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FINANCIAL SECTOR KNOWLEDGE SHARING

# TOOL TO CONDUCT CAPITAL MARKETS ASSESSMENTS IN DEVELOPING COUNTRIES

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## ACRONYMS

AT	Assessment Tool
CIS	collective investment scheme
CPSS	Committee on Payment and Settlement Systems
CRA	credit rating agency
EGAT	Bureau for Economic Growth, Agriculture, and Trade
FS SHARE	Financial Sector Knowledge Sharing Project
GDP	gross domestic product
IOSCO	International Organization of Securities Commissions
SME	small and medium-sized enterprise
SRO	self-regulatory organization

## INTRODUCTION

The United States Agency for International Development Bureau for Economic Growth, Agriculture, and Trade (EGAT) created the Financial Sector Knowledge Sharing Project (FS Share) to collaborate with USAID missions to develop effective and efficient financial sector programs that increase access to financial services and develop well-functioning markets worldwide. USAID awarded Chemonics International the FS Share delivery order under the Financial Sector Blanket Purchase Agreement. FS Share has a three-year period of performance, July 2008 through July 2011.

Through the FS Share, USAID EGAT and Chemonics International proactively collaborate with missions to identify financial sector priorities and develop strategies and programs for growing this sector. FS Share identifies financial sector best practices and aggregates them through model scopes of work, technical briefs, diagnostic tools, best practice case analyses, and other tools. The project then disseminates these technical deliverables to USAID missions to integrate into financial sector programming. On a case-by-case basis, FS Share can assist with implementation and connect mission staff to external resources on best practices. In response to mission demand, FS Share also delivers presentations and other knowledge-sharing endeavors.

### Objective of this TOOL

USAID EGAT developed the Capital Markets Assessment Tool (AT), which was derived from the Capital Markets Questionnaire for Equity and Corporate Debt Securities developed by Robert Strahota with support from USAID EGAT.

The objective of the AT is to conduct capital markets diagnoses in developing countries, based on a comprehensive questionnaire. The AT is designed to identify targeted technical assistance to develop and strengthen well-functioning public markets.

### FS Share Rapid Response Hotline

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To access the FS Share and EGAT assistance on any mission financial sector program, scope of work, or procurement questions, contact:

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The Capital Markets Assessment Tool and other technical materials on financial sector development are available on FS Share's Web site ([www.fsshare.com](http://www.fsshare.com)).

## **Purpose of the Capital Markets Assessment Tool**

The objective of the AT is to support assessment of a jurisdiction's markets for equity and corporate debt securities, with the intention of providing targeted technical assistance to develop well-functioning public markets. As used in this AT, an organized public market is a well-regulated market for equity or corporate debt securities that is open to retail and institutional investors and that is capable of performing effectively the functions normally associated with capital markets, including channeling savings into investments and offering reliable price discovery and liquidity. An organized public market provides companies with a cost-effective means of capital formation as an alternative to bank borrowing. It may be a securities exchange, automated trading system, or over-the-counter market.

## **Design and Methodology**

The AT was designed to be used independently to obtain and assess all information considered necessary for development and regulation of markets for equity or corporate debt securities. The tool also may be part of a broader financial sector assessment. In such circumstances, it may not be necessary to use some of the questions that pertain to topics addressed in other components of the broader assessment process.<sup>1</sup>

Because an assessment of the potential for development of a jurisdiction's capital markets requires an assessment of their regulation as well, the AT was designed so that it interfaces with, but does not duplicate, the questions included in the International Organization of Securities Commissions (IOSCO) methodology for Assessment of the Implementation of the IOSCO Objectives and Principles of Securities Regulation. To assess the adequacy of securities regulation in a jurisdiction, the assessor working on a best-effort basis should aim at obtaining answers to all of the questions in the IOSCO methodology.

The AT has four sections, as explained below. Sections 1 and 2 include questions intended to assess whether there exist, or it is realistic at present to attempt to develop, organized public markets for equity and corporate debt securities. Depending on the answer to this question, it may not be necessary to complete all of Sections 3 and 4.

### **Section 1: Current Markets**

The premise underlying Section 1 is that a critical mass of issuers and investors (or at least the potential for their development) is necessary for successful development of public markets for equity and corporate debt securities. Questions 1-12 in Section 1 are designed to enable the assessor to collect basic information to determine the current significance and financial viability of such markets and other markets that may affect development of such markets, the potential issuer base, and the potential investor base. These questions also require information about private markets for equity and corporate debt that may have a bearing on the development of

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<sup>1</sup> For example:

- a. Question 19 may be unnecessary if there is a Report of Observance of Standards and Codes conducted by the World Bank with respect to implementation of International Financial Reporting Standards and International Standards of Auditing.
- b. Question 20 may be unnecessary if the Organization for Economic Co-operation and Development or the World Bank is conducting a separate assessment of corporate governance in accordance with their respective methodologies.
- c. Question 28 may be unnecessary if a separate assessment of payments and settlement practices is conducted as part of an International Monetary Fund Financial Sector Assessment Program.

public markets in these securities, as well as information about the presence of informal markets or fraudulent securities transactions that will have to be addressed to effectively develop organized public markets.

## **Section 2: Preconditions – Country Commitment, Macro-Stability, and Transparency**

Even if the information obtained in response to the questions in Section 1 suggests that there exist, or that it may be realistic to attempt to develop, public markets for equity and corporate debt securities, three important country preconditions should be assessed before deciding whether to provide assistance to a country for development or improvement of such markets. These are: (1) a sufficient governmental commitment to capital market development; (2) macroeconomic conditions that will permit development and/or operation of such markets; and (3) the absence of corruption that is so pervasive as to prevent the operation of fair, orderly, and well-regulated markets in which investors will be willing to place their confidence. Questions 13-15 of Section 2 are intended to assess whether these preconditions are present.

## **Section 3: Legal and Regulatory Infrastructure Conditions**

If it is determined that the responses to the questions in Sections 1 and 2 are sufficient to warrant providing assistance in the development and/or improvement of a jurisdiction's markets for equity and corporate debt securities, Sections 3 and 4 should be completed.<sup>2</sup> Questions 16-23 of Section 3 are intended to assess the presence and adequacy of eight legal and regulatory infrastructure conditions. The satisfaction of all but two of these conditions should be viewed as essential for the development of equity and corporate debt markets. Two conditions — private civil remedies (Question 17) and self-regulation (Question 23) — should not be viewed as essential. A number of countries have successful markets for equity and corporate debt securities, particularly those with civil law jurisprudence, where private civil remedies and self-regulation are not present to any significant extent. There are also a number of other countries where the presence of these components has enhanced development and regulation of such markets so as to warrant assessment for these components in Section 3.

Where several of the legal and regulatory infrastructure conditions in Section 3 are absent, the information obtained in Section 3 should provide a basis for establishing priorities and devising an assistance strategy to address these shortcomings.

## **Section 4: Developing Market Components**

Questions 24-33 of Section 4 are intended to identify and prioritize market-development components that need to be addressed to optimally develop markets for equity and corporate debt securities.<sup>3</sup> At this stage in the assessment process, the assessor will have determined, based on the responses to the questions in Sections 1 and 2, that at least some forms of technical assistance to develop equity and corporate debt markets are warranted and, based on the responses to the

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<sup>2</sup> If it is determined that the goal of organized, public markets for such securities is problematic at the present time, but other forms of economic growth assistance may be warranted, there are individual questions in Sections 3 and 4 that may prove helpful in identifying and planning such assistance. For example, workable bankruptcy and insolvency laws (Question 22) are of critical importance to the financing of for-profit enterprises regardless of whether such enterprises are publicly owned. Similarly, venture capital and small and medium-sized enterprise (SME) financing (Question 24) are important enterprise building blocks, even in jurisdictions that may not be able to support viable public markets for equity and corporate debt securities.

