CFA INSTITUTE RESEARCH FOUNDATION / **BRIEF**

THE EMERGING ASIA-PACIFIC CAPITAL MARKETS
CHALLENGES AND OPPORTUNITIES

LARRY CAO, CFA, AND
LUIS GARCIA-FEIJÓO, CFA, CIPM
EDITORS

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CFA Institute Research Foundation

Statement of Purpose

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BIOGRAPHIES

Nazmul Ahsan, CFA, is head of Treasury at Midland Bank Ltd. and has extensive experience in treasury management, fixed income, and asset and liability management. Driven by his contributions on market making in fixed income, Midland Bank was awarded best primary dealer by Bangladesh Bank, the central bank of Bangladesh. Mr. Ahsan began his career at Eastern Bank Ltd., where he worked in Treasury and managed the foreign exchange and asset/liability management desk. He has supported various projects with Bangladesh Bank and other organizations to further the development of the fixed-income market in Bangladesh. Mr. Ahsan holds a BBA in finance from the University of Dhaka and is a founding board member and current vice president of CFA Society Bangladesh.

Thitiphong Amonthumniyom is an analyst in the R&D department at the Securities Exchange Commission, Thailand, where he works in the capital market risk field. He is responsible for monitoring and reporting on each aspect of capital market risk, including market risk, credit risk, and liquidity risk. Mr. Amonthumniyom also reports on the macroeconomy and capital market and is a member of the working group for financial stability. He holds a master's degree in economics and finance from the University of East Anglia and a bachelor's degree in economics from Kasetsart University. Mr. Amonthumniyom has passed the Level I exam for the CFA Program.

Sateesh Balani, CFA, is director of research at Ismail Iqbal Securities and possesses a decade of diversified finance- and investment-related experience. Previously, he was head of research at HBL Asset Management Limited (AML), where he was part of the investment committee, managing fixed income, equity, and asset allocation portfolios. Before joining HBL AML, he was responsible for making feasibilities and analyzing potential business ventures at Engro Corporation and its energy holding company. Mr. Balani also worked at Elixir Securities in equity research covering the energy and industrial sectors. He holds an MBA and a bachelor's degree from the Institute of Business Management, Karachi. Mr. Balani serves on the board of CFA Society Pakistan.

Bujinlkham Boldbaatar is a senior analyst at Long Term Partners of Mongolia, where she specializes in the research of various economic sectors and individual stocks. She holds a bachelor's degree in finance from the University of Finance and Economics, Mongolia.

Luc Can is chief economist at the Bank for Investment and Development of Vietnam and president of the BIDV Training and Research Institute. He is also a member of the National Fiscal and Monetary Policy Advisory Council and the Vietnam National Committee for Pacific Economic Cooperation. Dr. Luc holds a DBA and an MBA from Monash University, Australia, both under Australian government scholarships. He was also a (Fulbright) Humphrey Fellow and a Senior Fellow at Harvard Kennedy School.

Jin Yoong Chong, CFA, is director and principal trainer at Ogos Learning and co-founder of StudyLisa.com. Ogos Learning provides education services in the field of banking and finance, and StudyLisa.com is a mobile chat-based e-learning platform that caters to exam takers. Before forming Ogos Learning, he headed the structured products development team in

AmBank's Global Markets division and worked as a licensed fixed-income dealer at OSK Investment Bank. Mr. Chong is actively involved with the Asian Institute of Chartered Bankers (AICB) as an examiner, trainer, and curriculum developer for various examination programs. He also has authored and co-authored multiple textbooks in collaboration with AICB and Oxford Fajar, including textbooks for the PKMC licensing exam that is compulsory for all practicing interbank dealers in Malaysia. Mr. Chong obtained the PKMC certification with distinction. He currently serves as treasurer of CFA Society Malaysia.

Bayarsaikhan Davaadorj, CFA, is founder of Long Term Partners of Mongolia, an investment advisory firm. Previously, he worked as an equity trader at Deutsche Bank and as an investment officer at International Finance Corporation (World Bank Group). Mr. Davaadorj has also been a consultant for the Asian Development Bank, the Japan International Cooperation Agency, and the European Bank for Reconstruction and Development. He is co-founder and served as chair of the Mongolian Society of Financial Analysts.

Varabott Ho is an associate professor at CamEd Business School. His experience includes more than 12 years at Credit Suisse and encompasses private banking, asset management, hedge funds, private equity, bancassurance, and corporate advisory across Europe and Asia for such entities as the Association of Banks in Cambodia, Banque Hottinguer, Aberdeen Asset Management, AXA, and Leopard Capital. He holds an MBA from the University of Chicago Booth School of Business and is a certified European Federation of Financial Analysts Societies international investment analyst. Mr. Ho currently is pursuing the Corporate Director Program at Harvard Business School and the Economic Development and Public Policy program at Harvard Kennedy School.

Mark Ilao, CFA, CIPM, is a business development manager at COL Financial Group, Inc., where he currently heads the first online funds distribution platform in the Philippines: COL Fund Source. Previously, he was an investment analyst for BDO Trust and Investments Group, covering equity, fixed income, and macroeconomic research and strategy.

Raza Jafri, CFA, is head of equities at Intermarket Securities Limited. He has more than 13 years of experience in equity research and sales in Pakistan and specializes in covering commercial banks. Mr. Jafri serves on the board of directors of CFA Society Pakistan. He holds a bachelor of science degree (honors) in finance and accounting from the Lahore University of Management Sciences.

Nattawut Jenwittayaroje, CFA, is an assistant professor of finance at the National Institute of Development Administration Business School, where he lectures on financial markets, behavioral finance, derivatives, and market microstructure. Previously, he was a lecturer in the Department of Banking and Finance, Faculty of Commerce and Accountancy at Chulalongkorn University. Mr. Jenwittayaroje holds a PhD in business administration from the Nanyang Business School at Nanyang Technological University, Singapore.

Rajendra Kalur, CFA, is an independent consultant and financial educator. Using his extensive experience in the financial services domain, he mentors first-time entrepreneurs and offers training on such subjects as leadership, entrepreneurship, and wealth management. Previously, Mr. Kalur was the founding director and CEO of TrustPlutus, a boutique wealth management firm. He also has worked in various capacities at RBS N.V., ABN AMRO N.V., Wealth Advisors India Pvt. Ltd., ICICI Prudential AMC, DSP Merrill Lynch, and General Insurance Corporation of India. Mr. Kalur serves on the boards of CFA Society India and Multi-Act Trade and Investments Pvt Ltd. He is also a certified Ethics Trainer. Mr. Kalur holds an MBA from Cranfield School of Management, United Kingdom, and a postgraduate diploma in marketing from the Chartered Institute of Marketing, United Kingdom. He is also a long-distance runner and cyclist.

Asif Khan, CFA, is managing partner and co-founder of EDGE Research & Consulting Limited. EDGE provides investment research to a large number of globally reputed fund managers, commercial banks, and development finance institutions. Mr. Khan has more than 13 years of experience working in both buy-side and sell-side roles covering frontier markets. He is also a founding board member of CFA Society Bangladesh.

Md Shah Naoaj, CFA, is a deputy director of the Central Bank of Bangladesh, where he works on financial sector policy issues, macroeconomic analysis, and macroprudential policymaking. Previously, he was an economist for the International Monetary Fund (IMF), where he conducted Article IV missions and co-authored many pieces on the financial sector issues of IMF member countries. Mr. Naoaj is a current board member of CFA Society Bangladesh. He holds an MBA in finance from the University of Dhaka.

Dung Nguyen works in the strategic management department at the Bank for Investment and Development of Vietnam. He has published a number of articles on such topics as banking and finance, the effect of globalization on Vietnamese banks, and Vietnam's corporate governance. Mr. Nguyen holds a master's degree in banking and finance and is a PhD candidate at National Economic University.

Vidushan Premathiratne, CFA, is the founder and managing director of Elon Venture Catalysts, a boutique investment advisory and data analytics company in Sri Lanka. He also is an investment banker with 12 years of experience, including working with Asha Phillip Securities, York Street Partners, and Candor Capital.

Mr. Premathiratne serves as strategist, mentor, and financial adviser for many innovative startups and SMEs in Sri Lanka and has sourced, structured, and negotiated transactions involving debentures and merger and acquisition for leading corporates in Sri Lanka. Leading institutions seek his advisory expertise in such fields as data science, fixed income, derivatives, and digital payments. Mr. Premathiratne holds a bachelor's degree (honors) in chemical engineering from the University of Nottingham (United Kingdom) and an MBA in marketing from the University of Colombo. He is a member of CMA (Australia) and a Certified Global Business Analyst (Australia).

Mr. Premathiratne is currently reading for his doctorate in business administration at the University of Colombo.

Shwetabh Sameer, CFA, CIPM, is an applied statistical researcher with the Behavioral Sciences team at Morningstar. His primary responsibilities include conducting statistical analyses and survey research on the financial behavior and behavioral obstacles among investors and investment professionals. Previously, Mr. Sameer worked as a senior quantitative analyst with the Indexes team at Morningstar, where he helped create various factor- and sustainability-based solutions used for creating exchange-traded funds, structured products, notes, asset allocation, and benchmarking funds.

He holds a bachelor's degree from the Birla Institute of Technology and Science, Pilani.

Seng Chan Thoeun is managing director at SBI Royal Securities in Phnom Penh. Involved in the Cambodian investment industry for more than 10 years, he has directed the successful completion of several historic transactions, including the IPO of Phnom Penh Water Supply, the IPO of Phnom Penh Autonomous Port, and the IPO of Sihanoukville Autonomous Port. Mr. Seng also oversaw the issuance of the first-ever corporate bond in Cambodia and completed three other public issuances of corporate bonds among the six in total. He holds a master's degree in international finance from CERAM Business School and has passed the Level I and Level II exams for the CFA Program.

Mohammad Shoaib, CFA, is the founder and CEO of Al Meezan Investment Management Ltd., the first and only fully Shariah-compliant asset management company in Pakistan. He has authored articles in local and international publications, such as *Islamic Finance News*, and has been a speaker/panelist on Islamic asset management at various conferences in Middle Eastern and Far Eastern countries. Mr. Shoaib has extensive volunteer leadership experience, including serving as Presidents Council Representative for the Asia-Pacific Region of CFA Institute, chair of the Mutual Funds Association of Pakistan, and board member of the Institute of Financial Markets of Pakistan and the Pakistan Institute of Corporate Governance. Awards include Most Influential CFA Charterholder and Lifetime Achievement Award, both from CFA Institute. Mr. Shoaib was the founding president of CFA Society Pakistan and currently serves on its board as the Advocacy and GIPS® Standards chair. He holds an MBA from IBA.

Chakara Sisowath, CFA, is co-founder and managing partner of 3E-Fii Capital, the corporate finance practice within the 3E-Fii Group. His competencies include investment evaluation and selection, firm competitiveness and industry benchmarking, financial modeling and analysis, and risk identification and management. Previously, Mr. Sisowath was an equity analyst and portfolio manager at Fidelity International and Credit Lyonnais International Asset Management, both in Tokyo. As a partner and managing director at Comgest in Hong Kong, he managed Asian equity portfolios and directed the team of research analysts and portfolio managers. Mr. Sisowath is an independent non-executive director of Manulife TEDA Fund Management Co. in Beijing. He holds an MBA from the University of Chicago Booth School of Business and a BA from EDHEC Business School in Lille, France.

April Lynn L. Tan, CFA, is the vice president, head of research, and chief equity strategist at COL Financial Group, Inc. She also writes a weekly column, "Intelligent Investing," for the *Philippine Daily Inquirer* and hosts the TV show *Insight with April Lee Tan* for ANC, both of which focus on the stock market, business, and personal finance topics. Ms. Tan is an active member of CFA Society Philippines, where she's served as president and as the head of the society's Investment Research Challenge committee.

Ignatius Denny Wicaksono, CFA, CIPM, is head of the business development division at Indonesia Stock Exchange (IDX). His main responsibility is to support IDX and Indonesia Capital Market's initiatives to ensure a fair, orderly, and efficient capital market. Mr. Wicaksono holds an MBA from I.A.E. Grenoble, a master's of management degree from the University of Indonesia, and a bachelor's degree in electrical engineering from the University of Indonesia.

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FOREWORD

The world of investing is in a state of flux with, perhaps, too much money chasing after too few assets that are perceived to be investment-ready.

A wall of liquidity—fuelled by quantitative easing—has resulted in low yields and high correlation among traditional assets. Trends in technology and geopolitics, exacerbated since the onset of the pandemic, continue to upend business models and supply chains. The search for alternative investments—from private markets to crypto assets—continues apace.

At the same time, a significant portion of the world fails to receive investments commensurate with those countries' fundamentals of growth and demographics—or with opportunities in infrastructure, insurance, and pensions.

A critical barrier between the demand for and supply of investment capital is the quality of the conduit between them: capital markets.

The ecosystem of regulatory climate, market structure, history, and culture of professionalism enables matchmaking between sources and uses of funds. Fostering this ecosystem unleashes the power of investments to have real impact on real lives in the real economy.

A deliberate and continuous pursuit of education, ethical standards, and professional excellence can fuel the flywheel of knowledge, confidence, and investment in developing markets.

I congratulate the Research Foundation for this timely and valuable contribution to the body of knowledge surrounding these 11 emerging and frontier economies in Asia. At different stages of development, these markets provide a mix of domestic fundamentals, insulation, and connectivity to the global economy. This set of detailed, country-level perspectives produced by highly qualified, in-country experts should catalyse greater understanding, debate, and inclusion of these economies in the global investment dialogue.

Lutfey Siddiqi, CFA
Managing Director,
Global Regions & Society Relations
CFA Institute

INTRODUCTION

Many have argued that the 21st century will be the Asian Century. And yet many capital markets in Asia, particularly emerging markets, remain a mystery to much of the outside world. We hope this brief will help to fill that knowledge gap.

The MSCI Emerging Markets Asia Index, launched at the beginning of the century, includes nine markets today. The relatively large and liquid capital markets of China (A shares), South Korea, and Taiwan are better known in global markets partly because of the international success of local tech giants. This brief covers the remaining six markets in the index—India, Indonesia, Malaysia, Pakistan, the Philippines, and Thailand—plus five other up-and-coming Asian markets—Bangladesh, Cambodia, Mongolia, Sri Lanka, and Vietnam. In each chapter, local authors review the history, current characteristics, and challenges and opportunities of their respective capital markets.

The selected countries exhibit certain economic and financial similarities. Having travelled to the majority of the covered countries, we believe they also have another important attribute in common: hope. These countries witnessed how neighbors such as Japan, South Korea, Singapore, and, more recently, China have improved living standards for their people since the 1960s. Their citizens share a strong belief that hard work will pay off. So, despite conditions that many from developed markets may find challenging, throughout these countries you can hear the upbeat tone in the voices and see the smiles on the faces of people going about their business.

Still, these markets are substantially different in many ways. We venture three differences here to highlight the practical value of this brief:

HISTORY

Countries such as India, Malaysia, Pakistan, the Philippines, and Sri Lanka inherited a legal system influenced by the British system. Some even had exchanges set up centuries ago. Because of their history, their capital markets are more consistent with expectations formed from investing in the US or UK markets. In contrast, Mongolia and Vietnam were part of the Soviet area of influence after the Second World War. Their regulatory systems are now in transition toward Western standards.

ECONOMY

The size of these economies varies greatly. Based on data from the World Bank, in 2019, India's GDP was USD2,875 billion and Indonesia's was USD1,119 billion. On the other end of the spectrum, in 2019 Mongolia had a GDP of USD13.9 billion and Cambodia of USD27.1 billion. GDP per capita in 2019 ranges from USD1,285 for Pakistan to USD11,415 for Malaysia. This disparity is of course an important consideration for institutional investors because the economy is the foundation of capital markets and the main driver of their growth. Asian economies in general have experienced healthy growth in recent decades, and so have many of the covered countries, other than those that witnessed political turmoil. Consistent with these economic differences, the size of capital markets differs greatly among the 11 countries covered.

MARKET MATURITY

Market maturity is an important factor to consider when investing in emerging and frontier markets. More-mature markets offer increased levels of information disclosure and tend to experience less dramatic swings in prices. Where data is available, authors report the share of institutional ownership in a market and other indicators of market maturity.

History buffs may find it easy to understand why in some markets banking channels play a more important role in financing, whereas in others capital markets are more important—although market maturity also has some bearing on this.

The concept of the Asian Century was not without controversy from the beginning. Whether you are a believer or a skeptic, we sincerely hope that this research brief will help you identify new opportunities and navigate risks in the Asian emerging and frontier markets.

Happy investing!

Larry Cao, CFA
Senior Director, Industry Research
CFA Institute

Luis Garcia-Feijóo, CFA, CIPM
Associate Research Director,
CFA Institute Research Foundation
Associate Professor of Finance,
Florida Atlantic University

Acknowledgement

What sets this research brief apart is that all contributors are industry practitioners or academic researchers based in their respective market. These professionals' in-depth market knowledge and local expertise should increase readers' confidence that they are receiving first-hand information directly from the source. We also want to acknowledge our colleagues Brenda Hou, Reseena Abdullah, and William Boivin, as well as colleagues from local societies and volunteer groups for their support in sourcing the contributors. In addition, we recognize two colleagues in our India office, Vidhu Shekhar and Sivananth Ramachandran, for help with the India chapter.

BANGLADESH

1971	Independence of Bangladesh
1976	Formation of Investment Corporation of Bangladesh; Stock trading resumed
1986	Dhaka Stock Exchange (DSE) started operation
1993	Establishment of the Bangladesh Securities and Exchange Commission (BSEC)
1995	Establishment of the Chittagong Stock Exchange
1996	Capital market crash
1998	Introduction of electronic trading
2000	Incorporation of Central Depository Bangladesh Limited (CDBL) as a public limited company
2010	DSE became the second-highest-performing exchange globally with a 92% year-over-year return
2011	Second capital market crash
2013	DSE launched three new indexes: the DSE Broad Index (DSEX), DSE 30 Index (DS30), and DSEX Shariah Index (DSES); The Exchanges Demutualization Act 2013 was passed
2018	A consortium of the Shenzhen Stock Exchange and Shanghai Stock Exchange became the strategic partner of DSE, with 25% shareholding

BANGLADESH

Md Shah Naoaj, CFA
Deputy Director, Bangladesh Bank (The Central Bank of Bangladesh)

Asif Khan, CFA
Managing Partner, EDGE Research & Consulting Limited

Nazmul Ahsan, CFA
Head of Treasury, Midland Bank Limited

Equity Market Capitalization (USD)	40.67 Bn*	25.04 Bn*	Debt Market Capitalization (USD)
Domestic Equity Market Cap/GDP	14%*	8%*	Domestic Debt Market Cap/GDP
Equity Market Share Volume Traded	17,280 Mn**	2,250 Mn***	Debt Market Instrument Volume Traded
Number of Listed Companies	317*	5*	Number of Issuers (Bonds)

* As of June 2019
** June 2018–June 2019
*** As of June 2020

OVERVIEW

Bangladesh has an impressive recent track record for growth (8.15% GDP growth rate in 2019).[1] This growth resulted from a fast-growing manufacturing sector—which includes the second-largest garment industry in the world—and solid remittance inflows. Sustained reforms, prudent macroeconomic policies, and political stability have also contributed to this growth. In the last decade, the economy has experienced a GDP growth rate of close to 7% (according to the International Monetary Fund), with stable and moderate inflation, a low level of public debt, and adequate foreign reserves.

BANK-DOMINATED FINANCIAL SYSTEM

The financial system of Bangladesh is bank dominated. In 2019, the ratio of banking sector assets to GDP stood at 64%, and the market capitalization of listed domestic companies to GDP stood at 14%. These numbers imply there may be scope for capital market deepening. A wide range of reforms and initiatives have been put in place—including the Bangladesh Capital Market Development Master Plan 2012–2022—to

[1]Sources: World Bank national accounts data and OECD National Accounts data files.

bolster raising funds in a cost-effective manner, enhance financial intermediation, expand alternative sources of credit, enable investors to gain access to alternative investment opportunities, and boost investor confidence.

STOCK MARKET HISTORY

The history of the stock market in Bangladesh dates back to 1954, when the East Pakistan Stock Exchange Association Ltd. was formed. After the Bangladesh Liberation War ended in 1971, trading was halted for five years; it resumed in 1976. In 1986, the country's premier bourse took on its current name, Dhaka Stock Exchange (DSE). In 1993, the Bangladesh Securities and Exchange Commission (BSEC) was established as the regulator of the country's capital markets through the enactment of the Bangladesh Securities and Exchange Commission Act, 1993. Chittagong Stock Exchange (CSE), the country's second stock exchange, was established in 1995.

The two exchanges have similar equity market capitalization, around USD29 billion. As of 19 July 2020, DSE had 359 listed stocks and closed-end mutual funds and CSE had 329. The two exchanges have a lot of overlap in listed stocks, and it is possible to buy shares of a company on one exchange and sell them on the other. DSE dominates turnover, with more than 90% of the total trade volume on any given day. Therefore, we will focus primarily on DSE in the rest of this chapter.

Even though the capital market started functioning in 1976, the lack of infrastructure, a socioeconomic crisis, and political instability limited activity until the 1990s. The 1996 capital market crash triggered reforms, such as the introduction of electronic trading in 1998, the establishment of Central Depository Bangladesh Limited (CDBL) in 2000, and the formation of the independent Central Depository System (CDS) in 2004. These reforms, coupled with the Grameenphone IPO in 2007, helped build investor confidence, making DSE the second-highest-performing exchange in the world. The IPO book-building method, introduced in 2010, represented a major change from prior fixed-price IPOs. In 2013, DSE, in collaboration with S&P Dow Jones Indices, introduced the DSE Broad Index (DSEX), DSE 30 Index (DS30), and DSEX Shariah Index (DSES).

Another significant change came in 2013 when the exchange was demutualized. In 2018, a consortium of the Shenzhen Stock Exchange and Shanghai Stock Exchange became the strategic partner of DSE, with a 25% shareholding and plans for technological upgrades, new product development, and promotion of Bangladeshi indexes in China.

EQUITY MARKET STRUCTURE, INVESTOR PROFILE, AND TURNOVER

The ratio of market capitalization to GDP stood at only 14% in Bangladesh in June 2019 (see **Table 1**). The stock market is not a good representation of the economy, with many companies remaining private. As an example, the ready-made garment industry, which makes up 80% of the country's exports, has almost no presence in the stock exchange. The market has also performed poorly. From 2014 through 2019, the DSEX had a cumulative aggregate geometric return of 0.08%, in contrast to nominal GDP growth of 12%–14% per year.

There are about 2.55 million beneficiary owner (BO) accounts in Bangladesh. BO accounts are used to uniquely identify buyers and sellers of instruments, and therefore, it is mandatory to

TABLE 1. SUMMARY OF STOCK MARKET

Item	2009–10	2010–11	2011–12	2012–13	2013–14
MCAP (BDT billions)	2,276	2,327	1,932	1,977	2,386
Percentage of GDP	29%	25%	18%	16%	18%
ADTV (BDT millions)	10,593	13,466	4,841	3,542	4,650
Number of listed companies	273	267	279	296	307
Item	**2014–15**	**2015–16**	**2016–17**	**2017–18**	**2018–19**
MCAP (BDT billions)	2,702	2,614	3,239	3,263	3,436
Percentage of GDP	18%	15%	16%	14%	14%
ADTV (BDT millions)	4,643	4,432	7,460	6,574	6,032
Number of listed companies	326	330	334	343	355

Notes: MCAP = market capitalization. ADTV = average daily trading value. GDP = gross domestic product. BDT = Bangladesh taka.

Source: DSE.

have one before trading in the stock market. Active stock trading occurs in only 100,000–200,000 BO accounts, however, which implies that the stock market is not a popular investing destination for the vast majority of the Bangladeshi population of 170 million–180 million people. Fixed-income securities—such as fixed deposits and national savings certificates—and land tend to dominate asset allocation.

Figure 1 shows the sectoral market capitalization breakdown for DSE. The main sectors are telecommunication, financials, pharmaceuticals, consumer goods, and power. The top 20 companies by total market capitalization make up 54% of the market. In terms of shareholding, sponsors own the highest percentage, followed by foreign investors, the general public, institutions, and the government.

In terms of turnover, the market is dominated by local investors. Over the years, however, foreign institutional investors have been increasing their participation in daily activity. Compared with a daily market share of 1%–2%, foreign institutional investors in the last few years contributed around 6%–8% to daily transactions.

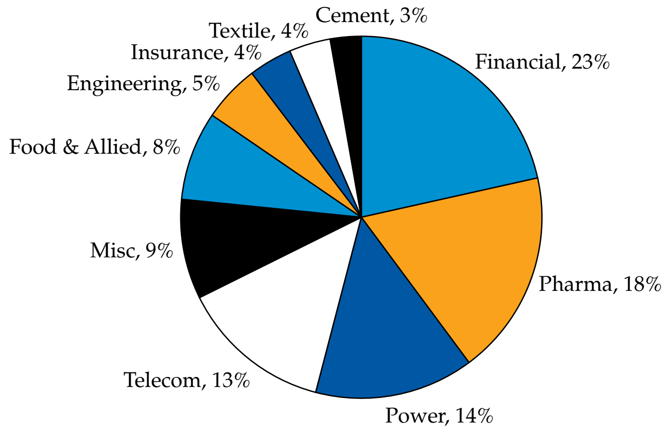
FIXED-INCOME MARKET IN BANGLADESH: POTENTIAL NOT YET EXPLORED

The fixed-income market in Bangladesh is dominated by government Treasury bills and bonds. Issuance of debt instruments by quasi-government entities and corporations is at a nascent stage because of a small investor base, relatively high issuance costs, and a lengthy time to issue compared with bank loans.

The Bangladeshi fixed-income market is relatively small. The government bond market accounts for only 7.9% of GDP, and the corporate bond market accounts for only 0.01% of GDP.

Since 2011, the settlement of government bonds has taken place on a platform called Market

FIGURE 1. DSE SECTORAL MARKET CAP BREAKDOWN AS OF 23 JULY 2020



Note: The data do not sum to 100% because of rounding.

Source: DSE.

Infrastructure Module, which is owned and maintained by the central bank.

FIXED-INCOME MARKET STRUCTURE

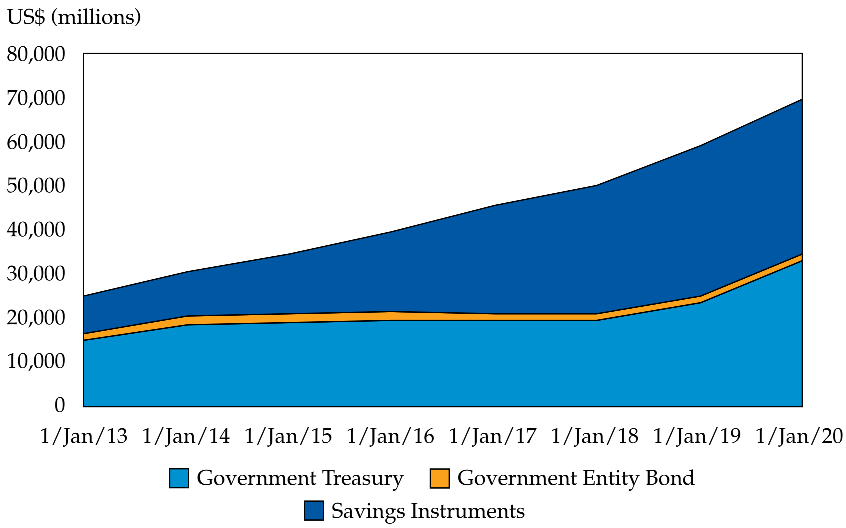
Government-issued instruments can broadly be categorized into three segments: Treasury bills and bonds, savings instruments, and government-entity-issued captive bonds, the latter two of which are non-tradable. **Figure 2** presents outstanding positions of debt instruments. As of June 2020, total outstanding debt securities stood at USD69.7 billion, of which USD33.27 billion (47.7%) were Treasury bills and bonds, USD1.25 billion (1.8%) were government-entity-issued captive bonds, USD35.5 billion (50.4%) were savings instruments, and the remaining USD45.6 million (0.1%) were listed corporate bonds.

From June 2015 to December 2020, 88 firms received approval to raise debt by issuing bonds in private placements, totaling USD4.48 billion. From July 2018 to June 2019, USD1.518 billion in bonds were issued in the form of private placements, mostly by banks in the form of debt for Tier 2 capital to comply with Basel III requirements. The fixed-income market in Bangladesh is denominated in local currency, and the country has not yet explored issuing debt instruments in foreign currency. Local companies are not allowed to invest in foreign-currency-denominated securities.

Yearly issuance of government Treasuries fluctuates with the interest rate cycle, which is the determining factor in the sale of government savings certificates. The government adjusts its fiscal deficit by fine-tuning issuance of Treasury bills and bonds. The corporate bond market is almost nonexistent.

The largest investors in the fixed-income market are commercial banks: In June 2019, investments from commercial banks and financial institutions (FIs) in government securities totaled

FIGURE 2. OUTSTANDING DEBT INSTRUMENTS



Sources: Bangladesh Bank; BSEC; Department of National Savings.

USD16.7 billion (70.4%; see **Table 2**). The second-largest investors are insurance companies (including the deposit insurance fund of the central bank), which held USD2.8 billion (11.6%) in government securities. Foreign investment in the bond market is at nascent stage, although there are no capital controls. The Bangladeshi taka has been a stable currency over the last two decades.

The automated process of trading and settlement of government bonds began in 2011, after which secondary trading started to flourish. Commercial banks are a major player in the secondary market. With a small investor base and

TABLE 2. TREASURY BILL AND BOND INVESTMENTS BY INVESTOR TYPE (IN USD MILLIONS)

	Central Bank	Commercial Banks and FIs	Insurance Companies	Corporate Bodies	Mutual Funds and Pension Funds	Foreign Investors	Individuals
June 2016	597.75	15,958.86	2,218.34	114.68	655.84	54.79	31.69
June 2017	635.78	15,578.51	2,421.15	74.53	660.44	5.43	43.75
June 2018	1,300.97	15,199.11	2,400.59	91.78	655.90	2.80	50.55
June 2019	3,363.06	16,704.51	2,753.16	73.65	785.28	–	48.24

Source: Bangladesh Bank (June 2019).

