

ASIAN DEVELOPMENT BANK

PCR: BAN 24103

PROGRAM COMPLETION REPORT

ON THE

CAPITAL MARKET DEVELOPMENT PROGRAM LOAN

(Loan 1580-BAN)

IN

BANGLADESH

August 2003

CURRENCY EQUIVALENTS

Currency Unit	–	taka (Tk)		
		At Appraisal		At Program Completion
		(July 1997)		(December 2000)
Tk1.00	=	\$0.0227		\$0.0184
\$1.00	=	Tk44.10		Tk54.10

ABBREVIATIONS

ADB	–	Asian Development Bank
BB	–	Bangladesh Bank
BRM	–	Bangladesh Resident Mission
BSEC	–	Bangladesh Steel and Engineering Corporation
CDBL	–	Central Depository Bangladesh Limited
CDS	–	centralized depository system
CMDP	–	Capital Market Development Program
CPF	–	Central Provident Fund
CSE	–	Chittagong Stock Exchange
DOI	–	Department of Insurance
DSE	–	Dhaka Stock Exchange
FI	–	financial institution
IAS	–	international accounting standards
ICAB	–	Institute of Chartered Accountants of Bangladesh
ICB	–	Investment Corporation of Bangladesh
ISA	–	international standards on auditing
IPO	–	initial public offering
MIS	–	management information system
MOC	–	Ministry of Commerce
MOF	–	Ministry of Finance
PC	–	Privatization Commission
RRP	–	Report and Recommendation of the President
SDR	–	special drawing rights
SEC	–	Securities and Exchange Commission
SOE	–	state-owned enterprise
TA	–	technical assistance
T-bill	–	treasury bill

NOTES

- (i) The fiscal year (FY) of the Government ends on 30 June. FY before a calendar year denotes the year in which the fiscal year ends.
- (ii) In this report, "\$" refers to US dollars.

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BASIC DATA

A. Loan Identification

1.	Country	Bangladesh
2.	Loan Number	1580-BAN(SF)
3.	Program Title	Capital Market Development Program
4.	Borrower	People's Republic of Bangladesh
5.	Executing Agency	Ministry of Finance
6.	Amount of Loan	SDR58.6 million (\$77.2 million)
7.	PCR Number	PCR: BAN 24103

B. Loan Data

1.	Appraisal		
	- Date Started	22 July 1997	
	- Date Completed	31 July 1997	
2.	Loan Negotiations		
	- Date Started	29 September 1997	
	- Date Completed	1 October 1997	
3.	Date of Board Approval	20 November 1997	
4.	Date of Loan Agreement	12 January 1998	
5.	Date of Loan Effectiveness		
	- In Loan Agreement	13 April 1998	
	- Actual	27 January 1998	
	- Number of Extensions	-Not applicable	
6.	Closing Date		
	- In Loan Agreement	30 June 2001	
	- Actual	22 December 2000	
	- Number of Extensions	-Not applicable	
7.	Terms of Loan		
	- Interest Rate	Fixed	
	- Maturity	40 years	
	- Grace Period	10 years	
8.	Terms of Relending		
	- Interest Rate	Not applicable	
	- Maturity	Not applicable	
	- Grace Period	Not applicable	
	- Second-Step Borrowers	Not applicable	
9.	Disbursements		
A.	Dates		
	<u>Initial Disbursement</u>	<u>Final Disbursement</u>	<u>Time Interval</u>
	13 February 1998	22 December 2000	2 years and 10 months

<u>Effective Date</u>	<u>Original Closing Date</u>	<u>Time Interval</u>
27 January 1998	30 June 2001	3 years and 5 months

B. Amount (\$ million)

Category/Component	Original Allocation	Last Revised Allocation	Amount Available	Net Amount Disbursed
Capital Market Development Program	77.2	77.2	0	77.2
Total (US\$ million)	77.2	77.2	0	77.2
Total (SDR million)	58.6	58.6	0	58.6

C. Program Data

1. Program Cost (\$ million)

Cost	Appraisal Estimate	Actual
- Foreign Exchange Cost	\$77.2 (SDR58.6 million)	\$77.2 (SDR58.6 million)
- Local Currency Cost	—	—
Total	\$77.2 (SDR58.6 million)	\$77.2 (SDR58.6 million)

2. Financing Plan (\$ million)

Cost	Appraisal Estimate	Actual
Implementation Costs		
- Borrower-Financed		
- ADB-Financed	\$77.2 (SDR58.6 million)	\$77.2 (SDR58.6 million)
- Other External Financing		
Total	\$77.2 (SDR58.6 million)	\$77.2 (SDR58.6 million)

ADB = Asian Development Bank.

3. Cost Breakdown by Program Component (\$ million) – Not applicable

4. Program Schedule

Item	Original Plan	Actual
First tranche release	13 April 1998	13 February 1998
Second tranche release	June 1999	22 December 2000

5. Program Performance Report Ratings

Ratings

Implementation Period	Development Objectives	Implementation Progress
(a) From January to December 1998	Satisfactory	Highly Satisfactory
(b) From January to June 1999	Partly Satisfactory	Partly Satisfactory
(c) From July to December 1999	Satisfactory	Satisfactory
(d) From January to June 2000	Satisfactory	Satisfactory
(e) From July to December 2000	Partly Satisfactory	Partly Satisfactory

D. Data on Asian Development Bank Missions

Name of Mission	Date	Number of Persons	Number of Person-Days	Specialization of Members
Reconnaissance	From 27 January to 5 February 1997	8	80	b, d (3),e (2),i, j
Fact-Finding	From 11 to 25 March 1997	8	120	a, b, d (3),e (2), i
Appraisal	From 22 to 31 July 1997	9	90	a, b, c, d (4), e, i
Review 1	From 18 to 27 August 1998	1	10	d
Review 2	From 14 to 16 March 1999	1	3	d
Review 3	From 19 to 25 March 1999	3	21	d, e, h
Review 4	From 23 to 27 May 1999	4	20	c, d (2), e
Review 5	From 11 to 18 July 1999	1	8	d
Review 6	From 17 to 18 July 1999	4	8	d (2),e, k
Review 7	From 20 to 24 August 1999	2	10	c, d
Review 8	From 18 to 28 October 1999	1	11	d
Review 9	From 9 to 11 November 1999	1	3	d
Review 10 ¹	From 7 to 10 February 2000	1	4	d
Review 11	From 19 to 21 September 2000	1	3	d
Review 12	From 12 to 14 December 2000	1	3	d
Review 13 ²	From 3 to 10 June 2001	1	8	d
Review 14	21 June 2001	2	2	d (2)
PCR ³	From 10 to 21 September 2002	2	24	d, j

a = capital markets specialist, b = financial analyst, c = counsel, d = financial economist, e = investment officer, f = consultant, g = programs officer, h = assistant project analyst, j = young professional, k = manager, PCR = Program Completion Report.

¹ Included discussion on the follow-on capacity building technical assistance.

² Included discussion on the follow-on financial market development project.

³ The PCR was prepared by V.T. Velasco, Senior Financial Economist, and Saitien Thongplengsri, Young Professional.

I. PROGRAM DESCRIPTION

1. The SDR58.6 million (\$80 million)¹ Capital Market Development Program (CMDP) loan from the Special Fund resources of Asian Development Bank (ADB) to the People's Republic of Bangladesh was approved on 20 November 1997. The Program aimed at enhancing market capacity and developing a fair, transparent, and efficient domestic capital market, to attract larger amounts of investment capital, which can augment capital resources provided through the banking system and improve efficiency in allocating resources (paragraph 71 and Appendix 10, Report and Recommendation of the President [RRP]). The Program was to be implemented over a period of about 3 years.

2. The CMDP comprised (i) a policy reform program designed to create a policy environment conducive to capital market development and (ii) technical assistance (TA) to improve governance and address capacity-building requirements of key institutions operating in the capital market. The CMDP was designed to achieve the following outputs: (i) stronger market regulation and supervision, (ii) improved capital market infrastructure, (iii) modern capital market support facilities, (iv) increased supply of securities in the capital market, and (v) increased institutional demand for securities. Three TA grants under the Program were (i) Capacity Building of Securities and Exchange Commission and Stock Exchanges (TA 2913), (ii) Institutional Strengthening of the Privatization Board (TA 2914), and (iii) Insurance Industry and Pension and Provident Fund Reforms (TA 2915).²

II. EVALUATION OF DESIGN AND IMPLEMENTATION

A. Relevance of Design and Formulation

3. Since 1990, ADB maintained continuing policy dialogue with the Government of Bangladesh (the Government) and closely coordinated with other aid agencies to design relevant and effective programs and TA for financial reforms. In 1992, the Government formulated, with the assistance of ADB, a program for the development of the capital market. This paralleled the financial sector reform program of the World Bank, which began in 1989, focusing on the banking sector. As the lead funding institution for capital market development, ADB provided TA in several areas.

4. The Government's development objectives were to reduce poverty, establish social justice, and improve the people's standard of living (paragraph 6, RRP). However, low savings and investment levels remained major constraints in achieving the medium-term target growth rate of 8%.³ To achieve its growth objectives, the Government placed high priority on the reform of the financial sector. The Government's development strategy recognized the importance of creating a broad-based financial system that is competitive, efficient, and stable. This included the development of a capital market that would be capable of providing long-term funding to industries as an alternative to commercial banks—many of which were burdened with large nonperforming loans—and the ailing development finance institutions, through which official development assistance was traditionally coursed.

¹ The actual disbursed amount was \$77.2 million, due to the difference between the SDR/US\$ conversion rate on the loan approval date and the rates when the loan was disbursed.

² Reports (TCR) for the three TA activities were circulated in the second quarter of 2003.

³ Bangladesh achieved a 5% average annual gross domestic product growth rate over the past decade. To meet the income poverty reduction target of the Poverty Reduction Partnership Agreement that the Government and ADB signed in April 2000, it will need a sustained annual gross domestic product growth rate of 7.5–8%.

5. The crash of the stock market in late 1996 shook investor confidence and threatened to erupt into a domestic crisis. The then minister of finance urgently requested ADB's assistance in stabilizing the stock market. The crash clearly showed severe inadequacies in the policy and regulatory framework of the capital market. At that time, the Securities and Exchange Commission (SEC) was a very weak organization, with little control over the stock exchanges. Since SEC was also understaffed—with only a handful of personnel—and had poor facilities, it was essential to strengthen the regulator and adopt policy reforms. The crash provided the impetus to accelerate the implementation of the Government's program for capital market development. The Government sought to restore public confidence and promote investments (paragraphs 4 and 43 and Development Policy Letter, RRP, Appendix 1).

6. The reform program was formulated in coordination with and supported by other donor agencies. Notably, to start the reform process prior to ADB's TA becoming available, the United States Agency for International Development and the United Nations Development Programme provided urgently needed TA on capital market regulatory reforms. ADB's reform program was initially designed to comprise program and investment components. However, due to the highly vulnerable state of the capital market, after the market crash, the program component was accelerated and the investment component was postponed.⁴ Accordingly, the CMDP, a program loan, was designed to rectify weak fundamentals of the Bangladesh capital market, including weak market regulation and supervision, inadequate market infrastructure, limited supply of securities, undeveloped institutional sources of demand, and weak policy coordination. The design was relevant to ADB's country strategy and the country's development objectives.

B. Program Outputs

7. The CMDP had policy actions for each of the five program outputs anticipated at loan appraisal (paragraph 2 above). The details of policy actions (24 second tranche conditions and 19 that are not conditions for tranche release) and their status of implementation are given in Appendix 1. Implementation of the main policy actions is examined below:

1. Strengthen Market Regulation and Supervision

8. The CMDP sought to strengthen the regulatory and supervisory role of SEC and to vest SEC with the authority to perform its functions effectively. Securities and exchange laws have been amended to make SEC an independent agency and empower it with the authority to issue its regulations without government approval. As a result, the process of issuing new regulations has been shortened considerably. SEC has also been given sole authority over the content of prospectuses, which was previously vested in the Registrar of Companies.⁵ The regulatory framework for disclosure, listing rules, inspection, sanctioning, and broker conduct has been strengthened. SEC has specific and direct authority over the clearing, settlement, and depository functions. Although SEC generally consults with relevant market practitioners when making rules,⁶ the consultation process needs to be made more formal⁷ and have wider

⁴ Possible sponsors for investments in the establishment of an asset management company and mutual funds for meeting the investment requirements of capital market institutions and for infrastructure financing at that time hesitated to make commitments, due to unstable market conditions arising from the stock market crisis.