<sup>3</sup> Question 33 regarding Islamic finance requires completion only for assessments in jurisdictions that require adherence to principles of Islamic finance or that wish to accommodate securities transactions that comply with Islamic finance.

questions in Section 3, whether legal and regulatory infrastructure conditions need to be addressed to proceed with market development. The completion of Sections 1-3 also should enable the assessor to reach some conclusions on how to proceed with market development that will affect whether all of the questions in Section 4 need to be addressed. Consider the following two examples:

- If it has been determined, based on responses in Section 1, that the number of viable issuers of equity or corporate debt securities is currently limited, but there is potential to increase the issuer base, obtaining answers to Question 24 (venture capital and SME financing to develop the issuer base) is more important than obtaining answers to Question 31 (developing collective investment schemes [CISs]), because until the number of viable issuers is increased, the inability to achieve portfolio diversification may make it impractical to develop CISs with diversified investment portfolios of domestic securities.
- If it has been determined, based on the responses to Section 1, that there is a small equity market with some potential for growth, but there is no corporate debt market, and it has also been determined in response to Question 14 that there is 15-plus percent inflation and the local currency may be devalued, obtaining responses to Questions 29 and 30 (corporate debt markets and credit rating agencies [CRAs]) will be less important than addressing other questions in Section 4 that may facilitate equity development, because it is unlikely that local currency corporate debt markets are feasible until macroeconomic conditions are stabilized.

## Completing the Assessment Tool

Perhaps the most critical decision to be made on use of the AT is which people and sources should be consulted to obtain reliable answers to the questions. Footnotes to the AT are intended to be of assistance in this regard. However, it is important to note that there is a significant degree of subjectivity and even a possible lack of completeness that may be reflected in responses when the people providing them are not wholly disinterested in the conclusions likely to be drawn from the responses. For example, the regulator may be the most logical party to answer questions regarding the law and regulations, but few regulators are likely to admit that they are doing an inadequate job. Similarly, market operators may be the best people to answer questions on market statistics and market development, but few market operators are likely to admit that they are not doing everything they could to develop a market.

For these reasons, an assessor should seek independent verification of responses provided. This may best be accomplished by also discussing the questions with

- Market participants, such as broker-dealers and institutional investors
- Issuers that are public companies and issuers that could access public markets but have chosen not to do so
- Attorneys and accountants who handle capital market transactions

Subject to the above caveat, it should be possible for an assessor to complete at least preliminary responses to many of the questions in Sections 1 and 2 before arriving on site, either by forwarding the AT to local authorities in advance or by consulting data that are publicly available on regulator or market participant's Web sites, as well as some databases referred to in the AT. Increasingly, regulators and principal market institutions are providing information on their Web sites in English as well as the jurisdiction's official language.

The assessor also may save time and duplicative effort by inquiring in advance whether there is already available current, reliable documentation that covers some of the information required by the AT.<sup>4</sup> As noted above, the AT is intended to interface with the questions used in the IOSCO methodology to assess implementation of the IOSCO principles. Accordingly, even if a third-party assessment of self-assessment regarding implementation of the IOSCO principles has not been conducted, the questions in the IOSCO methodology referred to in Sections 3 and 4 of the AT should be addressed as early as practicable in the assessment process. Although the answers to the questions in these sections are critical to whether there is potential for development of organized public markets for corporate equity and debt securities, it should not be necessary to engage in the benchmarking process envisioned by the IOSCO methodology unless, of course,

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<sup>4</sup> Examples of this type of documentation include Financial Sector Assessment Program reports or International Monetary Fund Reports of Observance of Standards and Codes that may have been conducted in the jurisdiction. The most relevant of these standards for assessment of capital markets regulation are: the IOSCO principles, International Accounting Standards, International Financial Reporting Standards, International Standards of Auditing, Organization for Economic Co-operation and Development Principles of Corporate Governance (OECD principles), Committee on Payment and Settlement Systems (CPSS)-IOSCO Core Principles for Securities Settlement Systems and Central Counterparties, Forty Recommendations of the Financial Action Task Force (anti-money laundering), and the Basel II capital adequacy provisions under the Core Principles for Effective Banking Supervision, insofar as the Basel II provisions are applicable to financial intermediaries engaged in securities activities. Here again, the value of such documentation will depend on how current it is, as well as the experience and competence of those who compiled the information.

the AT is being used as part of a World Bank-International Monetary Fund Financial Sector Assessment Program or IOSCO self-assessment. Performing a self-assessment before the assessor's on-site work will provide answers to many questions, at least from the perspective of the local authorities, although the assessor probably will have to verify and clarify some of the answers before or after arrival.

Finally, in addition to obtaining answers to the questions, it is advisable to obtain complete copies of legislation, regulations, market, depository and other governing instruments, rules and procedures, rules of professional associations, and codes dealing with and documenting the issues covered in this AT (electronic or paper versions in the jurisdiction's official language and in English, if available). It is important in this regard to ensure that the responses obtained to legal and regulatory questions are documented in laws and regulations.

## SECTION 1: CURRENT MARKETS

1. **Markets.** For each market in the country that trades equities, debt securities, or derivatives on equity or debt securities, determine:
  - a. The name of the market
  - b. The ownership and governance structure of the market (government-owned, member-owned, private ownership, publicly owned, informal unregulated markets)
  - c. The types of securities traded (if applicable, include types other than equity or debt, such as collective investment schemes, asset-backed securities, sovereign or sub-sovereign debt, or national bank notes)
  - d. The basis of participation in the market, for example:
    - i. Whether membership/direct access is open to banks, non-bank brokers, and dealers
    - ii. Whether membership/direct market access is open to investors or whether they must use an intermediary
2. **Equity securities issued and traded.** Obtain the following for the equity securities traded on the market:
  - a. Number of issues admitted to trading as of December 31, 2008.
  - b. Market capitalization as of December 31, 2008.
  - c. Average daily trading value for the year ending December 31, 2008.
  - d. Average number of transactions per trading day for the year ending December 31, 2008.
  - e. Market capitalization of top five issues as a percent of total market capitalization as of December 31, 2008.
  - f. Free trading float of top five issues as a percent of their market capitalization as of December 31, 2008.
  - g. Market capitalization as a percent of gross domestic product (GDP) as of December 31, 2008.
  - h. Value of annual trading volume for the year ending December 31, 2008.
  - i. Turnover for the year ending December 31, 2008.

- j. Value of annual trading volume as a percent of GDP for the year ending December 31, 2008.
  - k. Value of annual trading in top five issues as a percent of total value of annual trading for the year ending December 31, 2008.
  - l. Turnover (value of annual trading in top five issues as a percent of their market capitalization) for the year ending December 31, 2008.
  - m. Annual trading volume in shares for the year ending December 31, 2008.
  - n. Average transaction value (2c/2d) for the year ending December 31, 2008.
  - o. Average daily trading volume in shares for the year ending December 31, 2008.
  - p. Average transaction size (2o/2d) for the year ending December 31, 2008.
  - q. For the past five years, or such shorter period of market existence, the companies whose equity securities are traded on the market that have raised capital domestically via public offerings of a class of their securities. Obtain data on the number and size of these offerings.
  - r. Are there securities with sufficient liquidity that are subject to daily price limits that could be removed?
3. **Corporate debt securities issued and traded.** Obtain the following for corporate debt securities traded on the market (including over-the-counter data if available):
- a. Number of issues admitted to trading as of December 31, 2008.
  - b. Market value of issues as of December 31, 2008.
  - c. Average daily trading value for the year ending December 31, 2008.
  - d. Average number of transactions per trading day for year ending December 31, 2008.
  - e. Market value of top five issues as a percent of total market value as of December 31, 2008.
  - f. Market value as a percent of GDP as of December 31, 2008.
  - g. Value of annual trading volume for year ending December 31, 2008.
  - h. Turnover for the year ending December 31, 2008.