TABLE 3. RETURN COMPARISON OF DURATION-WEIGHTED PORTFOLIO AND 5- AND 10-YEAR GOVERNMENT BONDS, JULY 2015–JUNE 2020

	Weight	Avg.	Worst	Best	Std. Dev.
1-Year rolling return					
Hypothetical portfolio	Duration weighted	7.6%	–3.3%	25.1%	8.7%
5-year bond	100% on 5 year	6.6	–5.3	24.6	8.8
10-year bond	100% on 10 year	9.1	–1.6	32.3	11.7
3-Year rolling return					
Hypothetical portfolio	Duration weighted	9.8%	1.6%	17.1%	5.9%
5-year bond	100% on 5 year	9.4	0.7	17.7	6.4
10-year bond	100% on 10 year	11.0	1.7	19.3	7.0
5-Year rolling return					
Hypothetical portfolio	Duration weighted	10.2%	7.2%	12.8%	1.9%
5-year bond	100% on 5 year	10.1	6.3	13.1	2.5
10-year bond	100% on 10 year	11.5	7.9	14.0	1.8

Sources: Authors' calculations; Bangladesh Bank; Reuters.

the above-market interest rate of non-tradable savings certificates, there is limited secondary trading of government bonds. The average monthly transaction volume was USD202.9 million at the end of June 2020. The majority of the transactions took place in the OTC market.

There is no fixed-income index in Bangladesh. For a hypothetical market-duration-matched portfolio with semiannual rebalancing,[2] as of June 2020, the five-year (one-year) rolling total return would be 7.5% (8.3%). From July 2015 to June 2020, the average 1-year return of a 5-year (10-year) bond would be 6.6% (9.1%), as **Table 3** shows. Returns on all three-portfolios improve significantly over a longer time frame.

CHALLENGES, OPPORTUNITIES, AND THE WAY FORWARD

The following issues pertain to the future of the Bangladeshi stock market.

Lack of quality IPOs: The Bangladeshi stock market is not a good representation of the economy, because some key sectors, such as the garment industry, are not represented in the market. Also, with a new generation of technology companies emerging, IPO rules can be modified to foster listings.

[2]The portfolio is constructed by matching the duration of the portfolio with market duration. The portfolio is rebalanced semiannually by replacing older issues with fresh issues and is matched with market duration at each rebalancing date. Any cash flow received between rebalancing times is reinvested until the next rebalancing date at the prevailing T-bill rate. Cash flows for less than 30 days until rebalancing, however, are not reinvested.

Corporate governance and market integrity: Similar to other frontier markets, Bangladesh lags behind developed markets in terms of minority investor protection, corporate governance, and insider trading regulation. Making progress in these areas can lead to substantial benefits.

Lack of new products: Currently, an investor can take only long positions in equity securities via the stock market. Adding new types of products—such as index funds and exchange-traded funds—can attract different types of clients with higher or lower risk appetites.

Technology upgrades: During the initial stages of the COVID-19 pandemic, the stock market remained closed for two months because the stock exchange is not fully automated. With rising internet penetration and a more tech-savvy population, now is the perfect time to make the market fully automated by leveraging technology.

The following issues pertain to the future of the Bangladeshi fixed-income market.

Dual risk-free interest rate: Retail investors are not interested in government and corporate bonds, because they can earn higher interest rates on national savings certificates. To overcome this challenge, savings certificate rates must be aligned with market interest rates.

Creating a sizable demand side: The creation of pension funds and fixed-income mutual funds should help generate stable demand, an additional reason for the government to consider starting these initiatives.

Listing of government bonds: Currently, government securities are not listed on any exchange. Regulators should give priority to the listing of government securities. Additionally, older issues should be replaced with newer issues to reduce the number of instruments and to increase market liquidity.

Simplified listing requirements for corporate bonds: For corporate bonds, listing regulations should be simplified and listing costs reduced. Tax incentives should be considered. Semiautonomous bodies may consider issuing project-based bonds against a government guarantee to create a high-quality and stable source of supply.

Showcasing the strength of the country to global investors: Bangladesh is one of only a few countries with an average GDP growth rate of at least 7% over the last decade. Also, the Bangladeshi taka has been a stable currency in comparison to peer countries' currencies. New initiatives could be developed to increase the interest of global investors.

CAMBODIA

1991 — The signing of the Paris Peace Agreements ends the Cambodian Civil War

2006 — The Ministry of Economy and Finance of Cambodia (MEF) signed a memorandum of understanding with Korea Exchange (KRX) for the development of the security market in Cambodia

2009 — The MEF signed a joint-venture agreement with KRX to establish the Cambodia Securities Exchange (CSX)

2010 — The CSX was incorporated, with its capital 55% owned by the MEF and 45% owned by KRX

2011 — The CSX received approval from the Securities and Exchange Commission of Cambodia (SECC) as a market operator, clearing and settlement facility, and depository operator

2012 — Launching ceremony for security trading at the CSX with the listing of Phnom Penh Water Supply Authority (PPWSA)

2014 — Listing of Grand Twins International (Cambodia) Plc. (GTI)

2015 — Listing of Phnom Penh Autonomous Port (PPAP)

2016 — Listing of Phnom Penh Special Economic Zone (PPSP)

2017 — Listing of Sihanoukville Autonomous Port (PAS)

2018 — Listing of the first bond by Hattha Bank Plc.

2019 — Listing of bonds by LOLC (Cambodia) and Advanced Bank of Asia Ltd.

2020 — Listing of ACLEDA Bank Plc. (ABC) and PESTECH (Cambodia) Plc.; Listing of bonds by Phnom Penh Commercial Bank, RMA Cambodia, and PRASAC Microfinance Institution

CAMBODIA

Chakara Sisowath, CFA
Managing Partner, 3E-Fii Capital

Seng Chan Thoeun
Managing Director, SBI Royal Securities

Varabott Ho
Associate Professor, CamEd Business School

Equity Market Capitalization (USD)	**2.45** Bn*
Equity Market Cap/GDP	9%*
Equity Market Share Volume Traded	**15** Mn**
Number of Listed Companies	7*

0.13 Bn*	Debt Market Capitalization (USD)
0.5%	Domestic Debt Market Cap/GDP
—	Debt Market Instrument Volume Traded
8*	Number of Issuers (Bonds)

* as of Dec 2020
** 2019

THE EQUITY MARKET

Securities operations in Cambodia are conducted at the Cambodia Securities Exchange (CSX). In 2006, talks conducted by the Ministry of Economy and Finance of Cambodia (MEF) and Korea Exchange (KRX) on assisting Cambodia in setting up a stock exchange led to the signing of a memorandum of understanding (MOU) titled "The Development of the Securities Market in Cambodia," followed by another MOU in 2008, "The Establishment of a Cambodia Securities Exchange in the Kingdom of Cambodia." The CSX was registered in 2010 as a joint venture between the MEF (55%) and KRX (45%). The CSX received approval from the Securities and Exchange Commission of Cambodia (SECC) in 2011 as a market operator, clearing and settlement facility, and depository operator. Trading started on 18 April 2012. The regulatory authority of the CSX is the SECC, which was established in 2007. Derivatives (options or futures) do not trade on the CSX.

The CSX consists of the Main Board and the Growth Board. To date, six companies are listed on the Main Board and none on the Growth Board, which is designated for smaller companies with less demanding listing requirements.

The members of the CSX include six security underwriters, one security dealer, and three security brokers. Participants consist of three cash settlement agents, three security registrar and transfer agents, two paying agents, and one bondholder representative. Some companies perform several of these roles concurrently.

Figure 1 shows the percentage of trading by value for each of the six CSX security underwriters. **Figure 2** shows the free float percentage of the companies listed on the CSX.

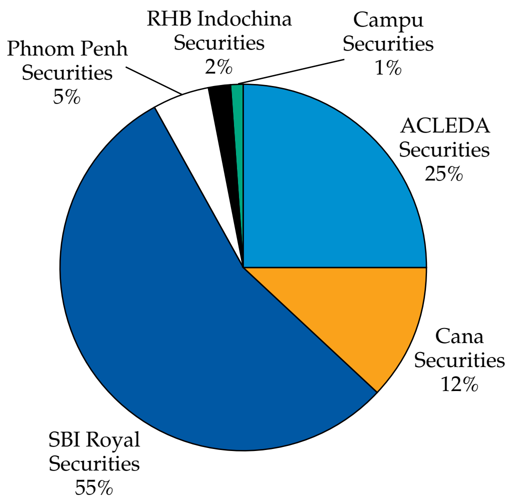
The market's average P/E is 16.3× (based on 2019 EPS). With a total market capitalization of USD2,486 million (USD582 million without ACLEDA Bank), the CSX is still small in terms of size and behind schedule in terms of development. The total market capitalization/GDP ratio in 2019 was 9.8%, up from 2% in 2018, but still behind the ratio in neighboring countries. This underlines the country's need to keep educating about its financial systems and continue modernizing them.

The CSX's performance is represented by the CSX Index, a composite market capitalization weighted average of all the stocks listed on the Main Board.

The performance of the CSX since its inception on 18 April 2012 has been lackluster, with an average annual return of 1.9%. Note that most of this positive performance occurred in 2018 and 2019. From 2012 to 2017, the annual performance of the CSX Index was negative. In comparison, an investment in a Cambodian riel (KHR) time deposit would have yielded higher weighted-average returns (5.4% annually; see **Figure 3**).

Stock market returns have been disappointing for a country with an average GDP growth of 7% per annum. Among many possible causes, one is that the listed stocks do not represent the economy as a whole. Indeed, four of the six stocks are state-related quasi-utilities with safe but unexciting growth prospects. Another issue is the competition from other investment options. Risk-averse investors can receive

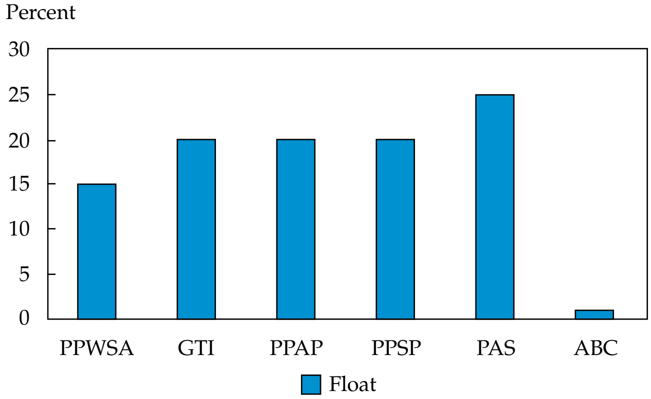
FIGURE 1. CSX TRADING BY VALUE,* 2019



*Estimated excluding a large trade in PAS in May 2019.

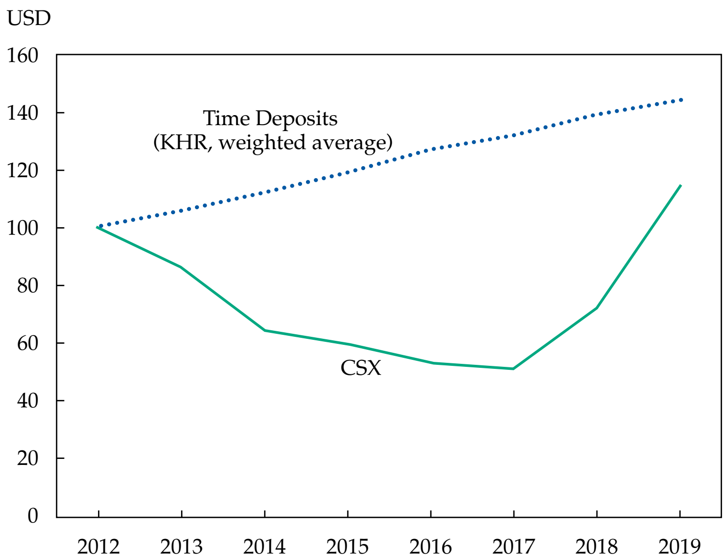
Sources: CSX; Phnom Penh Post.

FIGURE 2. FREE FLOAT AS OF 15 JULY 2020



5%–6% returns from time deposits. At the other end of the spectrum, real estate offers attractive prospects to investors with a greater risk appetite. The stock market sits uneasily somewhere in between. The situation, however, may improve dramatically, and the past two years have seen a strong rebound in the stock market. The listing of ACLEDA Bank brings more exposure to the Cambodian economy at large. More listings of interesting companies in the near future will draw yet more attention. Finally, a correction in property prices would remind

FIGURE 3. CSX INDEX VS. TIME DEPOSITS (WEIGHTED AVERAGE)



Sources: CSX; National Bank of Cambodia.

investors of the virtue of diversification into such asset classes as stocks and bonds.

THE BOND MARKET

Corporate bonds launched in Cambodia in 2018, when Hattha Bank Plc issued Cambodia's first-ever corporate bond. The historic transaction was supported by the International Finance Corporation and underwritten by SBI Royal Securities. Regulations allowing for corporate bond issuance, implemented in 2017 by the SECC, included the Prakas on Public Offering of Debt Securities,[1] Prakas on Corporate Governance Policy, and Prakas on Corporate Disclosure and Listing Rule on the CSX. The National Bank of Cambodia (NBC) issued its own prakas that allowed banks and financial institutions under its supervision to issue both equity and debt securities. The first bond built the issuance framework and roadmap for the future, and within one year, two more bonds were issued by financial institutions. Owing to the absence of government bonds, coupon rates were negotiated between issuers and investors. Bond issuances by banks and financial institutions were settled in Cambodian riel to be in line with the NBC policies of promoting the country's currency. To provide currency hedging for investors, the first long-term swap (a three-year swap) was introduced to the market during the bond issuance of PRASAC Microfinance Institution, which allowed offshore investors to hedge their currency risk.

Since the 2017 introduction of the regulations allowing for corporate bond issuance and with the first corporate bond transactions completed, bonds have become one of only a few financing options available for companies in Cambodia. Previously, companies had to rely on bank loans, shareholder injections, and stock issuance. The Royal Government of Cambodia offers bond issuers a 50% reduction on profit tax for three years in order to encourage participation in the development of the capital market.

There are currently six corporate bonds listed on the CSX, five of which are from financial institutions. So far, three types of bonds have been issued: plain bonds, foreign exchange–linked bonds, and guaranteed bonds. All the bond issuances to date total the equivalent of roughly USD130 million. One of the most recent corporate bond issuances was that of RMA Cambodia, a private automotive retailer. It was the first nonfinancial institution to issue a corporate bond and the first bond to be guaranteed by Credit Guarantee and Investment Facility, a trust fund of the Asian Development Bank. The bond also contained an option feature, allowing the issuer and investors to transact in US dollars, but was still priced in Cambodian riel. This transaction offers a good roadmap for other private companies to follow.

OTHER MARKETS

Besides equity and fixed-income markets, the SECC supervises the activities of several central counterparties (CCPs) that clear trades for derivative brokers. The approved derivatives consist of foreign exchange (FX) crosses, a few overseas stock indexes, and commodities.

The prakas dated 2 July 2015 defined the scope, licensing requirements, and supervision of derivative trading for the main actors: CCPs, derivative brokers, and derivative representatives. A derivative instrument is a contract between two parties under which the value of the contract is determined by the price fluctuation of an underlying asset.

[1]According to the Asian Development Bank, a "prakas" is a regulation issued by a minister or by the governor of the National Bank of Cambodia concerning banking or financial issues.

The CCP's task is to reduce counterparty operational, settlement, market, legal, and default risks for traders. Currently, there are five CCPs operating with 24 derivative brokers.

The aim of the SECC is to accelerate the modernization of Cambodian financial markets. Derivatives could be an important building block because they would allow hedging and increase trading activities in the underlying assets.

Presently, given that all the underlying assets are non-Cambodian assets, the derivative markets are mostly attracting individual investors who wish to actively trade in popular instruments listed overseas.

FUTURE DEVELOPMENTS

The Cambodian capital market is attracting attention from both domestic and offshore investors because of an expected improvement in return on investment and favorable tax conditions for investing in financial instruments. Offshore investors can invest directly in this capital market after obtaining an investor ID and a trading account at any securities firm, a process that takes less than two weeks and can be done mostly online.

Both the size and liquidity of Cambodia's equity market are still small compared with neighboring markets. Cambodia's strong banking industry has many companies that could benefit from listing stocks on the securities exchange. Almost all banks in Cambodia are 100% subsidiaries of foreign banks, however, so dilution of ownership could pose challenges. Recently, there is increasing interest from private companies, especially small and medium-size enterprises (SMEs), to participate in fundraising through the capital market. Much of the increased interest stems from the efforts of the SECC and CSX, both of which have been promoting the capital market in the media and through regularly held educational seminars that target both issuers and investors.

Although the capital market has seen strong growth, many developments and evolutions are still needed. New financial products, such as private equity, REITs, mutual funds, and other types of fund management firms, have been licensed by the SECC. A prakas on depository receipt is under consideration and expected to be released soon, with input coming from a variety of relevant market participants. Tax incentives for issuers and investors have been in place for many years. Government bonds are expected to launch soon and will become a much-needed benchmark for pricing all financial instruments.

To promote IPOs, the SECC has initiated the Excellency Program for SMEs. This program aims to educate potential issuers on the possibilities for fundraising through the capital market along with the requirements for doing so, including accountability, corporate governance, and financial reporting. Following the success of the program's first session in 2018, in which more than 70 SMEs participated, the second session commenced in July 2020. Although the initial program attracted a large number of participants, only a handful have pursued IPOs. The main challenge for SMEs is the recent adoption of International Financial Reporting Standards (IFRS) in Cambodia and the requirement for IFRS-audited financial statements. In the medium to long term, these SMEs will be big contributors to the capital market and will potentially drive listings if matters related to accounting standards, corporate governance, internal control, and taxes are addressed.

The bond market holds great potential for further growth because it is able to match the needs of issuers with the demands of local institutional investors. The energy, infrastructure, and real estate sectors all have strong interest in bond issuance as they seek long-term funding. There is also high demand for investments with longer duration from domestic institutional investors, such as insurance companies, looking to diversify their holdings, which so far have been limited to deposit accounts at local banks. In the near term, greater flexibility of currency denominations and structures would be helpful, given that the US dollar is the main currency of both issuers and investors. Plain vanilla bonds in Cambodian riel may not be a very attractive option for issuers because of the high costs of funds, brought on by high coupon rates demanded by the few investors that have sufficient Cambodian riel to invest. Restructuring the bond settlement scheme to be linked to the US dollar will unlock the market's potential and is key to its future. It will also support the government's objective of mobilizing more affordable funding for Cambodia. FX-linked bonds and bonds with US dollar derivatives have already been issued. The market will reap significant benefits if plain US dollar bonds become available, because commercial swap products are still very new in Cambodia.

INDIA

1952 — The Forward Contracts (Regulation) Act, 1952, led to the establishment of the Forward Markets Commission of India in 1953.

1955 — The Capital Issues (Control) Act, 1947, was passed by Parliament. Issuers in India needed to get government permission regarding the timing, size, and price of their issues.

1956 — The Companies Act, 1956, enabled companies to be formed by registration; set out the responsibilities of companies, their directors, and their secretaries; and provided procedures for liquidation of companies; The Securities Contracts (Regulation) Act, 1956 (SCRA), was created to regulate stock markets.

1963 — The Unit Trust of India Act, 1963, provided for the formation of the Unit Trust of India.

1992 — The Securities and Exchange Board of India Act, 1992, established the SEBI to protect the interests of investors in securities.

1993 — The Securities and Exchange Board of India (Mutual Funds) Regulations, 1993, were established.

1999 — The Foreign Exchange Management Act, 1999, consolidated and amended the laws relating to foreign exchange and replaced the Foreign Exchange Regulation Act, 1973; The Insurance Regulatory and Development Authority of India Act, 1999, established IRDAI, an autonomous apex statutory body for regulating and developing the insurance industry.

2016 — The Insolvency and Bankruptcy Code, 2016, instituted a time-bound process to resolve insolvency.

INDIA

Rajendra Kalur, CFA
Director, Research and Advocacy, CFA Society India

Shwetabh Sameer, CFA, CIPM
Applied Statistical Researcher, Morningstar

Equity Market Capitalization (USD)*	**1,506** Bn	**1,797** Bn	Debt Market Capitalization (USD)*
Equity Market Cap/GDP*	56%	67%	Domestic Debt Market Cap/GDP
Equity Market Share Volume Traded (USD)**	**1,282,000** Mn	**2,057,000** Mn	Debt Market Instrument Volume Traded (USD)**
Number of Listed Companies*	5,539	~29,000	Number of Issuers (Bonds)

* As of March 2020
** Fiscal Year 2020 (April 2019–March 2020)

EVOLUTION OF CAPITAL MARKETS IN INDIA

The capital markets in India had their modest beginnings near the end of the 18th century when the loan securities of the East India Company were being traded in India. By the early 19th century, a noticeable increase in the value of corporate securities of banks and cotton presses had occurred. However, only a handful of brokers were recognized by the banks to perform trades. During the onset of the American Civil War (1860–61), raw cotton imports from US industries to Britain plunged sharply. This change resulted in a heavy reliance on Bombay (now Mumbai) for cotton; it became the major supplier to Britain. With this rapid development, Bombay became the chief trading center in India, hosting almost 250 brokers at one time. This period was the first boom cycle in the history of India; however, it lasted only about half a decade. After this period, the importance of a share-trading institution became evident. In 1875, a handful of brokers formed the Native Share and Stock Brokers' Association, which became the Bombay Stock Exchange and is now simply called BSE. It is the oldest stock exchange in Asia.

After the formation of the Bombay Stock Exchange, various parts of India saw a rapid expansion of textile mills, with cotton and jute industries flourishing throughout the country. This expansion led to the formation of new exchanges in Ahmedabad and Calcutta. In the early 1900s, the Swadeshi movement (i.e., the boycott of British-made goods) and the establishment of such companies as Tata Iron and Steel Company (now Tata Steel) led to further development of Indian businesses. Consequently, World War I and World War II made the world recognize India as a key supplier of various commodities. But with restrictions on cotton, bullion, seeds, and other commodities, enterprises started looking for other sources of funds for their businesses. This trend prompted these companies to become listed on the exchanges, which led to the emergence of a few more exchanges in various parts of the country to facilitate the buying and selling of securities.

During World War II, most of the stock exchanges experienced a sharp fall. In the 1950s, as the scrips of such major companies as Tata Steel and Century Textiles and Industries Ltd began fluctuating wildly, a need for regulation and recognition of the exchanges emerged. When the Securities Contracts (Regulation) Act, 1956, came into force in 1957, the BSE became the first exchange to be recognized under the act, followed by seven other exchanges. The development of such financial institutions as the Life Insurance Corporation of India further helped revive the sentiment of the public, which had been affected by insurance fraud by owners of private insurance agencies. In 1963, the Unit Trust of India, the first mutual fund in India, was established at the initiative of the government of India and the Reserve Bank of India. The markets followed a downward trajectory over the next few years as the country suffered wars and droughts.

The 1980s saw tremendous growth in the security market in India. The introduction of public sector bonds and such successful issues as Reliance Industries Limited and Larsen & Toubro led to enlarged volumes in the secondary market, coupled with new listings and the establishment of new stock exchanges across India.

A stock scandal in 1992 led to the creation of the Securities and Exchange Board of India (SEBI) as the regulator of Indian capital markets and the formation of National Stock Exchange of India (NSE), an automated, paperless exchange, to bring about transparency in the Indian equity markets. Since then, NSE has grown tremendously, primarily because of the initial liquidity it was able to receive from its owners—banks and other financial institutions that had become important institutional holders of equities during the 1980s. Also, NSE gave cheaper and more efficient access to small brokers across the country, drawing liquidity away from other exchanges, including BSE.

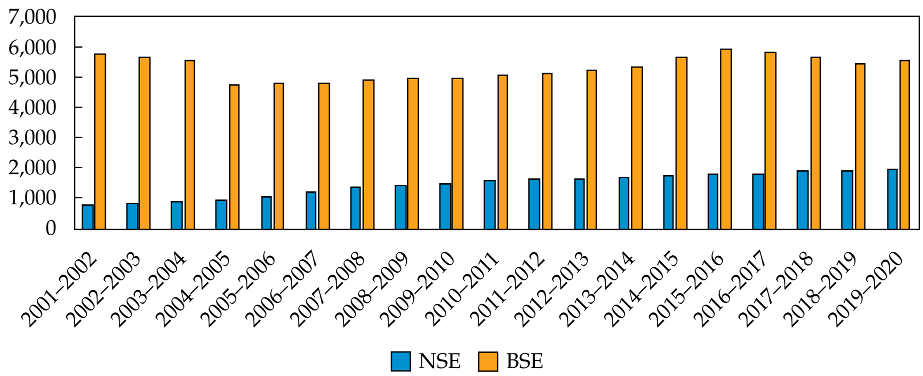
The idea of strong corporate governance was also prominent in the past three decades, which led to amendments in the existing governance structure and the establishment of the Naresh Chandra Committee on Corporate Audit and Governance by the Ministry of Corporate Affairs in 2002. Ethical practices and strong governance form the pillars of the history of Indian capital markets.

EQUITY

The India equity markets constitute around 6.5% of the Asia-Pacific equity market capitalization. NSE and BSE are the two most renowned national exchanges in India. Both follow the same trading mechanism and settlement process (T+2 rolling-settlement-cycle basis) and are regulated and governed by SEBI. The functions of clearing and settlement for NSE and BSE are provided by NSE Clearing Limited and Indian Clearing Corporation Limited, respectively.

BSE boasts more than 5,000 companies listed on it consistently over the last 20 years. NSE has seen a steady increase during this period, from around 800 companies in 2002 to almost 2,000

FIGURE 1. NUMBER OF COMPANY LISTINGS

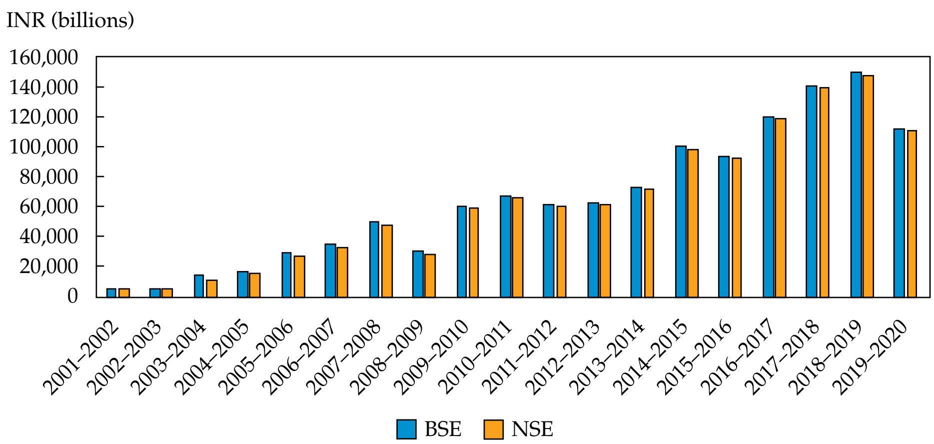


Sources: NSE; BSE.

in 2020 (see **Figure 1**). Although NSE has fewer listed companies, its market cap has been about equal to that of BSE throughout the period, with BSE and NSE being the 10th and 11th largest stock exchanges in the world by market capitalization (see **Figure 2**).

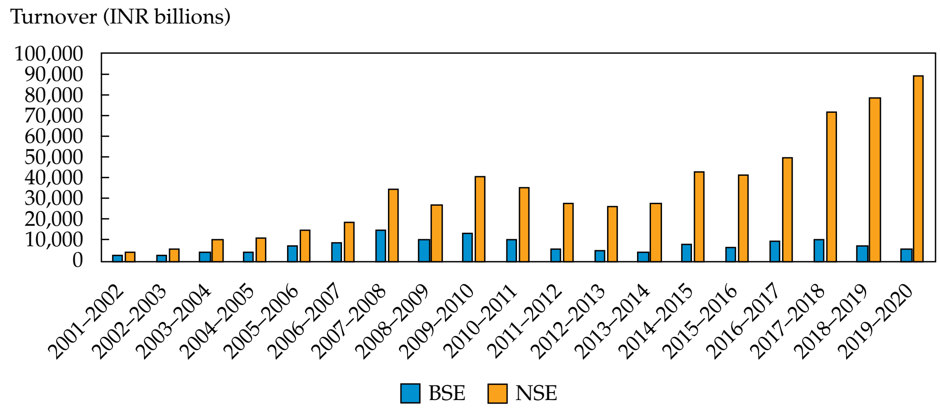
In terms of liquidity, both exchanges compete for order flow, which leads to reduced transaction costs and efficiency. NSE, however, enjoys the lion's share (i.e., more than 90% in recent years) of the total turnover (see **Figure 3**). Part of this turnover comes from NSE's fully automated trading system—the National Exchange for Automated Trading, or NEAT, which was introduced at the beginning of the exchange's establishment—and its vast network of very small aperture terminals, or VSATs (which require less infrastructure to service remote locations), and leased lines spread across more than 2,000 cities in India. This vast network and the high liquidity of NSE, along with that of

FIGURE 2. HISTORICAL BSE AND NSE MARKET CAP



Sources: NSE; BSE.

FIGURE 3. BSE AND NSE CASH TURNOVER



Sources: NSE; BSE.

BSE, also paved the way for the consolidation of 15 regional exchanges in 2014.

Each exchange introduced a new platform for small and medium-sized enterprises (SMEs) in 2012, in accordance with the rules and regulations established by SEBI, to raise funds from the public without an initial public offering. The NSE EMERGE platform has around 200 listed SMEs, and BSE has more than 300 companies listed on its SME platform.

In terms of sectoral composition, the Indian capital markets have seen much change over the past three decades. Prior to globalization, the composition of the BSE SENSEX was completely dominated by manufacturing companies, featuring 26 out of 30 companies. As the services sector grew, with a number of companies being nongovernment, especially in the finance and information technology industries, the number of manufacturing companies fell by half, to around 13 companies in 2018.

The mutual fund industry in India has become an integral part of the country's financial landscape, seeing significant growth in the past decade. Research conducted by the ET Intelligence Group shows that among public shareholders, mutual funds owned around 19% of the stocks in the S&P BSE 500 Index as of September 2019, compared with around 12% in 2015 (see **Table 1**).[1] This change can be attributed to multiple factors, including an increase in financialization after the 2016 demonetization, product innovations by asset management companies (AMCs) in the form of systematic investment plans, and improved reach of channel partners (especially direct channel, where sales happen through AMC branches and websites) to bring smaller investors into the pool. As a result, such factors have led to a recent surge in inflows from retail investors, reducing the reliance on offshore investments.

The clients of the asset management industry are predominantly individual asset owners, owning more than 50% of fund assets under management. This fact highlights how the Indian market has no separation of institutional asset owners and asset managers, unlike most developed markets.

[1] Rajesh Mascarenhas, "Domestic Investors Grow in Strength as Foreign Funds Take a Step Back," *Economic Times* (1 November 2019).

TABLE 1. OWNERSHIP AMONG PUBLIC SHAREHOLDERS IN S&P BSE 500 STOCKS (%)

Investors	September 2015	September 2016	September 2017	September 2018	September 2019
Banks	3.2	4.0	3.5	2.8	2.3
Foreign portfolio investment	53.3	51.9	49.2	48.5	48.2
Insurance	11.9	12.2	11.7	12.5	11.4
Mutual funds	11.6	11.5	14.0	16.1	18.8
Retail	20.0	20.4	21.6	20.1	19.3

Note: The S&P BSE 500 is a broad representation of the Indian market, consisting of the largest 500 constituents by market cap.

