



*Strengthening Financial Sectors*

**Supplementary Report on Cross Border Listings  
for the  
South Asian Federation of Exchanges**

**R303**

**Developing Model Listings Regulations**



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**Acronyms, Abbreviations and Notes**

|      |  |
|------|--|
| ADR  | American Depositary Receipts                   |
| BSE  | Bombay Stock Exchange                          |
| CDS  | Clearing Depository System                     |
| CSE  | Colombo Stock Exchange                         |
| DR   | Depository Receipt                             |
| DSE  | Dhaka Stock Exchange                           |
| FX   | Foreign Exchange                               |
| GDR  | Global Depository Receipt                      |
| ISE  | Islamabad Stock Exchange                       |
| KSE  | Karachi Stock Exchange                         |
| LSE  | Lahore Stock Exchange                          |
| MOU  | Memorandum of Understanding                    |
| NSE  | National Stock Exchange, India                 |
| RBI  | Reserve Bank of India                          |
| SAFE | South Asian Federation of Exchanges            |
| SEBI | Securities and Exchange Board of India         |
| SECP | Securities and Exchange Commission of Pakistan |

# Executive Summary

## ***Introduction***

This report supplements the Final Report in Phase 2 of the SAFE project on “Developing Model Listings Regulations” and seeks to tie together the recommendations in the Phase 2 Final Report with SAFE’s ongoing Harmonization of Listing Rules project.

## ***Overall Conclusions in Final Report***

The Final Report highlights the fact that significant restrictions on cross border linkages currently exist – primarily in the areas of foreign exchange controls and restrictions on inward foreign investment. Although these restrictions are being lifted gradually, there is a general lack of market inter-linkages at this stage and very limited interest in any form of cross border listing and/or trading within the SAFE member countries.

## **Demand for Cross Border Listing**

The primary research in the Final Report showed that there is very limited demand for cross border listings at this time. SAFE member exchanges are generally interested in having companies from other member countries to come and list on their exchange, but are not so keen to see domestic companies going to list in other countries.

However, each of the four countries visited have seen ADR/GDR issues by domestic companies. In the past, only India has had any success with DRs issued and listed overseas, but in the last 12 months Bangladesh, Pakistan and a Sri Lanka have seen companies successfully issue GDRs (with more issues planned).

In addition, the Final Report included examples of some early stage interest in cross border linkages:

1. Lanka IOC, the Sri Lanka subsidiary of a large Indian listed company has listed on the CSE;
2. recent newspaper reports suggest that Brandix, a Sri Lankan textile company, has opened a factory in India and is looking to list on the NSE in India as it becomes more Indian in outlook; and
3. Pakistani companies are now considering issuing DRs in Dubai and listing on the DIFX.

This Supplementary Report considers whether demand for cross border listings will increase if the existing obstacles are removed.

## **Demand for Cross Border Trading**

All of the SAFE member exchanges interviewed are interested in encouraging cross border trading. Obviously, they would like investors in neighbouring countries to be able to trade on their exchange.

A very low percentage of the population in each country (less than 5%) hold any form of securities and so there is very low demand for cross border investments at this time. To the extent that investors are looking overseas they are seeking diversification into Western markets, or the Gulf or South East Asia, rather than the neighbouring SAFE member countries.

## Current Hurdles Preventing Cross Border Listings

### Overall Summary



#### Current Hurdles to Cross Border Listing, by Country

| Hurdle   | Bangladesh | India                 | Nepal | Pakistan                             | Sri Lanka |
|--|------------|-----------------------|-------|--------------------------------------|-----------|
| Foreign Exchange Controls – Inward Investment  |            | Institutions only     | - 3   |                                      |           |
| Foreign Exchange Controls – Outward Investment | - 3        | - 3<br>US\$25,000 max | - 3   | - 3 (individuals)<br>- 3 (companies) | - 3       |
| Foreign Ownership Controls                     |            |                       | - 3   |                                      |           |
| Regulatory Restrictions                        | - 2        | - 2                   | - 2   | - 2                                  | - 2       |
| Legal Restrictions                             | - 2        | - 2                   | - 2   | - 2                                  | - 2       |
| Practical Restrictions                         | - 1        | - 1                   | - 1   | - 1                                  | - 1       |
| Harmonized Listing Rules                       | - 1        | - 1                   | - 1   | - 1                                  | - 1       |

