

**INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS**



**REPORT OF THE DEVELOPMENT COMMITTEE  
ON  
INCENTIVES FOR MARKET DEVELOPMENT**

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## SUMMARY OF RETURNS FROM BRAZIL, ISRAEL, MEXICO, NIGERIA, AND SOUTH KOREA

### **Introduction:**

At the 1991 Annual Meeting of the International Organization of Securities Commissions (IOSCO) in Washington D.C, U.S.A, six countries, Brazil, Mexico, Malaysia, Nigeria, South Korea and Turkey were selected for case study on incentives for market development. The choice of these countries was motivated by the fact that while most of them at one time or the other introduced market incentives which enhanced the growth of their capital markets, others are currently introducing economic reform programmes which have one way or the other also stimulated their securities market. The essence of the case study was to bring to focus the environment under which the incentives were introduced and how successful they were. It is believed that the result of such study could assist other markets in initiating similar policies in their respective countries. A questionnaire was to be drafted (a copy of which is herewith attached) for circulation to the six chosen countries. This was done by Nigeria, the co-ordinating country. The draft report which analyzed submissions from Mexico, Nigeria and South Korea was presented by Nigeria at the Development Committee meeting in Taipei, Taiwan in May, 1992 during which Indonesia, Israel and Trinidad and Tobago requested to be included in the case study. Thus the number of countries for the case study was enlarged to nine, as no objection was raised on the request of the three countries. A deadline of 30th June, 1992 was fixed for the despatch of completed questionnaire to the co-ordinating country.

Unfortunately, as at the time of writing, only Israel (of the three new additions) had responded to the questionnaire despite efforts to get the others to reply. Of the original six countries in the study, no response was received from Malaysia and Turkey in spite of appeals to both countries at the Taipei meeting and follow-up thereafter to respond. It was observed during the Taipei meeting that the non-response of Malaysia resulted from the multiplicity of regulatory function by various governmental bodies. Nonetheless, the Malaysian delegate at the meeting promised to send in duly completed questionnaire to the co-ordinating country in due course.

During the Taipei meeting, Brazil and South Korea were requested to make another submission which would be strictly based on the questionnaire. In other words, answers should be given to each questions rather than the write-ups on their economies and securities markets which were earlier submitted. Both countries have accordingly

complied. This report therefore covers answers as provided by the five countries which made returns to the co-ordinating country. The policy similarities and dissimilarities are consequently identified while the five countries submissions are attached.

### Similarities:

The importance of proper regulatory framework to capital market development was clearly revealed by all respondents.

Brazil, Mexico and Nigeria have quite similar economic environment under which incentives were introduced. For instance, packages of economic and financial market reforms were initiated to enhance competition, efficiency and economic growth. Key elements in the reforms included the gradual deregulation of the economies, specifically, interest rates and external trade were deregulated while some state-owned enterprises were privatized. All the five countries have embarked on privatization programmes and liberalization of securities markets. Nigeria additionally, liberalized its foreign exchange market. Incidentally, Brazil, Israel, Mexico and Nigeria have strengthened their financial market regulations by inter alia enacting new banking laws.

Brazil, Nigeria, Mexico and South Korea have also enjoyed relative political stability and from their experience this has aided the implementation of the reform programmes. In Brazil, Israel, Mexico and Nigeria public enlightenment of the populace about the capital market has been a joint responsibility of regulators (i.e. the Securities Commissions and the Stock Exchanges) and market operators. The provision of regular market information as well as organization of seminars and conferences were identified by these countries as important public enlightenment mechanism.

In Brazil and Mexico, the Securities and Exchange Commission (SEC) have technical assistance agreements with some institutions in the country. This is seen as one of the strategies of public enlightenment. By contrast, Nigeria and Israel currently have no such arrangement albeit, Nigeria has plans to visit higher educational institutions in the country in the near future for public enlightenment purposes. Nigeria has also embarked on radio and television programmes and produced a video on the capital market to be used as a teaching aid in institutions of higher learning and also to educate the general public.

The objective of the introducing incentives were not too different in Brazil, Mexico and Nigeria. There was the general desire to improve the efficiency, regulatory environment, participation, confidence as well as increase in supply of securities in the capital market. There was also the need to strengthen the flow of savings into productive investment in all the five countries. Some of the incentives such as privatization in Nigeria for instance, were not primarily directed at stimulating the capital market but ended-up having significant impact on its growth.

