock Exchange	2011 market value and number of companies data from daily summaries	No	No		
Sri Lanka	Colombo Stock Exchange	No data	No	Yes	World Bank gives Sri Lanka figures	

BSE = Bombay Stock Exchange, CMDA = Capital Markets Development Authority, FEAS = Federation of Euro-Asian Stock Exchanges, MMA = Maldives Monetary Authority, SAARC = South Asian Association for Regional Cooperation, WFE = World Federation of Exchanges.

[a] The FEAS covers mainly Eastern Europe and the Middle East. The Karachi and Lahore stock exchanges are members.

Source: Authors' analysis.

Table A.2: **World Bank Data, 2012**

SAARC Member	Number of Listed Companies	Market Value ($ million)	Equity Turnover Value ($ million)
Bangladesh	229	17,479	10,693
Bhutan	…	…	…
India	5,191	1,263,335	690,216
Maldives	…	…	…
Nepal	216	4,160	51
Pakistan	573	43,676	13,675
Sri Lanka	287	17,046	1,565

… = not available, SAARC = South Asian Association for Regional Cooperation.

The turnover is estimated using the turnover ratio and the end-of-year market value. The World Bank also gives a figure for turnover as a percentage of gross domestic product. Money value estimates using this ratio and the gross domestic product figures give results that are substantially different to other figures and so are not used.

Source: Authors' analysis.

Table A.3: **World Federation of Exchanges Data, 2012**

SAARC Member	Number of Listed Companies	Market Value ($ million)	Equity Turnover Value ($ million)
Bangladesh	…	…	…
Bhutan	…	…	…
India	BSE 5,191 NSE 1,665	BSE 1,263,336 NSE 1,234,492	BSE 106,726 …
Maldives	…	…	…
Nepal	…	…	…
Pakistan	…	…	…
Sri Lanka	287	16,974	…

… = not available, BSE = Bombay Stock Exchange, NSE = New Stock Exchange, SAARC = South Asian Association for Regional Cooperation.

Source: Authors' analysis.

Table A.4: Exchange Website Data, December 2012

SAARC Member	Number of Listed Companies	Market Value ($ million)	Equity Turnover Value ($ million)
Bangladesh	CSE … DSE 242	CSE 22,489 DSE 22,206	CSE 1,466 DSE 12,475
Bhutan	20	322	4
India	BSE 5,191 NSE 1,665	BSE 1,266,620 NSE 1,234,776	BSE 107,394 NSE 513,129
Maldives	6	504	0.1
Nepal	221	5,372	161
Pakistan	573	43,673	11,266
Sri Lanka	287	17,024	1,682

… = not available, BSE = Bombay Stock Exchange, CSE = Chittagong Stock Exchange, DSE = Dhaka Stock Exchange, NSE = New Stock Exchange, SAARC = South Asian Association for Regional Cooperation.

Source: Authors' analysis.

Table A.5: Data Comparison: Number of Companies

SAARC Member	World Bank	WFE	Stock Exchange	Conclusion
Bangladesh	229	…	CSE … DSE 242	World Bank: 229
Bhutan	…	…	20	Stock Exchange: 20
India	5,191	BSE 5,191 NSE 1,665	BSE 5,191 NSE 1,665	World Bank, WFE, Stock Exchange: 5,191
Maldives	…	…	6	Stock Exchange: 6
Nepal	216	…	221	World Bank: 216
Pakistan	573	…	573	World Bank: 573
Sri Lanka	287	287	287	World Bank, WFE, Stock Exchange: 287

… = not available, BSE = Bombay Stock Exchange, CSE = Chittagong Stock Exchange, DSE = Dhaka Stock Exchange, NSE = New Stock Exchange, SAARC = South Asian Association for Regional Cooperation, WFE = World Federation of Exchanges.

Source: Authors' analysis.

Table A.6: **Data Comparison: Market Value** ($ million)

SAARC Member	World Bank	WFE	Stock Exchange	Conclusion
Bangladesh	17,479	…	CSE 22,489 DSE 22,206	World Bank: 17,479
Bhutan	…	…	322	Stock Exchange: 322
India	1,263,335	BSE 1,263,336 NSE 1,234,492	BSE 1,266,620 NSE 1,234,776	World Bank, WFE: 1,263,335
Maldives	…	…	504	Stock Exchange: 504
Nepal	4,160	…	5,372	World Bank: 4,160
Pakistan	43,676	…	43,673	World Bank: 43,676
Sri Lanka	17,046	16,974	17,024	World Bank: 17,046

… = not available, BSE = Bombay Stock Exchange, CSE = Chittagong Stock Exchange, DSE = Dhaka Stock Exchange, NSE = New Stock Exchange, SAARC = South Asian Association for Regional Cooperation, WFE = World Federation of Exchanges.