**Key:** = Issues      = No/Limited Issues  
 3. Macro Political Issue; 2. Major Regulatory Issue; 1. SAFE Level Issue

### Foreign Exchange Controls

| Country           | Inflows   | Outflows   |
|-------------------|---|--|
| <b>Bangladesh</b> | Foreigners (both individuals and companies) may invest without restriction. 100% convertibility for proceeds of sale and dividends.   | Investors need State Bank approval to open a FX account.<br>Banga investors are only making limited investments in HK and US but none in SAFE region.  |
| <b>India</b>      | SCRA accounts allow only specific foreign institutions (FIIs) to invest in India with full convertibility of dividends and proceeds of sale. 30 day minimum holding period applies. Individuals may not open an SCRA account. | Individual Indian investors may now invest up to US\$25,000 per year outside India. The Remittance Scheme freely permits remittance for portfolio investment by individuals without restrictions. Mutual Funds may also invest |

|                  |  |  |
|------------------|--|--|
|                  | Indian companies are permitted to raise foreign currency resources through the issue of Foreign Currency Convertible Bonds (FCCBs) and/or issue of ordinary equity shares through Global Depository Receipts (GDRs)/American Depository Receipts (ADRs) to foreign investors i.e. institutional investors or individuals (including NRIs) residing abroad, with the prior permission of the Government of India, Ministry of Finance, Department of Economic Affairs, New Delhi. | outside India (to diversify their portfolio) up to US\$15 mil. or 25%.   |
| <b>Nepal</b>     | No mechanisms exist to enable foreign investment or assure convertibility for proceeds of sale and dividends.  | State Bank approval required for all outward investments.  |
| <b>Pakistan</b>  | SCRA accounts allow both individuals and foreign institutions to invest in Pakistan with full convertibility of dividends and proceeds of sale. No minimum holding period.   | Individual Pakistani investors are permitted to buy foreign exchange for any purpose, but main outflows are for real estate investments rather than for securities. Individual must apply to an Authorised Dealer for the foreign currency and the Authorised Dealer reports to the State Bank. The State Bank's F.E. Manual states that "Prior approval of the State Bank is now required for investment abroad by residents." Pakistani companies are not allowed to invest abroad without State Bank prior approval. State Bank is being more liberal with approvals, but over US\$5 mil requires ECC consent. State Bank is proposing opening up to allow mutual funds to invest overseas (as India has done) – 30% or US\$15 mil. |
| <b>Sri Lanka</b> | Share Investment External Rupee Accounts (SIERA) are fully convertible for companies and individuals   | All outward investments must be pre-approved by the MOF. Case-by-case approval process. Priority is  |

|  |   |  |
|--|---|--|
|  | (including Sri Lankan nationals overseas) | given to those investments that will generate FX |
|--|---|--|

## Restrictions of Foreign Investment

| Country           | Inflows  |
|-------------------|--|
| <b>Bangladesh</b> | No % limits except in some very limited sectors (e.g. forestry and arms manufacture)   |
| <b>India</b>      | Foreign investment is restricted in many sectors, but is being liberalised. The average is 49%, and ranges from 20% to 100% e.g. Banking and Telecoms companies can be up to 49% foreign owned and IT can be 100% foreign owned. |
| <b>Nepal</b>      | All foreign investment is restricted.  |
| <b>Pakistan</b>   | No restrictions on foreign investment (except in four specified sectors) but investors must report all holdings to the State Bank.   |
| <b>Sri Lanka</b>  | No percentage limits except in some very limited sectors (e.g. fishing, plantations and tourism – with a 40% limit).   |

## Regulatory Restrictions

Apart from the FX restrictions and foreign investment restrictions, there are some other major regulatory impediments to the development of cross border linkages.

For example, the Company laws and/or Listing Regulations of several countries require that a company must be incorporated in that country in order to be listed. For example, in Sri Lanka, Lanka IOC was able to list only because it is a subsidiary of IOC and is incorporated in Sri Lanka. The parent company, IOC, which is an Indian company, would not be able to list on the CSE. Similarly in Pakistan, the exchanges may only list domestically incorporated companies at the moment.

Similarly, broker members of the SAFE member exchange must be locally incorporated entities, although in most of the countries visited the domestic brokerage company could be 100% foreign owned.

In Pakistan, Section 62A of the Companies Ordinance states that a Pakistani company must obtain SECP approval for each issue of shares outside Pakistan.

## Practical Restrictions

In cross border trade the clearing and settlement issues are more complex than for domestic trades. This is because the investor must take delivery of the security in a foreign securities depository (CSD). This means that the investor must be linked, either directly or indirectly, to the foreign CSD. Because most institutional investors use a custodian the custodian must be linked to the foreign CSD or the domestic CSD must have an electronic link to its foreign counterpart. At the moment there are no such cross border links between CSD in the SAFE member countries.