It was also observed that though different types of incentives were introduced in the five countries, these incentives were introduced over a period of time. In effect to achieve desired results, it might be wise for countries to adopt a policy of gradual introduction of incentives. All the incentives introduced by the five countries were said to have yield the desired results and positively impacted on the capital markets and the economies. The attitude of entrepreneurs is changing in all the five countries towards seeking quotation and sourcing funds from the market as a result of the various reform programmes and incentives which have been put in place.

### **Dissimilarities:**

The economic, political and cultural environments during which Israel and South Korea introduced policy measures were quite different from those which prevailed in Brazil, Mexico and Nigeria. While Brazil, Mexico and Nigeria were faced with debt crisis and structural imbalances, incentives were introduced in South Korea with the aim of attracting foreign capital as the then agricultural based economy could not generate sufficient domestic savings to finance its economic plan. Israel on the other hand, was faced inter alia with a collapsed securities market caused by "speculative bubble".

Korea adopted more mandatory policy measures through enactment of securities laws which were aimed at forcing private companies to go public. Various preferential tax policies were introduced, reviewed and later rescinded after achieving desired objectives. Also, discriminatory bank credit policy in favour of public companies was adopted in Korea. Mexico and Nigeria on the other hand have used more persuasive measures through the use of public enlightenment programmes, while Israel employed effective regulation to restore confidence in its securities market and consequently enhanced its growth.

The major dissimilarity was in the type of incentives introduced which are quite different in the five countries. Brazil, Mexico and South Korea tended to have put in place more far-reaching incentives than Israel and Nigeria have done (See attached returns)

**The Development Committee of IOSCO would very much like to share your experiences and therefore, request that you supply us with comprehensive information on the following:**

1. The economic, political and cultural environment during which the policy measures were introduced. Please state in details the monetary, fiscal and other policy measures in place before and during the introduction of the incentives.
2. What was the general attitude of the populace towards securities market investment before and after the introduction of the policy measures?
3. What forms of public enlightenment programme did you introduce to increase awareness of the securities market?
4. What was the attitude of entrepreneurs towards seeking quotation on, or borrowing from the stock market?
5. What prompted the introduction of incentives and what were the objectives for introducing them?
6. List in detail the types of incentives that were introduced.
7. Were the incentives introduced gradually or all at once? Please indicate the process and time sequence.
8. What impact did the incentives have on:
  - (i) the securities market; and
  - ii) the economy of your country.
9. Did all the incentives yield the desired results?  
If any was not successful, what led to its failure?
10. Do you have any advice for countries that may wish to introduce any of the incentives you applied in your market?







THE BRAZILIAN EXPERIENCE WITH POLICIES  
FOR STIMULATION OF SECURITIES MARKET DEVELOPMENT

1. - The economic, political and cultural environment during which the policy measures were introduced. Please state in details the monetary, fiscal and other policies measures in place before and during the introduction of incentives.

After rapid growth from the late 60's to the early 80's, the Brazilian economy spent a decade in near stagnation, with per capita income in 1990 equal to that of 1980.

As is widely known, external savings were an important factor in financing economic expansion until 1982, when the inflow of offshore capital ceased.

Since then, funds needed to finance investments have been supplied mainly by domestic savings. The domestic financial system has functioned basically as a means of transferring private sector savings to the public sector, in order to meet the government's funding needs.

The uncontrolled growth of the public deficit and the escalation in the rate of inflation meant that the economy could no longer be financed in this manner, leading by the late 80's to the need for a change.

The scenario encountered by the Collor Administration in March 1990 was marked by economic stagnation with spiraling inflation and marked deterioration of public finances. The incoming administration set up an unprecedented economic stabilization plan consisting of extremely strict, far-reaching measures designed to deal directly with the problems of the Brazilian economy.

The Economic Stabilization Plan dealt with:

- public finances, by means of a tax reform;
- measures aiming at controlling prices and wages;
- property reform, consisting mainly of the privatization of state companies;
- administrative reform;
- monetary reform.



The plan also contained a program for deregulation and gradual opening up of the economy. The industrial and foreign trade policies that were introduced by the Collor Administration seek to integrate Brazil into the international market economy.

Based on history, the great challenge for Brazil at the beginning of this decade is to revert the situation of relative stagnation with high inflation by means of a new growth model, which permits competitive integration of the Brazilian economy into the advanced capitalist world. In other words, a new form of financing must be found to allow reactivation of economic growth. Brazil must modernize its economic institutions, privatize its state companies, and pursue a healthy market economy.