Source: ET Intelligence Group.

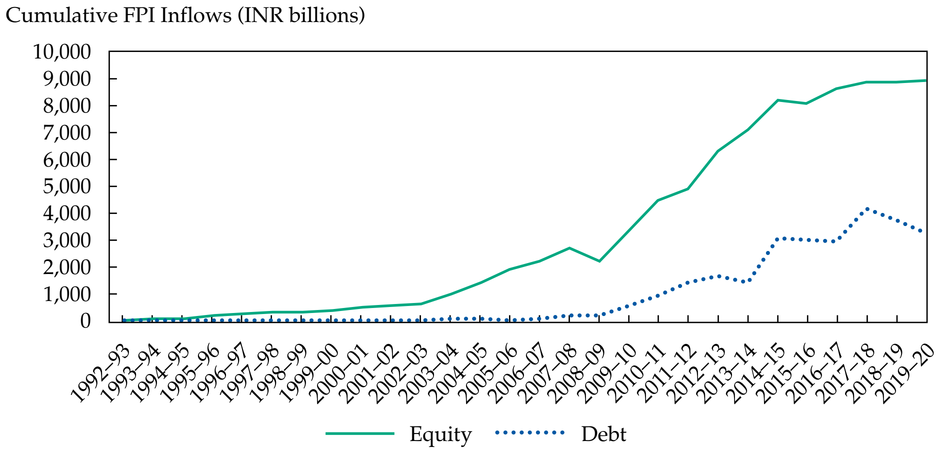
The last few years have also seen consistent growth in the participation of retail investors in owning equities, with the current number of Demat accounts, or dematerialized accounts, growing to almost 41 million. Demat accounts were introduced when the Depositories Act, 1996, was passed by SEBI to phase out share certificates and encourage holding shares in electronic form. Today, shares of Indian listed companies can be held only in a Demat account, since SEBI amended provisions to disallow the transfer of securities in physical form after March 2019.

In terms of foreign investor segments, there are two categories—foreign portfolio investment (FPI) and foreign direct investment (FDI). FPI is a harmonized route that came into effect in June 2014, merging the two existing modes of investments—foreign institutional investment (FII) and qualified foreign investment (QFI). The FPI category is governed by the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2019, and guidelines specified under FEMA 20 as issued by the Reserve Bank of India (RBI). India has witnessed significant FPI growth in equity markets in the wake of the 2008–09 global financial crisis. Cumulative net investments have significantly increased to almost INR9 trillion (see **Figure 4**). However, foreign investors have certain ownership limits when investing in Indian equities. The aggregate FPI limit for Indian companies is equivalent to the sectoral limits to which the companies belong. Securities are subsequently put on the RBI caution or breach list once the limit is reached and are monitored by Indian central securities depositories, National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL).

FIXED INCOME

Indian fixed-income securities consist of four major segments: government securities, corporate and public sector debt, money market securities, and bank and corporate deposits. Government securities (G-secs) constitute the largest and most liquid segment of the Indian fixed-income market. G-secs, along with money market securities, are regulated by RBI, India's central bank, whereas SEBI regulates the corporate debt market.

FIGURE 4. CUMULATIVE FOREIGN PORTFOLIO INVESTMENT INFLOWS SINCE GLOBALIZATION

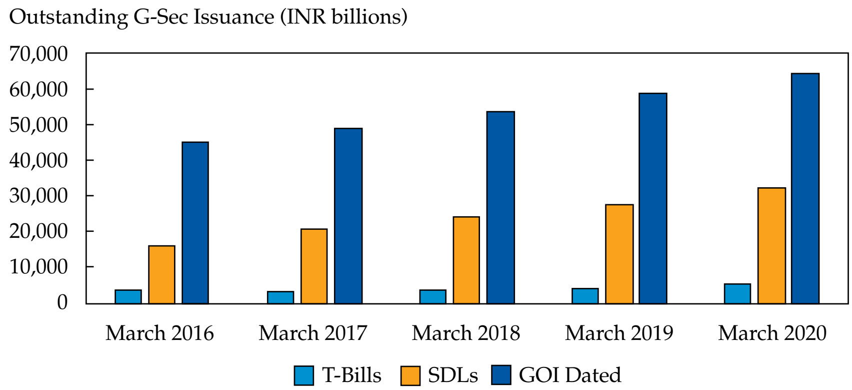


Source: NSDL.

The government security market includes T-bills; cash management bills (maturity less than 91 days); dated G-secs, which are issued by the government of India; and state development loans (SDLs), which are issued by state governments. Of these, dated G-secs constitute the highest share, with more than 40% of the Indian domestic fixed-income market, followed by around 20% of the market for SDLs (see **Figure 5**).

G-secs have experienced significant growth since the implementation of various structural and policy changes in 2012. They have become

FIGURE 5. OUTSTANDING AMOUNT OF G-SECS



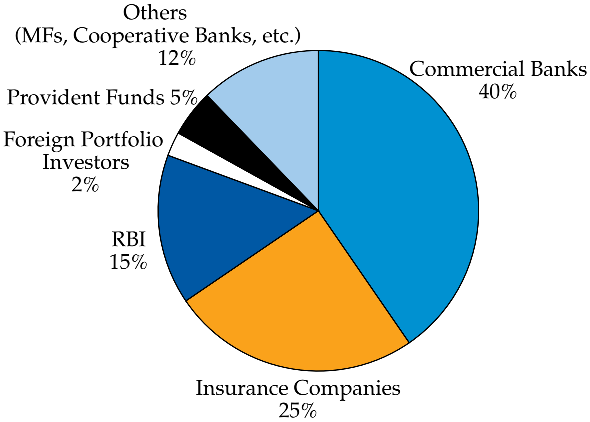
Note: "GOI Dated" represents Government of India dated G-secs; "SDLs" represents State Development Loans.

Source: RBI.

the third largest government debt market in Asia. The introduction of the Negotiated Dealing System (NDS), an electronic trading platform, in 2002 by RBI played a major role in improving the efficiency of the market. Prior to NDS, telephone orders and physical transfer forms, called SGLs, were used for the transfer and settlement of funds. With recent developments, G-secs can now be bought in secondary markets through NDS-OM (NDS Order Matching), OTC markets with NDS-OM reporting, or stock exchanges. The Clearing Corporation of India, established in 2001 for transaction settlement, has been instrumental in reducing the credit risk of participants by assuming the role of central counterparty. Even with these developments, however, the market is fairly skewed toward large institutional investors, with banks, insurance companies, RBI, and other major financial institutions representing a majority of owners (see **Figure 6**). These entities are mandated to invest in G-secs through such regulations as the minimum statutory liquidity ratio. In contrast, the participation of retail investors has remained negligible. Low awareness, high transaction costs for intermediaries, and the availability of similar instruments, such as National Savings Certificates and fixed deposits, have kept them away from this segment. New initiatives—such as NSE goBID (government Bond Investment Destination), an online platform for retail investors to buy G-secs—are aimed at increasing retail investor participation.

India's debt market is among the top four debt markets in Asia. Although it has made efforts to be included in the J.P. Morgan Emerging Market Bond Index, these efforts have yet to bear fruit. Structural weaknesses, including a current account deficit, a large fiscal deficit, and high consumer inflation, are seen as a strong deterrent, even though the large yield spreads and recent reforms may make it attractive for investors.

FIGURE 6. OWNERSHIP OF GOVERNMENT OF INDIA DATED BONDS, AS OF MARCH 2020

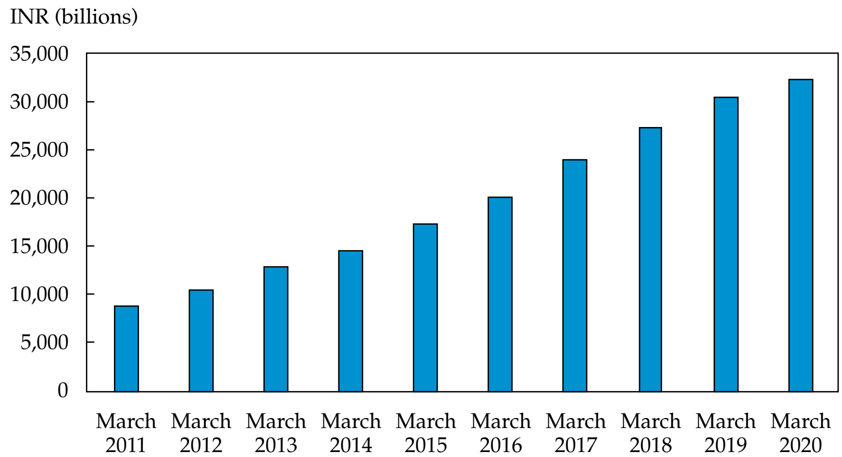


Note: "MFs" stands for "mutual funds."

Source: RBI.

The recent investments by foreign portfolio investors have remained below 5%, despite the lifting of various restrictions imposed on foreign investors' holdings by RBI in 2018. RBI introduced the Medium Term Framework, which increased the investment limits on G-secs from 5% to 6% over the span of two years, between Fiscal Year 2018 and Fiscal Year 2020. Furthermore, foreign portfolio investors are no longer required to invest in government bonds with a minimum residual maturity of three years, thus allowing them to invest in short-term bonds as well. Additionally, in order to expand its investor base and attract long-term oversees investments, RBI proposed a separate route, called the Voluntary Retention Route, that enables foreign investors to avoid

FIGURE 7. OUTSTANDING AMOUNT OF CORPORATE BONDS



Source: SEBI.

macro-prudent or other regulatory hurdles that exist for FPI. Unlike with the normal route, foreign portfolio investors would have to voluntarily commit to retaining a required minimum percentage of their investments in India for a period of their choice.

The next largest segment, the corporate bond market, consists of bonds issued by public sector undertakings and private corporations. It is much smaller than the government security market in terms of trading volume and size (see **Figure** 7). Its penetration has generally ranged between 15% and 20% of India's GDP. Around 80% of the market in corporate bonds consists of AAA and AA corporate issuances, most of them private placements. Financial sector companies represent around 75% of the total issuance. This market is relatively less developed compared with most developing countries because of the reliance of corporations on banks as the primary source of working capital. In addition, public sector ownership of banks and RBI's regulatory mechanism have prevented the growth of corporate bonds. The absence of a proper reward system has also hindered the development of well-capitalized financial intermediaries, which causes corporate bonds to have lower liquidity and quality. As a result, retail and institutional investors have stayed away from this market. Furthermore, the quotas on foreign investment make it difficult for foreign institutional investors to effectively participate in this market. The implementation of the Insolvency and Bankruptcy Code, 2016, and a few crucial amendments to RBI's Large Exposures Framework have provided a considerable boost to expand the market with more diverse issuers. However, the demand for such issues has mostly come from mutual funds and insurance products, which represent around 42% of market share, according to a report by CRISIL.[2] Hence, to attract new investors—including foreign portfolio investors and banks—more reforms are required, including incentives for market makers to improve the liquidity of bonds in the secondary market.

[2]CRISIL, "CRISIL Yearbook on the Indian Debt Market 2018" (24 October 2018).

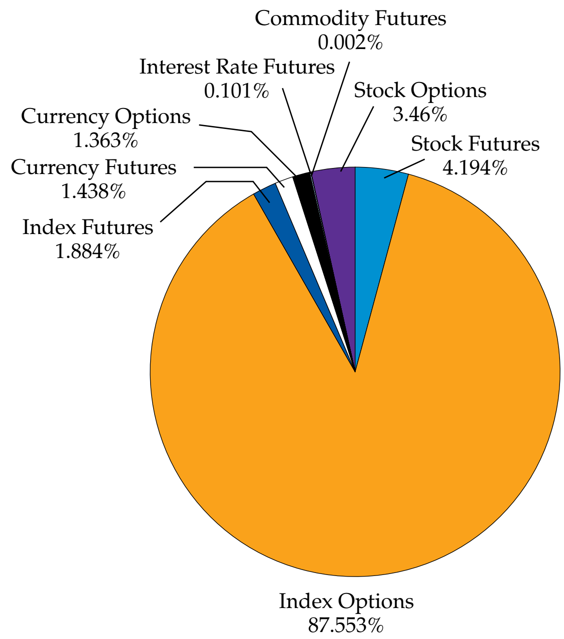
DERIVATIVES

The Indian derivatives market has experienced remarkable growth over the last decade. NSE and BSE are the major exchanges that provide trading in futures and options for indexes, individual stocks, currencies, and commodities. The market started in June 2000 with the trading of index futures contracts on NSE and BSE. Currency derivatives were introduced in 2008.

NSE offers the most liquid segment for index futures (NIFTY 50 and NIFTY Bank), stock futures, index options, and stock options. Its commodity segment, which started in 2018, is still in its nascent stage, with over 140,000 contracts traded on NSE in Fiscal Year 2019–2020. This segment got its start after SEBI allowed the integration of stocks and commodities trading on a single exchange in 2018, enabling NSE and BSE to launch a commodity derivatives platform. Before that, commodity derivatives were traded separately on commodity exchanges, such as MCX and NCDEX. But with the recent merger of SEBI and the Forward Markets Commission, SEBI has now been granted the power to approve trading of commodity derivatives on major exchanges.

Today, NSE is the world's largest exchange by the number of contracts, notching more than 6 billion contracts in 2019–2020. NSE's index options on NIFTY 50 and NIFTY Bank have a share of over 87% by turnover in the financial year 2019–2020 (see **Figure 8**). Interest rate futures and commodity derivatives, in contrast, represent a marginal portion, with shares of 0.1% and 0.002%, respectively. All options available on NSE are European style and can be exercised only at expiration.

FIGURE 8. TURNOVER OF OPTIONS AND FUTURES ON NSE, 2019–2020



Note: Only notional turnover is considered for options.

Sources: NSE; authors' calculations.

CHALLENGES AND OPPORTUNITIES

The principal capital market regulator, the Securities and Exchange Board of India, has taken a series of steps to not only protect the interest of investors but also foster innovation and entrepreneurship in the capital markets. Chief among them is to initiate steps to strengthen corporate governance in listed companies by implementing the Kotak Committee on Corporate Governance report. SEBI has also initiated steps to make trading more transparent by strengthening compliance to prevent the misuse of client funds by brokers. Recently, auditors have tried to escape scrutiny by resigning from companies believed to be in violation of various corporate laws. The regulator has initiated steps to ensure auditors do not escape their responsibility. Coordination among the various regulators has also improved through the Financial Stability and Development Council.

Notwithstanding these very welcome and path-breaking reforms, challenges remain, including the following:

1. Identify areas of regulatory multiplicity because India is handicapped by having several regulators, including the Reserve Bank of India, the Insurance Regulatory and Development Authority, the Pension Fund Regulatory and Development Authority, and the Insolvency and Bankruptcy Board of India.

2. Expand the bond markets beyond government securities and AAA rated bonds. Doing so would require freeing up and professionalizing the investment management arms of the Employees' Provident Fund Organisation and dismantling the rigid investment pattern mandated by the government. Also, certain supply-side measures, including clarity on stamp duty, securitization of assets, and recovery of assets through a fast-track mechanism, can lead to a much broader and deeper bond market.

3. Recognize exchange-traded funds as distinct from mutual funds, and create a separate set of regulations to encourage acceptance of and expand the market, which currently represents around 18% of the market share in India, compared with more than 40% in developed markets.

4. Improve incentives for foreign companies to list in India.

5. Identify steps to expand the commodity markets in India. In the past, political calculations and farm lobbyists have prevented the commodity markets from being adequately developed.

6. Make investments in companies listed abroad seamless.

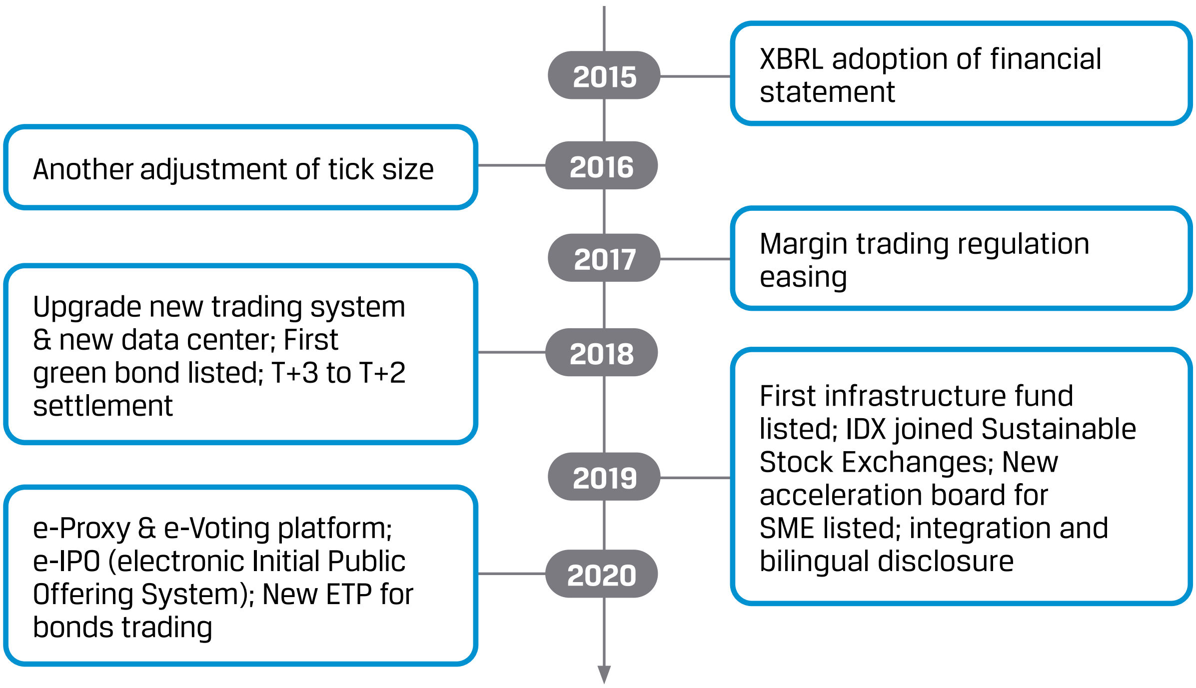
7. Create an environment for growth of the fintech space across the capital markets. Although growth in this sector is rapid and adequate capital seems to be available, there is a lack of clarity on the regulations and a multiplicity of regulators.

India has a young population, a fast-growing economy, and widespread access to the internet, but regulations need to become clear and precise and the red tape eased to fully reap the benefits of the demographic dividend and help India achieve the goal of becoming a US$5 trillion economy.

INDONESIA

1912	The first stock exchange in Indonesia was established in Batavia during the Dutch colonial era
1977	Indonesia government reactivation of capital market and establishment of Bapepam as the Capital Market Supervisory Agency
1992	Privatization of Jakarta Stock Exchange (JSX)
1995	Implementation of Jakarta Automated Trading System (JATS); Bursa Paralel Indonesia merged into Surabaya Stock Exchange (SSX)
1996	Establishment of Indonesia Clearing and Guarantee Corporation (KPEI)
1997	Establishment of Indonesia Central Securities Depository (KSEI)
2000	Electronic shares trading
2002	T+4 to T+3 settlement
2004	Launching of stock option
2007	Consolidation of SSX and JSX into Indonesia Stock Exchange (IDX); First ETF listed
2010	First MBS listed
2012	Establishment of Indonesia Financial Services Authority (OJK); Establishment of Indonesia Securities Investor Protection Fund (SIPF); First listed REITs
2014	Adjustment of lot size & tick size

INDONESIA


2015
XBRL adoption of financial statement
2016
Another adjustment of tick size
2017
Margin trading regulation easing
2018
Upgrade new trading system & new data center; First green bond listed; T+3 to T+2 settlement
2019
First infrastructure fund listed; IDX joined Sustainable Stock Exchanges; New acceleration board for SME listed; integration and bilingual disclosure
2020
e-Proxy & e-Voting platform; e-IPO (electronic Initial Public Offering System); New ETP for bonds trading

INDONESIA

Ignatius Denny Wicaksono, CFA, CIPM
Head of Business Development Division, Indonesia Stock Exchange

Equity Market Capitalization (USD)	**520.98** Bn*
Domestic Equity Market Cap/GDP	46%
Equity Market Share Volume Traded	**3,562,370** Mn*
Number of Listed Companies	668*

228.78 Bn*	Debt Market Capitalization (USD)
20%*	Domestic Debt Market Cap/GDP
522,830 Mn**	Debt Market Instrument Volume Traded (USD)
120**	Number of Issuers (Bonds)

* As of 2019
** Issuers of government and corporate bonds; volume based on government and corporate bonds and sukuk

HISTORY OF THE CAPITAL MARKET IN INDONESIA

The first stock exchange in Indonesia was established in 1912 in Batavia (now Jakarta) during the Dutch colonial era. At that time, the exchange was established for the interest of the Dutch East India Company (VOC) in the expanding plantations sector. After that era, however, the capital market became inactive for a period of time. The Indonesian government reactivated its capital market in 1977. The establishment of Bapepam as the Capital Market Supervisory Agency (later known as Bapepam-LK) showed the government's commitment to building an independent Indonesian capital market. At that time, Bapepam carried out its dual function as capital market executor and supervisor. In 1992, the managing function of the stock exchange was handed to the private sector, marked by the privatization of the Jakarta Stock Exchange (JSX) to complement the Surabaya Stock Exchange (SSX) established in 1989. In 1995, the JSX began using an electronic platform, the Jakarta Automated Trading System (JATS), to strengthen trading infrastructure.

The establishment of the Indonesia Clearing and Guarantee Corporation (*Kliring Penjaminan Efek Indonesia*, KPEI) in 1996, followed by the Indonesia Central Securities Depository (*Kustodian Sentral Efek Indonesia*, KSEI) in 1997, completed the development of self-regulatory organizations (SROs) for the Indonesian capital market.

To increase stock trading efficiency and effectiveness, electronic shares trading started in 2000 and was followed by remote trading in 2002. In 2007, SSX merged with JSX to become the Indonesia Stock Exchange (IDX). In its development, IDX continues to reform and refine the capital market supporting systems, facilities, and infrastructure. These efforts include the development of digital technology for the advancement of the Indonesian capital market.

The Indonesia Financial Services Authority (Otoritas Jasa Keuangan, or OJK) was established in 2012. The main function of OJK is to promote and organize a system of regulations and supervisions that is integrated into the overall activities of the financial services sector. Taking over these roles from Bapepam-LK and Bank Indonesia, OJK performs regulatory and supervisory duties over financial services activities in banking, capital markets, and non-bank financial industry sectors.

In addition to the OJK, three SROs—IDX, KPEI, and KSEI—provide rules and regulation for their members, as shown in **Figure 1**.

INDONESIA EQUITY MARKET

Equity is the main instrument in the Indonesian capital market. As shown in **Figure 2**, for the last 10 years, market capitalization increased to IDR7,265 trillion (equivalent to USD521 billion) in 2019 from IDR2,019 trillion (equivalent to USD214 billion) in 2009. Average daily trading value increased to IDR9.11 trillion (equivalent to USD653 million) per day in 2019 from IDR4.05 trillion (equivalent to USD300 million) per day in 2009.

The trading figures are supported by a rising number of listed companies. The number of listed companies on the IDX rose to 668 companies in 2019 from 398 companies at the end of 2009. On average, IDX has listed 30 new companies per year since 2010.

Over the last 10 years, USD53 billion in equity funds have been raised in Indonesia. The increasing trend indicates the capital market is a prominent place for sources of capital. The trade, service, & investment sector is the biggest sector (25.0%), followed by infrastructure, transportation, & utilities (13.7%) and then properties & real estate (11.9%).

FIGURE 1. FINANCIAL SYSTEM IN INDONESIA

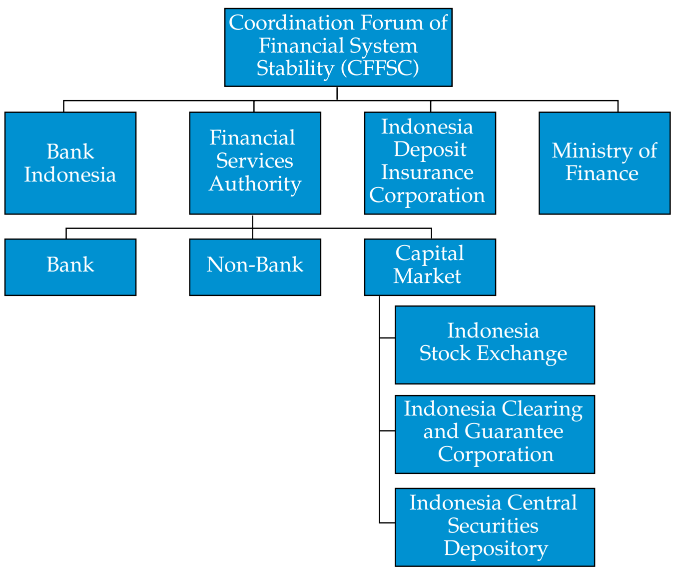
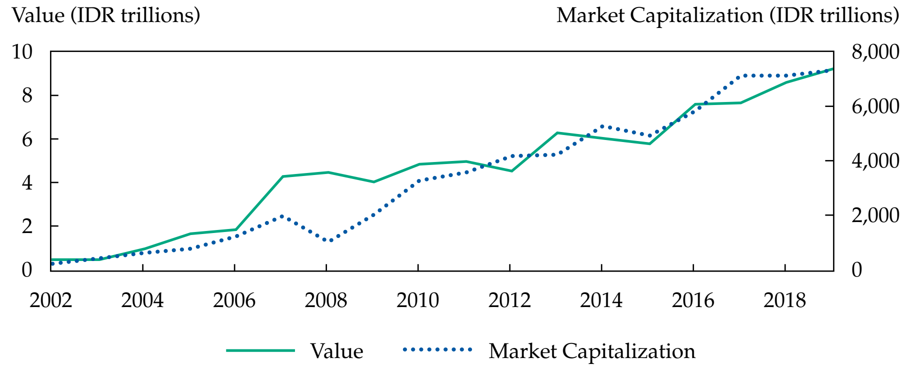


FIGURE 2. AVERAGE DAILY TRADING VALUE AND MARKET CAPITALIZATION



Source: IDX.

Market Development

Various outreach programs have been implemented to attract issuers and investors. Some of the major milestones include equity listing development, trading rules development, and other initiatives.

Equity Listing Development

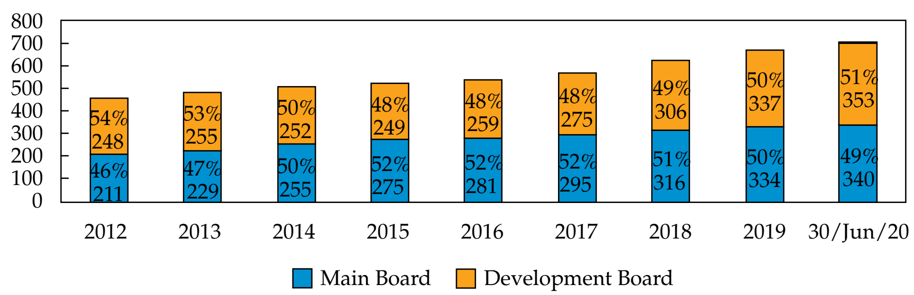
Several initiatives have supported the growth in equity listings:

- **Creation of a second listing board (2000)**

Before 2000, IDX had only one listing board. In 2000, to accommodate more companies, IDX divided the listing board into two segments: the main board (for relatively larger size companies) and the development board. Listing requirements for the development board are less stringent than for the main board. **Figure 3** shows that many companies use this new board. As of June 2020, 50.9% of listed companies were listed on the development board.

- **Indonesia tax amnesty (2016)**

FIGURE 3. NUMBER OF EQUITY LISTED COMPANIES BASED ON BOARD



Source: IDX.

The Indonesian government issued a tax amnesty program in 2016 to repatriate Indonesians' foreign assets at a favorable tax rate. This program changed investor composition in equity ownership. In 2015, overseas investors held 63.79% of equity and domestic investors held 36.21%. In 2017, the figures were 51.30% and 48.70%, respectively.

- **IDX Incubator (2017)**

To support Indonesian start-ups, IDX established IDX Incubator in 2017. IDX Incubator is a facilitator to help digital-based start-ups that want to go public in an IPO by giving access to underwriters, supporting professionals, and providing IPO preparation training.

- **Creation of "acceleration board" for small- and medium-sized enterprises (2019)**

In 2019, IDX added one more board, the acceleration board, to facilitate the listing of small- and medium-sized enterprises. The acceleration board has less stringent listing requirements compared with the main and development boards. Given that these initiatives align with the IDX Incubator program, some of the start-ups from the IDX incubator are listed on the acceleration board.

- **Simplification of going public and listing process (2019)**

In 2019, IDX and OJK integrated their listing and public offering document submissions. This integration simplified the listing process.

Trading Rules Development

IDX trading value and market capitalization have been steadily increasing. Some highlighted milestones are as follows:

- **Minimum floating shares and shareholders' requirements (2014)**

In 2014, IDX introduced a new regulation to maintain minimum floating shares and minimum shareholders as a continuous listing requirement. Listed companies were given two years to comply with this new regulation. As a result, several companies—including two large-cap companies, Bank Cimb Niaga Tbk PT (BNGA) and Hanjaya Mandala Sampoerna Tbk PT (HMSP)—increased their floating shares by right issue, thus bringing more liquidity in the market.

- **Changes of lot size and tick size**

IDX changed lot size from 500 shares/lot to 100 shares/lot in 2014, which made many expensive stocks more affordable for investors. This change was reflected in the substantial increase of trading frequency from 2013 to 2014.

- **Margin trading regulation easing and establishment of IDX securities financing**

In 2017, IDX eased margin trading regulations. The number of stocks that could be traded on margin jumped from 45 to 200 following the regulatory change.

In addition to regulation easing, IDX established the Indonesia securities financing company to support this initiative. IDX securities financing was established in 2016 and received its license from OJK in 2019. Because of the limited financial institutions that accept shares as collateral for loanable funds, IDX securities financing exists as an alternative source of funding for securities transactions, and it offers competitive costs of funds.

- **T+3 to T+2 settlement process**

In 2018, IDX started the T+2 settlement cycle to replace the T+3 settlement cycle. This initiative brings more efficiency in the market and is well supported by all the market players. Liquidity increased significantly after implementation of T+2 settlement.

Other Initiatives

- **XBRL disclosure adoption; integrated and bilingual disclosure**

To reduce the burden for listed companies, IDX and OJK integrated their disclosure system in 2019. The system has several features that can benefit investors, including eXtensible Business Reporting Language (XBRL) for financial statements (starting in 2015) and bilingual disclosure (in Bahasa Indonesia and English) forms.