⁵ However, the relevant section of the Companies Act 1994 has not been amended to accommodate the changes to the content and requirements of the prospectus. The Companies Act still has a detailed chapter on prospectus requirements.

⁶ SEC publishes proposed rules or regulations in three widely circulated newspapers and prefers to have individual or small group consultations with legal experts, academics, and reputed professionals in the private sector, rather

stakeholder participation. Complaints have been aired about lack of feedback from SEC concerning comments made on proposed rules. Concern has been expressed whether the impact of SEC's new rules and requirements on the growth and stability of the market has been adequately considered. The perception of market players is that SEC has not adequately disclosed its policy for exercising its powers and discharging its functions.

9. SEC lacks the capacity and resources to effectively exercise its inspection, investigation, surveillance, and enforcement powers. SEC has a severe shortage of qualified staff. Currently, SEC has 75 staff positions⁸—of which 27 are officers, including the chairman and three members—while its supervisory responsibilities cover the Dhaka Stock Exchange (DSE) and its 162 active member-brokers, the Chittagong Stock Exchange (CSE) and its 85 active member-brokers, and a total of 242 listed companies on both exchanges. The inability to attract capable personnel is mainly due to low compensation, in line with the civil service salary structure.

10. While SEC may be operationally autonomous, the Government determines the conditions of appointment of the chairman, members of the board, and all SEC staff; controls SEC funding; and exercises authority over SEC. To have more flexibility, SEC needs to be self-financing. However, because of the small size of the market, SEC is unlikely in the near future to levy sufficient fees on market players to finance its operations independent of the Government. For as long as SEC will still be dependent on the Government for its budget, it cannot become a fully independent entity.⁹ Through policy dialogue, the Government may agree to improve SEC staff's compensation package and bring more professionals into SEC.

11. The slow, unreliable court system has hampered SEC's ability to bring offenders of securities laws to justice in a timely manner. All too often, the District Court grants stay orders to SEC in proceedings related to enforcing securities laws. Actions commenced in the District Court are immediately appealed to the High Court, on procedural matters, giving rise to extended delays. For example, charges brought against parties involved in the 1996 share scams are still before the courts.

2. Develop Capital Market Infrastructure

12. This component of the CMDP included strengthening accounting and disclosure regulations and increasing the accountability and transparency of stock exchange operations. SEC issued Rules 1987, requiring listed entities to prepare annual financial statements, in accordance with international accounting standards (IAS), as adopted by the Institute of Chartered Accountants of Bangladesh (ICAB). Rules 1987 also requires that these financial statements be audited by a qualified chartered accountant, in accordance with international standards on auditing (ISA), as adopted by ICAB. Over the Program period, ICAB was required to adopt all applicable IAS and ISA and monitor compliance with these standards. As of the end

than having roundtables with stakeholders or holding public hearings. It is not the practice of SEC to provide feedback on comments received before finalizing rules and regulations.

⁷ Consultation between BB and SEC has been largely informal. Recently, BB and SEC decided to hold quarterly coordination meetings on matters of mutual interest.

⁸ SEC received approval for additional positions from the Ministry of Establishment (four directors and seven assistant directors). The recruitment of additional staff can begin once Ministry of Finance approval is received.

⁹ A consulting firm was commissioned by SEC to study its compensation structure. Key recommendations from the study included (i) increasing the compensation package for SEC staff, to make it comparable to private domestic financial institutions and (ii) amending relevant laws, to vest SEC with the authority to impose fees on the industry, including fees based on stock transactions. According to the study, the basic salaries of SEC executives are 20% lower than those paid to executives in the private domestic financial sector.

of April 2003, ICAB has adopted only 8 of the 34 IAS and 14 of the 46 ISA.¹⁰ ICAB has not been able to ensure the quality and reliability of financial statements. The gap between IAS and ISA and Bangladesh standards is widening. ADB has provided, under TA 3533,¹¹ training on IAS and ISA, in coordination with the World Bank and ICAB; at the initiative of SEC, accounting training programs have been organized in Dhaka and Chittagong for accountants and staff of listed companies, investment advisors, merchant banks, and the stock exchanges.

13. DSE and CSE separate policy making and management activities. Their respective boards have been restructured to include nonbrokers (50%). Both exchanges have raised the minimum capital requirement and introduced risk-based capital adequacy norms for brokers. To promote competition and efficiency among the stock exchanges, the mandatory dual listing of securities has been eliminated. DSE and CSE have each established an investor protection fund to compensate investors from losses arising from defaults of member-brokers. The CMDP has raised the qualification standards for members of the stock exchanges. SEC has provided training to authorized representatives of members of DSE and CSE.

3. Modernize Capital Market Support Facilities

14. The antiquated systems of trading on the stock exchanges have been replaced by automated trading systems, which include the basic surveillance tools, eliminating the problem of the kerb market.¹² Since the exchanges became automated, trading volume rose substantially. Total trading value of both exchanges almost doubled from Tk25.9 billion (\$590 million) in 1997 to Tk48.4 billion (\$1 billion) in 1998. During 1999–2002, trading value remained quite stable, in the range of Tk49–55 billion (\$1 billion). Capital market indicators can be seen in Appendix 2. The exchanges are expanding their trading networks, to provide access to investors nationwide. CSE has a wide area network system linking Chittagong, Dhaka, and Sylhet, and it plans to expand the network to cover the northern region. DSE will also go nationwide, when its computer system is upgraded, to accommodate about 5,000 workstations.

15. With the enactment of the Depositories Act in April 1999, a private company, Central Depository Bangladesh Limited (CDBL), was incorporated under the Companies Act in August 2000.¹³ CDBL is setting up an automated centralized depository system (CDS) that will hold shares in scripless form, for safekeeping, and book-entry settlement of securities transactions. CDBL will also provide clearing services for over-the-counter trades and eventually for clearing of exchange trades. The CDS will help prevent the trading of counterfeit shares, ensure transparency, restore investor confidence, and contribute to the efficient functioning of the

¹⁰ At the time of the release of the second tranche of the loan, it was reported that ICAB had adopted 23 of the 40 IAS and 22 of the 46 ISA. Since then, several IAS have been replaced or updated. The International Accounting Standards Board has superseded 10 of the 40 originally issued accounting standards with new standards (these use the same IAS numbers but have different content), issued an additional standard, and withdrawn seven.

¹¹ ADB. 2000. *Technical Assistance to Bangladesh for Capacity Building of SEC and Selected Capital Market Institutions*. Manila.

¹² Previously, the manual system of the stock exchanges was not sufficient for the increase in trading volumes during the speculative bubble in the second half of 1996. It led to the growth of the kerb market, which was an unregulated market operating outside the exchanges on a cash-and-carry basis, without commission. The kerb market caused substantial losses to investors, due to their lack of recourse when documents turned out to be fictitious (paragraphs 50 and 51, RRP [dated October 1997]). At the time of the CMDP loan appraisal, CSE was already computerized, while DSE was considering automation proposals. DSE became automated in 1998.

¹³ Section 6 of the Depositories Act requires securities in the newly formed depository to be dematerialized. The SEC depository regulation issued on 24 May 1999, under the 1999 Depositories Act (Sections 5, 6, 8, 9, and 10), requires the transfer of such securities through the depository register.

capital market. The CDS is scheduled to go live in the fourth quarter of 2003. In 2002, ADB approved an equity investment of up to the equivalent of \$526,000, for a 10% stake in CDBL.¹⁴

4. Increase the Limited Supply of Securities to the Market

16. To promote the issuance and listing of new securities, the CMDP sought to reduce the corporate tax rate for all listed banks, insurance companies, and financial institutions (FIs) and make the rate uniform with the rate for listed industrial companies. Finance Act 2000 reduced to 35% the applicable tax rate on the total income of publicly listed banks, insurance companies, and FIs, which equaled the rate for listed companies, whereas the rate for nonpublicly listed banks, insurance companies, FIs and nonlisted companies remained at 40%. The reduction in tax rate did not really serve as an incentive to banks and nonbank FIs to list their securities at a stock exchange, which was intended by the tranche condition, since banks and nonbank FIs were obligated by the Bangladesh Bank (BB), when applying for licenses, to be listed on a stock exchange after a given period (3 years for banks).¹⁵ During FY2002 and FY 2003, because of the need to raise revenue, the Government increased the tax rate (returning it to 40%) for all FIs, whether listed or not.¹⁶ In the FY 2004 budget, this rate was further raised to 45%.¹⁷

17. To increase transparency of new issue offerings, SEC has moved to a disclosure system, instead of the previous practices of merit regulation and fixing the price of new issues. The approval process has been significantly expedited, as SEC was vested with sole authority over the contents of prospectuses. As for the development of the long-term debt market, the Government has been holding weekly auctions of 28-day and 2-year treasury bills (T-bills) and, more recently, 91-day, 182-day, 364-day, and 5-year T-bills. Repurchase agreements (repos) are auctioned every working day for 28-day T-bills and for overnight and one-week periods. There is currently no secondary market for T-bills and repos.

18. The divestment of Government-held shares in public companies was implemented slowly. The condition for the Government to divest its shares in 17 state-owned enterprises (SOEs) was not fully complied with. Key problems were lack of government commitment, lack of a consistent and comprehensive strategy for privatization, and inadequate capabilities of Privatization Commission (PC) staff to properly carry out privatization transactions.

5. Develop Institutional Sources of Capital to Improve Demand for Securities

19. Relevant laws have been amended to facilitate increasing investments in capital market securities by institutional investors. The Insurance (Amendment) Act 2000 sets the mandatory investments of life insurance companies in government securities and government-approved

¹⁴ Prior to the equity investment, ADB provided TA for the establishment and capacity building of an automated CDS: (i) TA 2830-BAN: *Establishment of an Automated Depository System*, which was valued at \$100,000 and approved in July 1997 and (ii) TA 3787-BAN: *Central Depository Capacity Building*, which was valued at \$150,000 and approved in December 2001.

¹⁵ The requirement for public listing has been in vogue since the licensing of the first generation of private banks in the 1980s. The banks were then given 5 years to get listed on an exchange. The listing requirement was applied also to banks owned by the Government that were sold to the private sector. For the past several years, all private banks have been listed. The Department of Insurance also put a similar condition on the letter of intent of insurance companies, but many of them have failed to go public on the due date.

¹⁶ In comparison, the tax rates applicable to listed and nonlisted industrial companies were 30% and 35%, respectively. Finance Act 2002 also introduced an excess profit tax.

¹⁷ In the FY 2004 budget, the tax rate for listed companies was left unchanged at 30%, while the rate for nonlisted companies was increased to 37.5% and the rate for banks, insurance and other nonblank financial institutions (listed and nonlisted) was raised to 45%.

securities and investments at 30% of total investable funds and allows the balance to be utilized for other investments, including capital market securities, subject to prudential guidelines to be issued by Department of Insurance (DOI), while the Trusts (Amendment) Act 2000 permits private pension and provident funds, previously required to be fully invested in government securities, to invest up to 25% of total investable funds in listed securities. The CMDP also aimed to liberalize the entry of the private sector in merchant banking and mutual fund operations. The first private mutual fund (AIMS First Guaranteed Mutual Fund) was licensed in January 2000 and listed on DSE and CSE in May 2000. The second mutual fund (Grameen Mutual Fund One) was registered with SEC in August 2001.