- i. Value of annual trading volume as a percent of GDP for the year ending December 31, 2008.
  - j. Value of annual trading in top five issues as a percent of total value of annual trading for the year ending December 31, 2008.
  - k. Turnover (value of annual trading in top five issues as a percent of their market value) for the year ending December 31, 2008.
  - l. Annual trading volume in trading units for the year ending December 31, 2008.
  - m. Average daily transaction value (3c/3d) for the year ending December 31, 2008.
  - n. Average daily trading volume in trading units for the year ending December 31, 2008.
  - o. Average transaction size (3n/3d) for the year ending December 31, 2008.
  - p. For the past five years, or such shorter period of market existence, the companies whose debt securities are traded on the market that have raised capital domestically via public offerings of a class of their securities. Obtain data on the number and size of these offerings.
  - q. Are there securities with sufficient liquidity that are subject to daily price limits that could be removed?
4. **Other instruments traded.** Determine the following for each of the other types of securities traded in the country. These may include sovereign and sub-sovereign securities, national bank notes, asset-backed securities, forward foreign exchange, certificates of deposit, and derivatives such as options, commodities futures, and financial futures:
- 1. Number of issues admitted to trading as of December 31, 2008.
  - 2. Market value of outstanding issues as of December 31, 2008.
  - 3. Market value of top five issues as a percent of total market value of such issues as of December 31, 2008.
  - 4. Value of annual trading volume for year ending December 31, 2008.
  - 5. Turnover for the year ending December 31, 2008.
  - 6. Value of annual trading in top five issues as a percent of total value of annual trading of all such issues for the year ending December 31, 2008.
  - 7. Value of annual trading as a percent of total value of all trading in securities and other instruments for the year ending December 31, 2008.

8. Turnover in top five issues as a percent of their market value) for the year ending December 31, 2008.
  9. Average daily trading value of each type of instrument.
  10. Average daily trading by number of trades in each type of instrument.
  11. In the case of sovereign and sub-sovereign securities, the range of maturities of the issues traded.
  12. In the case of options and commodities and financial futures, a description of the basic contract terms of the issues traded.
  13. In the case of asset-backed securities (if any) a description of how these products are structured. For example, are government or other guarantees associated with any of the asset-backed securities issues? If so, describe.
5. **Private placements and other non-public offerings.** The principal purpose of this question is to assess the current level of capital formation that is exempt from prospectus requirements applicable to public offerings of securities.
- a. Provide a brief description of the principal terms and conditions of each private placement or non-public offering exemption whereby securities may be issued in the country without having to prepare the equivalent of a prospectus for a public offering of securities.
  - b. Provide data, to the extent practicable, on the number and size of private placements or other non-public offerings made in reliance on each of these exemptions for the purposes of raising capital for each of the past five years, including the type of securities issued and the type of issuer (listed company, private company, private collective investment scheme).
6. **Trends in market data.** If the data obtained in response to Questions 2-5 above indicate positive or negative trends compared with preceding years, explain why.
7. **Profitability of the market and market participants; cost burdens.** Please provide answers separately for each market participant identified in Question 1.
- a. Is the market being subsidized? If so, how, to what extent and for how long?
  - b. Is the market financially viable? If not, is the market considering all sources of potential revenue, including listing fees, transaction fees, market data fees, fees for access to the trading platform, and fees related to any self-regulatory functions applicable to members or participants?

- c. Alternatively, are transaction costs for using the market, including clearing and settlement costs, so high that intermediaries choose to trade off-market?
- d. Are there structural disincentives to going public and/or listing that could readily be corrected? For example:
  - i. Are there fixed commissions, stamp taxes, or other regulatory charges?
  - ii. Could changes in taxation be made to enhance trading? For example, are corporate dividends, interest payments, and capital gains on securities transactions subject to a less favorable tax regime compared to bank savings accounts and real estate transactions?
- e. Are market participants' securities activities profitable?
- f. What is the breakdown of the principal sources of revenues for intermediaries, for example, brokerage commissions, proprietary trading, and investment banking?
- g. In the case of bank-affiliated intermediaries, do they rely on cross subsidies from the banking operations?
- h. Is the profitability of the market and market intermediaries supported by anti-competitive practices such as limitations on the number of members or participants and minimum fixed commissions?

**8. Potential to develop asset-backed securities.**

- a. Is there a sufficient volume of outstanding mortgage loans, credit card receivables, or other assets capable of securitization to warrant consideration of asset-backed securities?
- b. Does the tax regime impose obstacles on market development, such as through the imposition of value-added tax or other substantial taxes on transfer of property, to special purpose vehicles?
- c. What steps are necessary to ensure that assets originated by a lender and pooled for purposes of asset-backed securities cannot be reached by creditors of the lender?

**9. Potential investor base.** Is there a significant class of domestic investors in the country with sufficient savings levels to warrant their participation in capital markets?

- a. What is the country's GDP per capita at **purchasing power parity**?
- b. What is the **potential investor base**, or the number of households with income sufficiently above the poverty level that they may be able to invest in equity or corporate debt securities?

**c. Individuals' brokerage accounts.**

- i. What is the total number of individual accounts with licensed intermediaries, such as banks and brokers?
- ii. How many of these accounts are considered active?
- iii. What are the percentages of total accounts and active accounts in relation to the potential investor base?
- iv. What are the total value of all individual brokerage accounts and the average value of an individual account?

**d. Individuals' savings accounts.**

- i. What is the number of individual savings accounts with licensed banks and other savings institutions?
- ii. What is the percentage of such accounts in relation to the potential investor base?
- iii. What are the total value of all individual savings accounts and the average value of an individual account?

**e. Individuals' ownership of sovereign debt.** If the jurisdiction has outstanding sovereign debt and individuals are permitted to hold such debt securities:

- i. How many individuals hold sovereign debt?
- ii. What is the total value of such debt held in individual accounts and the average value of debt held by an individual account?
- iii. What percentage of outstanding sovereign debt is held by individuals?

**f. If the country experienced mass privatization programs:**

- i. What is the number of privatization accounts with vouchers that may still be used to purchase securities?
- ii. What is the number of privatization accounts with securities holdings?

**g. Individuals' participation in collective investment schemes.** If there are publicly owned CISs in the country:

- i. What is the number of publicly owned CISs?
- ii. How many individuals have accounts with publicly owned CISs?
- iii. What are the total value of individual investments in CISs and the average value of an individual's CIS account?
- iv. What are the percentages of equity and corporate debt securities held by CISs in relation to market capitalization and market value, respectively?
- v. What is the distribution by type of CIS by percentages of portfolio assets among money market, equity, balanced, and fixed-income CISs?

- h. **Individuals' participation in pension schemes.** If a jurisdiction has voluntary private pension schemes that may invest in equities or corporate or sovereign debt:
  - i. What is the number of such pension schemes?
  - ii. How many individuals have accounts with such pension schemes?
  - iii. What are the total value of such individual pension accounts and the average value of an individual account?
  - iv. What are the percentages of equity, corporate, and sovereign/sub-sovereign debt securities held by such pension schemes in relation to market capitalization of equity securities and total market values of outstanding corporate debt and sovereign debt, respectively?
  
- i. Are there other **institutional investors**, such as insurance companies or banks, that are eligible to invest in equity or corporate debt securities or whose legal investment authority might be changed to permit such investments? **Please describe the terms, conditions, and limitations** that apply to each type of institutional investor, the size of these institutions, their current investment practices, and the potential amount of assets they might realistically be expected to invest in corporate equity and debt securities.
  
- j. Are institutional investors subject to any limits on their investment in:
  - i. Equity vs. debt securities?
  - ii. Foreign vs. domestic issues?
  - iii. Listed vs. unlisted securities?
  - iv. Publicly offered securities vs. securities issued in private placements or other non-public offerings?
  - v. CRA-rated vs. unrated securities?
  - vi. Corporate debt securities vs. government securities?
  - vii. Senior or secured debt vs. subordinate or unsecured debt?
  - viii. Other limitations? Describe.