- **Special notation for investor protection**

To further increase investor protection, in 2018 IDX implemented eight special notations for PLCs in certain conditions, such as an adverse auditor opinion, moratorium of debt payment, or negative equity. These disclosures are distributed via data feed, and securities companies will provide that notation in their online trading system. IDX continuously gathers needs from OJK and the market to determine whether to provide other notations.

- **Environmental, social, and governance (ESG) issues**

ESG improvement is one of the focuses in the Indonesian capital market. In 2017, OJK released new regulations that gradually mandate all financial institutions to publish sustainability reports—starting in 2019 for large banks onward. IDX joined the Sustainable Stock Exchanges (SSE) initiative in 2019 to strengthen its commitment to ESG issues.

- **Islamic capital market development**

Indonesia has the largest Muslim population of any country in the world; thus, Shariah and the Islamic capital market play a significant role in the Indonesian capital market. In 2007, Bapepam-LK (now OJK), together with the National Sharia Board of Indonesian Ulema Council (DSN-MUI), released criteria for and a list of Shariah-compliant stocks. These initiatives were followed by the development of Shariah indexes, online trading systems, and securities sub-accounts. Note that the Islamic capital market is not a separate system from the Indonesian capital market; rather, it includes special characteristics to ensure that products and transaction mechanisms do not go against Islamic principles.

IDX has received several awards from Global Islamic Finance Awards (GIFA). Three years in a row (2016–2018), IDX was awarded "Best Supporting Institution of the Year." In 2018, IDX was also awarded "Best Emerging Islamic Capital Market." In 2019 and 2020, IDX received the "Best Islamic Capital Market" award.

- **E-voting & e-proxy**

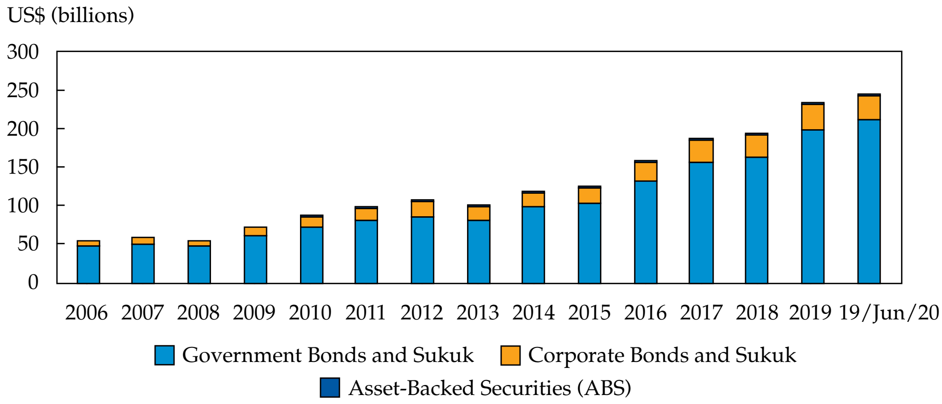
In 2020, KSEI launched an e-voting and e-proxy system. With this system in place, all shareholders can actively vote in the Annual General Meeting of Shareholders via e-proxy or e-voting.

INDONESIAN BOND MARKET: REGULATED OTC TRADING PLATFORM IS UNDERWAY

The Indonesian bond market is dominated by government bonds. As **Figure 4** shows, corporate bond issuance demand has steadily increased but is still far below government bond issuance. Most companies still approach banks for debt financing.

Bonds trade over the counter, with all traded bonds reported to the regulator and published on the IDX website. OTC market liquidity has increased over time, particularly for government bonds (see **Figure 5**).

FIGURE 4. OUTSTANDING GOVERNMENT AND CORPORATE BONDS AND SUKUK, AND ASSET-BACKED SECURITIES



Source: IDX.

The increasing bond demand has resulted from Indonesia's improved sovereign credit rating. Fitch Ratings (Fitch) gave a rating of investment grade in 2011, followed by Moody's in 2012 and Standard & Poor's (S&P) in 2017. At the end of August 2020, the Indonesia sovereign credit rating was Baa2/Stable by Moody's, BBB/Negative by S&P, and BBB/Stable by Fitch.

Islamic Bonds (Sukuk)

As a Shariah equity investment, the Indonesian bond market offers Islamic bonds (sukuk). PT Indonesia Satellite Corporation Tbk (Indosat) issued the first listed Shariah corporate bond in 2002, and the Indonesian government started issuing Islamic bonds in 2008. In Indonesia, sukuk have been considered as alternative fund-raising instruments. As of 2019, Indonesian government-issued Islamic bonds outstanding equaled USD34.8 billion, or 17.64% compared with total outstanding government bonds and Islamic bonds. Listed corporate Islamic bonds (sukuk) outstanding equaled USD2.6 billion, or 6.8% compared with total outstanding corporate bonds and sukuk.

Asset-Backed Securities (ABS)

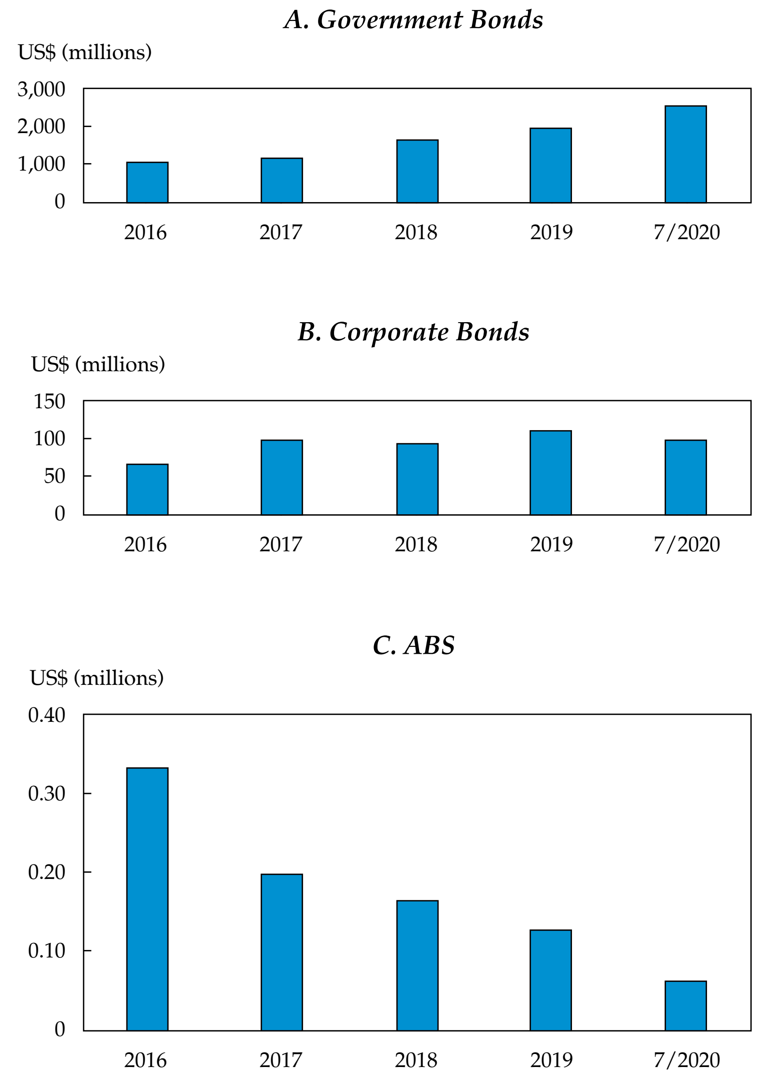
Indonesian asset-backed securities mainly consist of mortgage-backed securities (MBS). In 2008, the Indonesian government established PT Sarana Multigriya Financial (Persero) to promote secondary mortgage finance. The first issuance of MBS took place in 2010.

There are two types of ABS:

1. Collective investment contract, in which ABS are issued and monitored by the investment manager and custodian bank.
2. Letter of Participation, which is allowed only for special companies that promote secondary mortgage finance and does not require an investment manager.

In 2017, PT Mandiri Manajemen Investasi (Mandiri Investasi) issued the first ABS with an underlying based on future cash flows (toll road revenue). Subsequently, the Indonesian government issued several ABS through state-owned enterprises to finance Indonesian infrastructure development.

FIGURE 5. BONDS DAILY TRADING AVERAGE: OTC



Source: IDX, converted to USD.

Green Bonds

Green bonds regulation was established in 2017. The first green bond was issued in 2018 by PT Sarana Multi Infrastruktur (Persero). However, there is still limited demand for green bonds issuance in Indonesia.

Establishment of Indonesia Bond Pricing Agency

To increase pricing transparency and mark to market, the Indonesia Bond Pricing Agency (IBPA) was established in 2008. IBPA holds the role and function of valuating and determining the fair market price of debt securities issued in Indonesia on a daily basis. IBPA's fair market prices are used by the financial industry as a reference in debt securities transactions, asset valuation, auctions, audit activities, and fund performance appraisal.

Bonds Electronic Trading Platform

To increase liquidity in the Indonesian bond market, given license by OJK (previously Bapepam-LK), the Indonesia Stock Exchange also now provides an electronic trading platform to accommodate regulated OTC bond trading. The first phase of this initiative began in 2017 for retail government bonds only. In 2020, IDX provided a new electronic trading platform system for all bonds and sukuk.

OTHER MARKETS OR INSTRUMENTS

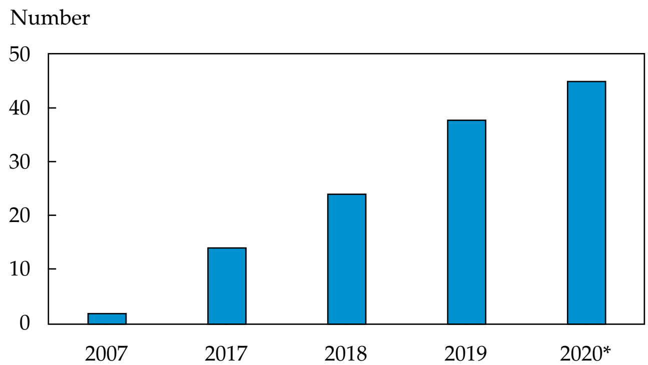
Exchange-traded funds (ETFs) have recently experienced tremendous growth in Indonesia. Starting in 2007 with only 2 listed ETFs (1 equity, and 1 bond), the number of ETFs increased to 14 in 2017. In 2018 and 2019, there were 10 and 14 newly listed ETFs, respectively, as can be seen in **Figure 6**. This trend is expected to continue.

Strong demand for index-based funds is one important factor behind ETF growth in Indonesia. The number of equity index funds has increased tremendously over the past five years, and their market share increased to 10.21% in 2019 from 1.31% in 2009.

Currently, Indonesia has only stock and bond ETFs. It does not yet have commodity-based ETFs or inverse or leveraged ETFs because current regulations do not allow such products to be listed.

Other instruments that are listed in Indonesia are real estate investment funds and derivatives products, such as options and futures. The volume of derivatives products transactions is very low. Ongoing regulatory initiatives are underway to grow derivatives and other product markets, including the uptick rule exception for liquidity providers to short the underlying for hedging purposes.

FIGURE 6. ETF MARKET GROWTH: NUMBER OF LISTED ETFS



*As of August 2020.

Source: IDX.

WAY FORWARD

Indonesia is a promising market in Asia. With nominal GDP of USD1.12 trillion in 2019, Indonesia has the largest GDP in the Association of Southeast Asian Nations (ASEAN). Furthermore, Indonesia has the highest population in ASEAN, at 267 million. There is much room for capital market growth from both investors and companies.

Indonesia consists of more than 17,000 islands separated by sea. Recent technology development initiatives have been effective in reaching all potential investors in Indonesia. This increased reach will provide a new source of growth to increase both demand and supply in the Indonesian capital market.

Several other initiatives are underway, such as boosting liquidity of non-equity products, developing stronger investor protections, and increasing ESG (environmental, social, and governance) investments. Product variation—such as structured warrants, futures, and ETFs—is expected to increase to complement existing equity products.

MALAYSIA

- **1930** — Singapore Stockbrokers' Association was established as the first formal securities business organization in then Malaya[1]
- **1937** — The Association was re-registered as the Malayan Stockbrokers' Association
- **1960** — Malayan Stock Exchange was established and public trading of shares commenced
- **1964** — Stock Exchange of Malaysia was established
- **1965** — Stock Exchange of Malaysia became the Stock Exchange of Malaysia and Singapore, with the secession of Singapore from Malaysia in 1965
- **1986** — Kuala Lumpur Stock Exchange (KLSE) Composite Index launched
- **1988** — KLSE Second Board launched
- **1997** — The Shariah-compliant securities list introduced
- **2002** — Launch of the MESDAQ market at KLSE
- **2004** — KLSE changed its name to Bursa Malaysia Berhad, following a demutualisation exercise
- **2005** — Bursa Malaysia listed on the Main Board of Bursa Malaysia Securities Berhad
- **2009** — New board structure comprising Main and ACE (Access, Certainty, Efficiency) Markets
- **2012** — ASEAN Trading Link was launched, connecting Bursa Malaysia and Singapore Exchange, and later joined by the Stock Exchange of Thailand
- **2017** — LEAP (Leading Entrepreneur Accelerator Platform) Market launched as an alternative platform for small and medium enterprises to raise capital

[1] *During the British colonial era, Singapore was part of the Straits Settlements, which were a group of British territories in Southeast Asia that included Penang and Malacca (states in Malaya and subsequently Malaysia).*

MALAYSIA

Jin Yoong Chong, CFA
Co-Founder, StudyLisa Education Platforms

Equity Market Capitalization (USD)	**369.06** Bn	**364.29** Bn	Debt Market Capitalization (USD)
Equity Market Cap/GDP	114%	114%	Domestic Debt Market Cap/GDP
Equity Market Share Volume Traded	**617,660** Mn	**158,070** Mn	Debt Market Instrument Volume Traded
Number of Listed Companies	932	75	Number of Issuers (Bonds)

As of June 2020

EQUITY CAPITAL MARKETS

Bursa Malaysia Berhad (formerly known as Kuala Lumpur Stock Exchange) traces its roots back to 1930 with the registration of the Singapore Stockbrokers' Association.[1] Securities were not traded until 1960, however, when the Malayan Stock Exchange was established to facilitate trading of public shares. The exchange had trading rooms in Singapore and Kuala Lumpur, linked by direct telephones lines into a single market. With the formation in 1963 of the Federation of Malaysia, which included Singapore, the Stock Exchange of Malaysia was established in 1964. Subsequently, following the secession of Singapore from Malaysia in 1965, the exchange was renamed the Stock Exchange of Malaysia and Singapore.[2] In 1973, the cessation of currency interchangeability between Malaysia and Singapore resulted in the split of the exchange into the Kuala Lumpur Stock Exchange and the Stock Exchange of Singapore. In 1989, the open outcry system in use at the Kuala Lumpur Stock Exchange was replaced by the implementation of SCORE (System on Computerised Order Routing and Execution).

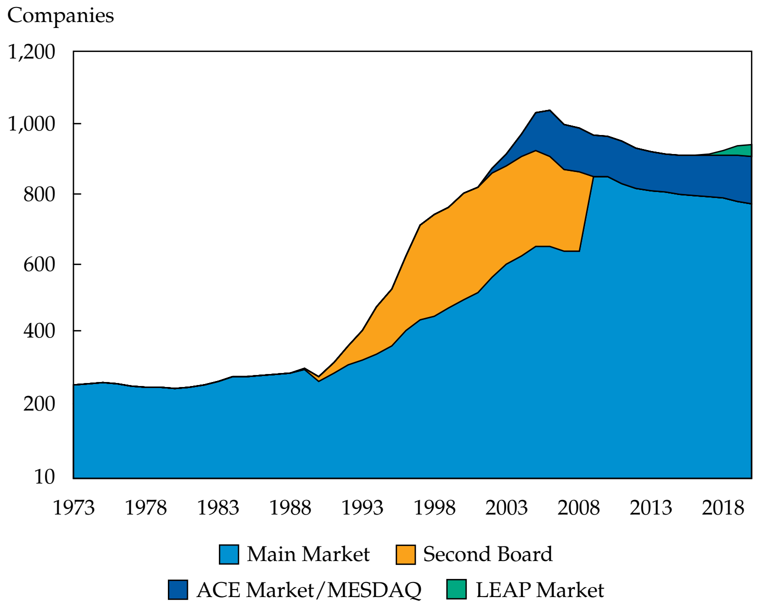
Malaysia boasts a prominent role in the field of Islamic finance, as demonstrated by the introduction in 1997 of the Shariah-compliant securities list by the Shariah Advisory Council (SAC) of the Securities Commission of Malaysia (SC).

Following a demutualisation exercise in 2004, the Kuala Lumpur Stock Exchange changed its name to Bursa Malaysia Berhad. And in 2005, Bursa Malaysia itself was listed on the Main Board of Bursa Malaysia.

As of 30 June 2020, the exchange lists 932 companies with the majority of the companies listed

[1]"Corporate History: A Brief Historical Background on the Exchange," Bursa Malaysia website: https://www.bursamalaysia.com/about_bursa/about_us/corporate_history.
[2]Effectively, the single exchange was serving two sovereign countries at this point.

FIGURE 1. NUMBER OF LISTED COMPANIES ON BURSA MALAYSIA (1973–2020)



on the Main Market. New listings via initial public offerings (IPOs) happen predominantly in the LEAP Market, which caters to smaller companies with a shorter track record of operations. The first half of 2020 saw a total of seven new listings, with all the IPOs occurring in the first three months of the year due to mid-March lockdowns imposed in response to the COVID-19 pandemic. The easing of these restrictions in late June resulted in a flurry of listing activity, with four IPOs in July alone.

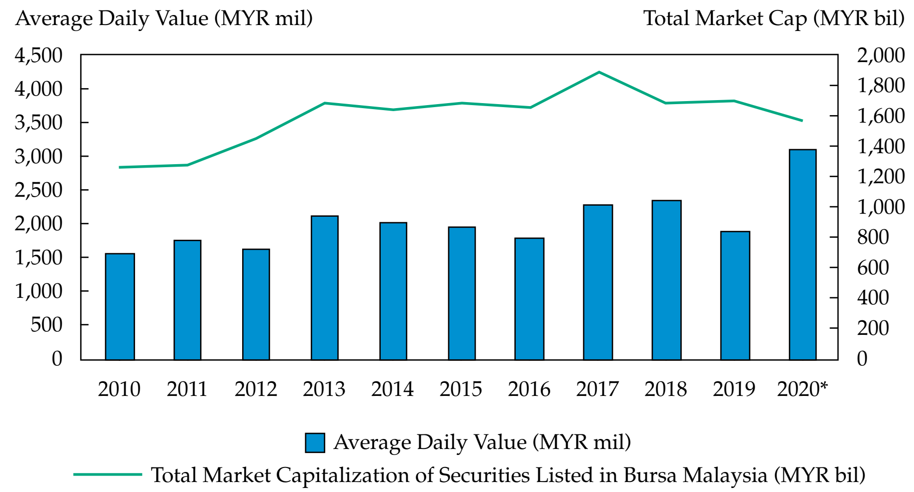
The total market capitalization for the exchange stands at USD369.06 billion as of 30 June 2020,[3] which is a drop of 9.9% in the local currency compared with a year ago, mostly attributed to the impact of the global pandemic that occurred in 2020.

[3]USD/MYR: 4.2800 on 30 June 2020 as per BNM's Exchange Rate page. Data from www.sc.com.my/analytics/equities.

The number of listed companies across the different markets in Bursa Malaysia between 1973 and 2020 is illustrated in **Figure 1**. In 2009, the Main and Second Boards were merged into the Main Market and the MESDAQ Market was reformulated into the alternative ACE (Access, Certainty, Efficiency) Market. The exchange was further complemented with the launch of the LEAP (Leading Entrepreneur Accelerator Platform) Market in 2017. The Main Market is the prime market for established companies that have met the standards in terms of quality, size, and operations. Potential issuers aiming to list on the Main Market must demonstrate operating and profit track records coupled with minimum size as measured by market capitalization. The Main Market also caters to listings for foreign companies including secondary listings.

The ACE Market is a sponsor-driven market designed for companies with growth prospects

FIGURE 2. TOTAL MARKET CAPITALIZATION OF SECURITIES LISTED IN BURSA MALAYSIA AND AVERAGE DAILY VALUE OF TRANSACTIONS



*As of 30 June 2020. All other figures are as of 31 December (average for a full year) of the indicated year.

but lacking an operating track record. Prior to 3 August 2009, it was known as the MESDAQ Market. Sponsors, which are typically investment banks or brokerage firms, perform the role of assessing the suitability of the potential issuers, taking into consideration such attributes as business prospects, corporate conduct, and adequacy of internal control. The ACE Market also facilitates listings for foreign companies but only for primary listings.

Finally, the LEAP Market is an adviser-driven market catering to emerging companies, including small- and medium-sized enterprises looking to tap the capital markets for fund raising. Shares listed on this market are accessible only to sophisticated investors. Hence the LEAP Market has a significantly lower secondary trading volume and liquidity due to the significantly smaller addressable investor base.

The volume of trading on Bursa Malaysia displayed an upward trend over the past 10 years as reflected in the Average Daily Value in **Figure 2**. A notable exception was observed in the year 2020, when nationwide lockdown measures introduced to combat the pandemic resulted in a huge influx of retail investors, causing an upward spike in trading activity.

DEBT CAPITAL MARKETS[4]

Public Debt

The Malaysian bond market started in the 1970s with the government issuing Malaysian

[4]For more information on the debt markets in Malaysia, see Muhammad bin Ibrahim and Adrian Wong, "The Corporate Bond Market in Malaysia," *BIS Papers*, No. 26, Part 16 (February 2016): https://www.bis.org/publ/bppdf/bispap26p.pdf. Also see Dato' Salleh Harun, "The Development of Debt Markets in Malaysia," *BIS Papers*,

Government Securities (MGS) to meet the funding needs of the country's public sector development expenditure at the time. MGS also served the purpose of meeting the investment needs of the Employees Provident Fund (EPF), local banks, and insurance companies in Malaysia. Between 1988 and 1997, however, MGS issuance slowed in line with the government's policy to increase the private sector's contribution towards economic growth.

The MGS issuance calendar outlines the timing, tenure, and issuance method (new issue/re-opening), which are announced at year-end for the following year to enhance market transparency. The actual issuance size is announced a week before the issuance date. Typical issuance sizes range from MYR1 billion to MYR4.5 billion, depending on government financing requirement. The government continuously issues 3-year, 5-year, 7-year, and 10-year MGS as benchmark (on-the-run) securities as part of its commitment to develop and maintain the benchmark yield curve. Benchmark securities are often reopened to enlarge outstanding size in order to improve market liquidity.

In addition, the government also offers the Government Investment Issues (GIIs), which is a type of Islamic security. GIIs are issued to facilitate Islamic banks' compliance with their statutory liquidity requirements. The issuance of these securities also enables banks to invest their liquid funds in instruments that adhere to Shariah principles, as Islamic banks cannot purchase or trade MGS, Malaysian Treasury Bills (MTB), or other interest-bearing instruments.

MGS and GII issuances are conducted on a competitive auction basis via the principal dealer (PD) system in Malaysia. The central bank, Bank Negara Malaysia (BNM), appoints selected banking institutions biannually as PDs based on a set of criteria. These criteria include the ability to handle large-volume transactions as measured by participation in primary auctions, secondary market trading volumes, and overall risk management capabilities. The PDs are obliged to bid for all government papers in the primary market, effectively underwriting all government issuance. PDs are also required to provide two-way price quotations for benchmark securities to ensure liquidity in the secondary market.

Private Debt

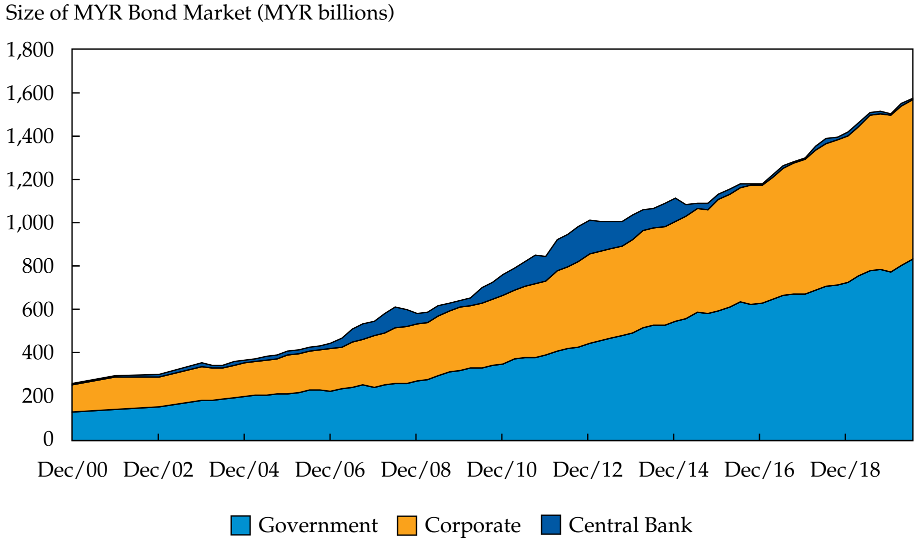
In the mid-1980s, the private sector started to play an increasingly important role in the development of the Malaysian economy. During that period, the corporate sector's primary source of financing was bank loans. This led the government to prioritize the development of the corporate bond market to diversify financing channels for the private sector. The Asian financial crisis that occurred in 1997–98 led the government to accelerate its efforts to develop the corporate bond market as an alternative source of finance for the private sector and to reduce funding mismatches.

Over the past 30 years, the government's effort to develop the Malaysian bond market have been a resounding success. The growth in the size of the bond market compared to domestic bank credit has been significant. The other notable achievement is the successful promotion of the Islamic bond market. Islamic bonds, which comply with Shariah principles, have played a major role in Malaysia's capital market development, contributing to the significant growth of the country's Islamic financial system.

The Malaysian corporate debt market has witnessed enormous growth, rising from

No. 11 (June–July 2002): https://www.bis.org/publ/bppdf/bispap11m.pdf.

FIGURE 3. SIZE OF BOND MARKET CATEGORIZED BY ISSUER



MYR4.1 billion in private debt securities (PDSs) outstanding in 1989 to approximately MYR698 billion in 2019,[5] a 170-fold increase, as illustrated in **Figure 3**. In addition, the Malaysian corporate bond market represents over 50% of the country's GDP in 2019. In stark contrast, corporate debt accounted for only 0.5% of the country's GDP in 1987.

ALTERNATIVE FUNDRAISING CHANNELS[6]

In 2015, the Securities Commission Malaysia (SC) introduced two alternative financing platforms via equity crowdfunding (ECF) and peer-to-peer (P2P) lending Both are essentially platforms that facilitate funding for companies or ventures by raising many small individual amounts of money from a large number of people. These platforms are set up to cater to the unique requirements of businesses, particularly micro, small, and medium enterprises (MSMEs), which traditionally have encountered challenges in raising capital. The ECF and P2P platforms were promoted as means to connect issuers with traditionally untapped pools of investors through cheaper, faster, and more convenient delivery channels. These alternative channels also aim to meet the demands of underserved investors.

Since the first license was awarded in 2015, the number of ECF platforms has grown to 10. These platforms have facilitated 106 successful fundraising (crowdfunding) campaigns, raising a total of MYR110.26 million via the issuance of equity (mostly in the form of preference shares) for 102 private limited companies.

[5]This total includes corporate bonds and sukuk. Data were retrieved from "Bonds & Sukuk Market Overall Statistics," SC Malaysia website: https://www.sc.com.my/analytics/bonds-sukuk-market.

[6]All numbers are cumulative (up to 30 June 2020) since inception and are based on data from the SC website Crowdfunding Statistics, Securities Commission Malaysia: https://www.sc.com.my/analytics/ecfp2p.

Conversely, P2P lending platforms have helped 2,231 issuers to raise MYR798.32 million of debt capital via the issuance of short-term notes. The P2P lending platforms also facilitate supply chain and invoice financing for their clients. The tenor of these borrowings typically ranges between 3 and 12 months. There are currently 11 licensed P2P platforms. Default rates across the platforms range from a low of 1.34% to a high of 10.42% as of September 2020.[7] The wide range of default rates could be attributed to the difference in size, credit risk, and concentration of loans across the platforms.

The largest group of investors in these platforms are those less than 35 years old. This group accounts for 46% of ECF investors and 63% of P2P lenders, which is consistent with the aim of reaching out to underserved investors. Naturally, retail participants form the bulk of the investor base with 60% and 88%, respectively, for ECF and P2P platforms. It should be noted that, at present, these platforms do not facilitate secondary trading of the securities issued.

ECF and P2P platforms are licensed under SC as Registered Recognized Market Operators. The other platforms are the Digital Asset Exchanges (DAX) and Property Crowdfunding (PCF). DAX are essentially cryptocurrency exchanges that operate in Malaysia.[8] All these alternative markets have only been formally introduced/regulated in the last five years, coinciding with the emergence and increasing prominence of FinTech in the traditional finance and banking sector.

DERIVATIVES

Palm oil is the most important commodity crop in Malaysia. This was a result of the government diversification program in the 1960s to reduce Malaysia's dependency on rubber and tin, which used to be core export commodities. Hence, crude palm oil (CPO) futures were one of the earliest derivatives to be traded when the Kuala Lumpur Commodity Exchange (KLCE) was launched in July 1980; the KLCE was the first futures exchange in southeast Asia.

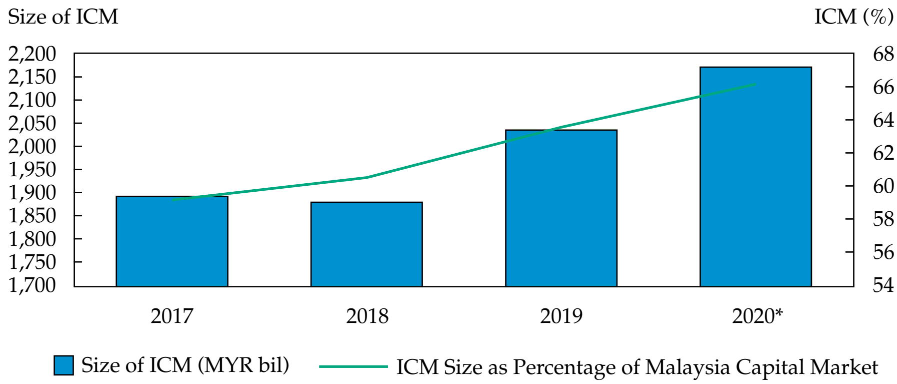
Stock index futures and stock index options were first traded on the Kuala Lumpur Options and Financial Futures Exchange (KLOFFE) on 15 December 1995 and 1 December 2000, respectively. Separately, in 1996, the three-month Kuala Lumpur Interbank Offered Rate (KLIBOR) futures contract was launched in Malaysia via the Malaysian Monetary Exchange (MME). By 2001, KLCE, MME, and KLOFFE were ultimately merged to form the Malaysia Derivatives Exchange Berhad (MDEX). Subsequently, in 2004, MDEX was renamed Bursa Malaysia Derivatives Berhad (BMD).