20. To create a level playing field in the capital market, the CMDP required the unbundling and restructuring of the Investment Corporation of Bangladesh (ICB). With the passage of the ICB (Amendment) Act 2000, three new subsidiaries were created to carry out merchant banking, mutual fund operations, and stock brokerage functions (paragraphs 28–29).

C. Program Costs

21. While the CMDP did not earmark funds, loan proceeds were deemed to have been used for adjustment costs related to revenue losses and expenditures necessitated by the Program over the medium term. These costs included the restructuring of ICB; rationalization of the tax structure among listed companies; removal of preferential pricing on government borrowings; and institutional strengthening of SEC, PC, ICAB, and the DOI.

D. Disbursements

22. The loan was disbursed in two tranches. The first tranche, equivalent to \$39.42 million, was released on 13 February 1998. At the time of the first tranche release, the Government had initiated actions to strengthen SEC and DOI, increase the transparency and professionalism of stock exchange operations, and curb preferential treatment of ICB in terms of access to concessional loans and government guarantees. The second tranche was initially scheduled for release around June 1999, which was 1 year and 6 months from the first disbursement. However, the release could not be effected as originally planned, due to delays in complying with several policy conditions. The Board approved the release of the second tranche on 22 December 2000, based on satisfactory compliance of the release conditions.

E. Program Schedule

23. The second tranche release was delayed from the original plan, due mainly to the lengthy processes for the enactment and amendment of relevant laws and slow progress on some policy reform measures, namely divestment of the Government's shares in SOEs and ICB restructuring. Nevertheless, the loan was closed on 22 December 2000, 6 months ahead of the 30 June 2001 closing date specified in the Loan Agreement.

F. Implementation Arrangements

24. Overall, implementation arrangements were satisfactory. The Banking Division of the Ministry of Finance (MOF) acted as the Executing Agency (EA) for the CMDP. The Government set up an interagency committee—composed of representatives from the Banking, Finance, Economic Relations, and Internal Resources Divisions of MOF, SEC, BB, the Ministry of Commerce (MOC), DOI, and ICAB—for proper monitoring and coordination of the CMDP. The committee was responsible for administering the use of loan proceeds.

25. ADB staff closely monitored the implementation of the CMDP. In June 1999, loan administration responsibility was transferred to the Bangladesh Resident Mission (BRM), but the responsibility for implementing related TAs remained with headquarters.

G. Conditions and Covenants

26. At the time of the second tranche release, 21 out of 24 conditions were deemed fully complied with, and three conditions were deemed substantially complied with. These three were (i) divesting the Government's shares in SOEs; (ii) unbundling ICB and creating three new subsidiaries to undertake merchant banking, mutual fund operations, and stock brokerage activities; and (iii) separating securities brokerage and dealership. Limited progress has been achieved in meeting these three conditions. Moreover, complete implementation of two fully complied with conditions has not been pursued actively. The five conditions are examined below:

1. Divesting the Government's Shares in State-Owned Enterprises

27. The divestment of the Government's shares in SOEs has been progressing slowly. From the list of 17 SOEs originally agreed during loan negotiation, 3 profitable SOEs were withdrawn and 8 were added as substitutes, creating a current list of 22 companies. Government's shares in 10 SOEs have been sold. The remaining companies are mostly loss-making SOEs consisting of five public listed companies and seven private companies (Appendix 3). ICB has experienced difficulties selling shares in the listed SOEs, due to poor performance and low liquidity of shares. The divestment of several SOEs is pending, due to protracted negotiation on share value with prospective buyers or delayed approval by the sector ministries to sell shares at below par value. To address the lack of supply of quality securities on the exchanges, market participants have urged the Government and concerned ministries to list profitable SOEs.

2. Unbundling Investment Corporation of Bangladesh

28. At the time of the second tranche release, the three ICB subsidiaries—ICB Capital Management Ltd. (merchant bank), ICB Asset Management Ltd. (manager of trusts and funds, including mutual funds), and ICB Securities Trading Ltd. (stock broker and securities dealer)—were incorporated under the Companies Act 1994. The then finance secretary expressed in writing a commitment¹⁸ to restructure ICB and outlined the two-stage capitalization of ICB subsidiaries. The subsidiaries were to receive their second stage capital after transferring ICB's assets and liabilities relating to merchant banking, mutual fund operations, and stock brokerage activities to the respective subsidiaries. On the basis of the assurance from the then finance secretary and incorporation of three new subsidiaries with their first stage capital, ADB considered the second tranche condition regarding the unbundling and restructuring of ICB to be substantially complied with. The former finance secretary also requested TA to undertake this complex task, which would include the audit of ICB accounts for FY2000 and the segregation, valuation, and transfer of assets and liabilities to ICB subsidiaries. The TA was to support the necessary tasks to effect the transfer and strengthen the capacity of the new subsidiaries to be able to compete on a level playing field with other firms and eventually be privatized. However, ICB management subsequently claimed that they were not consulted in the preparation of the said letter and that it was copied to them only later. In their view, the ICB unbundling was carried out and that was the reason for the release of the second tranche. Thus, ICB management was reluctant to include the transfer of assets and liabilities in the scope of the TA and wanted the TA to cover the strengthening of the capacity of ICB itself. The second stage capitalization of the subsidiaries has

¹⁸ Letter of 3 December 2000 addressed to the director of the then Programs Department (West), ADB.

not been implemented. Since the Government and ICB have not shown firm commitment to restructure ICB, the TA was subsequently dropped from ADB's TA program.

29. The three ICB subsidiaries became operational in July 2002. About 12% of ICB's 375 staff have been seconded to these subsidiaries, and up to 20% will be transferred in due course. The subsidiaries will be operating "new business," i.e. opening new accounts, while ICB will continue to operate "existing business," including the servicing of new and existing accounts of existing clients. This delineation, according to ICB management, is in accordance with Section 21A of the ICB Ordinance (Amendment) Act, drafted in consultation with ADB.¹⁹ ICB will continue to manage existing mutual funds and receive orders from existing clients, though the orders will be routed to and executed by the securities trading subsidiary. ICB has transferred its brokerage license to ICB Securities Trading Ltd.

30. During the program completion review in September 2002, the review mission reiterated to ICB and the Government that the intention of ICB restructuring was that after a transition period, ICB would cease to carry out merchant banking, mutual fund operations, and stock brokerage activities. The mission sent a letter in October 2002 to ICB emphasizing that any future TA for ICB and its subsidiaries would be contingent on the ICB board approving actions to seek the approval of mutual fund holders to place the management of the funds under SEC rules, initiate the transfer of investor accounts to the subsidiary, consider ways to expedite the transfer of ICB's assets and liabilities to its subsidiaries, and prepare a plan of action for the transfer.

3. Separating Securities Brokerage and Dealership

31. Due to the depressed state of the stock markets, SEC agreed to give stock exchange members up to 5 years, i.e. by the end of November 2005, to comply with the requirement to create separate entities for undertaking brokerage and dealership activities. The time span could be shortened, when market conditions improve sufficiently to enable members to financially sustain two organizations.

4. Securities and Exchange Commission as a Regulator

32. The tranche condition stipulated the replacement of part-time government members of SEC with full-time members, with priority to be given to candidates from the private sector, and the SEC (Amendment) Act 2000 stipulates that one member shall be from the private sector. However, the term "private sector" has been loosely interpreted. A former member, who was a professor at Dhaka University, was considered as having a private sector background. Despite being a public servant for many years, serving in several government entities, the immediate past chairman was not considered a government official, as he was not from the civil service cadre and was contracted as a professional individual. The three full-time board members are all retired government officials. Neither the immediate past chairman nor the members have any operational work experience in the financial sector.²⁰ SEC has not yet taken action to recruit a fourth member, as the three members together are apparently able to cope with the supervision responsibilities.

¹⁹ Excerpt of Section 21A: "...(a) no such subsidiary shall commence business specified above until it has been incorporated under the Companies Act, relevant license has been obtained for this purpose and a notification has been issued by the Government in the official gazette to the effect that the subsidiary is operational; and (b) after such notification the Corporation shall not undertake any of the business specified above that may originate as a new business."

²⁰ One member was formerly a member of the board of one of the government development financing institutions. The immediate past chairman and incumbent members of SEC are of the opinion that regulatory experience and personal integrity should be given preference over functional and operational experience.

To enhance private sector input, SEC should consider reactivating the Advisory Committee, consisting of knowledgeable private sector members. This concept was included in the design of the CMDP. SEC established a consultative committee, comprising 15 members from the stock exchanges, market players, and issuing companies, to serve as a forum for market-related actions and decisions. SEC reported that some members tried to exploit price-sensitive information from the committee's meetings. Consequently, SEC has not convened the committee for the past several years. This issue should be raised in the consultation for the next program loan, and a study should be conducted to introduce appropriate mechanisms to address conflicts of interest between the members' roles as advisers and as market participants and ensure the effective functioning of the committee.

5. Investment Regulations for Insurance Companies and Provident Funds

33. DOI has drafted a statutory order specifying the list of investments allowed. However, the list is unduly restrictive. For example, investments in ICB funds and those floated by its subsidiaries are allowed, but not in private mutual funds. Insurance companies are to be allowed to invest in shares and debentures of companies that are at least 25% owned by the Government or public listed companies that have a record of dividend payment exceeding 10% for the previous 2 years or at least 5 out of 7 years preceding the date of investment. DOI considers these as secure investments, but market participants view this rule as impractical, since it prohibits them from investing in good companies with shorter track records or lower dividend payouts. Almost 3 years after the amendment to the SEC Act, the statutory regulatory order has not yet been issued in final form (although an order which DOI said was still a draft was published in the gazette). DOI recently announced that the Insurance Rules 1958 would be amended by addition of Rule 10A (which is essentially the statutory regulatory order) to permit funds of insurance companies to be invested in the capital market. To date, the participation of insurance companies in the capital market is very limited.

H. Related Technical Assistance

34. **Capacity Building of the Securities and Exchange Commission and Stock Exchanges.** TA 2913 aimed to develop the capabilities of SEC in enforcing rules and regulations, conduct market supervision, promote market development, and assist the stock exchanges in developing their operational capabilities. The TA was rated partly successful.²¹ The TA achieved its capacity building objectives, including drafting securities regulations, improving the operation of SEC, training SEC staff, and introducing market surveillance procedures and investor protection funds at the stock exchanges. However, defects were subsequently found in the SEC Automation System, which was developed under the TA to facilitate market monitoring and detecting market irregularities. This problem was rectified under TA 3533. Making the CDS operational was delayed, due to organizational issues and funding problems. ADB subsequently provided TA 3787, to expedite making the CDS fully operational. The CDS is expected to go live in the fourth quarter of 2003. Meeting this target date will depend on the results of system testing, financing the shortfall in equity subscription, and preparing subscription and registration documentation.

35. Though significant progress was achieved under the TA, SEC needed to further strengthen its capacity, especially in the area of governance. Other key institutions, such as the

²¹ ADB. 2003. *Technical Assistance Completion Report on Capacity Building of the Securities and Exchange Commission and Stock Exchanges*. Manila. (Technical Assistance Completion Report for TA 2913)

exchanges, ICAB, and CDBL, also needed assistance to become more effective in discharging their responsibilities. TA 3533 was provided to meet their capacity building needs.

36. **Institutional Strengthening of the Privatization Board.** TA 2914 was formulated to improve the effectiveness of the Privatization Board, now named PC, in carrying out its functions, including developing the technical skills and knowledge of the staff and eliminating legal constraints to the privatization process. It provided significant outputs, including (i) training and a seminar on valuation and legal aspects of privatization; (ii) a valuation manual; (iii) a draft privatization policy and strategy; (iv) draft privatization regulations, to improve the legal framework; and (v) a computerized database of privatization candidates.