10. **Potential issuer base.** The following are “yes/no” questions to determine whether there are financially viable, potential issuers for public offerings and/or listing and if not, what the reasons are. Do the following conditions exist:

- a. Low price/earnings ratios that discourage companies from raising equity capital?
- b. Unrealistic listing criteria or merit-based requirements?
- c. Unattractive companies due to financial size, industry, or continued government ownership and control?
- d. Availability of financing on more favorable terms elsewhere?
- e. High public offering and listing costs?

- f. Aversion to the disclosure and financial reporting required of public companies.
  - i. Greater exposure to discretionary tax regimes
  - ii. Revealing related party transactions
  - iii. Costs of complying with public company requirements
  - iv. Revealing information to competitors
- g. Low price/earnings ratios that discourage companies from raising equity capital?
- h. Privatization policies that do not interface well with listing procedures?
- i. Potential loss of control?
- j. Lack of awareness of the possible advantages of using publicly traded securities as acquisition capital and for employee compensation?
- k. Is the market dominated by bank intermediaries? If so, do banks pressure issuer/clients to rely on bank lending rather than public offerings of debt securities?
- l. Is there reason to think that potential issuer-base issuers whose securities are publicly traded may increase in the near future? For example:
  - i. Does the country have a policy that includes privatization of enterprises via public offerings and/or listings?
  - ii. How many enterprises are there in the country that would meet legal requirements for going public and the market's listing standards for corporate equities? For corporate debt?
  - iii. How many of the above enterprises:
    - Are more than 50 percent state-owned?
    - Are more than 50 percent privately owned?
    - Are subsidiaries or affiliates of domestic financial industrial groups?
    - Are subsidiaries or affiliates of foreign enterprises?
    - Are other companies that already have public shareholders?
  - iv. Are the public offering and listing standards realistic? Could the number of publicly traded companies be increased significantly if, for example, merit-based public offering and listing standards were lowered, or lower market tiers of public trading were adopted with acceptable disclosure standards but without merit-based listing criteria?
  - v. Are there planned changes that may improve the potential issuer base, for example, a planned privatization of "crown jewel" companies that would reduce government control over issuers whose shares are already publicly traded?

- vi. Are there domestic companies that have raised money through equity and debt offerings outside the local market through public or private depository receipts facilities or otherwise? If “yes”, what are the number, total value, and average size of such transactions. Based on discussions with some of the issuers, determine why they chose to seek financing elsewhere.
- vii. Are the overall costs of going public/listing too high? Are the regulatory costs (charges by the regulator and the market) high?
- viii. How is the public offering price established — by the issuer and the underwriters, or is approval of the regulator or market required?
- ix. Do institutional investors and other market participants think offering materials are credible? If not, why not?
  - x. Does the company law include provisions on public offerings that conflict with regulation of public offerings by the regulator, or impose unnecessary obstacles that make the public offering process less efficient?
  - xi. If the company law allows ordinary shareholders to maintain their relative ownership of a company by buying proportional numbers of shares of any future issue of shares (i.e., pre-emptive rights)?
  - xii. Does it include exceptions or permit shareholders to vote to waive such rights so that securities may be issued in:
    - Private placements, e.g. to a strategic investor?
    - Business combination transactions?
    - Share compensation schemes?
  - xiii. Are rights required to be transferable so shareholders not in a position to exercise their rights may realize some value to compensate for dilution?
  - xiv. Are the rights offering procedures fairly designed to inform shareholders of the offering and to prevent insiders or market participants from purchasing unsubscribed rights at substantial discounts from the prevailing market price?

**11. Presence of fraudulent investments and unregulated markets.** Investigate the existence of manipulative or abusive schemes in the country, such as Ponzi schemes, pyramid schemes, boiler rooms, chain letters, and other unregulated promotional schemes (and/or their promoters) using certificates or other quasi-financial instruments outside the framework of securities market regulation. If these circumstances exist, they will have to be addressed to develop organized public markets.

If such schemes exist, determine whether the regulator or another government body has adequate authority to prohibit these schemes and prosecute violators. More general questions to consider include:

- i. Does the regulator have adequate authority to regulate these markets, and if so, what is its intention in this regard?
- ii. If not, what is the government's position with respect to seeking regulation of these markets?

## SECTION II: PRE-CONDITIONS – COUNTRY COMMITMENT, MACRO-STABILITY, AND TRANSPARENCY

12. **Government commitment.** Even though the government may be strongly committed to capital market development, it is constructive to confirm:
- a. If the government is committed to amending the securities law, if necessary, to adequately regulate the market consistent with IOSCO principles. What evidence exists to document an affirmative answer?
  - b. If the government is willing to commit to strengthen and fund, if necessary, the state committee on capital markets so its authority and independence is consistent with the IOSCO principles.
  - c. If the government has a comprehensive plan for developing markets for equity and debt securities. If so, does the plan address the issues affecting development of such markets that have been identified in responses to this AT?
  - d. If applicable, what is the government's record?
    - i. On prior capital markets assistance?
    - ii. In meeting applicable bilateral or World Trade Organization economic commitments?
  - e. Is the government willing to provide incentives to go public and/or list, such as reductions in income tax rates, tax credits, or tax amnesty?
13. **Macroeconomic conditions.** Are macroeconomic conditions in the country a significant impediment to capital market development? For example:
- a. Is the company experiencing hyperinflation or double-digit inflation?
  - b. Are interest rates at double-digit levels?
14. **Corruption level.** Is the level of corruption in the jurisdiction so pervasive as to discourage legitimate business activity, including capital market development?

### SECTION III: LEGAL AND REGULATORY INFRASTRUCTURE CONDITIONS

15. **The regulator and securities enforcement.** Assess the strengths and weaknesses of the regulation of markets and market-related activity in the country, with emphasis on the regulator's independence, objectivity, integrity, and enforcement capability.
- a. How do market participants view the integrity and effectiveness of the regulator in enforcing securities laws? Describe.
  - b. Are all personnel of the regulator subject to a code of conduct or ethics? If "yes":
    - i. Who enforces the code?
    - ii. Have people been sanctioned for violating the code? Describe.
    - iii. Does the code or other applicable regulation address the following:
      - a) Anti-bribery?
      - b) Misuse of position for private gain?
      - c) Prohibition on most forms of nongovernmental compensation?
      - d) Financial and personal conflicts of interest?
      - e) Prohibitions on gifts to superiors?
      - f) Use and misuse of government property?
      - g) Procurement integrity?
      - h) Reporting and monitoring securities transactions?
  - c. Does the regulator have:
    - i. Lawyers with the training and experience to investigate and prosecute securities violations?
    - ii. Professionally certified or licensed accountants capable of reviewing financial statements filed with the regulator for compliance with required auditing and financial reporting standards and conducting forensic accounting examinations related to financial fraud investigations?
  - d. What are the numbers of enforcement cases in each of the following categories that have been initiated by the regulator or other domestic enforcement authorities on recommendation of the regulator, and what are the number and percentage of cases in each category where there has been a successful prosecution or settlement?
    - i. Actions against unlicensed persons or unlicensed transactions
    - ii. Actions against licensed intermediaries, including collective investment schemes and CIS operators, other than routine matters, such as license revocations for failure to pay applicable fees
    - iii. Actions against issuers whose securities are admitted to public trading for:
      - a) False, misleading or materially incomplete disclosures, including failure to comply with applicable financial reporting standards
      - b) Failure to file required reports or other information

- c) Failure to disclose material related party transactions
  - iv. Actions against persons for failure to report major shareholdings
  - v. Actions against persons for insider trading or market manipulation
  - vi. Actions against external auditors for financial fraud or failure to adhere to accepted auditing standards, including independence requirements
- e. What is the breakdown and success rate in each of the above categories with respect to administrative proceedings before the regulator, civil actions in court, and criminal actions? If the success rates are low or there are delays in prosecuting cases, what are the reasons for the low success rates and delays?
- f. Is there a special prosecution unit in the government for prosecution of securities violations and other white-collar crimes?
- g. Is it possible to suspend or bar people who have engaged in fraud, theft, embezzlement, or similar acts that have caused losses to public companies or investors from serving:
  - i. In any capacity, including control, with a licensed person?
  - ii. As a director or member of the senior management of a listed company? If so, describe.
- h. Do the regulator and other prosecution authorities have legal authority to settle cases without litigation? If not, why not?