Bursa Malaysia Derivatives Berhad currently offers three categories of derivative products—namely, commodity derivatives, equity derivatives, and financial derivatives. The commodity derivatives space has the largest range of tradable contracts, consisting of six types of futures contracts and two types of option contracts. CPO and CPO-related contracts dominate this segment, given the importance of this commodity to Malaysia's economy. Currently, CPO futures constitute the bulk of the derivative trading volume in Malaysia. This CPO futures contract is now the global price benchmark for crude palm oil, for traders both in the physical edible oil industries or biodiesel energy and in the commodity futures trading markets.

[7]For more detailed information about P2P lending in Malaysia, see Jen-Li Lim, "What You Need to Know about P2P Lending in Malaysia," iMoney.my (10 September 2020): https://www.imoney.my/articles/p2p-lending-guide.

[8]Digital assets, such as Bitcoin and other cryptocurrencies, are prescribed as securities under Malaysia's Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019.

FIGURE 4. SIZE OF MALAYSIAN ISLAMIC CAPITAL MARKETS



*2020 numbers as of June 2020.

Source: Securities Commission Malaysia. "Statistics for Islamic Capital Market in Malaysia" (30 November 2020): https://www.sc.com.my/analytics/islamic-capital-market.

The equity derivative space consists of three types of futures contracts (most notably the KLCI Futures) and one option contract. Finally, the financial derivatives consist of the three-month KLIBOR futures and MGS futures.[9]

Despite the breadth of derivative products offered on Bursa Malaysia, equity-linked derivatives are still predominantly traded in the form of warrants listed on the Bursa Malaysia Main Market, including single stock warrants as well as warrants with indices as the underlying.

ISLAMIC CAPITAL MARKETS

The world's first contemporary sukuk issuance originated from Malaysia in 1990. This USD125 million sukuk was issued by Shell MDS (Malaysia) Sdn Bhd. Since then, the Malaysian government and regulatory authorities have continuously introduced measures to position Malaysia as a hub for Islamic financial market activities.

Among the many firsts achieved by Malaysia are the world's first Islamic real estate investment trust (REIT), the Al-Aqar KPJ REIT (which was invested in six hospitals), and Khazanah's issuance of the world's first exchangeable sukuk, the Islamic equivalent of an exchangeable bond. Both of these innovative instruments were issued in 2006.

Today, Malaysia continues to maintain its leadership in the Islamic capital market (ICM), particularly in the area of sukuk and Islamic funds. **Figure 4** shows how, as of the end of 2019, the Islamic capital market represented 63.57% of Malaysia's capital market, with a market size of MYR2,035.58 billion as of December 2019.[10] Globally, within the domestic sukuk issuance space, the Malaysian market contributed more than 50% of the total USD107.26 billion issuance in 2019.[11]

[9]There are three contracts covering the 3-, 5-, and 10-year benchmark (on-the-run) MGS.

[10]Securities Commission Malaysia, *Annual Report 2019* (December 2019): https://www.sc.com.my/resources/publications-and-research/sc-ar2019.

[11] *IIFM Sukuk Report 2020: A Comprehensive Study of the Global Sukuk Market* (9th edition), International Islamic

Within the equity markets, the market capitalization of Shariah-compliant publicly listed companies continues to account for the majority of the listed companies. In June 2020, the market capitalization of these Shariah-compliant companies totalled MYR1,072.92 billion as compared with the total market capitalization of MYR1,579.59 billion.

THE ROAD AHEAD: CHALLENGES

Acceleration in Digitization Efforts

The COVID-19 pandemic in 2020 has affected every segment of the economy including the capital markets. However, one positive outcome is that the ongoing digitization initiatives have now been accelerated.

In 2018, the SC launched the Brokerage Industry Digitisation Group (BRIDGe) to improve the competitive position of the Malaysian stockbroking industry. BRIDGe is a multilateral partnership between the SC, Bank Negara Malaysia, Bursa Malaysia, and industry participants. The BRIDGe working group concluded in 2019 with recommendations to implement the following initiatives:

- digital client onboarding experience;
- seamless and efficient post-trade and settlement experience;
- e-corporate actions for greater adoption and transparency.

Return of Retail Participation in Equity Markets

The year 2020 witnessed a sharp increase in retail participation in the equity markets to levels not seen since the mid-1990s. The ease of online trading coupled with a robust flow of information in the age of social media have facilitated a change in the demographics of investors. The emergence of a younger generation of investors who are tech-savvy and less risk-averse has contributed to the increasing risk appetite seen in the markets. However, concern about these investors' level of financial literacy remains. There has been a significant increase in online blogs, discussion platforms, and social media channels that focus on listed stocks. All these information sources are outside the typical regulatory oversight, causing justifiable concerns. This is not unique to Malaysia alone but also is a concern in other countries.

Low-Yield Environment and Credit Concerns for Bond Markets

The onset of the pandemic in 2020 triggered massive monetary and fiscal stimulus measures in most economies. Malaysia is no different, leading to strains on the government fiscal condition and yields at all-time lows.

Secondary trading activity in the fixed income markets continues to be dominated by government-guaranteed bonds and AAA rated securities. The sheer size of issuance and outstanding amount of these high-quality papers will ensure that this remains the case for the foreseeable future.

Financial Market (July 2020): https://www.iifm.net/sukuk-reports.

With the central bank having cut policy rates aggressively in 2020,[12] coupled with expectations for an extended low interest rate environment, portfolio managers will have a challenge seeking meaningful returns in the bond markets. Defaults and downgrades are also expected to increase in sectors affected by the lockdown measures as credit risk concerns intensify.

[12]The overnight policy rate (OPR) was cut from 3.00% in January 2020 to 1.75% in July 2020.

MONGOLIA

- **1991** — Start of market economy with privatization of state-owned assets; Mongolian Stock Exchange (MSE) established
- **1992** — 475 state-owned entities listed on MSE
- **1994** — Law of Mongolia on the Securities Market passed
- **1995** — Secondary market trading started
- **1996** — First government bond traded
- **1999** — TOP-75 stock index introduced
- **2001** — First corporate bond traded
- **2002** — Revised version of Law of Mongolia on the Securities Market approved
- **2003** — Mongolian Securities Clearing House and Central Depository established; TOP-75 index replaced by TOP-20 index
- **2005** — First IPO traded on the MSE
- **2006** — Financial Regulatory Commission (FRC) established
- **2007** — First corporate bond issued on international market
- **2010** — First IPO of Mongolian company issued on international market
- **2011** — London Stock Exchange cooperated with Mongolian government to modernize the MSE
- **2012** — MSE introduced Millennium IT system; Mongolian government issued first bond on international market

MONGOLIA

Bayarsaikhan Davaadorj, CFA
Director, Long Term Partners of Mongolia LLC

Bujinlkham Boldbaatar
Analyst, Long Term Partners of Mongolia LLC

Equity Market Capitalization (USD)	**0.984** Bn
Equity Market Cap/GDP	7.3%
Equity Market Share Volume Traded (USD)	**48.8** Mn
Number of Listed Companies	200

Note: As of 2019

An emerging economy, Mongolia has experienced rapid economic growth since the beginning of the 2000s. Economic growth has averaged 7% over the last 10 years, reaching a record of 17.3% in 2011. Economic growth has also been volatile, however, because of a heavy dependence on natural resources and trends in global commodity prices. There are concerns regarding the effectiveness of the government's macroeconomic policies.

Since Mongolia shifted to a market economy 30 years ago, the Mongolian banking sector has developed significantly to become the main provider of capital in the economy. Total assets of the banking sector equaled 87% of GDP at the end of 2019. The capital market, on the other hand, remains a small part of the financial market compared with the banking sector, despite the government's efforts to develop it.

OVERVIEW OF THE MARKET

The main laws that regulate the Mongolian capital market are the Law of Mongolia on the Securities Market (1994, revised in 2002 and 2013), the Company Law of Mongolia (revised 2011), the Law of Mongolia on Asset-Backed Securities (2010), and the Law of Mongolia on Investment Funds (2013). Both the corporate and securities laws were revised in 2011 and 2013, respectively, to facilitate security issuance. The other two laws introduced institutional investors and new investment instruments. The main governing body of the capital market is the Financial Regulatory Commission (FRC), established in 2006, which operates as the regulatory body. The FRC supervises more than 1,000 non-bank financial entities, including insurance companies, brokerage companies, non-bank lenders, and savings and credit cooperatives.

The Mongolian Stock Exchange (MSE) was established in 1991 to implement the privatization of state-owned entities in the early stages of transition from a centrally planned economy to a market economy. In the mid-1990s, a secondary market was established and private brokerage firms started operating on the stock exchange.

In April 2011, the Mongolian government signed a Master Service Agreement with the London Stock Exchange to modernize its trading system by improving the legal environment, financial infrastructure, and technology. Within the scope of this agreement, the Millennium IT operating system was introduced to the MSE in 2012, which brought such new capabilities as remote access and high-frequency trading, but it also increased operating costs of the exchange.

MARKET PARTICIPANTS

Figure 1 shows the participants in the Mongolian capital market as of 2019.

Securities Firms

As of 2019, 54 securities firms licensed by the FRC operated on the MSE. Most of these firms are small operations with limited staff and trading activity. The number of securities firms increased significantly in 2012, and at one point there were more than 100 securities firms. This growth was associated with government plans to list on the MSE a state-owned mining company, Erdenes Tavan Tolgoi JSC, that owns one of the largest coking coal deposits in the world. The listing was cancelled, and the number of securities firms declined gradually to the current level. For most companies, it is impossible to operate profitably given the current low trading volume on the MSE.

Listed Companies

As of 2019, there were 200 listed companies on the MSE, but only 8 out of the "Top 100" Mongolian companies are publicly listed. Among the listed companies, 18 companies are state owned, 10 have state participation, and the remaining 170 are private.

One special feature of Mongolian listed companies is that most became publicly listed as a result of privatizations in the early 1990s. The government directly distributed to all citizens vouchers that could be converted to a certain number of common shares in certain formerly state-owned companies. Consequently, right after the privatization, some 470 entities registered as listed public companies on the MSE. The number has gradually decreased as the stock exchange made efforts to delist companies that did not meet the listing rules. Also, some

FIGURE 1. NUMBER OF MARKET PARTICIPANTS, 2019

Stock exchange 2	Clearing and settlement 1	Securities depository 1	Brokerage firm 54
Investment management firm 24	Securities dealers' association 1	Custodian bank 3	Listed company 200

Source: Annual Report 2019, Financial Regulatory Commission.

companies went bankrupt and some majority shareholders took their companies private.

During the privatization process, a heavy stock concentration occurred for most companies as 50% to 90% of a company's common shares were collected by one individual or members of a family. Over the years, this share concentration and poor corporate governance practice may have had a negative impact on trading activity and on the general lack of public confidence in the stock market.

Mongolian mining companies commonly raise capital on foreign stock exchanges because it is difficult to raise large amounts of capital on the MSE. Among some 30 companies listed abroad, the majority are listed on the Toronto Stock Exchange and the Australian Stock Exchange, with some listed on the Hong Kong Stock Exchange, the US exchanges, and other stock exchanges.

Investors

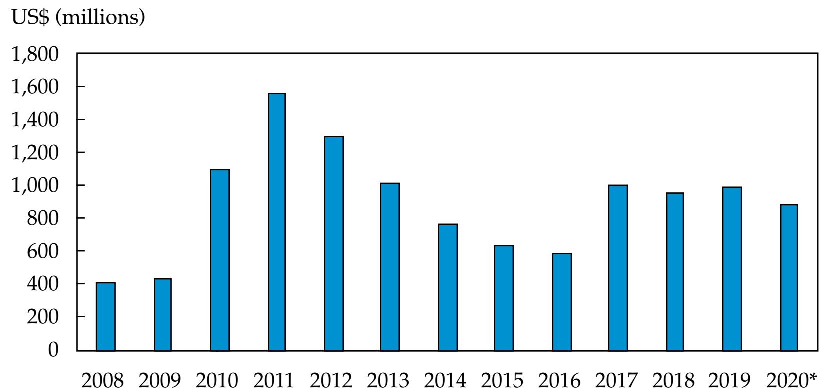
The investor base on the MSE consists mostly of local retail investors, who generated 96% of the total trading value in 2019. The Mongolian government's recent second attempt to list Erdenes Tavan Tolgoi JSC on the MSE and to distribute dividends to all citizens led most Mongolians to open securities accounts. Although the listing has not yet taken place, most Mongolians now have a securities account. In the first six months of 2020, almost 500,000 new brokerage accounts were opened, which is significant considering the total Mongolian population is 3.3 million. In addition to local citizens, 2,287 foreign individuals, 2,771 local companies, and 196 foreign companies and funds have opened securities accounts in Mongolia.

The institutional investor base is weak in Mongolia. Although the insurance sector is growing and some insurance companies invest in the local capital market, pension funds do not invest in public securities and there are no active mutual funds.

EQUITIES

Total market capitalization of the MSE as a percentage of GDP was only 7.3% in 2019 (see **Figure 2**).

FIGURE 2. TOTAL EQUITY MARKET CAPITALIZATION



*As of June 2020.

Source: Market overview 2019, Mongolian Stock Exchange.

The main equity index on the MSE is the TOP-20 index, a market capitalization–weighted equity index that consists of 20 leading stocks selected on the basis of market capitalization and trading activity. Lesser-known indexes include MSE ALL, MSE-A, and MSE-B.

The TOP-20 index has fluctuated widely in the past because of the fact that Mongolia is a small economy with high dependency on commodity cycles. The most recent example was in 2017, when the TOP-20 index increased by 62% as the government took drastic measures to improve the economic situation, such as applying for an International Monetary Fund (IMF) program. The high volatility is also linked to the market's low liquidity; average daily volume of the equity market in 2019 was only USD30,000.

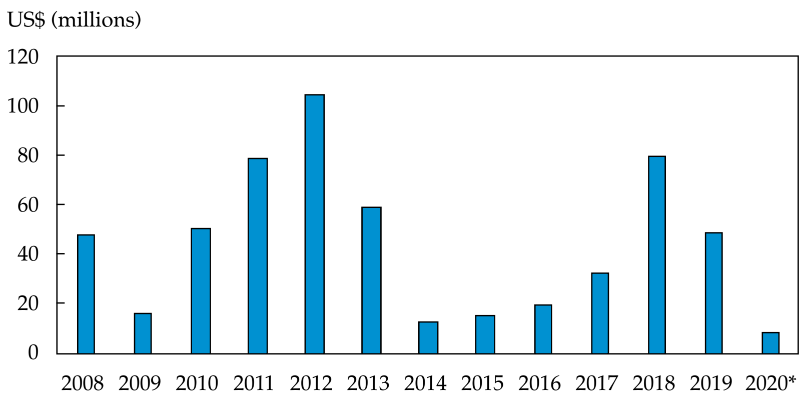
Equity trading volume in Mongolia is quite low by world standards and also fluctuates in line with the economic cycle, which in turn is highly correlated with commodity cycles (see **Figure 3**). Trading activity on the MSE increased to USD104 million in 2012 as Mongolia was in the middle of a mining boom, but it has decreased since then as the economic situation worsened from 2014 to 2017.

The market started becoming more active in 2017 as the economic situation improved. Another reason for the recent increase in trading activity is that more start-ups and/or young companies are listing on the MSE to raise capital. This is a positive trend because these companies tend to be more responsible in terms of corporate governance.

BONDS

The bond market in Mongolia consists mostly of government bonds (see **Figure 4**). The government of Mongolia issued local currency-denominated bonds regularly until 2017. The latest government bonds had maturities of one to three years and coupon rates of 14%–18%. Given the high yield and the fact that revenue from government bonds is risk-free and tax-exempt, government bonds are attractive investment instruments for all investors, most notably commercial banks and foreign investors. Local banks are the largest investors in government

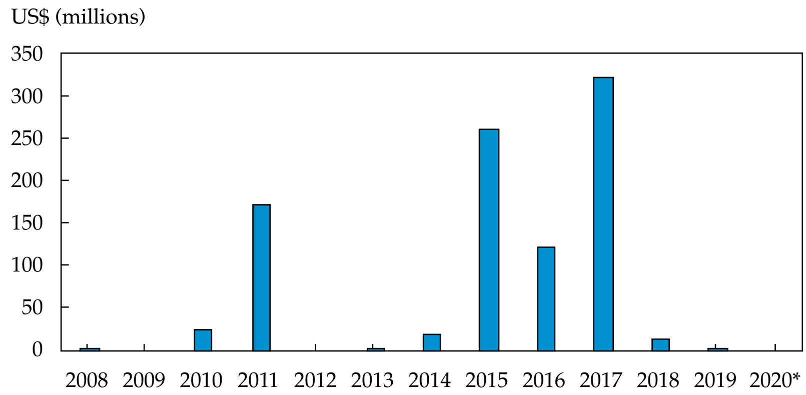
FIGURE 3. MSE EQUITY TRADING VALUE



*As of June 2020.

Source: Market overview 2019, Mongolian Stock Exchange.

FIGURE 4. GOVERNMENT BOND TRADING VALUE



*As of June 2020.

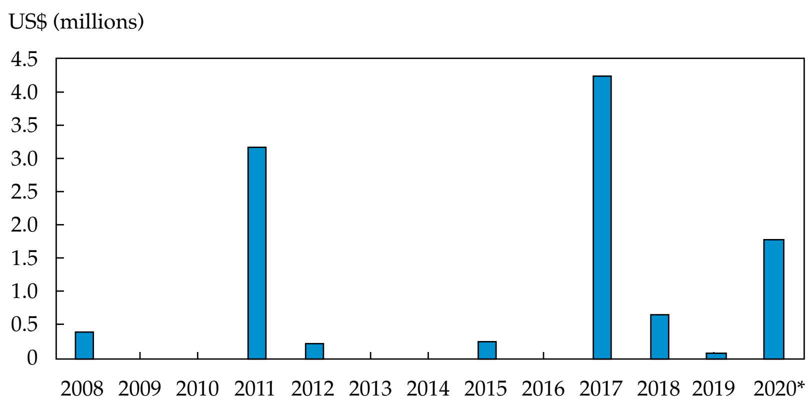
Source: Market overview 2019, Mongolian Stock Exchange.

bonds, which they usually hold until maturity resulting in low trading activity on the secondary market.

Regarding corporate bonds, there have been very few issuances with much smaller amounts (see **Figure 5**). The latest corporate bond was issued by LendMN, a mobile-based microfinance institution, with a maturity of one year and a coupon rate of 17%.

Demand for alternatives to bank deposits has been increasing in recent years, as evidenced by an increase in the issuance of so-called "private bonds" (in effect, loan agreements between a company and private investors).

FIGURE 5. CORPORATE BOND TRADING VALUE



*As of June 2020.

Source: Market overview 2019, Mongolian Stock Exchange.

THE WAY FORWARD

Multiple factors are behind the current underdeveloped state of the Mongolian capital market, but the most significant is poor corporate governance. Governance practices have improved significantly over the past few years, but minority shareholders need further attention. Poor corporate governance, in turn, negatively affects public interest in the capital market and the overall trading activity. The regulatory authorities have made efforts to improve disclosure and transparency, with some success. The MSE, for example, requires companies to disclose governance self-assessment reports annually. Also, while FRC and the MSE push poorly managed companies to delist, most newly listed companies tend to have much better governance practices, improving the overall credibility of the market.

Future opportunities for developing the Mongolian capital market include the following:

- The downward trend of interest rates in the past years has caused investors to look for opportunities other than term deposits at banks. The sudden increase in activity on the MSE in 2017 is thought to have been caused partially by several years of declining interest rates. Currently, the one-year term-deposit rate is around 10%, which is still high by world standards, despite falling by 6%–7% in the past 10 years. Inflation in 2019 was 5.2%.
- The corporate bond market has the potential to grow to provide long-term capital to businesses. Bank deposits and lending rates have a spread as wide as 4%, which means there is opportunity for companies to borrow directly on the MSE instead of borrowing from banks. Direct and indirect costs associated with issuing bonds should be lowered further in order for companies to feel comfortable issuing bonds.
- Since 2016, a number of successful IPOs and corporate bond issues have demonstrated the opportunity to raise capital on the stock exchange as an alternative to bank financing. Investors, on the other hand, have been learning how to invest in public securities.
- As attempted by the government in the past, if a major state-owned mining company is listed on the MSE, the event is expected to give a significant boost to the local market.
- The government recognizes the need to create an institutional investor base and has been developing the regulatory environment for investment funds.

PAKISTAN

- **1947–1949**: The Karachi Stock Exchange (KSE) is established in September 1947 and formally incorporated in March 1949
- **1970**: The Lahore Stock Exchange (LSE) is established in October
- **1989**: The Islamabad Stock Exchange (ISE) is established in October
- **1991**: The KSE-100 Index is introduced in November with a base value of 1,000 points
- **1995**: Private sector allowed to launch open-end funds
- **1999**: The Securities and Exchange Commission of Pakistan (SECP) is established and replaces the Corporate Law Authority as the apex regulator
- **2002**: The Karachi Automated Trading System is launched
- **2007**: The Pakistan Mercantile Exchange commences operations
- **2012**: The stock exchanges are demutualized
- **2014**: Trading of government securities allowed on the Bond Automated Trading System (BATS)
- **2016**: KSE, LSE, and ISE merge to form the Pakistan Stock Exchange (PSX) in January
- **2017**: A consortium led by Chinese exchanges acquires a 40% stake and control in PSX; Pakistan upgraded to MSCI Emerging Markets status
- **2020**: First exchange-traded funds (ETFs) launched in March

PAKISTAN

Mohammad Shoaib, CFA
CEO, Al Meezan Investment Management Ltd.

Raza Jafri, CFA
Head of Equities, Intermarket Securities Ltd.

Sateesh Balani, CFA
Head of Equities, Providus Capital

Equity Market Capitalization (USD)	**47.49** Bn	**113.7** Bn	Debt Market Capitalization (USD)
Equity Market Cap/GDP	18%	45%	Domestic Debt Market Cap/GDP
Equity Market Share Volume Traded	**302** Mn	**940** Mn	Debt Market Instrument Volume Traded (USD)
Number of Listed Companies	530	106*	Number of Issuers (Bonds)

Note: Data as of September 2020
* Excludes government bonds

Formal capital market activity in Pakistan began with the establishment of the Karachi Stock Exchange (KSE) in 1947. Initially, just five companies were listed (several of which are still listed today); this number grew to 81 by 1960 and then to 219 by 1970. The rapid progress in the 1960s coincided with an industrialization drive and high average GDP growth (6.8% per annum). Momentum was lost in the 1970s with the separation of East Pakistan (now Bangladesh) and the introduction of nationalization policies, before the 1980s saw the renewed encouragement of private enterprise. The formation of the Lahore Stock Exchange (LSE) in 1970 and the Islamabad Stock Exchange (ISE) in 1989 neatly frames this period. A turning point occurred in the 1990s with a combination of privatization and other measures to liberalize the economy, with the encouragement of the International Finance Corporation. Steps included the opening of the market to international investors and removing constraints to the repatriation of investment proceeds. This period also coincided with the introduction of a central depository for securities and the establishment of the Securities and Exchange Commission of Pakistan (SECP). The Central Depository Company of Pakistan (CDC) helped facilitate a shorter settlement cycle, catalyzed higher trading activity, and paved the way for the introduction of electronic trading. Despite intermittent periods of political volatility and poor security conditions, the subsequent market growth and development has been relatively rapid. From its launch in 1991, the benchmark KSE-100 Index has posted an annualized return of almost 15% (approximately 8% per annum in US dollars), and more than 500 stocks are now listed, with a combined market capitalization of more than USD50 billion.

Today, the Pakistan Stock Exchange (PSX) is the sole stock exchange in the country, formed after the merger of KSE, LSE, and ISE in 2016. A year later, in 2017, it was majority acquired by a consortium led by the China Financial Futures Exchange, the Shanghai Stock Exchange, and the Shenzhen Stock Exchange. These developments followed the demutualization that took place in 2012, as the exchange evolved from the broker-owned model. The operational architecture at PSX allows for electronic trading, clearing, and settlement, supported by CDC and the National Clearing Company of Pakistan Limited. This includes the trading of fixed-income securities as well, issued by both the government and the private sector. The regulatory environment for capital market activity in Pakistan is comparable to that of several regional peers. This was acknowledged by MSCI's decision to once again upgrade Pakistan to Emerging Markets status in 2016–2017, marking a return to when Pakistan was formally recognized as an Emerging Market in 1994.

EQUITIES

Buoyed by the economic liberalization of the 1990s, the market capitalization to GDP for Pakistan's equity market quickly moved from the single digits in the early part of the decade to the mid-teens by 1998. However, Pakistan's nuclear tests in 1998 sparked a chain of events that culminated in a military takeover. Market capitalization plummeted back to the single digits and recovered only in the mid-2000s. As Pakistan once again became an attractive investment destination, given its quickly growing economy, equities widely outperformed other asset classes during 2003–2007, with market capitalization to GDP expanding to a peak of approximately 45%. Equities suffered again during the global financial crisis, but the market capitalization to GDP in Pakistan has not fallen back into the single digits since, not even during the height of the COVID-19 pandemic. In P/E terms, Pakistan's valuations have typically fluctuated between 6× and 12×, with a long-term mean of approximately 9×.

The next phase of stock market development might see the fruits of the structural reforms undertaken in the past decade. Pakistan has been under democratic rule since 2008, the erstwhile energy deficiency has been greatly addressed, security conditions are the best in many years, and the government is making concerted efforts to deliver more sustainable and inclusive economic growth. This growth can provide a conducive environment for new listings, product innovation, and greater participation from the domestic retail investor base. In 2020, despite the challenges posed by the coronavirus pandemic, IPOs were oversubscribed, exchange-traded funds (ETFs) were launched for the first time, and the trading regime saw the introduction of index halts and wider circuit breakers (±7.5% for individual stocks, compared with ±5% earlier).

Major Equity Indices

Pakistan's benchmark stock index is the KSE-100, which replaced the KSE-50 in 1991. Several other indexes are available on PSX, including the KSE-30, the KSE All Share, the KMI-30, and the KMI All Share. The latter two indexes represent Shariah-compliant stocks, a popular category given that more than 95% of Pakistan's population is Muslim (the country's largest private sector asset management company is Islamic). The benchmark index, however, remains the KSE-100, which captures approximately 80% of the market capitalization of the KSE All Share Index. **Figure 1** shows the level of the KSE-100 since 2000.

Because the component weights of index companies are based on their free float market cap, several large listed multinational companies, such as Nestle, Colgate-Palmolive, and Philip Morris, have a relatively small bearing on the KSE-100 index. This became more the case after the early 2000s, when several large local banks and oil and gas exploration companies were listed. As can be seen in **Figure 2**, these two sectors today have a combined weight (free-float based) of approximately 40% in the KSE-100. The distribution of sector weights is more balanced on the KSE All Share Index, which incorporates the full market capitalization methodology, but some prominent absentees still exist. Like other emerging and frontier markets, sectors such as technology, real estate, and retail trade are not well represented at PSX. As companies in these sectors take on a more formal structure and become larger, they might well choose to list going forward. This scenario is what appears to have happened in the steel sector, with several steel manufacturers listing in the previous five years.

Of the more than 500 stocks listed on PSX, 9 have a market capitalization of more than USD1 billion, 12 have a market capitalization between USD500 million and USD1 billion, and nearly 70 have a market capitalization ranging from USD100 million to USD500 million. The number of stocks that traded more than USD0.5 million per day in 2020 stands at more than 40. As interest rates have declined sharply, local liquidity has significantly improved, and fiscal year 2021 commenced with an average daily turnover in excess of USD110 million, up from USD66 million over the previous fiscal year. This improvement has come about in the absence of large leverage in the system. Direct in-house financing by brokers was a key reason for the higher trading activity in the past but has not been allowed in recent years. Eligible financing products such as the Margin Finance System and the Margin Trading System are available, but their depth is minimal for now. Going forward, with the SECP consistently pushing better risk management and compliance, market leverage and liquidity could improve. A natural

FIGURE 1. KSE-100 INDEX (COMPOUND ANNUAL GROWTH RATE = 18%)

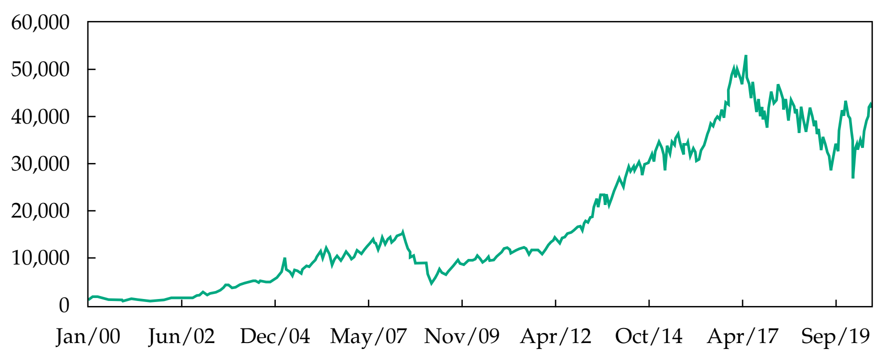
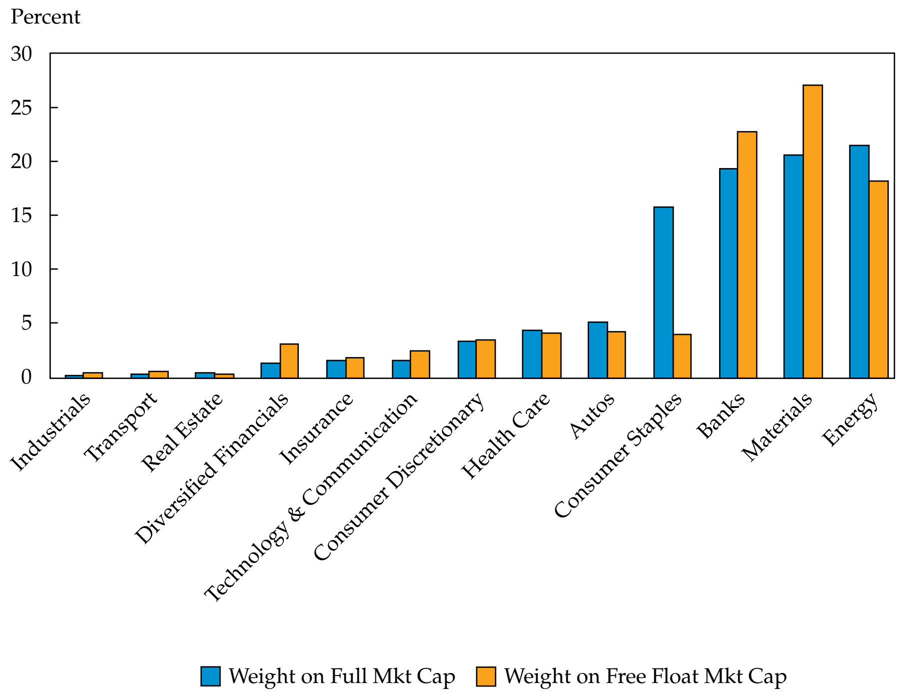


FIGURE 2. KSE-100 INDEX: SECTOR WEIGHT DISTRIBUTION



increase in trading activity should also occur as the number of retail investors increases and as institutional assets under management (AUM) grow, particularly for local mutual funds and insurance companies.