37. The TA was rated partly successful.²² Although the TA produced good quality outputs, privatization progressed at a slow pace. Government opinion is sought by PC prior to any privatization. Lack of competent PC staff remained the major constraint. The practice of rotating senior government officials to different ministries impeded the development of PC's institutional memory. In 2002, PC requested for further assistance in building its capacity to carry out privatization transactions. In response, ADB processed a small-scale TA in 2003.²³

38. **Insurance Industry and Pension and Provident Fund Reforms.** TA 2915 was formulated to cover insurance and pension and provident fund reform as well as training for concerned regulators and participants in both sectors. Because of the absence of response from MOC and DOI, the consultant could not proceed with improving the organization and management of DOI and carrying out follow-up work in the insurance sector.²⁴ Government and ADB agreed to refocus the consultant's work program, placing the emphasis more on pension and provident funds. MOC, as the EA, provided limited support for TA implementation, as pension and provident funds were outside its responsibility. As a result of the TA, there is greater awareness in Government of the mounting fiscal burden of unfunded pension liabilities of its pay-as-you-go pension system. MOC formed a committee to propose reforms in the insurance industry. The committee's recommendations are under consideration. The TA was rated partly successful.²⁵

39. Following up on the results of this TA, which revealed large economic and social benefits from a comprehensive reform of the contractual savings sector, ADB approved a TA proposal that would have prepared for a ban project to reform and strengthen the regulatory and supervisory framework for the insurance and pension sectors and extend coverage and begin building a multipillar pension system. This TA proposal was approved in December 2000, but it was cancelled in July 2002, when the deadline for signing the TA letter of agreement was not met, because of a delay in the preparation of the Government's own required TA project pro forma proposal. The Government remains open to policy dialogue on the need to reform, develop, and strengthen the insurance and pension and provident funds sectors under an appropriate legal and regulatory framework.

²² ADB. 2003. *Technical Assistance Completion Report on Institutional Strengthening of the Privatization Board*. Manila. (Technical Assistance Completion Report for TA 2914)

²³ ADB. 2003. *Technical Assistance to the Privatization Commission*. Manila. (TA 4104)

²⁴ ADB. 1993. *Technical Assistance to Bangladesh for Study of Insurance Industry and Pension and Provident Fund Operations in Bangladesh*. Manila. (TA 2033 recommended legal and regulatory reforms and drafted amendments to the relevant insurance laws. The committee, chaired by a BB deputy governor assigned to evaluate the recommendations of the TA, submitted its report only in 1999. Subsequently, MOC formed another committee to recommend reforms in the insurance industry.)

²⁵ ADB. 2003. *Technical Assistance Completion Report on Insurance Industry and Pension and Provident Fund Reforms*. Manila. (Technical Assistance Completion Report for TA 2915)

I. Performance of the Borrower and the Executing Agency

40. The performance of the Government and the EA could be rated partly satisfactory. Though the Government remained largely committed to developing the capital market, progress of reforms was slow in some areas, namely privatization, ICB restructuring, and pension and insurance sector reforms. This was primarily due to political interest and interference and a lack of competent personnel to handle complex tasks. The shortage of staff and frequent changes in high-ranking officials hindered the capacity building process, as staff could not devote sufficient time to holding discussions with consulting teams and participating in training programs.

J. Performance of the Asian Development Bank

41. The performance of ADB can be rated partly satisfactory, due to the ambiguity in the statements of certain tranche conditions, lenient interpretation of compliance status, and a lack of concrete follow-up measures to ensure full compliance. The tranche conditions should have been more specific, to set the stage for concrete implementation measures (paragraph 53). Neither the target number nor target sectors of SOEs to be divested were specified in the Loan Agreement, leaving leeway for the Government to hold on to profitable enterprises. ICB restructuring is also a pending issue that might have been avoided had the tranche condition explicitly specified the transfer of ICB's existing assets and liabilities to its subsidiaries. The assessment to determine the status of compliance was lenient. Divestment of SOEs on the divestment list was considered "substantially complied with," though the Government's shares in only five enterprises on the original list of 17 SOEs were actually divested. The condition for the unbundling and creation of new subsidiaries of ICB was considered "substantially complied with," after the new subsidiaries were incorporated but not yet operational. Regarding the conditions, which were substantially complied with at the time of the second tranche release, ADB did not request then for a concrete and time bound action plan to achieve full compliance.

42. ADB staff who designed the CMDP was not involved in its administration. Five staff supervised the Program at different times during the implementation phase. However, a few months prior to the second tranche release, there were extensive consultations among various staff who had been involved in the Program. ADB provided regular monitoring of the CMDP during the implementation period. From August 1998 to June 2001, a total of 14 review missions were fielded, totaling 138 person-days, and they were focused on the implementation of the CMDP and the three TA projects attached to it. After the release of the second tranche and the financial closing of the loan in December 2000, two missions were fielded in 2001, and one mission in 2002, for the program completion review. After the second tranche release, more regular dialogue should have been undertaken to pursue more expeditious actions on key implementation issues, including SOE privatization and ICB restructuring.

III. EVALUATION OF PERFORMANCE

A. Relevance

43. The design of the CMDP, which aimed at developing a fair, transparent, and efficient market to foster investor confidence and facilitate savings and investments, was highly relevant to the country's development strategy. A sound, stable, and deep financial system is essential for (i) promoting faster private sector-led growth—which will facilitate the achievement of the overarching objective of poverty reduction—and (ii) reducing the dependence of the Government and private sector on the banking system.

B. Efficacy in Achievement of Purpose

44. The CMDP is considered efficacious in achieving its stated purposes. A major achievement is the strengthening of SEC's capacity to be an independent and effective regulator. At the beginning of the Program, SEC faced the problems of inadequate and inexperienced staff as well as a lack of operational autonomy. During the implementation phase, at least two thirds of regular staff positions in SEC were filled, and SEC's supervisory capabilities were substantially strengthened. The SEC laws have been amended to vest SEC with authority to make rules and regulations, which shortened considerably the time it takes to issue new rules. The CMDP also strengthened the regulatory framework for disclosure, listing rules, inspection, sanctioning, and broker conduct. However, SEC needs to further develop its capacity and recruit more capable staff to handle its broad responsibilities.

45. The CMDP has substantially developed capital market infrastructure and support facilities. The stock exchanges have become automated with basic surveillance tools, eliminating the korb market. The functioning of the CDS, expected in the fourth quarter of 2003, will enhance transparency, solve the problem of counterfeit share certificates, and restore investor confidence in the market. The stock exchanges have restructured their boards to be independent, raised prudential standards of their member-brokers, and set up investor protection funds. The lack of competent SEC staff slowed down the implementation of some program components, such as training and testing market intermediaries, reviewing financial statements of listed companies, and auditing exchanges and brokers, while external factors, including the depressed state of the stock market and economic and political uncertainties, impeded progress in segregating brokerage and dealership functions into separate entities. However, SEC has shown commitment to furthering development in these areas.

46. The CMDP achieved limited success in enhancing the supply of quality securities.²⁶ The adoption of disclosure-based regulations brings more transparency to the market. The Government's shares in only five public companies were sold on the exchanges, and, of these, the Government held only 5-6% of the shares in three companies, contributing to a small increase in stock market capitalization. The Government's shares in the other five private companies were sold mainly to their existing shareholders, without being converted to public companies and floated in the stock market, which is the objective of the CMDP. The remaining SOEs on the divestment list are mostly loss-making enterprises. Though the Privatization Act 2000 was enacted to facilitate the divestment process, the lack of independence of PC and the lack of skilled PC staff remained major impediments.

47. Lack of commitment from the Government and its concerned ministries hindered the insurance and pension and provident fund reforms recommended by the TA undertakings. Though insurance and pension laws were amended to reduce restrictions on investments in the capital market, the list of permissible investment instruments, specified in the investment rules, is restrictive and not practical. Further, ICB restructuring is also a pending issue, as ICB was reluctant to transfer its assets and liabilities for merchant banking and mutual fund operations to the respective subsidiaries.

48. The lackluster trading sentiment, the DSE All Share Index hovering around 800-850 points, and the average daily trading value of Tk170-200 million (\$3-3.7 million) during 2000-

²⁶ There were a total of 40 newly listed companies, with total paid-up capital of Tk8.8 billion (\$154 million), in both exchanges from January 1998 to December 2002 (Appendix 2).

2002 could reflect that investor confidence has not picked up (see Appendix 2).²⁷ This was the result of market-specific factors, namely inadequate supply of securities and a lack of institutional demand, as well as the investment environment as a whole in Bangladesh, which has, along with most of the region, undergone difficult times, due to unfavorable external events arising from the East Asian crisis; the September 11 incident, in 2001; the Iraq war; and, most recently, Severe Acute Respiratory Syndrome.

C. Preliminary Assessment of Sustainability

49. The CMDP has laid down the key foundation for a legal and institutional framework for capital market development. Issuance of and amendment to many relevant laws considerably facilitated the development of market infrastructure. The CMDP also strengthened the human resources capacity at SEC, by replacing part-time members of the board with full-time members and filling staff vacancies. Training courses; on-the-job training programs, with real cases; and overseas training have enhanced the knowledge and skills of SEC's staff and enabled SEC to perform its supervisory role more effectively. These developments would likely provide sustainable benefits to the capital market. However, due to unattractive salaries, several officers who have undergone training under ADB's TA and other programs have left. Staff turnover, particularly at the senior level, posed significant constraints to the creation of institutional memory at SEC. To partly reduce the impact of staff turnover, it is important to create routines and procedures within SEC, enhance its management information system, and build up the capacity of relatively junior staff to handle certain supervisory tasks.

50. The institutional and regulatory setup and capacity building of key market participants under the CMDP are deemed to contribute to sustainable market development. However, the creation of a strong, deep, and efficient market, which can effectively function to achieve the goal of efficient mobilization and allocation of resources, requires (i) further development of the regulatory and governance framework and capacity building of key capital market institutions, (ii) an increase in the supply of quality securities, and (iii) development of institutional demand. The role of capacity building and training in the future should be to provide support for institutional changes and transitions to new rules and enforcement regimes.

IV. OVERALL ASSESSMENT AND RECOMMENDATIONS

A. Overall Assessment

51. The objectives of the CMDP were largely achieved. The CMDP is relevant to the country's strategy and development objectives and has achieved significant progress in many areas, including strengthening regulation and supervision and developing infrastructure in the capital market. However, the reforms to increase the supply of securities and develop institutional demand have progressed slowly, due mainly to a lack of Government commitment and a shortage of competent staff. Overall, the CMDP is assessed to be partly successful.

B. Lessons Learned

52. Due to the prevalence of malpractice in the market when the CMDP was designed, there was a strong need for increased transparency and disclosure and strengthened regulation and

²⁷ Market capitalization accounted for a negligible proportion of gross domestic product (average of 2.5% of gross domestic product during 2000–2002), compared with the deposits in the banking system (average of 27% of gross domestic product during the same period).

supervision of market players. However, the establishment of a disclosure-based system of regulation required several parallel reforms, including (i) a strong and independent but market-sensitive SEC; (ii) strong market players, including merchant banks; (iii) proactive exchanges willing and capable of self-regulation; (iv) the implementation of accounting and auditing systems to produce financial reports conforming to international standards; and (v) good corporate governance practices. Serious deficiency in any of these support reform elements makes it difficult to implement regulations based on full disclosure. The CMDP did not give balanced support to all these elements. Training and capacity building were heavily focused on SEC, almost to the neglect of other key capital market participants. Corporate governance, transparency, and adoption and implementation of accounting and auditing standards should have been given more priority. When brokers were barred from undertaking merchant banking functions, new merchant banks that were established did not have any experience and expertise. Accreditation should have been more selective, based on stricter criteria, and training on due diligence should have been provided.

53. The tranche release conditions should have been more specific, thereby avoiding ambiguity in interpretation. For example, it could have been stated that the “private sector” member of the SEC board should have working experience in industry or business or in the financial intermediary or securities businesses. As regards the condition to “establish” a company or institution, it should have been made clear that this meant not just getting the company incorporated but obtaining a license and becoming operational. It is not clear if the phrase “new business” in the ICB (Amendment) Law includes new transactions for existing clients. The tranche condition for the divestment of Government’s shares should have specified the minimum number of public and private limited companies to be divested and identified some of them. In many cases, the compliance status was assessed on the basis of the amendment of existing laws or the enactment of new laws, which were deemed to satisfy tranche conditions. However, enforcement of these laws in practice remained questionable.