2. - What was the general attitude of the population towards securities market investment before and after the introduction of policy measures?

The flow of savings to the stock market has historically been low, with a tendency to fall further since 1987. The market value of the stocks quoted in the stock exchanges was US\$ 17.6 billion in October 1990. Consequently, the market values of stocks were well below their net asset values, discouraging companies from issuing stocks.

With measures to strengthen and to deregulate the market, the Master Plan for the Brazilian Stock Market set the stage for the introduction of new market instruments and participants.

An important role in this process has been played by portfolios held in Brazil by foreign institutional investors.

Since May 1991, CVM has authorized more than 100 of these portfolios with US\$ 1.3 billion in investments.

3. - What form of public enlightenment program did you introduce to increase awareness of the securities market?

In 1991, CVM launched its Master Plan for the Brazilian Stock Market, which was the fruit of extensive debate with various specialists and institutions operating on the market as stock exchanges and broker-dealers, with conferences being held in different parts of the country.

In addition, CVM has participated in meetings around the country organized by different business associations to inform about the new instruments available on the market.



4.- What was the attitude of entrepreneurs toward seeking quotations on, or borrowing from, the stock market?

Data from the country's national accounts shows issues of stocks and bonds at an annual average of 2.5% of domestic savings in the 1977/1989 period, with a peak of 5.1% in 1982, falling to 2.0% in 1989.

Between December 1986 and December 1990, the number of companies listed fell from 1020 to 912.

The value traded on Brazilian stock exchanges was extremely low in 1990, with a daily average down from CR\$ 14.2 billion in 1989 to CR\$ 2.9 billion in 1990.

5. - What promoted the introduction of incentives and what were the objectives for introducing them?

The reactivation of the stock market would be important principally as an alternative to the debt model (internal and external) that has guided the Brazilian economy since the late 1960's.

Apart from this, the stock market is not simply a means of raising capital for companies. It is also the best known means of democratizing the country's capital and profit opportunities, with a positive effect on income distribution, in accordance with the real philosophy of participatory capitalism. Also, the development of the stock market is a decisive factor in the success of Brazil's privatization program, as is shown by the experience of other countries with successful privatization programs.

Thus, in a context of a stabilization program and a medium and long-term project for restructuring the economy in accordance with the principles of free enterprise in a search for efficiency, quality and a better distribution of income and opportunities, a fully-developed stock market is indispensable.

6. - List in details the type of incentives that were introduced.

#### DEREGULATION

- Brokers already qualified by the Central Bank need not register at CVM;

- Relaxation of restrictions on brokerage commissions charged on stock exchange transactions;



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- Revision and simplification of procedures for companies going public, while protecting minority shareholders' interests; and

- Transfer of regulatory responsibility for mutual share funds to CVM.

#### MEASURES TO STIMULATE MARKET

- Permit "shelf registration", that is, approve share issues in advance while allowing the price and other significant factors to be determined at the last moment in order to maintain the real value of primary placements of shares in an inflationary scenario;

- Admit nonshareholding partners to the stock exchanges upon payment of fees, but without needing to buy a share in the stock exchange in order to facilitate access of new brokers to stock exchanges;

- Encourage inflow of external savings through mutual share funds, share portfolios held directly by foreign institutional investors, and sale of depositary receipts of shares issued by Brazilian companies in order to increase the flow of resources to the stock market; and

- Make more flexible rules for the creation of new types of mutual funds, such as: real estate funds, diversified portfolio funds, and sectorial funds in order to broaden the range of market instruments.

7. - Were incentives introduced gradually or all at once? Please indicate the process and time sequence if the incentives are being introduced gradually.

The Brazilian Capital Market Master Plan divided the incentives into three types, according to the term of implementation.

The incentives listed in question 6 are short-term ones.

As examples of medium-term (up to 2 years) incentives, we could cite:

- Restructure the CVM, with emphasis on its supervisory function, and reaffirm its responsibilities, including the transfer of surveillance of futures markets to CVM in order to improve stock market relations and supervision thereof;



- Increase penalties imposed on transgressors and give CVM further legal powers, such as the end of bank secrecy in investigations already under way in order to discourage irregular practices and increase effectiveness of investigations.