Historical Turnover

At present, Pakistan has fewer than 275,000 central depository account holders (0.13% of the population), compared with more than 2 million in Bangladesh (1.3% of the population) and 25 million in India (2% of the population). Despite what is clearly a low level of retail investor penetration, individuals contribute approximately two-thirds of the local gross trading activity in Pakistan. This is possibly due to the outsized influence of high-net-worth individuals and a retail base that perhaps makes up for its small numbers with a high activity level. The next most active category is broker proprietary trading, followed by local mutual funds and foreign investors. The size of the local mutual fund AUM was last recorded at USD5.1 billion, of which USD1.5 billion is dedicated to equities (conventional and Islamic). If interest rates remain low and the equity market continues to perform well, mutual funds might be able to attract additional flows.

Foreign Investors in Pakistan—Key Highlights

Foreign institutional investors have been active in Pakistan since the 1990s and own an estimated USD3 billion of Pakistani equities (approximately 25% of the free float). No foreign ownership limits are in place, except for a few companies (e.g., PSX itself). Both foreign and local investors have to notify ownership levels of 10% and higher to the stock exchange, while special permission from the central bank is needed to build a 5% or higher stake in a commercial bank.

Foreign investors are treated similarly to local investors on taxation. Repatriation of investment proceeds takes place through Special Convertible Rupee Accounts.

Pakistan is part of the MSCI Emerging Markets (EM) Index, albeit with a very small weight of 2 bps. Currently, three stocks are part of the standard MSCI EM Index—namely, Oil and Gas Development Company, MCB Bank, and Habib Bank Limited. More than 20 stocks are part of the MSCI EM Small Cap Index. Before upgrading in 2017, Pakistan had an 8% weight in the MSCI Frontier Markets Index.

A few Pakistani stocks are listed abroad through global depositary receipt issuances. Global ETFs tracking Pakistan are also available.

BONDS

The banking sector reforms of the 1990s saw the development of the bond market, with the auctioning of short- and long-term government securities, which replaced the tap sale of government paper. March 1991 saw the first auction of the six-month Treasury bill (T-bill) as well as the Federal Investment Bond (FIB), with maturities of 3, 5, and 10 years. The FIB was replaced by Pakistan Investment Bonds (PIBs) in 2000, and a yield curve started to develop with participation through competitive bids. As the banking sector grew, an interbank money market began to develop, which subsequently transitioned into a secondary market.

Today, Pakistan's fixed-income market is dominated by government securities, with approximately 80% of domestic public debt (USD108 billion) in the form of tradable T-bills and PIBs. These securities are primarily held by the central bank and financial institutions. OTC trading in these instruments is active. The average daily trading volume in government instruments (conventional and Shariah compliant) was close to USD1 billion in fiscal year 2020.

PSX provides a full suite of trading services through its Bond Automated Trading System (BATS) for corporate debt instruments (term finance certificates, or TFCs) and government debt securities. The latter have been available for trading on BATS since 2014, offering the retail segment a liquid and direct platform for trading in government securities. **Table 1** shows the secondary market trading activity in government securities.

CDC has earmarked special participant status in the Pakistan Real-time Interbank Settlement Mechanism and Real-Time Gross Settlement system to ensure transparency and smooth execution of system-based transactions. Investors can also use Investor Portfolio Services (IPS) with CDC to open IPS accounts for investment in government securities.

Similar to its equity market, Pakistan's domestic fixed-income market is open to foreign investors via Special Convertible Rupee Accounts. Via this special window, foreign investors can invest in local-currency government debt securities and also make use of tax concessions (10% compared with 30% for resident investment). Total foreign inflows in Pakistan government securities during fiscal year 2019–2020 rose to approximately USD3.5 billion (primarily in T-bills).

Pakistan's corporate debt market is relatively smaller, with total outstanding issues of approximately USD4 billion (approximately 1.5% of GDP) by more than 100 issuers. After the

TABLE 1. GOVERNMENT SECURITIES: SECONDARY MARKET TRADING VOLUME (PKR BN)

	FY18	FY19	9M FY20
T-Bills			
3 months	20,118	23,330	12,452
6 months	3,147	41	2,314
12 months	258	33	4,741
	23,523	**23,404**	**19,507**
PIBs			
3 years	1,062	1,596	2,713
5 years	1,031	889	973
10 years	928	1,017	1,266
15 years	10	1	-
20 years	11	1	9
	3,042	**3,503**	**4,961**
Government Ijara Sukuk	992	2,202	3,635
Grand total	27,557	29,109	28,103
Daily average volume	112	118	156

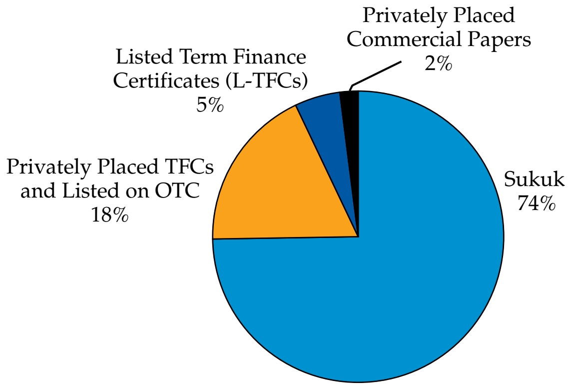
Source: State Bank of Pakistan.

nationalization policies of the 1970s, the first corporate bond was issued in 1988 by WAPDA, the national power utility at that time, and not until 1995 were private companies again allowed to issue corporate bonds. This delayed start, among other factors, has meant that Pakistani corporates still rely mainly on bank financing for their needs.

The investor base in the corporate debt market is primarily institutional, with low participation from the retail sector. Some of the factors behind the small size of the corporate debt market and limited retail participation include the following: (i) a low savings-to-GDP ratio (less than 20%), (ii) crowding out due to competition from the government's National Savings Scheme (NSS), and (iii) issues such as low liquidity, lack of benchmark rates, and high costs of issuance. Some of these issues are structural, whereas some could improve with time. To promote the listing of debt securities, regulatory requirements for operational history, credit rating, and audited accounts (reduced from five years to two years) have been relaxed.

Furthermore, since 1 July 2020, institutions have again been disallowed from investing in NSS products, which could divert funds toward the corporate bond market. Also, almost 75% of the corporate debt issuances by value are through sukuk (see **Figure 3**), in sharp contrast to the sovereign debt market, which continues to be dominated by conventional instruments. The success of sukuk might show the corporate

FIGURE 3. DOMESTIC CORPORATE DEBT MARKET



bond market a way to attract more institutional interest (Islamic banks cannot invest in T-bills or PIBs) and retail participation, as has been ably demonstrated by recent successful sukuk issuances by K-Electric, Pakistan's largest private sector utility company.

Over the years, the government has attempted to reduce volatility in the fixed-income market with a structured approach to fixed-income auctions. The acceptance ratio has been in the 28%–56% range, with gradual issuance of bonds in the secondary market, and this has helped the government in reducing its fiscal costs. The government's recent emphasis has been on diversifying the available fixed-income products and elongating the maturity profile of its domestic debt. In this regard, the government has introduced new products, such as floating-rate bonds with 3-year, 5-year, and 10-year maturities. The government has also started reissuing 15-year fixed-rate PIBs.

On the Islamic front, the government has introduced five-year floating-rate sukuk, issued in the primary market along with conventional instruments. Moreover, the government issued Pakistan Energy Sukuk in March 2019 and March 2020 (two separate issues) via the "reverse Dutch auction" to tap the Shariah-compliant debt market, with the proceeds to be used to improve liquidity in the energy chain. In July 2020, the privately placed Pakistan Energy Sukuk-II of approximately PKR200 billion was listed on PSX, which marked an important milestone because it was the first debt issuance through book building in Pakistan. Equity IPOs already take place through book building and the "Dutch auction" method.

CHALLENGES, OPPORTUNITIES, AND THE WAY FORWARD

Unlike many others, Pakistan is a market where a negative perception continues to permeate deeply. A recent quote from Mattias Martinsson, chief investment officer and founding partner at Tundra Fonder AB, one of the active foreign institutional investors in Pakistan, aptly summarizes this situation and highlights why opportunities are sometimes missed in this market by international US-dollar-based investors:[1]

> One of the most common questions we get is: How come you are so positive towards Pakistan?
>
> There are two reasons why we believe this market long-term provides a unique opportunity within the low-income and lower-middle-income countries:
>
> (1) Its financial infrastructure for investors in listed equity is among the best in our universe. You can choose a sector and favorite company within that sector, as opposed to investing in whatever is available in similar markets.

[1]Interview: Mattias Martinsson, "DeepDive: Investing in Pakistani Equities," 7 July 2020.

> (2) The Perception Arbitrage—As a local entrepreneur put it: "95% of what is written about Pakistan is about the 5% negative." I should not have to explain that when most investors are negative without even looking, it leaves a lot of potential on the table for those that take a neutral stance.

The catalyst for immediate change can come from the Chinese ownership at PSX and the appointment of new senior leadership. Early in 2020, the first two ETFs at PSX were launched. As new products come through, this could significantly increase market trading volumes and investor participation in the stock market. On the fixed-income side, the first ever government bond (a 10-year sukuk) was listed in July 2020, and the potential for the government to raise money for infrastructure projects from retail investors in the future is immense. Going forward, local product development can dovetail with possible cross-border listings and investments from China.

A long-standing challenge in the local capital markets is the participation of only a small retail investor base. The total number of investors is less than 300,000, investing either directly or through mutual funds (excluding those investing through retirement funds). Given the size of Pakistan's population and its tilt toward the young and middle-income segments—an estimated 40% of the population belongs to the middle class (80 million people), and approximately 50% of the population is younger than 24 years old (another 40% is between 25 and 54 years)—this is a market ripe for disruption. Technology is a key factor that could help bring about quick change, with approximately one-half of the country's 167 million cellular phone subscribers now on 3G/4G, alongside a similar number of broadband subscribers. With brokerage business models more feasible after the 15 bp commission rate floor in 2019, local brokerage firms may now look to increase their marketing efforts as well. Such efforts should find fertile ground in the recently launched Roshan Digital Accounts, via which the government allows overseas Pakistanis to digitally open bank deposit accounts in Pakistan and use those funds to invest in the capital market. Given that the Pakistani diaspora is large, this development could result in a notable flow of funds. More vibrant capital markets might also attract many of Pakistan's high-potential companies to list at the exchange.

Finally, one of the key pillars of every market is long-term institutional investors, including retirement funds, pension funds, endowments, and insurance companies. In Pakistan, the public sector employee retirement plans are, by and large, unfunded and on a pay-as-you-go basis. As a result, the participation of such long-term investors in capital markets is well below the desirable level. Even where such plans are funded, their focus is mainly on investment in government securities. As a result, they miss out on the Pakistani corporate sector's double-digit earnings growth and, in turn, on the higher returns offered by equities over the longer run (since its launch, the KSE-100 has returned approximately 15% per annum in Pakistani rupee terms). The next round of reforms could address this important area of the capital market.

The future offers several reasons to be optimistic about the Pakistani capital markets. New ownership at PSX can lead to technological and product innovation and facilitate cross-border listings in the future. An improved outlook for Pakistan's economy can attract sustained investor interest, particularly from the domestic retail market, which has significant room to grow. Investing in Pakistan offers access to the fifth largest population in the world (more than 200 million people), which leads to strong domestic consumption. Pakistan can attract foreign buying to its equities, similar to the foreign interest it has seen in its government bonds over the past year. However, more needs to be done to develop the corporate debt market, where a high fiscal deficit has traditionally crowded out the private sector. Fiscal discipline would have a positive impact. Notably, the government's Debt Management Office has taken several steps recently to develop the longer end of the yield curve, which should have positive implications going forward.

THE PHILIPPINES

- **1927** — Establishment of the Manila Stock Exchange (MSE)
- **1963** — Establishment of the Makati Stock Exchange (MkSE)
- **1992** — Consolidation of MSE and MkSE into the Philippine Stock Exchange (PSE)
- **1995** — Launch of an electronic auction system for bonds
- **1997** — Launch of scripless government securities
- **1998** — Launch of Small Investors Program for government bonds, which lowered the minimum denomination from PHP10 million to PHP25,000
- **2001** — The PSE transformed from a nonprofit, nonstock, member-governed organization into a shareholder-based, revenue-earning corporation; Government bonds were first listed and traded on the PSE
- **2003** — Incorporation of the Philippine Dealing & Exchange Corp. (PDEx); Listing of the PSE on the local stock exchange
- **2005** — Fixed Income Exchange first began to operate
- **2008** — PDEx granted authority to operate an over-the-counter market; Passage of the Personal Equity and Retirement Account (PERA) Act
- **2009** — Passage of the Real Estate Investment Trust (REIT) Act
- **2013** — Launch of the PSE's online service bureau, which allowed several stockbrokers to launch their own online trading facility

2019

The PSE launched the PSE Electronic Allocation System (PSE EASy) website and mobile application, allowing investors who want to take part in the local small investor (LSI) tranche of an IPO to subscribe online

2020

Listing of the first REIT on the PSE; Launch of mobile app, allowing small investors to purchase retail Treasury bonds for as low as PHP5,000; PERA launched in digital form

THE PHILIPPINES

April Lynn L. Tan, CFA
Vice President and Head of Research, COL Financial

Mark Ilao, CFA, CIPM
Business Development Manager, COL Financial

Equity Market Capitalization (USD)	**324.5** Bn
Equity Market Cap/GDP	88%
Equity Market Share Volume Traded	**95,975** Mn
Number of Listed Companies	274

178.4 Bn	Debt Market Capitalization (USD)
48%	Domestic Debt Market Cap/GDP
127,800 Mn	Debt Market Instrument Volume Traded (USD)
57	Number of Issuers (Bonds)

Note: All as of end of 2020

EQUITY MARKET

The Philippine Stock Exchange (PSE) was formed in December 1992 following the consolidation of the Manila Stock Exchange (MSE), which was established in August 1927, and the Makati Stock Exchange (MkSE), which was established in May 1963. The MSE and the MkSE traded the same stocks of the same companies, despite being separate exchanges.

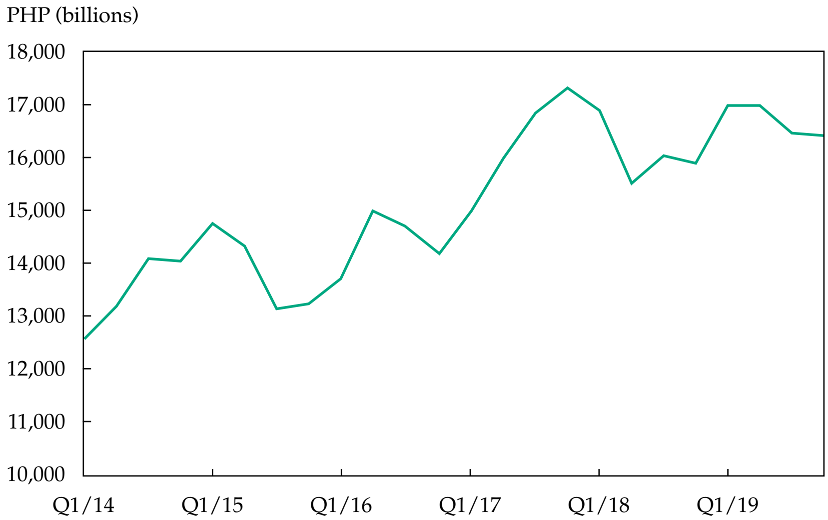
The PSE owns 20.98% of the Philippine Dealing System Holdings Corporation (PDS), which, in turn, owns the Philippine Dealing & Exchange Corp. (PDEx). Incorporated in 2003, PDEx provides the trading infrastructure and operates the organized secondary market for the trading of fixed-income securities, including both government and corporate securities.

The PSE is a self-regulatory organization (SRO), which means it can implement its own rules and establish penalties for trading participants (TPs) and listed companies that violate its rules. In 2001, the PSE transformed from a nonprofit, nonstock, member-governed organization into a shareholder-based, revenue-earning corporation. In 2003, it listed on the local stock exchange.

The main index for PSE is the PSE Composite Index (PSEi). It is a free-float-adjusted, market-capitalization-weighted index composed of 30 listed companies. The members of the index and their index weights are adjusted every six months according to a specific set of public float, liquidity, and market-capitalization criteria.

Despite the Philippines having one of the oldest stock exchanges in Asia, it has the lowest

FIGURE 1. PSE ALL SHARE INDEX TOTAL MARKET CAPITALIZATION (IN BILLIONS OF PHILIPPINE PESOS), 2014–2019



Source: Bloomberg.

number of listed companies. As of the end of 2019, the PSE had 267 listed companies, hardly changed from the total of 261 at the end of 2014. Consequently, the market capitalization of Philippine listed stocks was only PHP16.43 trillion, or USD324.38 billion, as of the end of 2019 (see **Figure 1**), equivalent to only 84% of GDP, making it one of the smallest equity markets in Asia.

As **Figure 2** shows, the average daily value turnover in the Philippine Stock Exchange is shrinking; it fell to only PHP6.25 billion (USD125 million) in 2019, which is a seven-year low. This drop occurred despite the high level of foreign investor participation, which averaged around 53% during the past five years.

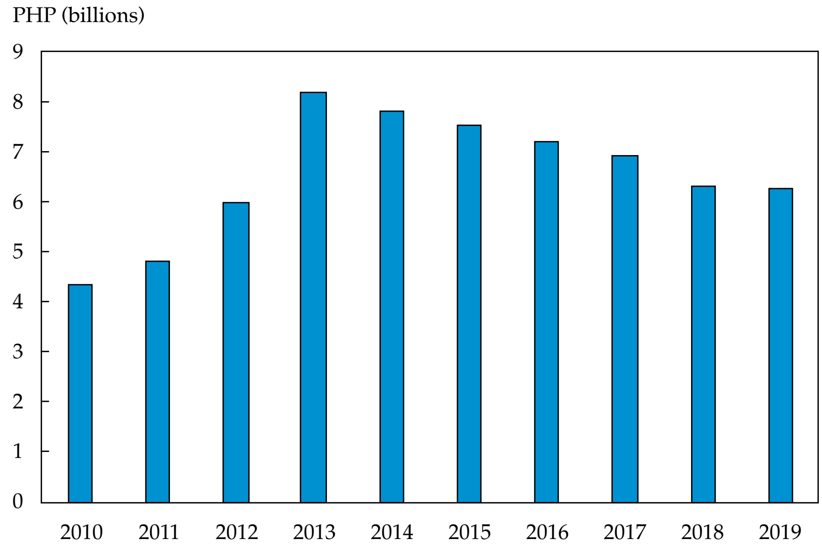
The PSE also has a small number of investors buying and selling stocks. As of the end of 2019, the number of investor accounts reached 1,228,038, which is equivalent to only 1.1% of the country's population.

BOND MARKET

The Philippine bond market has long been present in the country's history but managed to gain wider traction starting in 1995. In that year, the Bureau of Treasury launched an electronic auction system, which was followed by the introduction of scripless government securities in 1997. These developments paved the way for a more transparent trading environment for the local bond market. In 1998, government securities were also democratized with the launch of the Small Investors Program, which lowered the minimum denomination of such investments from PHP10 million to as low as PHP25,000.

In 2001, the first listing and trading of government bonds happened at the PSE, but it was not until March 2005 that the Fixed Income Exchange started to operate, albeit on an exclusive interdealer platform at that time. The creation of the exchange was spearheaded by the Bankers Association of the Philippines (BAP),

FIGURE 2. AVERAGE DAILY VALUE TURNOVER (IN BILLIONS OF PHILIPPINE PESOS), 2010–2019



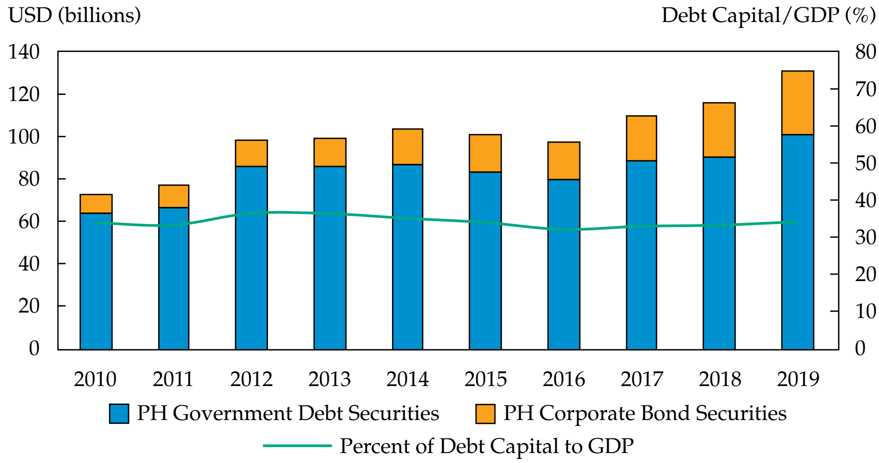
Source: Bloomberg.

which is owned and managed by the Philippine Dealing System Holdings Corporation (PDS), together with its three subsidiaries: the Philippine Dealing & Exchange Corp. (PDEx), the Philippine Securities Settlement Corp. (PSSC), and the Philippine Depository & Trust Corp. (PDTC). In 2008, the Securities and Exchange Commission (SEC) granted PDEx the authority to operate an over-the-counter (OTC) market and at the same time function as a self-regulatory organization consistent with its OTC rules. PDEx was also licensed by the SEC as an exchange under the Securities Regulation Code. This allowed PDEx to open its doors as the trading platform for fixed income, where broker participants can transact with one another.

In terms of size, the Philippine debt capital market stood at PHP6.6 trillion (USD131.2 billion) as of year-end 2019 (see **Figure 3**). This is equivalent to just 34% of the country's GDP over the same period, underscoring the overall credit health in the economy and the potential for debt capital markets to expand. Recent regulatory efforts have laid the groundwork for this expansion; for example, the Securities Regulation Code was amended in 2015 to align the local bond market with global and regional best practices in terms of an enhanced shelf registration process and longer issuance periods, among other things. The country has also taken part in regional partnerships to deepen the local bond market through the implementation of the ASEAN+3 Multi-Currency Bond Issuance Framework (AMBIF).

Regarding the breakdown of the Philippine bond market, of the total outstanding figure as of year-end 2019, PHP5.1 trillion (USD101.5 billion) is from government securities, representing 77.4% of the total market. Of the total outstanding government debt paper, roughly 80% is denominated in Philippine pesos, and the maturity profile is a barbell, with more than 60% being payable either less than 3 years or more than

FIGURE 3. SIZE OF THE PHILIPPINE DEBT CAPITAL MARKET, 2010–2019



Sources: AsianBondsOnline; Bureau of the Treasury PH; Philippine Statistics Authority.

10 years. Meanwhile, corporate paper stood at PHP1.5 trillion (USD29.7 billion), or 22.6% of the market, but unlike government securities, 60% of this figure is denominated in foreign currency.

On the new issuance side, a total of PHP1.5 trillion (USD29.2 billion) of government securities was raised in 2019, while only PHP366.6 billion (USD7.1 billion) was raised by corporates. Although corporate bonds have increased in size recently, the growth is still concentrated around the usual issuers in the country, which are also the companies with the largest publicly listed stocks. The entire outstanding corporate bond market can be traced back to only 50+ issuers. Clearly, the Philippine debt market is heavily skewed toward government paper.

In fact, in 2019, a total of PHP5.3 trillion of fixed-income securities changed hands, and of this figure, 98.7% was attributable to government securities. This also is related to the structure of market participants in the Philippine debt capital market. Absent an official database, it is common knowledge in the industry that fixed-income volumes are largely attributable to banks, investment houses, asset managers, and insurance companies; in short, the market is mainly driven by institutions. Retail investor participation is still low because of the dearth of options to directly access bonds and the larger amounts often required by intermediaries to allow them to invest in such securities. Usually, the participation of most individual investors is even limited to just short-term instruments, such as Treasury bills.

Foreigners are also largely absent, likely owing to the high tax rates on interest income and trading gains as well as poor liquidity.

CHALLENGES AND OPPORTUNITIES

The Philippine equity and bond markets face numerous challenges, the most significant of which are poor liquidity and low retail participation.

For the equity market, poor liquidity is largely a function of the limited number of listed companies. For the bond market, poor liquidity is also a result of the absence of large foreign investors and dealers, aside from having only a limited number of issues available. Nevertheless, recent developments could help boost market liquidity for both the equity and bond markets.

In 2020, the PSE listed its first real estate investment trust (REIT) after regulators amended the implementing rules and regulations of the REIT Act earlier in the year, making it more attractive for companies to list REITs.

During the same year, the PSE also disclosed plans to relax listing rules by removing the PHP500 million (USD10 million) minimum market-capitalization requirement for a company to be listed on the main board. The PSE also plans to remove the requirement that companies must generate a positive EBITDA in at least two of the last three fiscal years, reduce the required operating history from three years to two years, and replace the PHP100 million (USD2 million) minimum authorized capital stock requirement with PHP25 million (USD500,000) paid-up capital to qualify for listing on the SME (small and medium-size enterprise) board.

Meanwhile, to boost liquidity for the bond market, the Philippines has taken part in regional partnerships to deepen the local bond market through the implementation of the ASEAN+3 Multi-Currency Bond Issuance Framework.

The government also plans to gradually reduce taxes on bonds, which are currently among the highest in the region. The government plans to reduce the tax on interest income from 20% to 15% and reduce the tax on trading gains slowly from as much as 30% to 20%.

In addition, there are various initiatives to boost retail participation in both the stock and bond markets.

Aside from regularly conducting free basic stock market seminars and road shows around the country, the PSE in 2009 signed a memorandum of agreement with the Department of Education for the integration of a capital market segment in the high school curriculum in the senior year economics subject.

In 2013, the PSE launched its online service bureau, which allowed several stockbrokers to launch their own online trading facility by simply using the stock exchange's online trading platform.

In 2019, the PSE launched the PSE Electronic Allocation System (PSE EASy) website and mobile application, allowing investors who want to take part in the Local Small Investor (LSI) tranche of an IPO to subscribe online. Prior to the launch of PSE EASy, retail investors who wanted to subscribe to the LSI tranche of an IPO had to go to designated IPO kiosks in selected malls to secure and fill out a form, bring this form to their stockbroker's office for acknowledgement, and then bring the same form back to the kiosk to make payments. Because of the cumbersome process, the take-up of the LSI tranche of IPOs has never exceeded 2%, even though the LSI tranche is at least 10% of the offering.

To encourage more retail participation in the bond market, the Bureau of Treasury, together with a private bank, launched in July 2020 the first mobile app in the country that allows small investors to purchase retail Treasury bonds for as low as PHP5,000 (USD100). Some online brokers have also started exploring the distribution of fixed-income instruments through their platform.

One major development that could significantly boost both market liquidity and investor participation in the future is the digitization of Personal Equity and Retirement Account products. The Personal Equity and Retirement Account (PERA) Act is an initiative that aims to promote a voluntary retirement savings account for working Filipinos by providing annual tax incentives. Although the act was passed in 2008, only a few Filipinos have participated because of a lack of awareness and financial literacy, as well as the difficulty of accessing this scheme through traditional bank branches.

Nevertheless, investor participation could finally pick up because PERA was recently relaunched by the Bangko Sentral ng Pilipinas, the central bank, in digital form, allowing Filipinos to open an account and make their contributions online. The central bank has a target of at least 5 million of these accounts over the next five years. Aside from increasing investor participation, this development would boost demand for stocks and bonds, leading to greater market liquidity, to the benefit of the local capital market.

SRI LANKA

- **1896** — Formalized share trading commenced in Colombo with the Colombo Share Brokers Association (CSBA)
- **1904** — CSBA renamed the Colombo Brokers Association (CBA)
- **1984** — CBA establishes public trading floor
- **1985** — Colombo Securities Exchange (GTE) Ltd formed as an amalgamation of the Stock Brokers Association (SBA) and the CBA
- **1987** — Securities Council Act No. 36 of 1987 passed, providing for the establishment of a regulator for the capital market
- **1990** — GTE name changed to the Colombo Stock Exchange (CSE); Liberalization of investment in stock market with abolition of the 100% transfer of property tax on share purchase by nonnationals
- **1991** — Clearinghouse of CSE automated with the establishment of a Central Depository System (CDS)
- **1995** — Company Takeovers and Mergers Code introduced
- **1996** — Marked 100 years of share trading in Sri Lanka; Introduction of two-tiered board, the Main Board and the Second Board; CSE appointed as the National Numbering Agency
- **1997** — Automation of trading with a screen-based trading system; Establishment of Settlement Guarantee Fund and Compensation Fund
- **2005** — CSE introduces Triaxial Ribbon as a part of its new logo; Settlement cycle shortened to T+3 for buyers and T+4 for sellers
- **2007** — CSE introduces single-tiered settlement of T+3; Corporate Governance Rules for Listed Companies introduced

SRI LANKA

Vidushan Premathiratne, CFA
Founder and Director, Elon Venture Catalysts

Equity Market Capitalization (USD)	12.989 Bn*	1.389 Bn*	Debt Market Capitalization (USD)
Equity Market Cap/GDP	16%*	2%*	Domestic Debt Market Cap/GDP
Equity Market Share Volume Traded	4,443 Mn*	40 Mn**	Debt Market Instrument Volume Traded
Number of Listed Companies	287*	–	Number of Issuers (Bonds)

* As of 31 July 2020
** Only corporate debt

CAPITAL MARKETS OF SRI LANKA

Sri Lanka is a USD84 billion economy with a GDP per capita of USD3,852. Its capital market consists primarily of government securities, stock, and corporate bond markets that have a combined value of USD66.3 billion. The government securities market is the dominant sector, with a value of USD52.5 billion, whereas the stock market capitalization is USD13.8 billion. Stocks trade on the Colombo Stock Exchange (CSE).