54. As noted during formulation of CMDP, a lack of cooperation by the parties involved in the Program and their weak capacities were major risk factors (paragraph 128, RRP). The Government’s ownership of the policy reforms was vital to the success of the Program. MOF, as the EA for the CMDP, and SEC, as the EA for TA 2913, provided strong support for the implementation of the Program, contributing to significant progress in enhancing SEC’s supervisory capabilities. However, the development of the supply and demand sides of the capital market progressed slowly. The lack of management and staff skills in PC, inappropriate rules and procedures, and bureaucratic consultation impeded the privatization process. The insurance and pension and provident fund reform is a complicated and broad-based issue, requiring policy decisions by the Government. The slow response from the Government in evaluating recommendations related to insurance sector reform became an impediment to subsequent development. The scope of TA 2915 had to be refocused on pension and provident fund reform, but MOC (instead of MOF) continued to be the EA. With more extensive discussion during Program formulation, an appropriate implementation arrangement for the TA could have been designed. Staff and lack of skills in regulatory authorities hampered implementation of the CMDP and its attached TA activities. Transforming these regulatory bodies into independent self-funded organizations with greater flexibility in setting their own compensation scale is a delicate issue to be taken up with the Government under ADB’s future assistance program.

55. Weaknesses in corporate governance have been a pervasive problem. The quality of financial reports and adequacy of disclosures of listed companies have to be improved to be in line with international norms. The privatization process lacked transparency and had serious deficiencies in policy, regulation, and valuation methods. Although reforms under the CMDP

have corrected many of these shortcomings, further improvement in corporate governance is imperative to foster investor confidence and attract capital flows to Bangladesh.

C. Recommendations

56. **Program-Related.** Three tranche conditions considered “substantially complied with” at the time of the second tranche release were not fully complied with at the time of the program completion review and need to be closely monitored. The Government’s commitment to privatization can be gauged during the implementation of TA 4104 on privatization, which will provide “learning by doing” assistance to expedite the divestment of pilot profitable SOEs. The response of ICB management to ADB’s request for a detailed time bound action plan for restructuring ICB will indicate the Government’s and ICB’s willingness to complete the restructuring process. The separation of the organizations handling brokerage and dealership activities will be monitored, taking into consideration evolving capital market conditions.

57. The appropriate time for the preparation of the Project Performance Audit Report is first quarter of 2004, before loan fact-finding for the programmed financial markets governance loan. It is expected that by that time, ongoing TA 3533 will be finished and substantial work will be completed for TA 4104 and the project preparatory TA for the programmed loan. This will allow a fuller assessment of the market and institutional developments that CMDP reforms aimed to achieve. The Government’s commitment to policy and governance reforms could be better assessed when based on agreements to be made and upfront actions taken for the next loan.

58. Significant progress has been achieved in the CMDP. However, gaps and weaknesses, especially in the area of governance, remain. Promotion of good governance was one of the program focus areas under the Country Strategy and Program. Financial market governance would be the main theme for ADB’s future assistance in the financial sector. This would build investor confidence and strengthen financial intermediation through appropriate policy, legal, regulatory, and institutional reforms that cover all market segments, including regulators, financial intermediaries, stock exchanges, market participants, listed companies, and issuers of securities. Institutional capabilities to enforce good corporate governance, financial reporting, and disclosure have to be strengthened. Funding constraints and the lack of qualified staff in regulatory bodies that impeded full implementation of several reform measures under the CMDP should be addressed, to ensure the success of good governance initiatives.

59. **General.** The design of a program loan, especially its tranche conditions, should be specific and concrete, taking into consideration the design’s effect on the monitoring phase. If a tranche condition involves several action steps to complete, these steps should be spelled out as tranche or nontranche subconditions, to avoid subsequent debate on compliance status.

60. For the tranche conditions considered “substantially complied with” at the time of the second tranche release, ADB should request the Government and EA to set a time bound action plan specifying measures to be implemented to upgrade the status to “full compliance.” The subsequent program review missions should then focus on the implementation of this action plan, to ensure the sustainability of the Program.

POLICY MATRIX

Objectives and Policy Actions	Second Tranche Release Conditions		Nontranche Release Conditions	
	Actions	Status of Compliance	Actions	Status of Compliance
A. Strengthen market regulation and supervision.	1. Replace part-time members of the Securities Exchange Commission (SEC), who are affiliated with the Government, with full-time members, preferably from the private sector.	<i>Complied With:</i> Sections 5 (1) and 5 (2) of the SEC (Amendment) Act 2000 specify that the board should be composed of a chairman and four full-time members, with one member coming from the private sector. The part-time members have been withdrawn. Appointment of a new chairman is pending. The three full-time members are former government employees (a member of the National Board of Revenue, an additional secretary of the Ministry of Industries, and a district judge). SEC has not recruited a fourth member.	1. SEC to complete staffing in accordance with approved expanded organization plan.	<i>Complied With:</i> Since the revision of SEC's organogram, in September 1997, all 75 regular staff posts have been filled. SEC received approval from the Ministry of Establishment for additional positions (four directors and seven assistant directors). Further approval by the Ministry of Finance (MOF) and its Monitoring Cell has been pending for more than 3 months.
	2. Vest in SEC the authority to make rules and regulations, consistent with SEC Act and any other statutes in force, without the need for prior government approval.	<i>Complied With:</i> Under Section 24 of the SEC (Amendment) Act 2000, SEC can, by notification in the official Gazette, make rules for carrying out the purpose of the Act without government approval.	2. Amend SEC Act to incorporate all existing legislation concerning securities.	<i>Complied With:</i> Parliament has passed relevant amendments to the SEC Act 1993 and SEC Ordinance 1969, for meeting the second tranche condition. A consolidated SEC Act, incorporating all existing legislation, has been finalized and vetted by the Ministry of Law. The draft Act was sent to MOF, for its consideration, at the end of 2001.
	3. Transfer to SEC related authorities over the contents of the prospectuses vested currently with the Registrar of Companies.	<i>Complied With:</i> Under Section 2B of the Securities and Exchange (Amendment) Act 2000, SEC has been vested with authority over the contents of the prospectuses.	3. Appoint special court(s) to hear and deal with securities cases and investors' grievances.	<i>Substantially Complied With:</i> The Government did not consider it necessary to appoint special courts to hear securities cases and investors' grievances, because (i) the number and frequency of such cases were likely to be too few and sporadic to justify special courts, and (ii) the sessions judge has the jurisdiction to try security-related

Objectives and Policy Actions	Second Tranche Release Conditions		Nontranche Release Conditions	
	Actions	Status of Compliance	Actions	Status of Compliance
				offenses, under the existing legal framework of SEC
				Ordinance 1969 and SEC Act 1993. Further, SEC has established a designated complaint desk to handle investors' complaints. The stock exchanges have also established mechanisms to deal with complaints against stock brokers/dealers. While complaints related to securities laws are directly dealt with by SEC, those related to trade/business are dealt with by the stock exchanges. The Dhaka Stock Exchange (DSE) has appointed a panel of retired district judges to hear and pass judgment on complaints, while the Chittagong Stock Exchange (CSE) has formed a complaint subcommittee, composed of exchange members.
	4. Provide SEC specific and direct authority over clearing, settlement, and depository functions.	<i>Complied With:</i> With the Parliament's passing of the Depositories Act 1999 and the Securities and Exchange (Amendment) Act 2000, along with the removal of Section 25 of the 1993 SEC Act and the powers under sections 33 and 34 (2) (xi) and (xiv) of the Securities and Exchange Ordinance 1969, the SEC now has specific and direct authority over clearing, settlement, and depository functions.	4. SEC to implement technical assistance (TA) on capacity building, which will cover monitoring and surveillance, audit and inspection, and management information system development.	<i>Complied With:</i> TA 2913 was completed in June 2000. Several important recommendations from the TA have been implemented, and others are in the process of being implemented. A follow-on TA 3533 focused on promoting corporate governance in listed companies and market intermediaries, strengthening the quality of financial reporting and implementation of the SEC automation system.

Objectives and Policy Actions	Second Tranche Release Conditions		Nontranche Release Conditions	
	Actions	Status of Compliance	Actions	Status of Compliance
B. Develop capital market infrastructure.	5. Require the councils/boards of directors of the stock exchanges to include nonbrokers (at least 50%) and adequately represent issuers and investors.	<i>Complied With:</i> The amended Memorandum of Articles of Association of both stock exchanges now each provide for the inclusion of nonbrokers (50%). The stock exchanges have implemented this condition.	5. The Institute of Chartered Accountants of Bangladesh to adopt international accounting standards (IAS) and international standards on auditing (ISA) for all listed companies. This will involve continuous monitoring.	<i>Substantially Complied With:</i> With the issuance of the Public Issue Rules 1998 and Amendments to Securities and Exchange Rules 1987, SEC has made it mandatory that all financial statements filed with the commission must be in accordance with the applicable IAS and audited according to all applicable ISA. The Institute of Chartered Accountants of Bangladesh (ICAB) has so far adopted 8 out of 34 IAS and 14 out of 39 ISA. SEC is pursuing, with ICAB, the possibility of implementing the remaining standards. To ensure full compliance, ICAB would need to impart intensive training to its members. Under the follow-on TA 3533-BAN, ADB will use training materials prepared under a recently completed World Bank-financed ICAB project.
	6. Raise the minimum capital requirement for brokers.	<i>Complied With:</i> Both stock exchanges have set a minimum capital requirement of Tk2.5 million. In accordance with SEC's Notification, dated 4 June 2002, a broker must maintain a net worth of at least 50% of the minimum capital required (i.e. Tk1.25 million). Brokers that are members of both exchanges must maintain capital of at least Tk5 million, which is twice the amount of minimum capital required. Brokers must comply with these capital and net worth requirements by 31 December 2003.	6. Eliminate membership limitation at the stock exchanges, except in clearly justifiable cases, such those involving overcrowding.	<i>Complied With:</i> Both exchanges now permit membership up to 500. Under amended Clause 4 (b) of CSE's Memorandum of Articles of Association and under Clause 7 of the Memorandum of Articles of Association of DSE, the two exchanges have raised membership to 500 each. However, due to the depressed state of the stock market, current membership is considerably lower. At present, there are 162 and 85 active DSE and CSE members, respectively.

Objectives and Policy Actions	Second Tranche Release Conditions		Nontranche Release Conditions	
	Actions	Status of Compliance	Actions	Status of Compliance
	7. Introduce risk-based capital adequacy norms for all member-brokers of the stock exchanges.	<i>Complied With:</i> With the amendment to Securities and Exchange Rules 1987 (dated 15 December 1999), a new rule (15) has been introduced, which stipulates that a broker-member will, for the purposes of his/her business, maintain a ratio of 1:20 between net capital and aggregate liabilities.	7. Remove inactive members from the stock exchanges.	<i>Complied With:</i> Necessary amendments to SEC (Stockbroker, Stock Dealer, and Authorized Representative) Regulations 1994 have been introduced.
	8. Eliminate the practice of dual listing securities.	<i>Complied With:</i> This condition is met by the introduction of clause 13 in SEC Public Issue Rules 1998 (dated 3 January 1999).	8. Raise qualification standards for membership at the stock exchanges, specifying minimum services that member-brokers must provide and prescribing the requirement for brokers to engage in active trading. Additionally, floor representatives are to be required to meet minimum qualifications, based on educational attainment, moral background, and passing written qualifying examinations.	<i>Partially Complied With:</i> Provisions relating to minimum required services to be provided by a member-broker are embodied in rules 4 to 8 of the Securities and Exchange Rules 1987 and regulations 10 and 12 of SEC (Stock Dealer, Stock Broker, and Authorized Representative) Regulations 1994. As per Regulation 4, a floor representative (authorized representative) must have the equivalent of intermediate academic qualifications (12 classes) and certification from an institute recognized by SEC or have a certain number of years of experience in securities trading, prescribed by SEC. Training programs were organized by SEC to train approximately 500 floor representatives. To date, 424 floor representatives have been certificated, and SEC plans to hold more training sessions for the approximately 90 representatives remaining.