Source: Authors' analysis.

Table A.7: **Data Comparison: Equity Turnover** ($ million)

SAARC Member	World Bank	WFE	Stock Exchange	Conclusion
Bangladesh	10,693	…	CSE 1,466 DSE 12,475	World Bank: 10,693
Bhutan	…	…	4	Stock Exchange: 4
India	690,216	BSE 106,726	BSE 107,394 NSE 513,129	World Bank: 690,216
Maldives	…	…	0.1	Stock Exchange: 0.1
Nepal[a]	51	…	161	World Bank: 51
Pakistan	13,675	…	11,266	World Bank: 13,675
Sri Lanka	1,565	…	1,682	World Bank: 1,565

… = not available, BSE = Bombay Stock Exchange, CSE = Chittagong Stock Exchange, DSE = Dhaka Stock Exchange, NSE = New Stock Exchange, SAARC = South Asian Association for Regional Cooperation, WFE = World Federation of Exchanges.

[a] The exchange data was calculated from monthly fact sheets on the website. World Bank data were used for consistency since equity turnover values for other countries were taken from World Bank.

Source: Authors' analysis.

B. Brokers and Exchange Numbers

Exchanges do not generally give a statistic for the number of brokers, but they usually provide a list of members. However, where a country has more than one exchange there is likely to be some overlap of membership. Figures were calculated from a range of sources by the consultants. Usually an exchange lists its current members, so the figures are for the date when the calculation was done, i.e., early 2012, rather than for an end-of-year date. Where a country has multiple exchanges, specific solutions were devised by the consultants:

- Bangladesh: Dhaka Stock Exchange has 238 members and Chittagong Stock Exchange has 147. An exact name comparison showed that 36 firms are members of both exchanges, giving 349 individual broking firms.
- India: Brokers are licensed for different subsections of the market, e.g., the cash market or the equity derivatives market. India has 19 exchanges all of which have members, giving a total of 8,804 memberships in 2010.[3] Only two exchanges, the New Stock Exchange (NSE) and the Bombay Stock Exchange, do any significant trading. The NSE has 1,175 members and the Bombay Stock Exchange has 1,003. Almost all firms that are members of one of the two main exchanges are members of both. Therefore the estimate used is based on the NSE membership of 1,175.
- Pakistan: The Securities and Exchange Commission of Pakistan gives a single figure for licensed brokerage firms of 264.

Table A.8: **Final Data Summary**

Equity Market Size—SAARC Countries					
SAARC Member	Number of Listed Companies	Market Value ($ million)	Number of Brokers	Number of Stock Exchanges	Equity Turnover Value ($ million)
Bangladesh	229	17,479	357	2	10,693
Bhutan	20	322	3	1	4
India	5191	1,263,335	1,269	2	690,216
Maldives	6	504	4	1	0.1
Nepal	216	4,160	60	1	51
Pakistan	573	43,676	261	3	13,675
Sri Lanka	287	17,046	29	1	1,565
Total	**6,496**	**1,346,523**	**1,983**	**11**	**716,204**

SAARC = South Asian Association for Regional Cooperation.

Notes:

1. Exchange rates used for computation: Bhutan: $0.018/Nu, Maldives: $0.065/Rf, and Pakistan: $0.01/PRe. Exchange rates are end of period.
2. Numbers may not sum precisely because of rounding.

Source: Authors' analysis.

[3] Securities and Exchange Board of India. Handbook of Statistics of the Indian Securities Market. www.sebi.gov.in/sebiweb/home/list/4/32/0/0/Handbook-of-Statistics

Development of Capital Markets in Member Countries of the South Asian Association for Regional Cooperation

The globalisation of capital markets has encouraged moves toward regional harmonization and integration. This report examines and compares the level of development of capital markets in the South Asian region, assesses the prospects for greater harmonization and integration, and proposes a set of measures to move that process forward. The study of the markets shows wide variations not only in market size but also in the standards of regulation and general development.

The level of integration and harmonization of South Asian capital markets is low. There are major barriers including exchange controls, ownership restrictions, and differences in regulatory standards and enforcement capacity. The proposals address some of these barriers and include measures to promote awareness, stimulate innovation, raise regulatory standards, and champion the value of integration.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two-thirds of the world's poor: 1.7 billion people who live on less than $2 a day, with 828 million struggling on less than $1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

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