EQUITY MARKET

Trading stocks in Sri Lanka has a long history, dating back more than one hundred years. Stock trading commenced with the establishment of the Colombo Share Brokers Association (CSBA) in 1896 as a secondary market. In 1904, the CSBA was renamed the Colombo Brokers Association (CBA). Since its inception, the market has witnessed numerous transformations and has borne periods of growth and decline as a result of economic and political challenges.

The modern stock market was formed in 1985, when the Colombo Securities Exchange (GTE) Ltd was established. This was following the amalgamation of two stock brokerage associations, the Stock Brokers Association (SBA) and the CBA. The SEC was established in 1987 as the regulatory body. In 1990, the GTE was renamed the CSE.

The stock market has had its own Central Depository System (CDS) since 1991, and trading has been fully automated under the Automatic Trading System since 1997. The main securities traded on the CSE include ordinary and preference shares, closed-end funds (unit trusts), and corporate debentures. The CSE currently has two indexes, namely, the All Share Price Index and the S&P Sri Lanka 20 Index

(S&P SL 20). In 2009, the CSE was named the best performing stock market in the world, with growth of 120%.

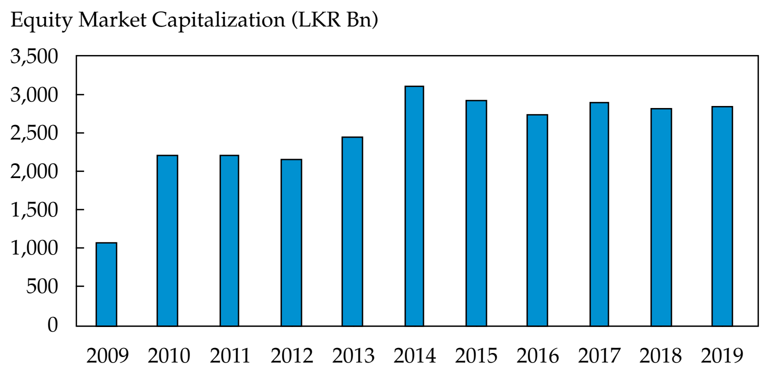
The activities of the exchange are driven primarily by 15 members and 14 trading members, who are licensed as stockbrokers for equity and debt (three of whom work exclusively in the debt market). The policy-making body of the CSE is the board of directors (BOD), comprising nine members: Five are elected by the members, and four are appointed by the government on the recommendation of the SEC. The BOD is responsible for appointing subcommittees and delegates with the required authority to convey recommendations on daily operations. The subcommittees comprise capital issues, rules and by-laws, disciplinary and arbitration, research and development, finance, and listings.

CSE market turnover was recorded at LKR171 billion during 2019, of which LKR62 billion was attributed to foreign investors. Market capitalization stood at LKR2,851 billion by the end of 2019 (see **Figure 1**). CSE is a limited-by-guarantee company and a mutual exchange. A company limited by guarantee usually refers to a public company that is formed with the intention to benefit the community. This type of company does not have share capital or shareholders. Instead, the members of such companies act as guarantors and agree to contribute a set amount of capital toward the company each year. The SEC has been taking measures to demutualize the CSE, and such measures are expected to materialize in the coming years.

GOVERNMENT SECURITIES MARKET

The Public Debt Department (PDD) of the Central Bank of Sri Lanka (CBSL) is in charge of the issuance of government securities and public debt management on behalf of the government treasury. Government securities are issued in both rupee-denominated and foreign currency–denominated securities. Rupee-denominated securities include Treasury bills and Treasury bonds, and foreign currency–denominated securities include Treasury-denominated bonds, such as Sri Lanka Development Bonds (SLDB) and Sri Lanka International Sovereign Bonds. Since 2007, Sri Lanka has been issuing sovereign bonds. Sri Lanka has made 14 international sovereign bond issues with maturity periods of 5 and 10 years, for a total of USD15,050 million. Sovereign bonds are listed on the Singapore and Berlin Stock Exchanges.

FIGURE 1. CSE MARKET CAPITALIZATION FROM 2009 TO 2019



Treasury bills are zero-coupon, short-term securities with 3-, 6-, and 12-month maturities. Treasury bonds have been issued within the range of 2- to 30-year maturities. Treasury bonds carry a fixed rate of interest. SLDB have been issued with short-term maturities of 3–12 months and with longer-term maturities of two years, with both fixed and floating interest rates.

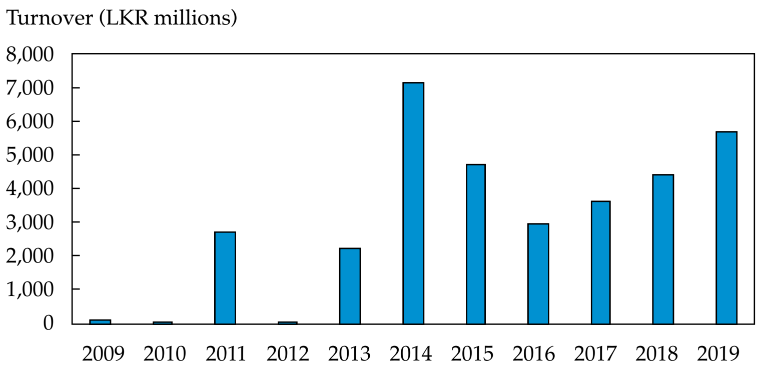
Government securities are sold by the PDD through multiple-price competitive auctions on the primary market. The participants of the primary auction are approved primary dealers, and currently, 15 primary dealers exist, consisting of eight bank primary dealers and seven non-bank primary dealers. Each primary dealer is required to bid for at least 10% of the value of securities offered at the primary auction. Sri Lanka has relied primarily on short-term funds for financing the government's cash flow requirements.

CORPORATE BOND MARKET

The primary market for listed corporate debt became active in 2013 as a result of incentives introduced for corporate debt listing by the CSE. One such measure was the enactment of new listing rules for corporate debt in 2013. Further, tax incentives were provided by the government for investing in listed debt securities. Such incentives included the exemption from income and withholding taxes of interest income received from listed debt. Such action prompted the rise in debt issues in 2013—where 28 debt issues raised LKR68 billion, representing 72% of all the capital raised through the CSE that year. The CSE also changed the maximum tick size to LKR10,000 in 2013 to improve liquidity among listed debt instruments. Entities that sought a listing managed to raise LKR55.9 billion in 2018 and LKR57.9 billion in 2019 through listed debt instruments. In 2019, debt issues represented 55% of the total capital raised through the CSE.

The listed corporate debt market in Sri Lanka began in 1997. The turnover in the corporate debt market has witnessed a considerable increase, from LKR75 million in 2012 to LKR5,677 million in 2019 (see **Figure 2**). However, the corporate debt market turnover was only approximately 3% of the stock market turnover in 2019. The market capitalization of the listed corporate debt market was LKR257.9 billion in July 2020, compared with the stock market size of LKR2,412 billion. The corporate bond market in Sri Lanka is only approximately 8% of the size of the stock

FIGURE 2. CSE DEBT MARKET TURNOVER FROM 2009 TO 2019



market. This is mainly due to the preference of entities to resort to bank-based financing for their capital needs. Another reason is the lack of familiarity with capital markets in Sri Lanka.

FOREIGN INVESTMENT IN THE CSE

Both the CSE and SEC aim to strongly encourage foreign investment in companies listed on the CSE. Such investments are unrestricted to any particular entity but are subject to certain ownership restrictions in entities of certain industries. Foreign ownership is permitted up to 100% in all listed entities of the CSE, except for a cap of 40% on plantation stocks. A 10% restriction exists for banking sector stocks for any single local or foreign accountholder or accountholders acting in concert. However, with the approval of the Monetary Board of the CBSL, ownership can be extended up to 15%. No specific restrictions are in place on the ownership of debt instruments listed on the CSE. In terms of government securities, the threshold limit on foreign ownership of Treasury bills and bonds is 5%.

THE WAY FORWARD

The SEC has developed a master plan for the CSE. The aim of the set strategies is to develop the CSE in line with global exchanges. A few of the key challenges emphasized include enticing new listings from both the private and public sectors locally and attracting new global investors, such as investment funds. Attention has also been given to developing new financial instruments for the exchange in an effort to expand the investment options available.

With the view of expanding market operations, consideration has been given to the development of capital market–related infrastructure and the implementation of a risk management system, delivery versus payment, and central counterparty. The SEC has now facilitated the introduction of a real estate investment trust (REIT) framework, and the proposed initiative provides real estate developers and owners the option to convert fully completed properties into REITs. This new product, REIT, will be the first product introduced to the CSE after a lapse of 23 years, following the introduction of corporate bonds to the capital market in Sri Lanka in 1997.

Equity Market

The equity market has limited attractiveness for large-scale investments because it is small in size relative to the economy and regional nations. The size of the market also limits diversification and growth, with many listed firms having a smaller public free float that impedes active trading.

Compared with regional counterparts and emerging markets, the equity market is less liquid. The lack of market making can be considered one aspect that severely limits liquidity. Transaction costs on stock trades in Sri Lanka are high. Too many intermediaries are involved in Sri Lanka's stock market, and the presence of specialized brokers for different capital market products is not economically feasible. Stockbrokers lack adequate technical skills required to provide investor advice on alternative instrument products.

Over the years, many suggestions have been made on policy initiatives and incentives to expand and grow the CSE. One such measure was to encourage the listing of large, privately owned enterprises, given that most of the well-known entities, some of which are public, continue to remain unlisted. Other suggested initiatives have included creating a national policy framework for public enterprise reforms linked to capital market development and implementing such public enterprise reforms to restructure state-owned enterprises (SOEs) to make them profitable and financially robust. An initial measure would be to list at least a minority stake of some SOEs on the stock market.

Capital markets can also help raise funds for infrastructure development corporations and infrastructure development projects. One such measure included the proposal to establish the Small and Medium Enterprises (SMEs) Board for listing SMEs. This proposal became a reality in 2019. In addition, consideration can be given to establishing listing boards for companies approved by the Board of Investment of Sri Lanka (BOI). The BOI is the main institution entrusted to encourage and promote investment, specifically foreign direct investment, in Sri Lanka. Most entities that obtain BOI approval receive tax concessions and are primarily export-oriented industries (i.e., driven predominantly by foreign investment).

Several regulatory measures are currently being considered to implement higher public float requirements to increase liquidity. The main reason for the low public float has been that the major shareholders of local enterprises have preferred to retain majority shareholding and continue to do so.

An important requirement is the establishment of a market-making mechanism to ensure a continuously liquid market for listed equities. To reduce transaction costs, the introduction of negotiated brokerage could be considered. The design and implementation of a brokerage industry consolidation plan to create a financially strong and competitive brokerage industry is also paramount. A universal brokerage model can be adopted to allow market intermediaries to deal in all capital market products, such as equity, debt, mutual funds, and derivatives.

Government Securities Market

A majority of bond issues have been of short-to-medium maturity, resulting in lower liquidity at long maturities and higher refinancing risk. The secondary market trading in government bonds is illiquid at longer maturities, hindering the dependability of the Treasury yield curve. The lack of an auction calendar makes auctions and interest rates less predictable and undermines the auctions' credibility.

Measures must be taken to establish an evenly distributed maturity structure that spans both medium-term and long-term divisions. A mechanism must also be in place to develop a reliable benchmark yield curve by issuing relatively more benchmark securities at key points along the yield curve. The CBSL must publish a quarterly Treasury auction calendar in advance containing security type, term to maturity, coupon rate, volume, announcement date, auction date, and settlement date to provide credibility and predictability to auctions. Steps must also be taken to increase the competition in the primary market by creating a more diversified range of investors in government securities.

Corporate Bond Market

The supply of corporate debt securities is related primarily to bank, finance, and insurance sectors. At present, one key concern is that the secondary market for listed corporate debt remains highly inactive and illiquid. And a market-making mechanism for corporate bonds is lacking. Transaction costs on large debt trades are high, and unlisted corporate debt (including bonds, debentures, commercial paper, and promissory notes) remains unregulated. Moreover, stockbrokers have an insufficient level of knowledge and skills with respect to investing and trading in debt securities.

The immediate development and implementation of policy reforms must be undertaken to increase institutional investor participation in the listed corporate debt market, thereby creating a strong investor base for corporate debt. In addition, conditions must be established to make debt financing through the capital market more beneficial to companies than bank-based financing to increase debt security issuance by a wider range of industries.

Measures can also be established to develop the necessary framework for introducing corporate bond derivatives and to develop market fundamentals that are suitable for bond derivatives. A formal market-making mechanism for listed debt securities should be introduced, and measures must also be taken to lower transaction costs for trading debt securities and to bring unlisted corporate debt under SEC regulation. Unlisted corporate debt includes debt instruments (e.g., debentures) issued by both public and private entities that do not trade on the debt board of the CSE. Training must be conducted to enhance the technical capacity of stockbrokers and other market professionals on debt instruments and trading, which will strengthen the existing financial industry education and qualification framework.

A new government was elected to office in August 2020, and the foreign ownership restrictions just mentioned can be subject to amendment if the foreign investment policy is modified. However, no indication of a dramatic change has been made public up to this point. Amendments to the existing SEC Act of 1987 are expected to take place to attract more foreign investors to the CSE. In addition, the development of the corporate bond market, as well as of the unit trust industry, is at the forefront of the financial instruments that come within the SEC's strategic plan to attract more overseas investment.

THAILAND

- **1963** — The first Thai stock exchange, established as a limited partnership in July 1962, was registered as a limited company and renamed the Bangkok Stock Exchange Co., Ltd. (BSE)
- **1970** — A comprehensive report titled "A Capital Market in Thailand," produced by Professor Sidney M. Robbins, became the master plan for the development of the Thai capital market
- **1972** — The Thai government amended the "Announcement of the Executive Council No. 58 on the Control of Commercial Undertakings Affecting Public Safety and Welfare"
- **1974** — The Securities Exchange of Thailand was established to provide for securities trading in order to promote savings and mobilize domestic capital
- **1975** — The Securities Exchange of Thailand officially started trading
- **1991** — The Securities Exchange of Thailand was renamed the Stock Exchange of Thailand (SET)
- **1992** — The Securities and Exchange Act of 1992 (SEA) stipulated that the SET be overseen by the Securities and Exchange Commission (SEC)
- **1999** — The Market for Alternative Investment (MAI), a market for listing securities of small and medium-sized enterprises, established under the SEA, officially began operations
- **2000** — Settrade.com Co., Ltd. was established by the SET to facilitate trading
- **2004** — The Thailand Futures Exchange (TFEX) was established by SET
- **2005** — The Thai Bond Market Association (ThaiBMA), founded in 1994 as the Bond Dealers Club (BDC), was granted the license of a securities business–related association under the Securities and Exchange Act B.E. 2535 (1992)

THAILAND

Nattawut Jenwittayaroje, CFA
Assistant Professor of Finance, NIDA Business School, National Institute of Development Administration

Thitiphong Amonthumniyom
Risk Management Analyst, Research Department, The Securities and Exchange Commission

Equity Market Capitalization (USD)	471.57 Bn*
Equity Market Cap/GDP	87%*
Equity Market Share Volume Traded (USD)	412,970 Mn**
Number of Listed Companies	724*

419.12 Bn**	Debt Market Capitalization (USD)
77%**	Domestic Debt Market Cap/GDP
2,830 Mn†	Debt Market Instrument Volume Traded (USD)
199††	Number of Issuers (Bonds)

*As of the second quarter of 2020
**As of 2019
†Per day as of 2019
††In Q2 2020 only

The formation of the capital market in Thailand can be traced to 1963 with the registration of the Bangkok Stock Exchange (BSE). The BSE, however, operated as an informal securities exchange market with little trading volume. Stock trading formally commenced in Thailand in 1975 on the Securities Exchange of Thailand, which was renamed the Stock Exchange of Thailand (SET) in 1991. As of mid-2020, SET ranks 25th in terms of market capitalization among the stock exchanges around the world and is the 11th largest stock market in the Asia-Pacific region, with a market capitalization of roughly USD471.6 billion in Q2 2020.

As shown in **Figure 1**, the total number of companies listed on SET and the Market for Alternative Investment (MAI) has been increasing steadily during the past 10 years, from 541 companies in 2010 to 724 companies in Q2 2020. The growth in size of listed companies (as measured by market capitalization) is illustrated in **Figure 2**. The market capitalization of SET and MAI has increased significantly over the past 10 years, from USD270.6 billion in 2010 to USD471.6 billion in Q2 2020.

EQUITIES

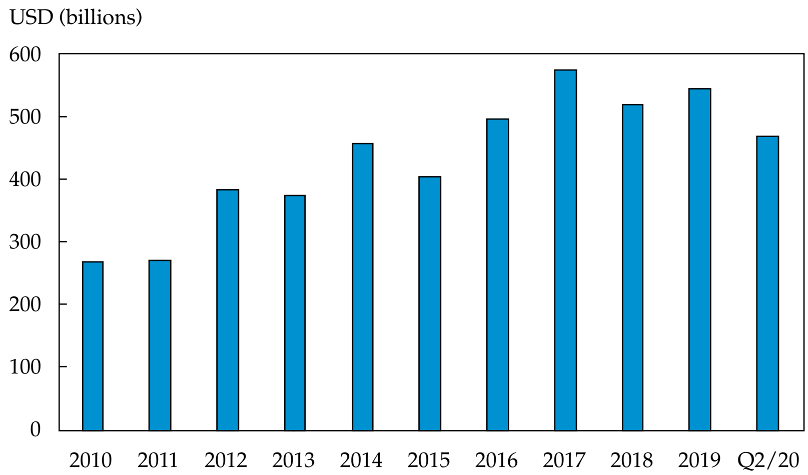
In the Thai capital market, there is only one securities exchange: SET Group. SET Group provides a wide variety of securities exchange services, including listing and trading, clearing

FIGURE 1. TOTAL NUMBER OF LISTED COMPANIES ON SET AND MAI, 2010–Q2 2020

Source: SETSMART.

and settlement, depository, and market supervision. SET Group operated a local bond market, the Thailand Bond Exchange (TBX), from 2003 to 1 March 2021. SET Group recently ceased trading on TBX due to inactivity and traders' lack of interest in bond trading. SET Group also operates a derivatives market, the Thailand Futures Exchange (TFEX), which was founded

FIGURE 2. MARKET CAPITALIZATION OF SET AND MAI, 2010–Q2 2020



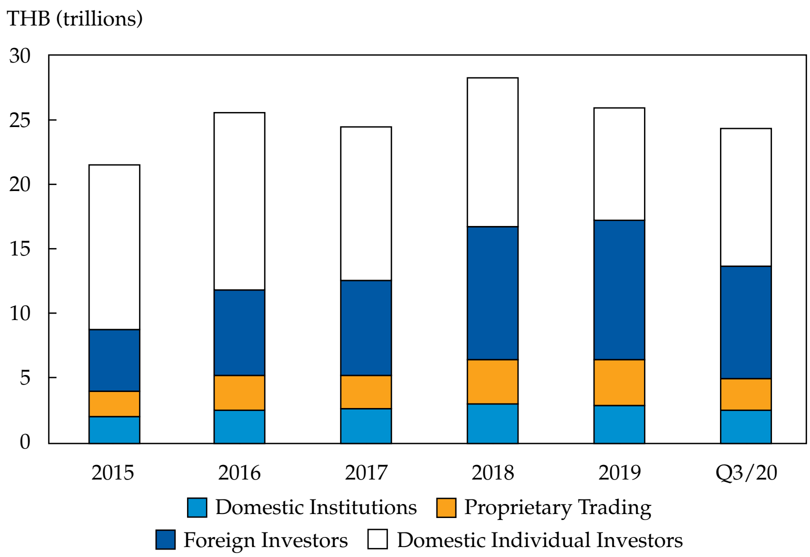
Source: Stock Exchange of Thailand.

in 2004. TFEX is an exchange for trading futures and options on various underlying assets. Trading activities of all derivative products traded on TFEX are supervised by SET Group.

Under SET Group, there are two equity bourses: SET and MAI. The SET bourse is for established companies with a minimum market cap of THB7.5 billion. The MAI bourse is for young companies and has no minimum market capitalization requirement. As of mid-2020, 555 companies are listed on the SET bourse, with a total market capitalization of THB14.41 trillion, and 169 companies are listed on the MAI bourse, with a total market capitalization of THB207.2 billion. Various types of equity instruments are available on the SET and MAI bourses—namely, common stock, preferred stock, warrants, unit trusts, non-voting depository receipts (NVDRs), and depository receipts (DRs). Other types of instruments include derivative warrants (DWs), exchange-traded funds (ETFs), real estate investment trusts (REITs), property funds (PFs), and infrastructure funds (IFFs).

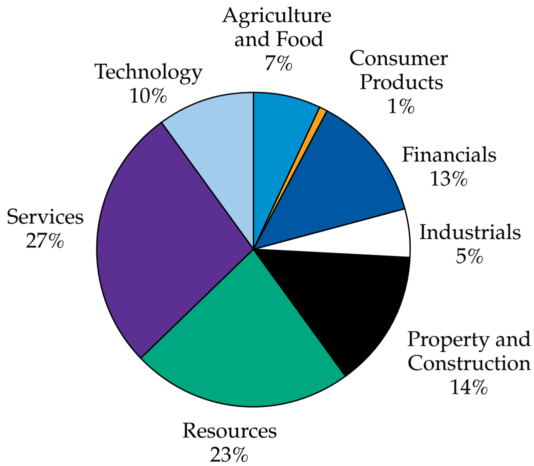
SET and MAI investors can be divided into four main types: domestic institutions (such as mutual funds, banks, insurance companies, pension funds, and provident funds), proprietary traders (brokers' own accounts), foreign investors, and domestic individual investors. As shown in **Figure 3**, from 2015 to Q3 2020, the most active investor group was domestic individual investors, followed by foreign investors, proprietary traders, and domestic institutions. The proportions of baht volume traded during 2015–Q3 2020 ranged from approximately 34% to 59% for domestic individual investors, 22% to 41% for foreign investors, 9% to 14% for proprietary traders, and 9% to 11% for domestic institutions. Trading activity by foreign investors during the past few years (i.e., during 2018–Q3 2020), however, accounted for a larger proportion, ranging from 36% to 41%, the highest level during 2015–Q3 2020.

FIGURE 3. TOTAL BAHT VALUE TRADED FOR EACH INVESTOR TYPE, 2015–Q3 2020



Source: SETSMART.

FIGURE 4. PROPORTION OF EIGHT INDUSTRY GROUPS IN TERMS OF MARKET CAPITALIZATION, Q2 2020



Source: SETSMART.

Figure 4 illustrates the proportion of the market capitalization of eight industry groups as of Q2 2020. The four biggest industry groups in the Thai stock market are the services industry (27%), resources (23%), property and construction (14%), and financials (13%).

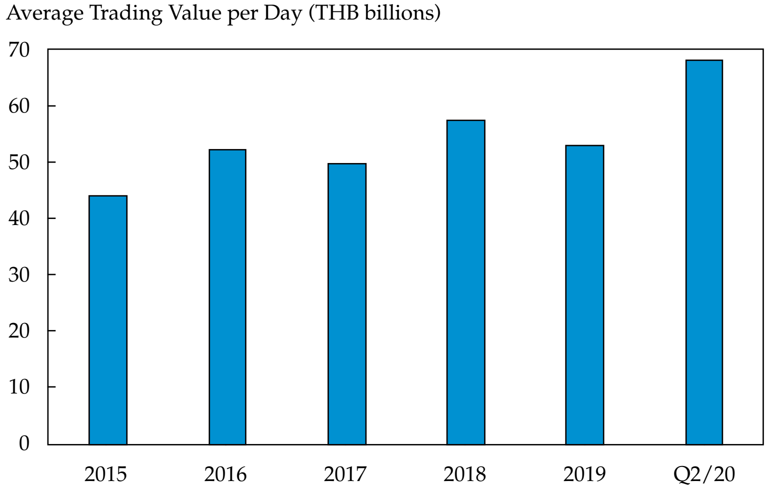
There are several stock indexes on the SET and MAI bourses, all of which are market-capitalization-weighted indexes. Popular stock indexes are the SET Index, the SET50 Index, and the MAI Index. The SET Index comprises all stocks traded on the SET bourse, and the SET50 Index comprises the top 50 stocks on the SET bourse in terms of market capitalization and trading volume. The MAI Index comprises all stocks on the MAI bourse.

Equity market activity in Thailand improved steadily from 2015 to Q2 2020. As shown in **Figure 5**, the average daily trading value of SET and MAI was THB44.3 billion in 2015 and reached its highest level, THB68.6 billion, in Q2 2020. This trend reflects the fact that both SET and MAI have consistently improved market liquidity over time, though a steady increase in the number of companies listed on SET and MAI over that period could be a partial explanation as well.

BONDS

The main bond market in Thailand is the Thai Bond Market Association (ThaiBMA). It was founded in 1994 as the Bond Dealers Club (BDC), which was restructured and renamed the Thai Bond Dealing Center (ThaiBDC) in 1998. In September 2005, with the support from the Thailand Securities Exchange Commission (SEC), ThaiBDC was granted the license of a securities business related association under the Securities and Exchange Commission Act 1992 and named ThaiBMA. ThaiBMA is a self-regulatory organization, aiming to provide fair and efficient operation of the bond market. In addition, ThaiBMA aims to be an information center of Thai bond data for Thai bond market participants.

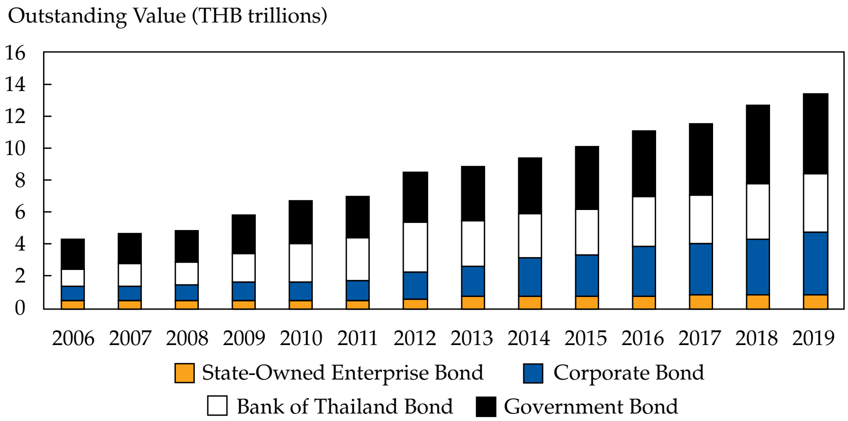
FIGURE 5. EVOLUTION OF LIQUIDITY IN SET AND MAI



Source: SETSMART.

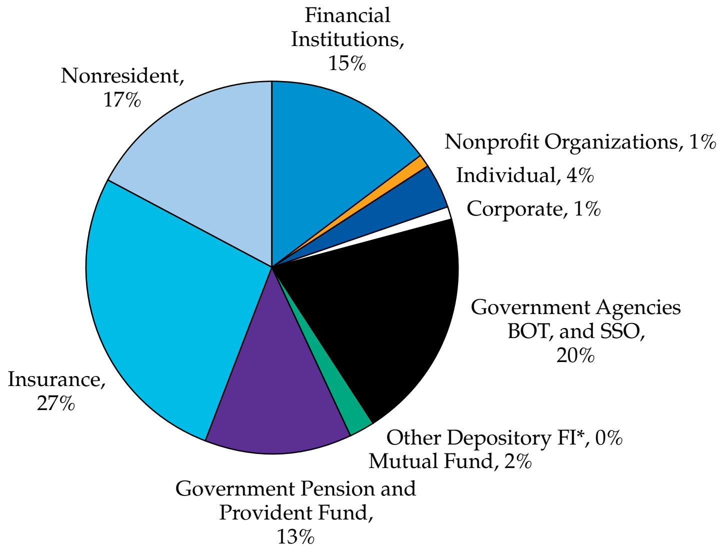
Figure 6 shows the outstanding value in baht of bonds listed by ThaiBMA from 2006 to 2019. The size of the Thai bond market has been growing steadily, from THB4.32 trillion in 2006 to THB13.52 trillion in 2019—an impressive growth rate of 9.2% per year. The steady growth over time can be seen in every type of bond traded on ThaiBMA. For example, government bonds grew from THB1.83 trillion in 2006 to THB4.97 trillion in 2019. Of the total outstanding value of Thai bonds in ThaiBMA, government bonds account for the highest share, 37%, followed by corporate bonds (29%), Bank of Thailand bonds (27%), and state-owned

FIGURE 6. SIZE OF THAI BOND MARKET BY TYPE OF BOND, 2006–2019



Source: ThaiBMA.

FIGURE 7. PROPORTION OF GOVERNMENT BOND HOLDINGS BY INVESTOR TYPE, 2019



Source: ThaiBMA.

*Shows as 0% because of rounding.

Notes: BOT = Bank of Thailand; SSO = Social Security Office. Other Depository FI = Other Depository Financial Institutions, such as cooperatives.

enterprise bonds (6%). At just 1%, foreign bonds are too small to be represented in the figure.

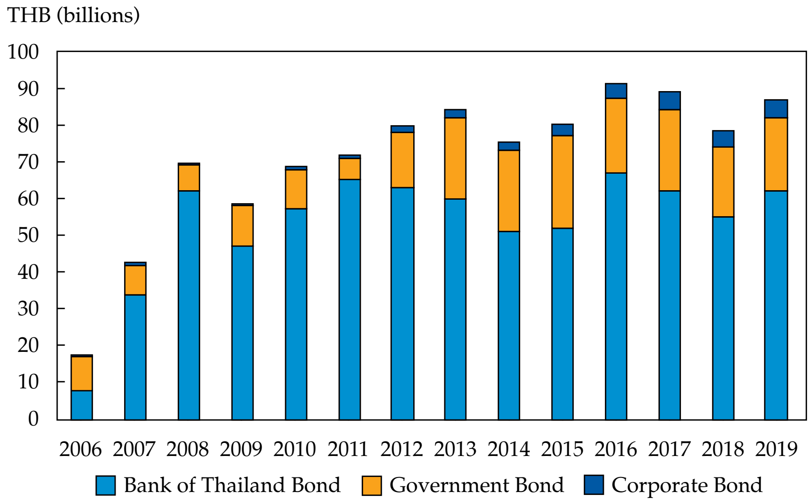
Figure 7 shows the proportion of government bond holdings categorized by investor type in 2019. Insurance firms held the largest share of government bonds outstanding, representing 27% of the total. Government agencies, BOT, and SSO were the second largest holder, at 20%.

Thai bond trading activity has improved gradually since 2006, as shown in **Figure 8**. The average daily trading value of bonds in ThaiBMA was about THB18 billion in 2006, reached its highest level—THB92 billion—in 2016, and stayed relatively flat thereafter. Bank of Thailand bonds are the most liquid, with an average daily trading value of around THB55 billion–THB67 billion in the past few years. The second most liquid bonds in ThaiBMA are government bonds, with an average trading value of around THB20 billion recently. These numbers reflect the fact that ThaiBMA has consistently improved market liquidity over time.