Objectives and Policy Actions	Second Tranche Release Conditions		Nontranche Release Conditions	
	Actions	Status of Compliance	Actions	Status of Compliance
	9. Require that securities dealership and brokerage operations be carried out by separate entities with separate organizations and books of accounts.	<i>Substantially Complied With:</i> SEC has amended Rule 8 of SEC Rules 1987 (dated 3 June 1999), which makes it mandatory for members to maintain separate ledgers (or comparable accounts) for brokerage and securities dealership. However, due to the depressed state of the market, stock exchange members are unable to create separate organizations for undertaking dealership and brokerage functions. The Government appreciates the importance of this condition and is of the view that complete compliance will take time. Consequently, Sections 2 and 3 of SEC (Stock Broker, Stock Dealer, and Authorized Representative) Regulations 1994 have been amended, to allow a time span of 5 years within which stock exchange members are mandated to create separate entities, with separate organizations, for undertaking brokerage and dealership. This 5-year period will end on 28 November 2005.	9. SEC to complete audit and inspection of the stock exchanges and member-brokers of the stock exchanges. This will involve continuous monitoring.	<i>Complied With:</i> SEC has adopted a set of audit and inspection methodologies/procedures for carrying out audits and inspections of the stock exchanges and member-brokers of the stock exchanges. SEC has completed the audit and inspection of DSE, CSE, and DSE's member-brokers, and it is in the process of auditing and inspecting CSE's member-brokers. The exercise will involve continuous monitoring.
	10. Require stock exchanges to establish investor protection funds.	<i>Complied With:</i> Both stock exchanges have created separate investor protection funds (under Investor Protection Fund Regulations 1999) governed by uniform rules and regulations.		
C. Modernize capital market support facilities.	11. Establish an automated central depository that adequately represents users of the system, based on an appropriate legal and regulatory framework.	<i>Complied With:</i> With the Parliament's approval of the Depositories Act, in June 1999, a private company called Central Depository Bangladesh Limited (CDBL) has been formed. The company has been incorporated	10. Initiate integration of operations of stock exchanges based on results of the earlier study, including the introduction of an odd-lot board and over-the-counter system.	<i>Complied With:</i> Steps have been initiated to integrate the operations of the stock exchanges, and these steps are governed by a uniform set of laws. Moreover, SEC formed the Reforms Committee, consisting of

Objectives and Policy Actions	Second Tranche Release Conditions		Nontranche Release Conditions	
	Actions	Status of Compliance	Actions	Status of Compliance
		<p>under the Companies Act and received the certificate for commencement of business on 20 August 2000. CDBL has already installed hardware and is in the process of testing software. Approval by SEC of the Depository Regulations is expected in the third quarter of 2003. Due to operational and funding problems, the centralized depository system (CDS) is expected to be functional in the fourth quarter of 2003, about 1 year after the original target date of the end of November 2002.</p>		<p>senior management of DSE and CSE and commission staff. Another development is the voluntary formation of two trade associations: The Association of Merchant Banks (formed toward the end 1998) and the Bangladesh Association of Stock Exchange Listed Companies (formed in July 1999). Both associations frequently interact with SEC to consider proposals for strengthening the stock market.</p> <p>SEC has also introduced a variant of the over-the-counter system, by creating a separate category for the shares of companies that (a) have failed to hold annual general meetings regularly; (b) have not been in operation for more than 6 months; and (c) have negative accumulated losses, net of reserve, exceeding the paid-in capital. The shares of such companies are categorized as "Z," and transactions in these shares are settled directly with the broker/dealer at T+7, with intimation to clearing house of the stock exchanges. In October 2002, SEC placed 93 securities in DSE and 31 securities in CSE in the "Z" category.</p>
	12. Introduce automated trading systems at the stock exchanges and extend investors' access to listed securities, making this nationwide.	<p><i>Complied With:</i> DSE (since 10 August 1998) and CSE (since 2 June 1998) are trading on-line. Both stock exchanges have included basic surveillance tools in these trading systems. CSE's automated wide area network</p>		

Objectives and Policy Actions	Second Tranche Release Conditions		Nontranche Release Conditions	
	Actions	Status of Compliance	Actions	Status of Compliance
		system currently links three major cities—Dhaka, Chittagong, and Sylhet. CSE is also attempting to bring the northern region under its on-line trading network, by opening an outlet at Bogra. In the next phase of expansion, CSE will try to launch on-line trading operations in Khulna and Rajshahi. DSE also plans to expand the network nationwide and increase the number of workstations to 5,000, from 600.		
D. Increase limited supply of securities in the capital market.	13. Introduce legislation to further reduce the corporate tax rate for all listed banks, insurance companies, financial institutions, and nonresident companies to 35%, to make the rate uniform with the rate applicable to listed industrial companies.	<i>Complied With:</i> In Finance Act 2000, the applicable rate of tax on total income of publicly traded companies, which have registered offices in Bangladesh, was 35%, in compliance with the second tranche release condition. This tax rate was maintained in FY2001. In Finance Act 2002, because of the need to raise revenues, the Government returned the tax rate to 40% for all financial institutions, whether listed or not. Finance Act 2002 also introduced an excess profit tax. The tax rate for listed and nonlisted industrial companies was set at 30% and 35%, respectively. In FY 2004, the tax rate for listed companies was kept at 30% while the rate for nonlisted companies was raised to 37.5% and the rate for financial institutions (listed and nonlisted) was increased to 45%.	11. For Government-held shares in private companies whose memoranda of associations carry restrictions on the sale of shares to the public, (a) the Government is to take steps to convert private companies (shares not publicly traded) to public limited companies and offer securities of these companies to the public and/or (b) sell its shareholdings in such private companies in accordance with existing laws.	<i>Partially Complied With:</i> The Government sold most of its shares in Reckitt and Coleman on DSE, with the UK parent company maintaining majority ownership and management control. Government shares in five private companies were sold to the private majority shareholders or foreign partners. Divestment in some unlisted companies could not proceed because of disagreements between the Government and the majority owners on the valuation of the shares.

Objectives and Policy Actions	Second Tranche Release Conditions		Nontranche Release Conditions	
	Actions	Status of Compliance	Actions	Status of Compliance
	14. Amend the Banking Companies Act, Financial Institutions Act, and related regulations, to vest exclusive authority for merchant banking functions with SEC.	<p><i>Complied With:</i> Under Section 8 of the Securities and Exchange (Amendment) Act 2000, SEC has the authority to register and regulate merchant banks. To remove the competing control of the Bangladesh Bank (BB) on the operation of merchant banks, BB (in consultation with the Government) has issued two notifications in exercise of the powers vested under Section 48 of the Financial Institutions Act 1993 and Section 121 of the Banking Companies Act 1991, exempting merchant banks that do not take deposits from the public from the purview of the two acts.</p> <p>MOF has permitted commercial banks to operate as merchant banks, through a separate wing, without forming subsidiary companies and issued notification, dated 19 October 2000, exempting the merchant banking units of commercial banks from the jurisdiction of the Banking Companies Act 1991, effective from 23 October 2000.</p>		
	15. Eliminate SEC's practice of fixing the prices of new securities, once merchant banks become operational.	<p><i>Complied With:</i> Under Section 2A of the Securities and Exchange (Amendment) Act 2000, SEC no longer has the power to fix the prices of new issues.</p>	12. Accelerate divestment of state-owned enterprises (SOEs) by strengthening the Privatization Board and facilitate the privatization process.	<p><i>Partially Complied With:</i> With the enactment of the Privatization Act 2000, the autonomy of the Privatization Commission (PC) has been enhanced in terms of exercising different options for privatization. Though the law allows PC to independently finalize the sale of enterprises up to Tk250 million, in practice the Government exercised the authority to withdraw profitable</p>

Objectives and Policy Actions	Second Tranche Release Conditions		Nontranche Release Conditions	
	Actions	Status of Compliance	Actions	Status of Compliance
				companies from the list. Further, some cases are pending, because the concerned ministries have not yet decided if they will allow sales at prices below par values. The divestment process remains slow.
	16. Divest government shareholdings in certain public national and multinational companies.	<i>Substantially Complied With:</i> The Loan Agreement did not specify the number of public (national and multinational) companies in which the Government was expected to divest its shareholdings. During loan negotiations, the Government suggested a list of 17 enterprises. Subsequently, during the implementation phase, the Government suggested to ADB a revision of the list, in view of the difficulties it was experiencing, due to (a) the depressed state of the stock market, (b) acceptable valuation of its equity in nonlisted companies, and (c) rapid deterioration of the financial position of some of the companies suggested earlier for divestment. ADB agreed to the Government's request. The updated list comprises 22 SOEs (including eight substitute and additional companies and three withdrawn from the original list). The Government has been able to divest all or almost all of its shares in 10 companies, i.e. 60% of the original target. These include five public companies (which were sold in the stock market through the	13. Implement TA to establish legal framework for governing privatization of SOEs and operation of the Privatization Board and submit report for ADB review and consideration.	<i>Complied With:</i> TA 2914 was implemented as scheduled. The Government also enacted the Privatization Act 2000, which provides an enabling legal framework for governing the privatization of SOEs. The autonomy of PC has been enhanced.

Objectives and Policy Actions	Second Tranche Release Conditions		Nontranche Release Conditions	
	Actions	Status of Compliance	Actions	Status of Compliance
		Investment Corporation of Bangladesh (ICB) and five private companies (which were sold to the other existing shareholders). For the remaining 12 companies, ICB is in the process of off-loading shares in four public listed companies. It will off-load its shares in another listed company, pending the split up of share certificates by the Ministry of Industries. The remaining seven private companies are in the process of revaluation or negotiation with prospective buyers. SEC recommended, and the PC agreed, that in the future at least 3 brokers (which may include ICB) would be appointed to sell government-owned shares.		
	17. Issue government securities with a maturity of not less than 2 years on a regular basis, through the auction system, to be evidenced by ownership certificates.	<i>Complied With:</i> BB has been holding weekly auctions of 28-day and 2-year Treasury bills (T-bills), since September 1998. More recently, 91-day, 182-day, 364-day, and 5-year T-bills have been auctioned weekly. Auction is through multiple pricing, where BB progressively accepts bids at higher yields until the auction quota (which is not known in advance) is satisfied. All T-bill maturities are offered at the weekly auction, but the Government, through the auction committee, has complete discretion concerning the acceptance or rejection of bids. These securities have been purchased mainly by commercial banks. Repurchase agreements (repos) are available for 28-day T-bills and overnight and one-week	14. Implement TA to enhance the capacity of the Privatization Board to undertake the valuation and analysis of bids and tenders for sale and disposition of SOEs and their assets.	<i>Complied With:</i> Under the TA, a Valuation Manual was prepared to help Privatization Commission officials supervise the valuation work done by the firms doing the valuing, which has helped strengthen the commission's in-house technical capabilities. The TA also assisted in preparing the Privatization Policy Statement and Privatization Regulations. In addition, three seminars/workshops were arranged. Government officials, representatives of different professional groups, journalists, and labor and political leaders participated in the seminars/workshops. A training course was also organized on valuations of SOEs and legal aspects of privatization.