**16. Private civil remedies.** Private rights of action enabling investors to pursue their own civil remedies are an important complement to regulatory enforcement. Assess the adequacy of private civil remedies, including the availability of alternative dispute resolution mechanisms.

- a. Are investors permitted to initiate lawsuits based on alleged securities law or company law violations in which they may seek:
  - i. Actual damages suffered?
  - ii. Other remedies? Describe.
- b. If “yes” to “a”, what are the violations for which such civil suits are permitted?
- c. If “yes” to “a”, what persons may be subject to liability for actual damages or other relief in civil suits?
- d. What are the obstacles to bringing civil suits, such as short statutes of limitations, bond requirements, court and legal costs, or high burdens of proof?
- e. Under what circumstances are shareholder derivative actions permitted and against whom?

- f. Under what circumstances are shareholder class actions permitted and against whom?
- g. Are there other mechanisms, for example, where an organization that owns securities of the issuer or an ombudsman may bring a lawsuit to recover damages suffered by an issuer or its shareholders as a result of securities or company law violations?
- h. Are there dispute resolution mechanisms, such as arbitration and mediation, that enable investors to seek redress, including damages, for securities and company law violations? If “yes”, describe and ask:
  - i. To what extent are arbitration decisions binding?
  - ii. Who oversees the fairness of these mechanisms?
  - iii. How timely are they?
  - iv. What is the success rate experienced by investors?

**17. Adequacy of the judicial system.**

- a. Is there a system of civil courts where securities cases can be prosecuted by the state committee for securities or another governmental authority? Describe.
- b. Do civil courts have the authority to prescribe or fashion remedies that are not specifically authorized by statute?
- c. What is the average length of time to:
  - i. Calendar and decide a securities law case in a civil court, or if there is no precedent for securities law cases, a commercial law case?
  - ii. Calendar and decide a securities law case in a criminal court, or if there is no precedent for securities law cases, a white collar crime case?
- d. Are there training programs to educate prosecutors and judges on capital market regulation, including corporate governance?
- e. Are there now, or would it be possible to establish:
  - i. Commercial courts that specialize in hearing commercial cases?
  - ii. Courts that specialize in hearing only securities law and company law cases?
- f. Are there other provisions in the jurisdiction’s laws that may be used to:
  - i. Prosecute securities violations?
  - ii. Prosecute pyramid and Ponzi schemes?

**18. Accounting and auditing. (IOSCO Principle 16 key questions)**

- a. Are public companies required to include audited financial statements in:

- i. Public offering and listing particulars documents?
  - ii. Publicly available annual reports?
- b. Do the required audited financial statements include:
  - i. A balance sheet or statement of financial position?
  - ii. A statement of the results of operations?
  - iii. A statement of cash flow?
  - iv. A statement of changes in ownership equity or comparable information included elsewhere in the audited financial statements or footnotes?
- c. With respect to the financial statements required in public offering and listing particulars documents and publicly available annual reports:
  - i. Are these required to be prepared and presented in accordance with a comprehensive body of accounting standards?
  - ii. Are these accounting standards of a high and internationally acceptable quality?
- d. Are the financial statements presented under circumstances so that they:
  - i. Are comprehensive?
  - ii. Are understandable by investors?
  - iii. Reflect consistent application of accounting standards?
  - iv. Are comparable if more than one accounting period is presented?
- e. With respect to the audited financial statements included in public offering and listing particulars documents and publicly available annual reports:
  - i. Are these required to be audited in accordance with a comprehensive body of auditing standards?
  - ii. Are these auditing standards of a high and internationally acceptable quality?
- f. Are there standards or requirements sufficient to ensure that the external auditor is independent?
- g. Where unaudited financial statements are used, for example, in interim reports and interim period financial statements in public offering and listing particulars documents, in full or summary format, is the financial information presented in accordance with accounting standards that is of a high and internationally acceptable quality?
- h. In regard to oversight, interpretation and independence:

With respect to accounting standards:

- i. Does the regulatory framework provide for an organization responsible for establishment and timely interpretation of accounting standards?
- ii. If “yes”, are the organization’s processes open and transparent and, if the organization is independent, is the interpretation process undertaken in cooperation with, or subject to oversight by, the regulator or another body that acts in the public interest?

With respect to auditing standards:

- iii. Does the regulatory framework provide for an organization responsible for establishment and timely interpretation of auditing standards?
- iv. If “yes”, are the organization’s processes open and transparent and, if the organization is independent, is the interpretation process undertaken in cooperation with, or subject to oversight by, the regulator or another body that acts in the public interest?

With respect to the external auditor, in the case of listed companies:

- v. Is the external auditor required to be independent in fact and appearance of the company being audited?
  - vi. Is there a governance body independent in fact and appearance of the management of the company (e.g., shareholders or a statutory or corporate audit oversight body) that oversees selection and appointment of the external auditor?
  - vii. Is prompt disclosure of information about the resignation, removal, or replacement of an external auditor required?
- i. Is there an adequate mechanism in place for:
    - i. Enforcing compliance with accounting standards, such as requiring restatements of financial statements that deviate from accepted standards?
    - ii. Enforcing compliance with auditing and auditor independence standards, such as refusal to accept, or requiring revision of, audit reports that deviate from required standards as to the opinion expressed or scope of the audit, or for lack of independence?
  - j. If public offerings or listings by foreign issuers are significant within the jurisdiction, does the regulator permit the use of high-quality, internationally acceptable accounting standards by foreign companies that wish to list or offer securities in the country?

19. **Corporate governance.** Assessing the degree to which enterprise managements are committed to “being publically owned”, and binding policies exist to instill investor confidence and help build shareholder value, does the regulatory framework and legal

infrastructure address the rights and equitable treatment of shareholders in connection with the following:

- a. Voting:
  - i. For election of directors?
  - ii. On corporate changes affecting the terms and conditions of their securities?
  - iii. On other fundamental corporate changes?
- b. Timely notice of shareholder meetings?
- c. Procedures that enable beneficial owners to give proxies or voting instructions efficiently?
- d. Ownership registration (in the case of registered shares) and transfer of their shares?
- e. Receipt of dividends and other distributions, when, as, and if declared?
- f. Transactions involving:
  - i. A takeover bid?
  - ii. Other change-of-control transactions?
- g. Holding the company, its directors, and senior management accountable for their involvement or oversight resulting in violations of law?
- h. Bankruptcy or insolvency of the company?
- i. Is full disclosure of all information material to an investment or voting decision required in connection with shareholder voting decisions generally and the transactions referred to in Questions 20.f.i and 20.f.ii specifically?
- j. With respect to transactions referred to in Question 20.f.i and 20.f.ii, are shareholders of the class or classes of securities affected by the proposal:
  - i. Given a reasonable time in which to consider the proposal?
  - ii. Supplied with adequate information to enable them to assess the merits of the proposal?
  - iii. As far as practicable, given reasonable and equal opportunities to participate in any benefits accruing to the shareholders under the proposal?
  - iv. Given fair and equal treatment (in particular, minority security holders) in relation to the proposal?
  - v. Not unfairly disadvantaged by the treatment and conduct of directors of any party to the transaction or by the failure of the directors to act in good faith in responding to or making recommendations with respect to the proposal?
- k. With respect to substantial holdings of voting securities:

- i. Is information about the identity and holdings of persons with a substantial (well below controlling) beneficial ownership interest in a company required to be disclosed in a timely manner:
    - In public offering and listing particulars documents?
    - Once the ownership threshold requiring disclosure has been reached?
    - At least annually (e.g., in the issuer's annual report)?
  - ii. Are material changes in such ownership and other required information required to be timely disclosed?
  - iii. Are these disclosure requirements applicable to two or more people acting in concert even though their individual beneficial ownership might not have to be disclosed?
  - iv. Is the legal infrastructure sufficient to assure enforcement of, and compliance with, the applicable requirements?
- l. With respect to holdings of voting securities by directors and senior management:
- i. Is information about the beneficial ownership interest and material changes in beneficial ownership in a company required to be timely disclosed?
  - ii. Is such information available:
    - In public offering and listing particulars documents?
    - At least annually (e.g., in the issuer's annual report)?
  - iii. Is the legal infrastructure sufficient to ensure enforcement of and compliance with these requirements?
- m. **Cross-border.** If public offerings or listings by foreign issuers are significant within the jurisdiction, does the jurisdiction require disclosure in foreign issuers' offering and listing particulars documents of any governance provisions or information relating to the foreign issuer's jurisdiction that may materially affect the fair and equitable treatment of shareholders?