DERIVATIVES

Derivatives in the Thai capital market are traded on the Thailand Futures Exchange (TFEX), which was founded in 2004. The main derivatives products traded on TFEX are futures and options on such assets as stock indexes, individual stocks, bonds, interest rates, precious metals, agriculture products, and exchange rates. There were 40 TFEX members as of January 2020. These members are allowed to access the

FIGURE 8. AVERAGE DAILY TRADING VALUE OF THAI BONDS BY TYPE, 2006–2019



Source: ThaiBMA.

TFEX trading system, can trade all products listed on TFEX, and can trade for their own accounts and for their clients.

Liquidity, as measured by the number of futures and option contracts traded, has improved drastically during the past five years. As of 2019, the most liquid derivative product on TFEX was the futures on single stocks (there were approximately 120 underlying stocks of those futures as of Q2 2020), with a total of 52.1 million contracts traded. The second most liquid derivative product was the SET50 Index futures, with 42.4 million contracts traded in 2019.

As is the case for developed derivative markets, SET50 Index futures on TFEX are the most popular and widely traded product. SET50 Index futures first traded in 2006. Since then, the popularity of SET50 Index futures has grown significantly, particularly in the past five years, reaching its peak in 2018 and 2019 with an approximate total of 42.5 million contracts traded per year.

CHALLENGES AND FUTURE DEVELOPMENT

For the past five years, Thailand's economy has been lackluster, with relatively low growth compared with its peers in the Association of Southeast Asian Nations region. The Thai stock market has been facing foreign capital outflows because foreign investors have continued to be net sellers of Thai equities, worth about THB711.6 billion from January 2015 to September 2020. The Thai stock market has experienced declining share prices for the past three years, and the SET Index is currently back to its level of five to six years ago.

According to SET Group's strategic plan for 2020–2022 (from "Annual Report 2019 of the Stock Exchange of Thailand"), three key strategies will be implemented in the next three years to enhance internal operating efficiency and to enable stakeholders to achieve long-term sustainable growth. The first strategy is to "grow with efficiency: improve enterprise-wide business management." This strategy aims to reform and revise regulations that are outdated, unclear, inconsistent, or redundant. In addition, SET Group has continued to develop a central database for economic, financial, and industrial data, accessible by the general public.

The second strategy is to "grow with new opportunities: reachout and expand businesses." This strategy aims mainly to partner with more exchanges globally to explore opportunities to launch new financial products. Moreover, since small and medium-size enterprises (SMEs) will be a core engine driving the growth of the Thai economy in the future, SET Group will provide an alternative, more cost-efficient fundraising platform for those SMEs.

The third strategy is to "grow with stakeholders and sustainable society: development toward inclusive growth." SET Group will continue to develop IT infrastructure to improve the cost efficiency of all exchange-related businesses. In addition, it aims to enhance the quality of the listed companies by integrating ESG (environmental, social, and governance) considerations into their businesses, thereby potentially increasing the number of listed companies on the SET Thailand Sustainability Investment (THSI) list. Lastly, SET Group is focused on developing its education platform to provide online financial knowledge to the general public.

VIETNAM

Year	Event
1992	Equitization of state-owned enterprises (SOEs)
1996	State Securities Commission (SSC) established
2000	Ho Chi Minh (HCM) City Stock Trading Center opened; Seven securities companies licensed
2003	Government Decree 144 on securities markets and securities companies
2005	Hanoi Stock Trading Center established
2006	Vietnam Securities Depository established
2007	Securities Law of 2006 went into effect; HCM City Stock Trading Center upgraded to HCMC Stock Exchange
2009	Hanoi Stock Trading Center becomes Hanoi Stock Exchange
2010	Revised Securities Law
2012	Securities market restructuring plan issued
2014	Proposal on establishment of derivatives market approved
2015	Decree 42 on derivatives market issued
2017	Financial derivatives market established
2019	Revised Securities Laws; Decision 242 on restructuring the securities and insurance markets until 2020 and orientation to 2025
2020	Financial inclusion strategy to 2025 and orientation to 2030; Guidelines (decrees) for implementing the revised Securities Laws

VIETNAM

Luc Can
Chief Economist of BIDV

Dung Nguyen
Head of Finance & Banking Research, BIDV Training and Research Institute (BTRI)

Equity Market Capitalization (USD)	**188.97** Bn
Equity Market Cap/GDP	73%
Equity Market Share Volume Traded	**140** Mn
Number of Listed Companies	1,659

51.26 Bn	Debt Market Capitalization (USD)
11%	Domestic Debt Market Cap/GDP
–	Debt Market Instrument Volume Traded
211	Number of Issuers (Bonds)

Note: All data as of 31 December 2019

Vietnam's capital markets have grown strongly over the past 20 years. Products and services are increasingly diversified to meet the growing needs of investors and other participants. Moreover, market institutions are more and more professional, providing a safe and sustainable business environment for participants.

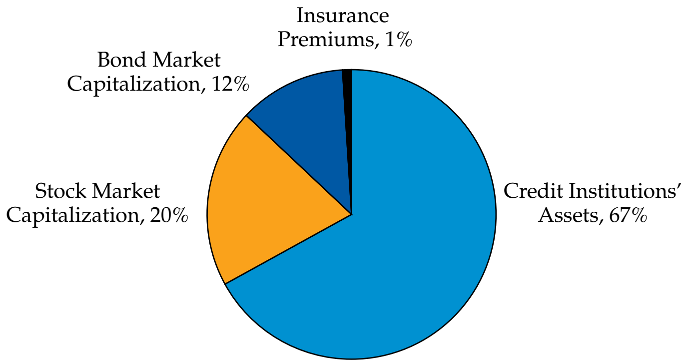
Vietnam's financial markets consist of three subsectors: banking, securities, and insurance. As shown in **Figure 1**, the securities sector currently accounts for 32% of total financial assets, credit institutions 67%, and insurance premiums approximately 1%, indicating that Vietnam is still a bank-based economy. However, the capital markets are growing rapidly.

Vietnam's financial markets are functionally regulated and supervised by the State Bank of Vietnam (SBV) and the Ministry of Finance (MOF). More specifically, as **Figure 2** illustrates, Vietnam is adopting a sectoral supervisory framework, in which credit institutions are regulated by the SBV, whereas the securities market is regulated by the State Securities Commission (SSC) and the insurance market by the Insurance Supervisory Department, both under the MOF. The National Financial Supervisory Commission coordinates the supervisory work and provides advice to the government in supervising the financial system.

OVERVIEW OF VIETNAM'S CAPITAL MARKETS

The starting point for formatting capital markets in Vietnam was the establishment of the SSC on 28 November 1996. Approximately four years later, on 28 July 2000, Vietnam's stock

FIGURE 1. STRUCTURE OF VIETNAM'S FINANCIAL SYSTEM (% OF TOTAL ASSETS), JUNE 2020

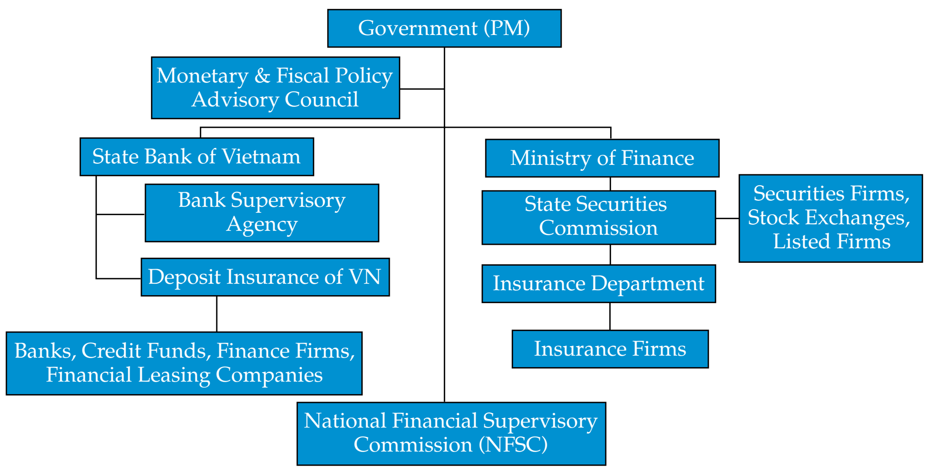


Source: Estimation of BIDV Training and Research Institute (BTRI).

market officially came into operation with the establishment of the Ho Chi Minh (HCM) City Stock Trading Center. Following that, the Hanoi Stock Trading Center opened in 2005. Both centers were then upgraded to exchanges in 2007 and 2009, respectively. The Unlisted Public Companies Market (UPCoM) was founded in 2009 and the financial derivatives market in 2017.

Vietnam's capital markets have achieved robust growth over the past few years. The country's overall market size jumped from less than 40% of GDP in 2011 to 104% of GDP as of June 2020. Despite this rapid expansion, Vietnam's stock market is still much smaller than those in other Asian economies. Notably, the bond market in Vietnam is dominated by government bonds

FIGURE 2. REGULATORY AND SUPERVISORY STRUCTURE OF VIETNAM'S FINANCIAL SYSTEM



Source: BTRI.

because the corporate bond market is still underdeveloped.

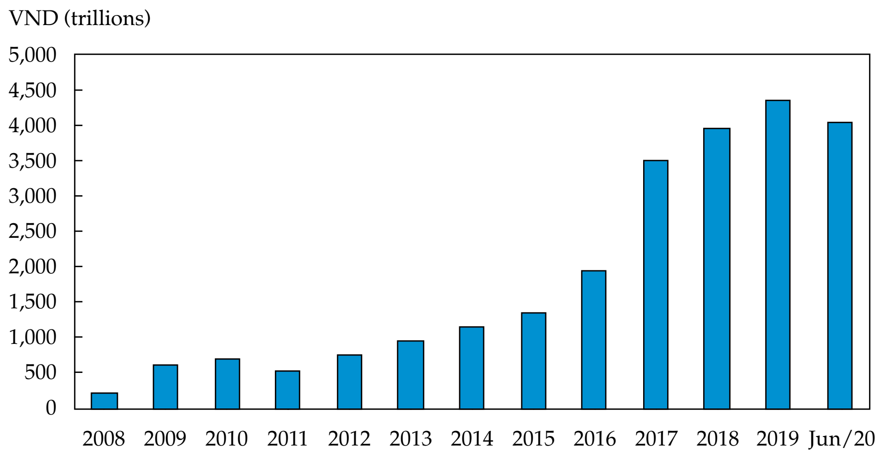
Given the relatively short history of the capital markets, long-term financial products are quite limited. However, the government has been pushing the restructuring of the financial sector.

THE STOCK MARKET

The stock market in Vietnam is quite young, with the HCM City Stock Trading Center established just 21 years ago in 2000 before being upgraded to a stock exchange in 2007. However, it took Vietnam approximately 10 years of preparation, starting with the equitization of state-owned enterprises (SOEs) in 1992 and followed by the establishment of the SSC in 1996. The Hanoi Stock Trading Center opened in 2005 and was upgraded to a stock exchange in 2009. The securities law was passed in 2006, then revised twice, in 2010 and in 2019. Notably, the financial derivatives market was launched in 2017 to help diversify various stock markets in Vietnam. In 2019, in the context of the country's economic restructuring, Decision 242 on restructuring the securities and insurance markets was issued. As a result, the stock market's institutional and legal frameworks have been gradually established.

In the initial stage (2000–2005), Vietnam's stock market capitalization was only approximately 1% of GDP. After the 2008–09 global financial crisis, and motivated by Vietnam's participation in the World Trade Organization, the stock market started booming and attracting a large number of foreign investors. The stock market capitalization to GDP increased rapidly from 12.4% in 2008 to 72.6% in 2019 (according to the SSC). As of 30 June 2020, the capitalization of the stock market reached nearly VND4,000 trillion (see **Figure 3**), equivalent to approximately 65% of GDP. The stock market has played an important role in mobilizing medium-to-long-term capital for economic development. Since 2012, the volume of capital mobilized via the stock market has increased significantly,

FIGURE 3. VIETNAM'S STOCK MARKET CAPITALIZATION (2008–2020; VND TRILLION)



Source: SSC.

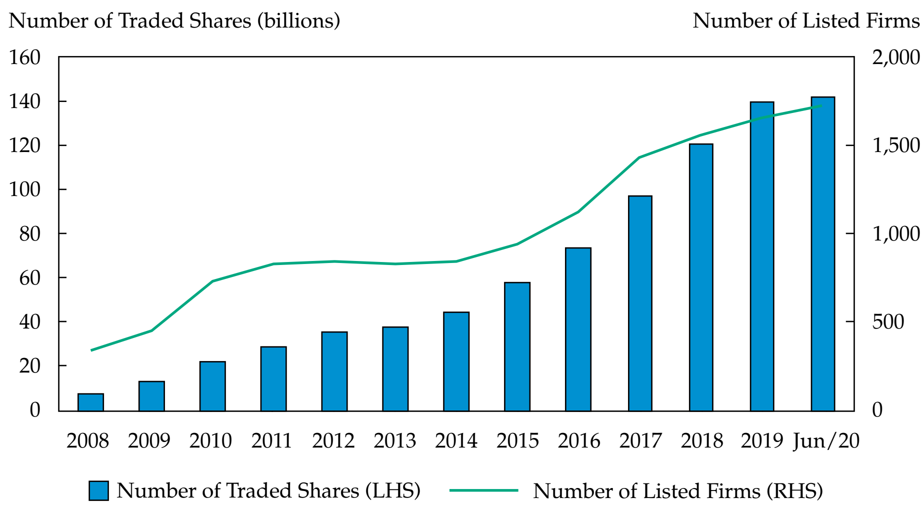
with an average growth rate of approximately 30% per year, doubling the growth rate of capital supplied by the credit institution system. By the end of 2019, the amount of capital mobilized through the stock market had reached approximately VND300 trillion (approximately USD13 billion).

Despite such a high growth rate, the relative size of Vietnam's stock market (72.6% of GDP in 2019) is still much smaller than that of other economies; for example, that of ASEAN–5 was 104.56%, the world average was 93%, and those of the more developed economies of Japan and Korea were 121.8% and 87.3%, respectively.

The first trading session on the HCM City Stock Trading Center took place on 28 July 2000 with only two tickers, REE and SAM, and a total capitalization of VND270 billion. By the end of 2000, only five companies were listed, with a total of 32.1 million shares. At the end of 2005, 41 companies were listed, of which 32 were on the HCM City Stock Trading Center and the others on the Hanoi Stock Trading Center. Since 2006, the SOE equitization wave associated with listing on the stock market began to thrive. As of 30 June 2020, Vietnam's stock market had 1,723 stocks and fund certificates listed or registered for trading, including 737 stocks and fund certificates listed on both stock exchanges and 903 registered for trading on the UPCoM. Not only is the number of listed stocks growing but also many new products are being introduced. Some examples are VN30 Index futures contracts, covered warrants (CWs), green bonds, and green stocks (in an experimental stage).

The total number of stocks listed or registered for trading in 2001 was 52,000, which grew to 142 million in June 2020 (see **Figure 4**)—an increase of 2,715 times. Even though product quantity has increased rapidly, product quality and diversification need further improvement. Among the 1,723 stocks and fund certificates listed on the market are some inefficient small

FIGURE 4. NUMBER OF TRADED SHARES AND LISTED FIRMS ON VIETNAM'S STOCK MARKET (2008–2020)



Source: SSC.

businesses with low corporate governance capacity. Some products, such as investment fund certificates, hedging instruments, options contracts, and capital preservation investments, have not been provided.

The legal framework for market operations has been established in accordance with the practical contexts, international experiences, and practices, helping the stock market develop more stably. In August 2019, the International Finance Corporation and the SSC issued a set of 10 corporate governance principles in accordance with the best practices for publicly listed companies in Vietnam. Listed companies, especially SOEs after equitization, will receive an annual corporate governance rating according to those principles.

The number of investors participating in the market has rapidly increased. In 2000, there were approximately 3,000 investment accounts, more than 99% of which belonged to individual investors. By June 2020, the number of investment accounts was 2.54 million, 820 times higher than in 2000, of which 16,000 accounts belonged to institutional investors.

The securities assets of domestic investors account for a small proportion of the stock market. In 2015, to attract foreign capital to the market, the Vietnamese government issued Decree No. 60/2015/ND-CP, then Circular No.123/2015/TT-BTC, regulating foreign investment activities in the securities markets. Accordingly, foreign ownership in Vietnamese publicly listed companies has accelerated to meet international integration commitments and practices. As a result, the number of foreign investors has grown by 15% per year since 2015, higher than the 10% growth rate of investment accounts in the stock market. By the end of June 2020, the number of foreign investment accounts reached 33,000, accounting for 1.3% of the total number of investors on the stock market.

Information technology (IT) and databases have developed significantly. From a primitive IT infrastructure system, Vietnam has built a relatively complete IT infrastructure, ensuring safety and security for its securities markets. Early warning systems have been built to help improve the regulation and supervision of the capital markets to protect investors. In particular, the information disclosure system for publicly listed companies to report and publish electronic information has gradually replaced the paper-based one. Moreover, IT systems used for supervising market institutions such as the securities company management database system are becoming increasingly important tools over time. Currently, all market members report and publish information on the SSC's web portal using an IT system.

THE BOND MARKET

The government bond market officially began operations in 2009, bringing all bidding activities and government bonds trading to the Hanoi Stock Exchange. Over the past 11 years, the legal system for the government bond market has improved significantly. Furthermore, the government has introduced several market mechanisms aimed at improving the functioning of the domestic bond market.

First, the Vietnam State Treasury (VST) has introduced regular auctions, with auction dates announced for the entire year. Tenor selection has become more predictable, but tenors are announced only shortly before the auction, constraining investors from planning well in advance.

Second, the benchmark issuance programs implemented by the VST should help reduce debt portfolio fragmentation. Since early 2019, the VST has increased the target size of the benchmark bonds issuance and successfully achieved targets for 10- and 15-year bonds. The targeted outstanding volume of the benchmark bonds, which is currently approximately USD500 million, is expected to increase in the coming years to improve market liquidity and support portfolio consolidation. As of 31 December 2019, the capitalization of government bonds reached approximately VND1,770 trillion, or 29% of GDP (see **Figure 5**), having increased since 31 December 2012 by 3.7 times and 2 times, respectively.

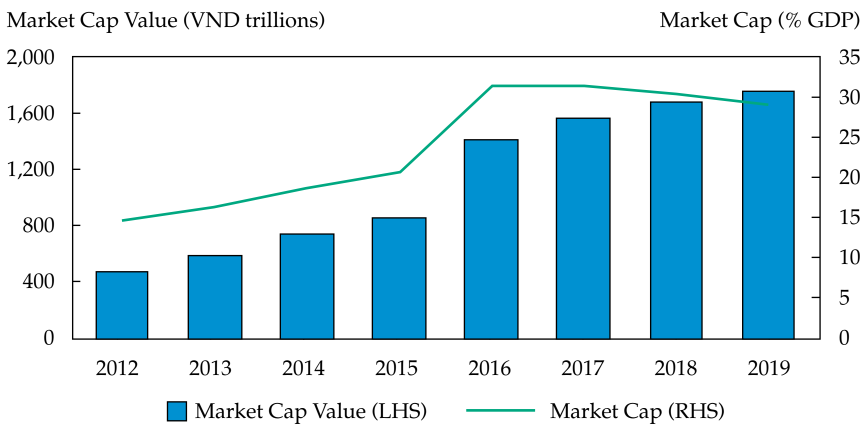
Before 2011, the government bond market only had products with tenors of less than one year up to 10 years. Now it has a full range, from short-term tenors to those of 20–30 years. As illustrated in **Figure 6**, government bonds with a maturity of five years or more account for approximately 70% of the total volume issued. In addition, one-lump-sum and flexible-interest payment bonds are available to meet investors' diverse needs. In July 2019, government bond futures were officially launched, providing investors with a tool to hedge risks and contributing to liquidity and market development.

The institutional investor structure has improved and become less concentrated, with decreased holding by commercial banks and increased holding and participation by other investors, as shown in **Table 1**. Specifically, the holding by commercial banks decreased from 84% in 2012 to 44% in 2019, while that by insurance companies and social security agencies increased from 2% and 12% in 2012 to 7% and 44% in 2019, respectively.

The government bond market liquidity has also improved, with the turnover ratio growing from 1 in 2013 to 1.2 in 2019.

Because of the improved primary market and market size, secondary market liquidity has also increased, with an average trading volume of approximately VND10 trillion per day in 2019 compared to VND1.67 trillion in 2013 and VND6.28 trillion in 2016.

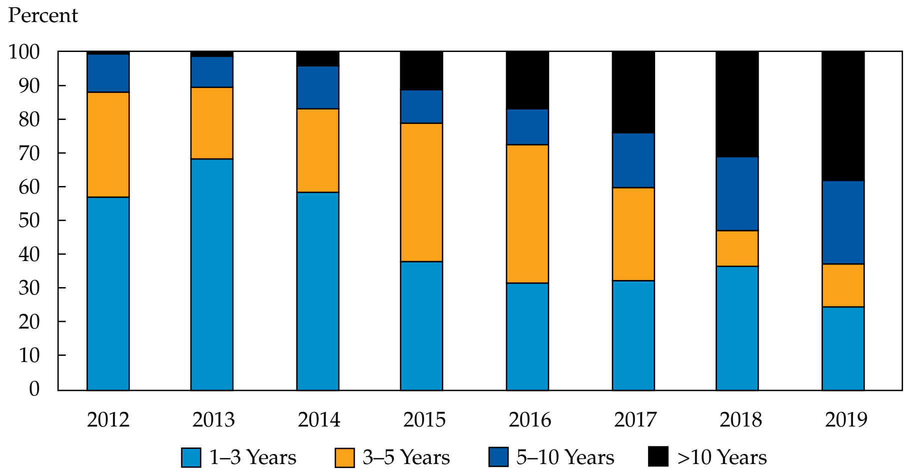
FIGURE 5. VIETNAM'S GOVERNMENT BOND MARKET (2012–2019)



Note: Government bond data collected and published since 2012.

Source: asianbondsonline.adb.org.

FIGURE 6. VIETNAM GOVERNMENT BONDS MATURITY PROFILE: LOCAL CURRENCY



Source: asianbondsonline.adb.org.

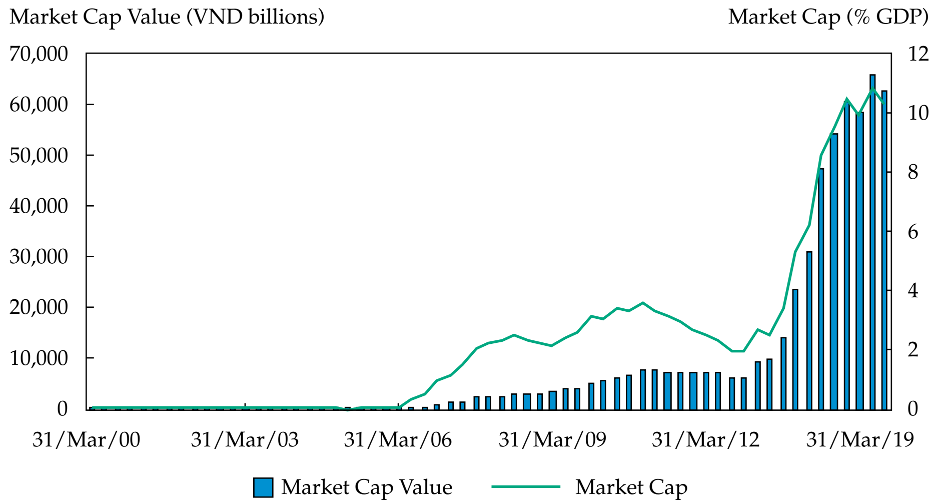
On the other hand, the corporate bond market, despite having commenced operation in 2000, has developed only recently, especially since 2015, and, as shown in **Figure 7**, has seen a boom since 2018, after the regulations on issuing corporate bonds were loosened (Decree No. 163/2018/ND-CP on 12 April 2018). As of June 2020, the market capitalization was VND700 trillion, 11.4% of GDP, which was more than double the 4.1% of GDP seen in 2011. The total value of corporate bonds issued during 2018–2019 was VND570.35 trillion, a majority (94%) of which was through private placement, given the lighter regulations.

TABLE 1. INSTITUTIONAL INVESTORS IN VIETNAM GOVERNMENT BONDS (%)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Banks	84%	80%	80%	77%	56%	53%	48%	44%	45%
Insurance Companies	2	3	5	8	6	7	7	7	7
Social Security Fund	12	9	8	7	34	36	41	44	44
Deposit Insurance of VN	0	3	3	4	3	3	3	3	3
Securities Companies	0	0	0	0	0	0	0	0	0
Investment Funds	0	0	0	1	0	0	0	0	0
Offshore	1	1	1	0	1	1	1	1	1
Others	0	3	3	3	1	1	1	1	1

Source: asianbondsonline.adb.org.

FIGURE 7. SIZE OF VIETNAM'S CORPORATE BOND MARKET



Source: asianbondsonline.adb.org.

The term structure has also been broadened, ranging from one to 15 years. The most popular maturities are two, three, and five years; the average maturity of bonds issued in 2019 was 4.1 years. Most bonds pay coupons periodically, with floating rates based on the one-year deposit rate of state-owned commercial banks. However, since 2019, some companies have issued bonds with high coupon rates (12%–15% per annum) to attract private investors through private placements, raising concerns over risks for retail investors. As a result, Decree No. 81/2020/ND-CP, which was intended to make the corporate bond market more transparent and sound, was issued and become effective as of 1 September 2020. The secondary market for corporate bonds is still limited and not very liquid. Most primary investors buy and hold the bonds until maturity.

Starting in 2021, the bond market will be regulated by the revised Securities Law 2019 and Corporate Law 2020 (both going into effect on 1 January). The market will be more professional to match the international practices that require issuers to satisfy higher standards of information disclosure, issue and private investor limits, and so on. The new regulations also encourage the establishment of local credit-rating firms to better support the growing bond market. The plan to integrate the two stock exchanges into a national one and to upgrade market infrastructure will facilitate a broad-based improvement in the efficiency of trading, clearing, and settlement mechanisms, making the securities markets more transparent and effective.

Although the bond market in Vietnam has been growing quickly, it is still relatively small compared to those of its regional peers.

THE FUND MANAGEMENT INDUSTRY

As of June 2020, 48 fund management companies were operating in Vietnam, with registered capital of VND4 trillion (according to the SSC). Total net asset value of all funds at the end of 2019 was VND32.6 trillion, an increase of 45%

year over year and of 320% versus 2016. Total assets under management was VND312 trillion, an increase of 20% year over year and of 200% versus 2016. The impressive growth in this sector has been attributed to foreign investors, led by Korean funds.

However, the performance of these fund management companies in Vietnam has not been impressive. According to the SSC, only 10 out of 48 companies (20%) are profitable and have growth. Most of the remaining are recording losses as high as 50% of registered capital, 19 out of 48 companies (40%) have never managed any funds because they are unable to attract capital, and four companies have not managed any portfolio.

THE FINANCIAL DERIVATIVES MARKET

Vietnam's financial derivatives market started official operation on 10 August 2017. Initially, it had only three main products: VN30 Index futures, five-year government bond futures, and CWs. The VN30 stock futures are considered a success, satisfying investors' risk management and investment needs.

As of June 2020, 59 million VN30 futures contracts had been traded on the market. In the first half of 2020, the average trading volume was 165,479 contracts per day, an increase of 86.48% over the 2019 average and 15 times the 2017 average. The five-year government bond futures contracts began trading in July 2019, and 278 contracts have been traded to date. In addition, CWs began trading in 2019. Currently, 134 CWs are traded in the market, compared to just 10 CWs when the market started. The total volume traded as of August 2020 was 990 million CWs, with a value of VND1.48 trillion.

OPPORTUNITIES AND CHALLENGES

The capital markets in Vietnam have become important capital mobilizing and investment channels for Vietnamese firms and investors (both foreign and domestic). Ample opportunities are available for them to develop in the future.

First, the legal framework for the capital markets should be improved. The Securities Law, Corporate Law, and Investment Law (revised in 2020) went into effect on 1 January 2021, creating a standardized framework for developing the capital markets sustainably. In addition, the country's financial inclusion strategy issued in January 2020 has affirmed the government's commitment to develop both the depth and width of the financial markets.

Second, more financial products and services are being introduced, creating more investment, capital raising, and hedging instruments for market participants and investors. Green bonds and stocks as well as hedging and digital financial products will be provided as options for investors.

Third, banking is one of the eight areas prioritized for developing digitalization in the national digital transformation program issued in June 2020. Therefore, digital financial services are expected to boom in the near future, given such trends as peer-to-peer lending, crowdfunding, and digital stocks and bonds, which are all growing quickly and their legal frameworks are established.

Fourth, Vietnam has been making a great effort to get upgraded from Frontier Markets to Emerging Markets in the MSCI and FTSE Russell classifications, so that its securities market could be upgraded by 2023. The upgrade will enable Vietnam to attract more foreign investments, especially portfolios.

Fifth, Vietnam's economy is forecast to have bright prospects for early recovery from the impact of the COVID-19 pandemic and continued strong growth during 2021–2030. Under the country's plan, the GDP annual growth rate should be 6.5%–7%.

Sixth, because of the trade and technological tensions between economic powers as well as the impact of COVID-19, Vietnam is considered one of the bright spots for shifting investments and production chains. Importantly, the Vietnamese government has committed to further improving the business-investment environment as an important measure to attracting more investment (both foreign and domestic).

Finally, the government has also committed to continuing equitization and divestment of SOEs, as well as to improving corporate governance, transparency, IT, and infrastructure for developing the capital markets. The market is also expected to continue its strong growth momentum because of the needs of recapitalizing banks and of financing SOEs and other important infrastructure projects.

However, various challenges also exist. First, the size of Vietnam's stock and bond markets is still small in comparison with those of its peers in the region. This implies a lot of potential for development but also low liquidity and a limited product range, narrowing opportunities for firms to raise capital and investors to invest or hedge.

Second, a limited range of products and services also makes the market less attractive, especially for professional investors and foreign institutional investors.

Third, the investor base is quite limited. Only approximately 3% of the population is active in the stock market; this is low compared to the relative percentages in other countries in the region. Besides, most investors (more than 90%) are individual, and far fewer are institutional. Individual investors normally lack professional knowledge, which might lead to higher volatility.

Fourth, policy coordination is still weak, especially with respect to managing systemic risks in the financial markets. Given that the size of the financial system's assets is approximately 300% of GDP, the country really must develop institutions and tools to manage such systemic risks.

Finally, such fundamentals as institutions, high-quality human resources, financial infrastructure, IT, big data, transparency, and disclosure need to be further improved so that Vietnam's securities market can be upgraded to the Emerging Markets classification and develop sustainably.

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