As examples of long-term (up to 4 years) incentives, we could cite:

- Opening up of the market to foreign investments so as to allow for a free flow of capital and investments, and to include greater freedom for brokers and other foreign financial institutions, in accordance with the principle of reciprocity in order to increase capital mobility; and

- Creation of a specific court for trying financial and stock market issues in order to increase investors' trust and credibility, and consequent market development.

8. - What impact did the incentives have on:

(a) the securities market:

In the first five months of this year stock issues grew 502.8% in real terms as compared with the same period in 1991.

The market value of the stocks listed on the stock exchanges (which was US\$ 17.6 billion in October 1990) reached nearly US\$ 70.0 billion.

In May 1992 the average daily volume traded on the São Paulo Stock Exchange reached US\$ 110 million while the same figure was, approximately, US\$ 30 million in 1991.

(b) the economy of your country:

The improvement of the securities market has been reflected by the success of the privatization process, which by late May 1992 concluded the sale of 10 state-owned companies, with proceeds of some US\$ 2.9 billion.

9. - Did all the incentives yield the desired result? If any was not successful, what led to its failure?

In general, the results of implementation of incentives have yielded positive results. It should be mentioned that we are still in the process of determining the results of many of these measures. It should also be noted that while some of the policies had immediate impact on the capital market, such as the flexibilization of the rules for foreign investors in stock exchanges, it took some time for others, such as improvements in the regulatory body, to be felt on the market.



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10 - Do you have any advice for countries that may wish to introduce any of the incentives you applied in your country?

Yes. We think that a slow-but-steady policy yields the best results. Many countries with emerging capital markets have adopted this strategy with good results, such as Brazil, Mexico and Korea.



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## BRAZIL

1. - Although it has been under study for some time, a two-tier market has not yet been introduced in Brazil.

2. - The unification of stock exchanges is currently under study. Both the Rio de Janeiro and São Paulo stock exchanges, however, have automatized trading systems that may also be used by the members of other exchanges.

3. - The over-the-counter market has existed in Brazil for a considerable time. It has not yet been organized, however, and has no self-regulatory body nor computerized trading system.

CVM Ruling No. 93, published in December 1988, authorizes and regulates the organization of OTC regulatory associations, but to date none have been registered.

4. - Venture capital companies exist and are regulated by National Monetary Council Resolution No. 1184 of 1986.

5. - Open-end mutual funds, organized as condominiums, have existed in Brazil since 1965.

6. - Brazil also has closed end investment companies, the so-called foreign capital investment companies created by Decree-law No. 1401 of 1975. Some of these companies are still in existence under National Monetary Council Resolution No. 1289 of 1987. Sectorial closed end funds were regulated by CVM Ruling 149/91, but none have been registered to date.

7. - There are several other types of collective investment funds in Brazil:

- pension funds (open and closed)
- investment clubs
- collective retirement plans, known as PAIT (Worker Individual Retirement Plan), etc.

8. - Margin loans operate under CVM Ruling 51 of 1986.

9. - There are no other investment support loans. Brokerage houses are actually forbidden to finance their clients in any way other than margin loans. Banks are not barred from making loans for investment on the securities market but no special provision has been made, and such loans would not be treated differently from ordinary loans.

10. - There are three types of market information dissemination systems in Brazil:

- (a) stock market price indices. The São Paulo Stock Exchange Index (IBOVESPA) has been established since 1968, and that of the Rio de Janeiro stock exchange since 1971. The methodology of the latter has been available since January 2, 1984;
- (b) daily, monthly and annual bulletins have been compulsory on all stock exchanges since 1966;
- (c) on-line information from the Rio de Janeiro, São Paulo and Minas Gerais stock exchanges is available.

11. -(a) The surveillance system and infrastructural facilities are efficient and adequate in Brazil. Financial institutions are also efficient and diverse, while institutional investors are active players on the market.

- (b) Direct transaction costs are low, ranging from a maximum of 2% on smaller transactions to 0.5% on the larger ones.

Indirect costs are now higher because of the recent imposition of taxes on capital gains.

- (c) The same occurs with the cost of raising capital.

Direct registration and intermediation costs are low.

Indirect costs, however, are considered high, and sometimes include index pricing of new issues, in addition to the costs involved in disclosure.

- (d) Financial instruments available on the securities market are shares, bonds, commercial paper put and call options (the market for the latter being considerably less active); forward and future contracts on individual stock index futures and options on index futures have been introduced, but their market is currently inactive.