Alternatively, securities may be deposited in a regional CSD that, unlike a purely domestic CSD, holds international securities from several countries and has electronic links to the domestic CSD in each of those countries. Again, there is currently no SAFE regional CSD.

In addition, settlement problems would arise from the differences across SAFE member countries in settlement cycles (the time between trade execution and settlement), which range from T+3 to T+7, and in domestic currencies. As a result, the highest cost of investing in cross border securities in the SAFE region will be the settlement costs.

Another practical restriction is that the regulators do not currently have comprehensive MOUs between countries. This leads to concerns about the level of regulation in each country and how regulators in one country could enforce their domestic regulations against a broker from another SAFE member country, assuming that brokers who are licensed in one member country are permitted to carry on business in other member countries.

Key issues that need to be addressed before cross border trading can develop include:

1. How to get simultaneous disclosure of company/price sensitive info on all markets?
2. Trading arrangements. What currency? Local or US\$?
3. Settlement arrangements – each market has different standards (T + 3 – 7). Could we establish a new central depository for cross border issues?
4. Markets have different holidays (some dates move based on when the moon is sighted).

## The Timetable For Change

Changes will take a long time, but unless SAFE starts the process now it will never achieve the liberalisations and enhancements that will make cross border linkages possible.

### Foreign Exchange Controls

Foreign Exchange controls are applied by governments as part of the macro economic policy. This means that SAFE can do no more than lobby for change, and hope that the macro economic fundamentals (e.g. level of foreign currency reserves) improve sufficiently to enable reform and liberalisation to occur.

This is likely to take 1 – 3 years in India, Pakistan and Sri Lanka and 2 – 5 years in Bangladesh and Nepal.

### Restrictions of Foreign Investment

Again, these controls are applied by governments as part of the macro economic policy. However, as noted in the Phase II Final Report, the South East Asian Region is opening up quickly, as a result of the globalisation of markets and the development of free trade zones.

Beneficial changes to liberalise these restrictions are likely to take 2 – 3 years in all SAFE member countries.

### Regulatory Restrictions

If the securities regulators in each SAFE member country become part of SAFE, then SAFE will be able to push harder for changes in these areas. However, some restrictions are built into national laws (e.g. the Companies Act in Pakistan), and changes in laws take time.

Beneficial changes in these areas could be achieved in the next 1 – 3 years.

## Practical Restrictions

These changes are mainly within the control of SAFE member exchanges.

Beneficial changes in these areas can be achieved over the next 1 – 2 years.

## Encouraging Cross Border Linkages through Harmonised Disclosure Norms

In the Phase I Report dated February 2004 on “Strengthening Stock Exchange Listing Regimes and Regional Harmonisation”, the first recommendation was as follows:

*“1. It is recommended that SAFE develops a set of listing harmonisation principles.”*

Given that there is not currently much demand for cross border listings, SAFE needs to consider how much time to devote to this process at this time.

It is clear that cross border linkages are almost impossible to develop whilst there are foreign exchange controls and foreign investment restrictions that effectively prohibit the free flow of capital between SAFE member countries.

However, once these macro barriers are removed, cross border linkages will continue to develop slowly, unless the SAFE member exchanges have made pro-active steps to facilitate such linkages. Harmonisation of listing regulations will be one major contribution to the creation of the “level playing field” that enables cross border linkages to develop quickly.

The Phase I Report concluded that SAFE should continue to promote harmonisation of listing regulations in the SAFE region, both to improve the quality of its domestic constituent markets, and also to contribute to efforts for the development of regional capital markets.

In particular the Report stated that these efforts will:

- Improve market quality: Improve the overall quality of the domestic capital markets operated by SAFE members by providing benchmarks for listing standards and information and knowledge-sharing opportunities amongst its member exchanges and thus encourage greater capital formation and investment opportunities within those countries.
- Encourage greater intra-regional cross-border investment in the SAFE region: Encourage greater investment by regional investors in the SAFE region through the greater exposure afforded by regional cross-listings.
- Encourage more investment by FII's: Encourage greater investment by overseas institutional investors in the economies of the SAFE member countries by encouraging adherence to international standards of listing regulations such as those espoused by IOSCO, overseas regulatory authorities and guidelines issued by industry representative bodies.
- Provide groundwork for regional investments trading initiatives: Develop the ground for wider regional capital markets development initiatives that ultimately could allow free trading of investments across the region as economies continue to liberalise.
- Take advantage of the commonality of legal traditions and heritage between SAFE countries. All the SAFE countries have the same official legal language (English) and should draw upon this to help in the ongoing process of shaping a legal and regulatory foundation for harmonisation and co-operative arrangements between SAFE exchanges.