Objectives and Policy Actions	Second Tranche Release Conditions		Nontranche Release Conditions	
	Actions	Status of Compliance	Actions	Status of Compliance
		periods. Repo auctions are held every working day, with BB having the discretion to accept or reject bids in part or in full. There is as yet no secondary market for these debt securities.		
			15. Enact legislation to govern the privatization of SOEs.	<i>Complied With:</i> The Parliament enacted the Privatization Act 2000, which will now govern the privatization of SOEs.
			16. Enhance the autonomy of the chairman and members of the PC board by fixing their terms of appointment and stipulating that they may be removed solely for causes.	<i>Substantially Complied With:</i> The Privatization Act 2000 provides a provision, by fixing the terms of reference of the chairman and the members of PC (sections 7, 8, and 10 of the Privatization Act 2000).
E. Develop institutional sources of capital to improve demand for securities.	18. Restrict mandatory investments by insurance companies in government securities and government-approved securities and investments to 30% of total investable funds. Capital market investments are to be subject to prudential guidelines, to be introduced by the Department of Insurance (DOI).	<i>Complied With:</i> Section 27 of the Insurance (Amendment) Act 2000 states that at least 30% of investable (insurance) funds shall be invested in government securities and that the balance can be used for any other investments, including capital market investments. DOI issued its Notification, dated July 28, 2002, specifying the list of investments for the balance assets (other than government securities).	17. Reorganize and staff DOI to meet redefined objectives and implement operating plan.	<i>Substantially Complied With:</i> To reorganize DOI, a six-member committee was set up under the chairmanship of Dr. Sohrabuddin, Deputy Governor of BB. The committee submitted a report recommending 69 DOI posts, consisting of 23 Class-I, 4 Class-II, 21 Class-III, and 21 Class-IV posts. The Ministry of Establishment has consented to the creation of a total number of 53 DOI posts, of which 20 are permanent and the remaining 33 are temporary, including the post of chief controller of insurance. Out of the said 53 posts, 14 are Class-I, 4 are Class-II, 22 are Class-III, and 13 are Class-IV. The ministry has proposed to abolish 13 existing posts. No actions have been taken based on the recommendations of Dr. Sohrabuddin's committee. Meanwhile, the Ministry of

Objectives and Policy Actions	Second Tranche Release Conditions		Nontranche Release Conditions	
	Actions	Status of Compliance	Actions	Status of Compliance
				Commerce has formed another committee, chaired by Secretary Soyed Tanveer Hossain, Ministry of Textile (former chief controller of insurance), to study the reorganization of DOI.
	19. Introduce legislation to allow at least 25% of private pension and provident funds currently fully invested in government securities to be invested in the capital market.	<i>Complied With:</i> Section 20B of the Trusts (Amendment) Act 2000 allows up to 25% of private pension and provident funds to be invested in any security listed with the stock exchanges of Bangladesh.	18. The Government to revise existing insurance and pension and provident fund regulations in accordance with the recommendations of Bank TA 2033-BAN: <i>Study of Insurance Industry and Pension and Provident Fund Operations.</i>	<i>Partially Complied With:</i> To revise insurance and pension and provident fund regulations, Dr. Sohrabuddin's committee has finalized a report that has been submitted to the Ministry of Commerce. No actions have been taken based on the recommendations.
	20. Grant private sector-sponsored mutual funds licenses to operate.	<i>Complied With:</i> SEC registered the first private sector mutual fund (AIMS First Guaranteed Mutual Fund) on 27 January 2000. The second private mutual fund (Grameen Mutual Fund I) was registered with SEC in August 2001, and the asset management company is in the process of reviewing the implication of the new Mutual Fund Rules on their planned investment scheme.	19. Implement TA for DOI and pension and provident funds, to: <ul style="list-style-type: none"> strengthen DOI's ability to regulate and supervise insurance industry operations, in particular to undertake the tasks of amending insurance regulations, establishing prudential guidelines governing the operation of insurance companies, and building capacity; and assist in the implementation of recommendations made under TA 2033 and establish prudential norms for pension and provident funds. 	<i>Partially Complied With:</i> Under TA 2033 amendments to the Insurance Act of 1938, the Insurance Rules of 1958, and the Insurance Corporation Act of 1973 were drafted. In addition, under the TA, a diagnostic review of DOI's organization structure, staffing, training and equipment needs, and operations was undertaken and modest practical improvements were proposed. No actions have been taken based on the recommendations of Dr. Sohrabuddin's committee. With respect to pension reform, TA 2915 proposed new regulations concerning the provision of retirement, superannuation, gratuity, and provident fund benefits; estimates of future government pension liabilities to government employees; and an estimate of the

Objectives and Policy Actions	Second Tranche Release Conditions		Nontranche Release Conditions	
	Actions	Status of Compliance	Actions	Status of Compliance
				cost of shifting to a fully funded system. The TA also proposed and designed the Central Provident Fund for the formal private sector, with possible application to the public sector. The TA's output included projections of funding accumulations and revision in investment guidelines. In response to TA recommendations, the Government revised the investment guidelines and approved a modest increase in DOI staff.
	21. Require that separate entities undertake merchant banking, portfolio management, and stock brokerage.	<i>Complied With:</i> SEC has passed a regulation amending SEC (Merchant Bankers and Portfolio Manager) Regulations 1996 [Section 5 (2)], SEC (Mutual Fund) Regulations 1997 (Section 2), and SEC (Stock Broker, Stock Dealer, and Authorized Representative) Regulations 1994 [Section 4 (1) (b)], which requires separate entities to undertake merchant banking, portfolio management, and stock brokerage functions.		
	22. Require merchant banks, mutual funds, and stock brokerage firms to have no interlocking officers and management.	<i>Complied With:</i> Necessary amendments to SEC (Merchant Banker and Portfolio Manager) Regulations 1996 (15A), and SEC (Mutual Fund) Regulations 1997 (section 12A) have been made.		
	23. Require merchant banks, mutual funds, and stock brokerage firms to not have more than 50% of their boards composed of directors of affiliates or persons associated in any manner with sponsors.	<i>Complied With:</i> Necessary amendments to SEC (Merchant Banker and Portfolio Manager) Regulations 1996 (Section 6A) and SEC (Mutual Fund) Regulations 1997 (Section 12A) have been made.		

Objectives and Policy Actions	Second Tranche Release Conditions		Nontranche Release Conditions	
	Actions	Status of Compliance	Actions	Status of Compliance
	<p>24. Unbundle and restructure ICB and create three separate entities under the Companies Act 1994, as amended, to carry out the merchant banking, mutual fund operation, and stock brokerage activities, respectively, of ICB, in accordance with a plan acceptable to ADB.</p>	<p><i>Substantially Complied With:</i> Section 21A of ICB (Amendment) Act 2000 stipulates that (a) only one of the three established subsidiaries will carry out, respectively, merchant banking, mutual fund operations, and stock brokerage; (b) the companies must be registered under the Companies Act, licensed by SEC to undertake their business, and notified by the official gazette to make the subsidiary operational; and (c), once notified, ICB will not undertake any new business in these areas. The three subsidiaries—ICB Trading Company, ICB Asset Management Company, and ICB Capital Management Company—were registered under the Companies Act 1994 and granted licenses from SEC on 11 August 2002, 14 October 2001, and 16 October 2001, respectively. ICB Trading Company became a member of both stock exchanges. ICB Asset Management Company has been granted approval by SEC to set up one open-end fund (ICB AMCL Unit Fund) and one closed-end fund (ICB AMCL First Mutual Fund). ICB Capital Management sent an application to the SEC for its first securities offering transaction for Mutual Trust Bank.</p>		

CAPITAL MARKET INDICATORS—DHAKA STOCK EXCHANGE AND CHITTAGONG STOCK EXCHANGE

Table A2.1: Capital Market Indicators—Dhaka Stock Exchange and Chittagong Stock Exchange

Item	Dec. 1996	Dec. 1997	Dec. 1998	Dec. 1999	Dec. 2000	Dec. 2001	Dec. 2002
No. of Listed Companies	186	202	208	213	223	231	242
Market Capitalization (million)							
In taka	168,106	71,302	50,254	44,789	62,932	63,777	71,269
In \$	4,003	1,569	1,036	870	1,165	1,119	1,239
Market Cap (as % of GDP)	10.00	3.95	2.51	2.04	2.65	2.52	2.63
Trading Volume (million)	123	163	1,498	1,083	1,320	1,698	1,890
Avg Daily Trading Volume (million)	0.48	0.61	5.46	4.21	4.77	6.34	6.59
Trading Value (million)							
In taka	36,219	25,871	48,405	50,503	53,298	54,676	48,570
In \$	866	589	1,031	1,028	1,022	979	835
Avg Daily Trading Value (million)							
In taka	141	96	176	196	192	204	171
In \$	3.39	2.20	3.77	4.00	3.69	3.66	2.94
Initial Public Offering							
No. of companies listed during the year	3	16	6	5	10	9	10
Paid-up capital of companies listed during the year (million)							
In taka	3,195	5,530	656	460	2,686	2,299	2,748
In \$	76	126	14	9	50	41	47
Portfolio Investment in Securities by Nonresident Bangladeshis^a (million)							
In taka	716	518	316	95	393	323	(348)
In \$	17.15	11.80	6.74	1.95	7.55	5.80	(6.00)
Economic Data							
GDP (\$ million) ^b	39,796	41,169	42,676	44,758	45,462	47,125	46,934
GDP (taka billion)	1,663	1,807	2,002	2,197	2,371	2,535	2,714
M2 (taka billion)	488	536	598	690	823	944	1,069
Gross domestic investments (taka billion) ^c	333	375	433	488	546	586	628
Gross national savings (taka billion) ^c	336	390	436	490	548	568	611
Demand and time deposits (taka billion)	386	431	477	543	646	757	861
Change in consumer price index (%) ^d	1.61	5.59	6.78	7.79	2.77	1.66	2.35
Exchange rate (end of period) ^e	42.450	45.450	48.500	50.850	53.850	57.000	58.000
Exchange rate (average of period) ^e	41.794	43.892	46.906	49.085	52.150	55.815	57.900

% = percentage.

Avg = average, Dec = December, GDP = gross domestic product, M2 = broad money, No. = number, and \$ = US dollars.

^a Source: SEC Annual Report, fiscal year ending 30 June.

^b Millions of dollars at current market price: fiscal year ending 30 June.

^c Fiscal year ending 30 June.

^d Base: 1985–1986 = 100 (fiscal year ending 30 June).

^e Taka per US dollar.

Table A2.2: Capital Market Indicators—Dhaka Stock Exchange (DSE)

Item	Dec. 1996	Dec. 1997	Dec. 1998	Dec. 1999	Dec. 2000	Dec. 2001	Dec. 2002
No. of Listed Companies	186	202	208	212	222	231	241
DSE Index (general index)	3055.56	1005.32	717.62	647.95	853.75	829.61	848.41
DSE-20 Index	NA	NA	NA	NA	NA	1,075.72	1,054.89
Market Capitalization (million)							
In taka	168,106	71,302	50,254	44,781	62,924	63,769	71,260
In \$	4,003	1,569	1,036	870	1,165	1,119	1,230
Market Cap (as % of GDP)	10.11	3.95	2.51	2.04	2.65	2.52	2.62
Trading Volume (million)	103	91	1,015	791	949	1,107	1,303
Avg Daily Trading Volume (million)	0.40	0.34	3.77	3.08	3.43	4.13	4.54
Trading Value (million)							
In taka	30,137	17,327	34,369	38,965	40,365	39,869	34,984
In \$	721	395	733	794	774	714	603
Avg Daily Trading Value (million)							
In Taka	118	65	128	152	146	149	122
In \$	2.83	1.48	2.72	3.09	2.79	2.67	2.10
Initial Public Offering							
No. of companies listed during the year	3	16	6	4	10	9	10
Paid-up capital of companies listed during the year (million)							
In taka	3,195	5,530	656	416	2,686	2,299	2,748
In \$	76	126	14	8	52	41	47

% = percentage.

Avg = average, Dec = December, DSE = Dhaka Stock Exchange, GDP = gross domestic product, No. = number, and \$ = US dollars.