## 20. Takeover regulation.

- a. If the country has legislation that covers takeover bids:
  - i. How is a takeover bid defined, with respect to voluntary bids and mandatory bids (if applicable)?
  - ii. Do the regulations address the possibility of persons acting in concert to avoid the requirements?
- b. Are takeover bids required to be pre-cleared by the state committee for securities? If so, what review criteria are used? For example, may the state committee for securities:
  - i. Pass upon the adequacy of the price offered?
  - ii. Impose other merit-based conditions? If not, describe.

- c. How long does clearance normally take?
- d. What other approvals are required? For example, review by anti-monopoly authorities or government ministries responsible for the target company's industry.
- e. Is a target company required to make a recommendation regarding a bid or explain why it is not doing so?
- f. What defensive measures may be taken by the target company?
  - i. Before a bid is announced?
  - ii. Once a bid is announced?
- g. Is the bidder or the target company required to obtain a fairness opinion regarding the bid, or is this the normal practice? Describe.
- h. In the case of mandatory bids, how is price determined? Describe.
- i. How soon must a mandatory bid be made after a mandatory bid requirement is triggered?
- j. Under what circumstances may a mandatory bid requirement be altered?
- k. Does the market for the target company's securities remain open during the pendency of a takeover bid?

**21. Bankruptcy and insolvency law.** Does the bankruptcy/insolvency process permit fair and expeditious resolution of creditor claims?

- a. What is the status of secured and unsecured debt in the priority of creditor claims during bankruptcy or insolvency?
  - i. Is the priority respected in practice? Under what circumstances are there exceptions?
  - ii. Is it possible for debtors and creditors to enter into enforceable agreements to use other law and tribunals regarding creditors' rights?
- b. Are there provisions that enable creditors to put a debtor into bankruptcy or insolvency on a timely basis?
- c. Do the bankruptcy/insolvency laws permit a debtor and creditors to propose reorganization of the debtor as an alternative to liquidation?

## 22. Self-regulation

- a. With respect to any self-regulatory organizations (SROs) identified in response to the key questions under Principle 6 of the IOSCO methodology:
  - i. What are the annual budgets and staffing levels of each SRO?
  - ii. Are such levels adequate to permit to each SRO to perform the self-regulatory activities it currently performs?
  - iii. Is there interest within the membership of the SRO that would warrant the SRO performing additional self-regulatory activities?
  - iv. Is there enough political will in the SRO's industry to provide sound governance of the SRO so that potential conflicts of interest inherent in self-regulation are addressed?
  - v. If "yes" to "iii" and "iv", is there willingness on the part of the regulator to permit the SRO to take on additional self-regulatory functions?
- b. If there are potential SROs that might be organized to perform self-regulatory functions, determine whether creation of such SROs is feasible.
- c. For the last five years, or such shorter time period that each market, depository, or any SRO has been in existence, what are the number of disciplinary cases that have been initiated by each organization against intermediaries, persons working for intermediaries, and other persons subject to the organization's jurisdiction that have resulted in a significant sanction, such a monetary fine, suspension, or revocation of the right to conduct or participate in organization's activities?<sup>5</sup> If the answer to this question is none or very few actions, obtain explanations.

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<sup>5</sup> The question is asked in this format because even if markets and depositories are not established specifically by law or regulation as SROs, they are capable of exercising some forms of self-regulation by virtue of their contractual relationship with members or participants. In such circumstances, the key questions in the IOSCO methodology under IOSCO Principle 7 are relevant to assessing regulatory oversight.

## SECTION IV: DEVELOPING MARKET COMPONENTS

### 23. Venture capital and SME financing to develop the potential issuer base.

- a. With respect to each of the private placement or non-public offering exemptions described in response to Question 5:
  - i. Are there unnecessary restrictions in the exemptions, such as limits on the number of institutional investors, limits on the amount of funds that can be raised, or pre-clearance with the state committee for securities?
  - ii. How does the law or the state committee for securities prevent leakage of securities issued pursuant to the exemptions into the broader public market for securities that have been registered for public offering or to trade publicly without restrictions?
  - iii. Is there a specialized secondary market for transactions in SME securities or securities issued to institutional investors in nonpublic offerings? If so, assess this market to the extent applicable under Question 2. If not, is this viewed as a constraint on the growth in private placements of debt and equity securities? Have the authorities considered adopting (suitably modified) one of the market models used in other jurisdictions?
- b. How many venture capital funds are active in the jurisdiction and what is the amount of their assets under management?
- c. Are there foreign-owned or -controlled funds, and if so, what is their share of the market?
- d. What is the average length of a portfolio holding by a venture capital funds?
- e. What exit strategies are employed? Public offering or sale of the company? Do public offerings use the local market? If not, why not?
- f. What programs are established by the government or others to support development of the venture capital industry and SME financing, such as tax incentives, small business loan programs, fund of funds, and direct investment, and what is their significance quantitatively?
- g. Are obstacles to venture capital and SME financing present? For example:
  - i. What domestic institutional investors are not permitted to invest in venture capital funds, or directly or indirectly in unlisted SMEs? Examine the reasoning for such prohibitions.
  - ii. Are privately funded venture capital funds exempt from CIS regulation? Describe.

- iii. Is there an investment structure that allows venture capital fund/vehicle investments to avoid taxation at the fund and fund investor levels? Are there tax incentives related to carried interests or management fees?
- iv. Does the company law impede venture capital investment and SME financing? For example:
  - a) Is it possible to issue securities such as convertible preferred stock, convertible debentures, or super-voting common stock that enable a venture capital investor to protect an investment position and control certain fundamental decisions, such as additional financing, representation in management, and exit strategy?
  - b) Does the company law permit venture capital funds, portfolio companies, and other shareholders of portfolio companies to enter into stock purchase agreements and shareholder agreements that contain consensual provisions different from the default provisions in the company law?