As a result of this recommendation, SAFE member exchanges have commenced the process of setting standardized Listing Regulations for overseas companies to list in each market. Work originally started at the Regional Markets Committee meeting of SAFE held at the BSE in August 2005. The KSE, BSE, DSE and the stock exchanges in Nepal and Bhutan have already prepared a “comparative review” of their disclosures requirements. The CSE is in the course of completing the document on its listing rules. The idea is to establish a separate set of new, harmonized regulations that will enable the listing of an overseas company from another SAFE member country on any of the exchanges. Having harmonized disclosure rules will considerably reduce the cost for any company that wishes to list on more than one market in the SAFE region.

The Final Phase II Report makes the following recommendation for immediate action by SAFE:

*“SAFE should complete the Harmonization of Disclosure Norms project that was started in August 2005 and produce a set of new Listing Regulations that are agreed by each member exchange and submitted to the regulators in each country with a view to providing common disclosure standards for cross border listings in future;”*

This effort should continue because common disclosure and listing standards are an essential pre-condition to the development of cross border listings and because it will assist in raising the listing standards throughout the SAFE member countries.

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

The Final Phase II Report, therefore, made the following additional recommendations for immediate action by SAFE:

*“The securities regulators in each SAFE member country need to become part of SAFE,*

*The exchanges and regulators in each SAFE member country need to establish comprehensive MOUs between themselves and the exchanges/regulators in each of the other member countries, to provide for the proper regulation of cross border business, as it develops, and appropriate enforcement of those regulations across borders;*

*SAFE needs to actively lobby governments and state banks for liberalisation of foreign exchange regimes – at least to permit individuals to make cross border investments in securities that are listed in other SAFE member countries;”*

## **Including Dubai in SAFE**

The Final Phase II Report made the following recommendation for action by SAFE, in respect of Dubai:

*“Given the existing linkages and the growth in the Gulf region, SAFE should invite the DIFX and DGX to join SAFE.”*

This recommendation is based on the growth of Dubai as a regional financial centre and the fact that Dubai is now seeking to play a greater regional role through the launch of The

Dubai International Financial Exchange (DIFX) and the Dubai Gold & Commodities Exchange (DGCX). The DIFX web site states, as follows:

“An Exchange with International Standards

The Dubai International Financial Exchange (DIFX) aims to become the leading stock exchange between Western Europe and East Asia. It opened in September 2005.

It is unique in its region because its standards are comparable to those of leading international exchanges in New York, London and Hong Kong.”

The DIFX may therefore attract listings (either direct cross listings, or GDRs), issued by some of the largest issuers in India and Pakistan, but it is not looking to provide a market for the thousands of small and medium size listed companies in the SAFE member countries.

Accordingly, there is still a growing need for a regional market for these small and medium size companies, which the SAFE member exchanges can develop through greater cross linkages.

The stock market capitalization of listed companies in the four SAFE member countries visited is, in total, around US\$550 billion, which is around 1% of world market capitalization (approximately US\$50 trillion). Excluding India (US\$500 billion), these markets are just too small on their own to attract much global investment. There is therefore a need for more integration of these markets and a need to develop securities that cover the entire SAFE region, in order for them to compete effectively for global capital flows.

## Conclusion

Given the significant macro economic restrictions on cross border linkages that currently exist – primarily in the areas of foreign exchange controls and restrictions on inward foreign investment - there is a general lack of market inter-linkages at this stage and very limited interest in any form of cross border listing and/or trading within the SAFE member countries. Accordingly, SAFE needs actively to lobby governments and state banks for liberalisation of foreign exchange regimes – at least to permit individuals to make cross border investments in securities that are listed in other SAFE member countries.

SAFE should complete the Harmonization of Disclosure Norms project that was started in August 2005 and produce a set of new Listing Regulations that are agreed by each member exchange and submitted to the regulators in each country with a view to providing common disclosure standards for cross border listings in future. These new common standards will do two things:

1. facilitate cross border listings, once the macro economic hurdles have been overcome; and
2. assist immediately in raising the listing standards throughout the SAFE member countries.

Both the gradual removal of the macro economic hurdles and the harmonization of listing standards will help to encourage the development of cross border linkages (e.g. making it easier for companies like Lanka IOC to get listed).