Table A2.3: Capital Market Indicators—Chittagong Stock Exchange (CSE)

Item	Dec. 1996	Dec. 1997	Dec. 1998	Dec. 1999	Dec. 2000	Dec. 2001	Dec. 2002
No. of Listed Companies^a	105	128	136	144	151	163	172
CSE Index							
CSE All Share Price Index	1,157.90	332.98	232.80	197.83	NA	NA	NA
CSE All Share Price Index (Base 1000)	NA	NA	NA	1,000.00	1,412.25	1,836.87	1,841.14
Market Capitalization (million)							
In taka	147,043	55,832	41,383	36,542	57,760	56,430	60,468
In \$	3,464	1,228	853	719	1,073	990	1,043
Market Cap (as % of GDP)	8.84	3.09	2.07	1.66	2.44	2.23	2.22
Trading Volume (million)	19	72	482	292	371	591	587
Avg Daily Trading Volume (million)	0.08	0.27	1.69	1.13	1.34	2.21	2.05
Trading Value (million)							
In taka	6,082	8,544	14,036	11,539	12,934	14,806	13,586
In \$	146	195	299	235	248	265	232
Avg Daily Trading Value (million)							
In taka	23	32	49	45	47	55	49
In \$	0.56	0.72	1.05	0.91	0.90	0.99	0.84
Initial Public Offering^b							
No. of companies listed during the year				1 ^c			
Paid-up capital of companies listed during the year (million)							
In taka				44			
In \$				0.90			

% = percentage.

Avg = average, Dec = December, CSE = Chittagong Stock Exchange, GDP = gross domestic product, No. = number, and \$ = US dollars.

^a Dhaka Dying is the only listed company on CSE that is not listed on DSE.

^b Exclude (i) DSE-listed companies that have a secondary listing on CSE and (ii) newly listed companies that have also been listed on DSE.

^c Dhaka Dying.

PRESENT STATUS OF DIVESTMENT OF STATE SHARES

Table A3.1: Original 17 Companies in the Divestment List

Name of SOEs	Public Ltd./ Private Ltd.	Products	Govt's Share (as of 17 Sep 2002)	Face Value (Tk)	Market Price ([Tk] as of 17 Sep 2002)	Status/Remarks
A. SOEs already divested						
1. Reckitt & Coleman Ltd., Chittagong ^a	Public Ltd. (listed)	Pharmaceuticals & Toiletries	0.29% (6.68% already divested)	10/-	96.70	The enterprise is profitable. Management control lies with Reckitt and Coleman, UK. The Government decided to divest 6.97% of its shares, and 6.68% have been sold at the average price of Tk176.20 (on the Dhaka Stock Exchange [DSE]). The Investment Corporation of Bangladesh (ICB) acted as a broker.
2. Metalex Corporation Ltd., Dhaka	Public Ltd. (listed)	Electric Fan	0 (51% already divested)	100/-	88.00	The company has been incurring losses for several years and has huge negative net worth. The Government held 51% of Group A shares and had management control. All shares were sold to buyers in the same group at the average price of Tk109.69 (on DSE in 2001). ICB acted as a broker in the transactions. There was no restructuring prior to the sale.
3. Berger Paints Bangladesh Ltd., Chittagong	Private Ltd.	Enamel, Emulsion Paints	0 (42.33% already divested)	–	–	The enterprise is profitable and privately managed. All 42.33% of state-owned shares were sold out in block to J&N Investments, which belongs to Berger Group, the majority shareholder in 2000.
4. Siemens Bangladesh Ltd., Dhaka	Private Ltd.	Trading	0 (31.67% already divested)	1,000	–	The enterprise is profitable and privately managed. A valuation study commissioned by the Government has been completed. All remaining shares were sold to Siemens AG, Germany in 2000.
5. National Iron & Steel Ltd., Chittagong	Private Ltd.	Bailing Hoops	0 (17.11% already divested)	10	–	All remaining state-owned shares were sold in block to existing shareholders in 2001.

Name of SOEs	Public Ltd./ Private Ltd.	Products	Govt's Share	Face Value (Tk)	Market Price ([Tk] as of 17 Sep 2002)	Status/Remarks
B. SOEs withdrawn from the divestment list						
1. National Tubes Ltd. Tongi, Gazipur	Public Ltd. (listed)	GI, MS, and API Pipes	51%	100/-	519.75	This profitable company is a subsidiary of Bangladesh Steel Engineering Corporation (BSEC). The Government wanted to retain management control and keep 25% of its shares. Although sale through the stock exchange was initially approved by the Government, the Cabinet Committee on Economic Affairs subsequently decided to exclude the company from the divestment list.
2. Eastern Cables Ltd., Chittagong	Public Ltd (listed)	Electric Cables	(51%-15%)= 36%	100/-	210.50	This profitable company is a subsidiary of BSEC, which holds 51% of the Group A shares. BSEC sold 49% to the public, including 10% earmarked for employees. The employees have gone to court to claim 15% of the 51% remaining, which BSEC is holding, at par value. The Cabinet Committee on Economic Affairs decided to remove the company from the divestment list.
3. Atlas Bangladesh Ltd., Tongi, Gazipur	Public Ltd. (listed)	Motorcycles and Tricycles	51%	100/-	193.80	This profitable company is a subsidiary of BSEC. Management control is with BSEC, as holders of Group A shares. The Government proposed divestment in small lots through stock exchanges. The Cabinet Committee on Economic Affairs decided to withdraw the sale of government shares in the company.
C. SOEs in process of divestment						
1. Zeal Bangla Sugar Mills Ltd., Jamalpur*	Public Ltd. (listed)	Sugar	53.52%	10/-	5.60	The consultant advised that the company should fold, because of heavy losses. The Privatization Committee (PC) delivered shares to ICB for subsequent sale, and ICB has sold only 3.8% of the shares in the stock market, at an average price of Tk14.11.

Name of SOEs	Public Ltd./ Private Ltd.	Products	Govt's Share	Face Value (Tk)	Market Price ([Tk] as of 17 Sep 2002)	Status/Remarks
2. Shaympur Sugar Mills Ltd., Rangpur*	Public Ltd. (listed)	Sugar	99.23%	10/-	5.20	The company has been incurring losses for several years and has huge negative net worth. A consultant advised that the company should fold, because of heavy losses. PC delivered shares to ICB for subsequent sale, and ICB has sold only 8.3% of these shares in the stock market, at an average price of Tk13.47.
3. Usmania Glass Sheet Factory Ltd., Chittagong	Public Ltd. (listed)	Glass Sheet	51%	100/-	700.00	This profitable company is a subsidiary of Bangladesh Chemical Industries Corporation. Management is with the Government, the majority shareholder. The Ministry of Industries has to split share certificates into market lots for subsequent divestment in the stock market. PC plans to divest the shares using the top ten brokers.
4. Renwick Janeswar & Co. Ltd., Kushtia*	Public Ltd. (listed)	Agricultural Machinery	60%	100/-	45.50	PC delivered the shares to ICB for sale, and ICB has not yet been able to divest these shares in the stock market, because of the company's poor performance.
5. Arco Industries Ltd., Chittagong	Private Ltd.	Leather Board	11.5%	–	–	PC appointed a chartered accounting firm to undertake valuation. However, the existing shareholder did not accept the share price determined by the firm undertaking the valuation. A re-valuation was undertaken. The sale has not been finalized, due to the price disagreement.
6. Tiger Ware Products Ltd., Narayanganj	Private Ltd.	MS Ware	-18.95%	–	–	PC appointed a chartered accounting firm to undertake valuation. However, the existing shareholder did not accept the share price determined by the firm undertaking the valuation. A re-valuation was conducted, but the shareholder did not accept the share price calculated in the second valuation.
7. S. A. F. Industries, Jessore	Private Ltd.	Process Finished Leather	13.63%	–	–	PC appointed a chartered accounting firm to undertake valuation. However, the existing shareholder did not accept the

Name of SOEs	Public Ltd./ Private Ltd.	Products	Govt's Share	Face Value (Tk)	Market Price ([Tk] as of 17 Sep 2002)	Status/Remarks
						share price determined by the firm undertaking the valuation. A re-valuation was conducted, but the sale has not been finalized, due to some disagreement.
8. Dhaka Match Factory Ltd., Dhaka	Private Ltd.	Matches	30%	–	–	The company has been incurring losses for several years and has huge negative net worth. The Government proposed to substitute this with other companies (see below). A valuation study commissioned by the Government has been completed. The shareholders did not accept the share price determined by the firm undertaking the valuation. It is difficult to sell the shares to other buyers, due to restrictions in the Articles of Association.
9. Mirpur Ceramics Ltd., Dhaka	Private Ltd.	Brick, Tiles	20% (70,000 shares [formerly owned by the brother of an existing shareholder who left the country] acquired by the Govt through nationalization)	–	–	This company is profitable and privately managed. Valuation by the Government in 1996 was Tk135 per share, which the controlling shareholder accepted. The Government commissioned another valuation in 1999. The recommended value was over Tk1,700 per share, for a total of Tk12 crores. This valuation erroneously treated the land as freehold land. The company has only the right to use the land and does not own the land. The existing shareholders did not accept the adjusted share price determined by the firm that performed the valuation. State shares are yet to be sold.

Tk = taka.

Govt = government, Ltd. = limited, and SOE = state-owned enterprise.

^aThe name was changed to Reckitt Benckiser (BD) Ltd., Chittagong.

Table A3.2: Substitute and Additional Companies for Divestment of Government Shares

Name of SOEs	Public Ltd./ Private Ltd.	Products	Govt's Share	Face Value (Tk)	Market Price ([Tk] as of 17 Sep 2002)	Status/Remarks
A. SOEs already divested						
1. Islami Bank Ltd., Head Office, Dhaka	Public Ltd. (listed)	Banking	5%	1000/-	3,140.75	Already fully divested in DSE, at the average price of 3,892.38, through ICB in 2001.
2. National Bank Ltd., Head Office, Dhaka	Public Ltd. (listed)	Banking	5%	100/-	237.50	Already fully divested in DSE, at the average price of 221.35, through ICB in 2001.
3. Eastern Bank Ltd., Head Office, Dhaka	Public Ltd. (listed)	Banking	20%	100/-	343.25	Already fully divested in DSE, at the average price of 109.96, through ICB in 2001.
4. Int. Oil Mills., Chittagong	Private Ltd.	Edible Oil	50%	-	-	All state shares were sold to a foreign partner in 2001.
5. Van Omeran/Tank Terminal Ltd.	Private Ltd.	Storage of Oil	50%	-	-	All state shares were sold to a foreign partner in 2001.
B. SOEs in the process of divestment*						
1. Monopol Paper Manufacturing Co.	Public Ltd. (listed)	Paper	30%	100/-	47.75	The Government sent its shares to ICB for sale on the stock exchanges, but the shares could not be sold, due to the legal restriction preventing sale at a price above face value. However, the Government recently decided to sell the shares at the present market price. Accordingly, necessary actions are being taken by PC.
2. Bangladesh Can	Private Ltd.	Package	66.66%	-	-	The company has been incurring losses for several years and has huge negative net worth. PC has invited tenders six times for sale of the Government 's shares. PC did not receive any bids.
3. Lyra Industrial Enterprise	Public Ltd. (not traded)	PVC products (e.g. pipe)	62.5%	-	-	The company has been incurring losses for several years and has huge negative net worth. PC has invited tenders seven times, the last time in March 2003. Sale to the highest bidder is under process for final approval by the Government.

Tk = taka.

Ltd. = limited, and SOE = state-owned enterprise.

Note: *Currently there are 97 SOEs on the divestment list, which can be broken down into (i) 9 SOEs for which letters of intent have been issued but not handed over to the buyers; (ii) 4 SOEs whose shares have been delivered to ICB for sale on the stock exchanges; (iii) 2 SOEs whose sale to potential buyers was approved by PC and the Cabinet; (iv) 6 SOEs whose sale to potential buyers was approved by PC (pending the approval of the Cabinet); (v) 5 SOEs put out for international tender for the first time, (vi) 10 SOEs retendered; and (vii) 61 remaining SOEs, of which around one third are under the valuation process.