#### **24. Expanding the role of intermediaries.**

- a. If the response to Question 7.e suggests that additional intermediaries should be willing to enter the market, what obstacles prevent them from doing so? For example:
  - i. Are minimum capital requirements unnecessarily high?
  - ii. Are other licensing requirements arbitrary or unnecessary?
  - iii. Does the governance and membership structure of the market need to be reformed to admit more intermediaries?
  - iv. If threshold qualification requirements for intermediaries are a problem, would it be possible to establish a system of introducing and clearing brokers so that brokers who do not meet capital adequacy requirements to handle customer accounts directly may do so through qualified clearing brokers?
- b. May activities of licensed intermediaries be expanded so there is better interaction with customers, as well as making intermediation much more profitable and attractive to new entrants? For example:
  - i. Are brokers also permitted to act as dealers and underwriters?
  - ii. May brokers provide investment recommendations without licensing as investment advisers as long as their compensation is limited to brokerage commissions they would earn for a transaction even if they did not give advice?
- c. What is the breakdown of licensed intermediaries among bank, non-bank, and foreign intermediaries, and the share of market transactions handled by each group?
- d. Is there a level playing field for licensing of bank and non-bank intermediaries? For example:

- i. Are the securities activities of all market participants subject to examination and oversight by the same regulator?
  - ii. Are bank and non-bank intermediaries permitted to hold customers' funds and securities?
  - iii. Do bank and non-bank intermediaries have equal access to clearing and settlement facilities?
  - iv. What safeguards exist to address potential moral hazard issues, such as bank intermediaries using insured assets to subsidize securities activities?
  - v. Is the licensing and regulation of foreign intermediaries based on national treatment in licensing and regulation, or are the regulatory procedures protective of domestic Intermediaries?
- e. Are there requirements that unnecessarily impede the customer-intermediary relationship? For example:
- i. If the customer has entered into a written customer agreement with the intermediary, may the customer place orders by telephone with the intermediary?
  - ii. May information such as prospectuses and account statements be made available to customers (with their consent) via the Internet, including posting on Web sites?

## **26. Education of investors and others.**

- a. What efforts have been made to educate investors about the advantages and risks of investing? How effectively and by whom?
- b. Do the regulator and the market have procedures for processing complaints that tie in with investor education and enforcement so that problem areas are identified and addressed as part of the investor education and enforcement programs?
- c. Are there programs designed to educate market participants, companies, financial analysts, and the media about capital markets and corporate governance issues? How well-designed and effective are the programs?
- d. Are the jurisdiction's information dissemination requirements for issuers designed to make maximum use of new information technologies?

## **27. Trading infrastructure.**

- a. To what extent is the market automated? For example:
  - i. Are bid- and asked-quotations posted on computers or similar displays?
  - ii. Are orders executed electronically, by phone, or otherwise?
  - iii. Is remote trading possible or do all persons entering quotes and/or trades have to be at a centralized location?

- iv. Does the market provide straight-through processing whereby executed transactions are confirmed and passed directly to the clearing and settlement facility?
  - v. Are trade reports published immediately to the public via data vendors?
- b. Is the market an auction market, a dealer market, or a combination of both? Describe.
  - c. If the market is primarily an auction market, would the introduction of dealers as market-makers improve liquidity for institutional investors, and are there potential dealers who would be willing to become market-makers?
  - d. If the market is primarily a dealer market, would the introduction of an auction market facility improve the execution of retail orders?
  - e. Do the market's operating procedures, such as setting opening and closing prices, use of trading halts, margin account trading, stock borrowing, intermediary financing, and regulation of short-selling, correspond to international best practices?

**28. Depository, clearance and settlement, and securities registration infrastructure.**

- a. How is clearance and settlement of transactions in equity and corporate debt securities handled? Is there a depository or other clearance and settlement facility? Who owns it and who are the members or participants?
- b. For each depository or other clearance and settlement facility for equity and corporate debt securities, the assessor should use the key questions in CPSS-IOSCO methodology to assess the adequacy of the facility. If the depository acts as a central counterparty, it also should be determined whether the depository operates in accordance with the CPSS-IOSCO recommendations for central counterparties.
- c. If there is a depository but it does not also function as a central registry for securities, how is registration of securities handled? For example:
  - i. Who maintains the register of a publicly traded issuer's security holders — the issuer or separate registrars? If the latter, are the registrars required to be independent of the issuer?
  - ii. Who oversees the registration process — the regulator or another government body? Describe.
  - iii. How is it assured that the records in the share registries conform to the records in the depository; e.g. regarding shares outstanding?
- d. If money settlement is not handled within the same facility as securities settlement, how are the two processes coordinated to ensure delivery vs. payment?

- e. Does the depository-registration system make it possible to determine the beneficial owners of securities; e.g. the persons who make voting and disposition decisions with respect to the securities?
- f. Is there a legal concept substantially equivalent to that of a good-faith purchaser for the value of securities, notwithstanding claims of earlier fraudulent transfers of the property unknown to the purchaser, so the prospect of having to undo a series of secondary market transactions may be avoided?
- g. Regardless of whether the registration infrastructure involves a central registry or separate registrars, is there a principal agent or equivalent legal relationship between the issuer and those responsible for the registry so that the issuer may be held legally accountable for errors and omissions in the registry that are the fault of the issuer?

**29. Developing the corporate debt market, including asset-backed securities.**

- a. If there are issuers who have issued medium- to long-term corporate debt securities, what is the significance of this financing compared with the amount of outstanding medium- and long-term loans to private companies?
- b. Who are the purchasers of the corporate debt securities?
- c. What are the maturities and other terms and conditions of the debt securities?
- d. What credit enhancements are used, if any? Describe.
- e. Is there a public offering exemption for issuance of short-term debt securities; e.g. a maturity of less than one year, but that are often rolled over?
- f. If corporate debt is not listed, or off-market transactions are permitted in listed corporate debt, is there transparency with respect to price and volume of transactions?
- g. Are there different disclosure and financial reporting requirements for public offerings of debt securities vs. equity issues? If so, describe.
- h. Is there some precedent in the jurisdiction that may serve as a basis for encouraging institutional trading in corporate debt securities? For example, is there an institutional trading market for government bonds that might be extended to corporate?
- i. Are there banks or other institutions already involved in trading financial derivatives, such as currency futures, that might serve as a pilot group and/or market for introducing trading of corporate debt securities?
- j. What is the length and depth of the yield curve for government securities?

- k. Is there a “crowding out” effect, whereby issuances of government debt are absorbing all of the buy-side interest in debt securities?
- l. Are there shelf registration procedures that would facilitate the ability of companies that are already publishing annual reports and other information to more readily make public offerings of corporate debt?
- m. In the case of public offerings of debt securities, is there a trustee or other representative of security holders who monitors the issuer and who may act on their behalf? If so, is the right of investors to pursue their own remedies on default preserved?
- n. Are there legal constraints on the issuance of subordinated debt?

**30. Presence and regulation of credit rating agencies.**

- a. Are there any credit rating agencies providing ratings on corporate debt? If so:
  - i. Are they affiliated with the government?
  - ii. Are they free of industry pressure or influence?
  - iii. Do they have any international experience of providing ratings; e.g. affiliation with a multinational CRA?
- b. What are the ratings criteria?
- c. Are credit ratings mandatory?
- d. Are the CRAs licensed or regulated? If so, how and under what criteria?
- e. Are CRAs required to meet the IOSCO Code of Conduct Fundamentals for CRAs? If so, how is compliance assessed by the regulator?
- f. If there is more than one rating, are all ratings from qualified CRAs required to be disclosed?
- g. Are CRAs permitted to issue unsolicited ratings? If so must be nature of the rating be clearly disclosed?
- h. Who pays for the rating — the issuer or the investor?
- i. If CRAs are active, are their ratings valued by investors? If not, why not?

**31. Developing collective investment schemes.**

- a. What is the total amount of assets under management by publicly owned, domestic CISs?

- b. What is the percentage of total assets to GDP?
- c. What is the number of operators/investment advisers/managers licensed to operate publicly owned CISs?
- d. What are the principal types of portfolio investments of publicly owned CISs?
- e. Are there open- and closed-end publicly owned CISs and if so, what is the number of CISs in each category and the amount of assets under management in each category?
- f. Does the tax regime permit avoidance of double taxation of CISs, at the CIS and investor levels, and is the tax treatment the same for open- and closed-end CISs? Describe.
- g. Are non-diversified CISs permitted?
- h. Are non-managed CISs permitted? For example, would it be possible to establish a trust that has a fixed portfolio of 10-12 government or corporate bonds that will pass through interest and principal payments to investors and self-liquidate as the bonds are paid at maturity or earlier redemption?
- i. To what extent are CISs permitted to invest in foreign securities?
- j. Are there government-sponsored CISs that have competitive advantages or may be “crowding out” private sector CISs?
- k. If there are bank-sponsored CISs, are they subject to the same regulatory regime as non-bank CISs?
- l. May a foreign operator or sponsor establish a domestic CIS? If so, is the regulatory regime one of national treatment?
- m. Is there an exemption from CIS regulation for private funds, for example, those limited to institutional investors or with less than a specified number of investors?
- n. Does the CIS governance model correspond to one of the four models recognized by IOSCO, including recommended independent oversight criteria?
- o. If CISs are permitted to invest in real estate, what regulatory or other safeguards are in place to ensure sufficient liquidity of the CISs and a fair and objective determination of net asset value?
- p. Are there alternative investment vehicles, such as real estate investment trusts, that enable investors to participate in passive real estate investment? If not, does the real estate market offer the potential to develop such investment vehicles?

- q. Are there regulations that adversely affect performance reporting or require CISs to depart from concepts of market value and fair value in determining their net asset value?
- r. Are performance guarantees prohibited? They should be.
- s. Do distribution channels for CISs encourage or restrict competition?

### **32. Foreign portfolio investment.**

- a. In what industries or sectors is foreign portfolio investment prohibited or subject to percentage limitations?
- b. Are there World Trade Organization or bilateral trade negotiations that may serve as a basis to advocate or accelerate the removal of these restrictions?
- c. Are there currency controls, repatriation restrictions, or similar policies that inhibit foreign investment? Can they be removed or simplified?
- d. Do foreign investors have to open special accounts or comply with other procedures that delay movement of funds as a condition of investing?
- e. If the country's markets are covered in the annual S&P Emerging markets Factbook, what problems, if any, are identified in the Factbook sections on foreign investment ceilings, similar controls, and clearing and settlement?

### **33. Islamic finance.**

- a. Are there regulatory requirements or guidelines on the issuance of securities intended to comply with principles of Islamic finance? For example:
  - i. Are there special disclosure requirements applicable to such securities so that investors understand the related risks?
  - ii. If Islamic finance requires that the financial reporting standards used in the jurisdiction differ from the International Financial Reporting Standards, how are such differences disclosed to investors?
- b. How does the jurisdiction ensure that financial product approvals and portfolio investments will be made on a Shariah-compliant basis (e.g., certification process or advisory committee of Islamic law experts)?
- c. Are there additional inspection/examination procedures or other requirements imposed on intermediaries to ensure Shariah compliance?

## GLOSSARY OF KEY TERMS

This glossary is not all-inclusive, but sets forth definitions important for use of this AT. A number of questions in the AT direct the assessor to use questions in other methodologies, such as the IOSCO methodology and the CPSS-IOSCO methodology, while other questions and footnotes direct the assessor to other questionnaires and resources the assessor may wish to consult. The assessor should be able to find definitions of many technical terms not included below in these other resource documents.

- Asset-backed securities** A security whose value and income payments are derived from and collateralized (or "backed") by a specified pool of underlying assets. The pool of assets is typically a group of small and illiquid assets that are unable to be sold individually. Pooling the assets allows them to be sold to general investors, a process called securitization, and allows the risk of investing in the underlying assets to be diversified because each security will represent a fraction of the total value of the diverse pool of underlying assets.
- Auction market** A market where all orders to buy and sell a security admitted to trading on the market come together at one point and interact with each other, on a physical trading floor or through an automated trading system. Also called order-driven markets.
- Collective investment scheme** Unless otherwise indicated, includes public and private CISs organized as legal entities or in contractual form.
- Company law** The law of a jurisdiction that sets forth procedures for establishment and governance of for-profit business companies or corporations, often referred to as joint stock companies or shareholding corporations. In the case of listed companies, corporate governance requirements in securities laws and regulations, market listing requirements, and codes of corporate governance often will supplement the company law.
- CPSS-IOSCO methodology** The Assessment Methodology for Recommendations for Securities Settlement Systems issued by the Committee on Payment and Settlement Systems and the Technical Committee of IOSCO (CPSS-IOSCO) in November 2002, and to the template for assessing observance of the Recommendations for Central Counterparties included in Recommendations for Central Counterparties issued by CPSS-IOSCO in November 2004.
- Credit rating agency** A company that assigns credit ratings for issuers of certain types of debt obligations, as well as the debt instruments themselves.

<b>Dealer market</b>	A market where all buy- and sell-orders for a security admitted to trading on the market do not interact with each other as in the case of an auction market. Instead, one or more dealers act as market makers quoting their own bid and asked prices for the securities. Dealer markets are also referred to as quote-driven markets.
<b>Depository</b>	A central securities depository that provides clearance and settlement facilities for securities transactions. It may be an independent organization or part of a market. It also may provide securities registry services for issuers, although such activity often is provided separately by registrars, a separate central securities registry, or the issuers themselves.
<b>Derivatives</b>	Publicly traded options or futures contracts whose value is determined based upon the value of one or more underlying securities or financial instruments or indices thereon. <sup>6</sup>
<b>Free float</b>	The number of outstanding shares of a securities issue that are actually available for trading after deducting shares that may not be freely traded. Free trading float is the number of shares in the free float as of a specific date multiplied by the market price of the security on that date.
<b>Intermediaries</b>	Licensed securities firms that are in the business of executing orders, dealing in or distributing securities, managing portfolios of securities and providing information relevant to the trading of securities.
<b>International Organization of Securities Commissions</b>	The global professional organization of securities regulators. <sup>7</sup>
<b>IOSCO principles</b>	The IOSCO Objectives and Principles of Securities Regulation (2008).
<b>IOSCO methodology</b>	The Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation (2008).
<b>Listed company</b>	A company whose equity or debt securities are admitted to trading on a market that has established standards for listing or admission to trading.

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<sup>6</sup> For some purposes of this AT, consideration of derivatives is even more narrowly limited to derivatives that may enhance the liquidity of markets for corporate equity and debt securities. Futures on physical commodities, employee share schemes, and global depository receipts or American depository receipts are not considered derivatives for purposes of this AT.

<sup>7</sup> All IOSCO documents referred to are downloadable from the public library section of the IOSCO Web site: [www.iosco.org](http://www.iosco.org)

<b>Market</b>	Except as more narrowly used in the context of certain questions, market refers to any secondary market for trading securities, including derivatives, regardless of whether the market is licensed or unlicensed, formal or informal, automated or manual, exchange or over-the-counter.
<b>Market capitalization</b>	In the case of an individual securities issue, the number of shares of the issue that are outstanding as of a specific date multiplied by the market price of the security on that date. In the case of a market, refers to the sum of the market capitalizations of all issues traded on the market. Commonly used with respect to equity securities, although it is also sometimes used separately with respect to debt securities.
<b>OECD principles</b>	The Organization for Economic Co-operation and Development's Principles of Corporate Governance (2004).
<b>Price/earnings ratio</b>	Usually calculated by dividing current market price by an issuer's earnings per share for the last four financial quarters available.
<b>Potential investor base</b>	The estimated number of persons in a jurisdiction that may reasonably be expected to be investors in the jurisdiction's public markets for equity and corporate debt securities, as determined pursuant to Question 10.
<b>Potential issuer base</b>	The estimated number of legal entities in a jurisdiction that may reasonably be expected to have equity or corporate debt securities publicly offered or admitted to public trading on a market in the jurisdiction, as determined pursuant to Question 11.
<b>Regulator</b>	The government organization responsible for market regulation. In some jurisdictions, there may be more than one.
<b>Self-regulatory organization</b>	For purposes of this AT, an SRO is an organization of participants in the market with common interests that exercises some form of regulation over the participants and, in turn, is subject to oversight by the regulator. Examples of SROs include organized markets, depositories, and associations of intermediaries.
<b>Transparency</b>	The timely availability of price and volume information relative to current opportunities to trade securities and recently completed trades.
<b>Turnover</b>	The trading value for a period of time divided by market capitalization. May be calculated for an individual security or all or part of a market.

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