12. -(a) Tax withholding on dividends has not been abolished.

- (b) Capital gains taxes, which did not exist, have been imposed as at January 1, 1991.

- (c) Cheap credit policy directed at preferred sectors has been abolished.





13. - There are no tax incentives for companies to go public in Brazil. No percentage of distributed dividends may be deducted from corporate tax. The costs of going public and issuing new stock, however, are fully deductible as company expenses.

14. -(a) Foreign investors may participate in Brazilian markets through foreign capital investment companies (closed end). Foreign capital investment funds (open end) and country funds (investment companies incorporated abroad, the purpose of which is to invest on the Brazilian market), if they are qualified investors as defined in CVM Ruling 169/92, can establish a securities portfolio directly in Brazil.

(b) Domestic companies are neither forbidden to issue stocks abroad nor be listed on foreign markets, but to date only a very few have done so, and without much result. A recent regulation of the National Monetary Council (No. 1927/92) provides for the investment of foreign capital in the stock of Brazilian companies by means of Depositary Receipts issued abroad. To date only one company (Aracruz) has raised money on a foreign market by means of this new instrument.

(c) Foreign capital applied in Brazil by investment or in funds is no longer required to remain here for a specific minimum period.

(d) There is a debt conversion program in connection with which several auctions were held in 1988, but they have been suspended since early 1989. A privatization program was established in 1990, and ten companies have been privatized by auction on the stock exchange.

15. - The debt conversion program has not caused any impact on promotion of the capital market. To date, the financial results of the privatization program have attained US\$ 2,7 billion, with two companies going public.

16. - Auditing and disclosure requirements regarding Brazilian companies, intermediaries and the market are of comparable quality to those of any developed market.

17. - The Brazilian Securities Commission (Comissão de Valores Mobiliários - CVM) is in charge of regulating, surveying and developing the market for companies issuing securities and those of futures and option contracts having such securities as their underlying assets. All such markets are subject to the Commission's prior authorization before going into operation.



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In order to be authorized to sell their securities to the public, companies must be registered with the Commission and meet a number of registration requirements which include full disclosure and independent auditing of their accounts. All intermediaries must also be registered with both the Central Bank and the Commission, and are subject to auditing by both agencies. Stock exchange members are also under the surveillance of the stock exchange. The use of insider information is prohibited, and subject to a number of penalties.

All this makes for a legal and regulatory framework of comparable level to that of the more developed markets.

I S R A E L   S E C U R I T I E S   A U T H O R I T Y

I O S C O

International Organization of Securities Commissions

Development Committee

Working Group on Market Incentives

The Israeli Experience

on

Market Incentives

June 1992



1. THE ECONOMIC, POLITICAL AND CULTURAL ENVIRONMENT DURING WHICH THE POLICY MEASURES WERE INTRODUCED. PLEASE STATE IN DETAILS THE MONETARY, FISCAL AND OTHER POLICY MEASURES THAT WERE TAKING PLACE BEFORE AND DURING THE INTRODUCTION OF THE INCENTIVES

At the beginning of 1983, the securities market collapsed. Within a few days, shares lost a significant portion of their value, and by the end of that same year they had lost up to 80% of their worth. Some argue that the cause of this decline was a speculative market bubble, similar to that of the 1929 stock market crash in America. At its root was the activity of the commercial banks, which for many years, supported their own share prices, despite losses. As a result of this support, bank shares were considered a liquid asset with little attendant risk. The share crisis in the beginning of 1983 and the expectation of a currency devaluation towards the end of 1983 induced many investors to dump their bank shares. The banks, on their part, were unable to support their share prices. In order to prevent a devastating crisis that threatened to engulf the entire capital market, the Israeli government intervened and acquired bank shares, intending to hold them for a few years during which they would be sold back to the public.

The collapse of the share market at the beginning of the year, and the crash of the bank shares at the end of the year, created a crisis of confidence that was felt long thereafter and whose repercussions are prevalent to this day. Research reports have shown that this crisis of confidence can be noted in the public's attitude to risk factors and as such the public's hesitancy to invest in risky assets such as shares, particularly, given the long-term economic recession and political instability in the proceeding years of 1983. During these years, inflation climbed to an annual rate of higher than 400%. The inflationary whirlpool, coupled with the economic recession, induced the Israeli government to propose a reform of the capital market, whose essence lies in lessening government involvement in the capital market.

It was proposed: 1) to curtail the issuance of designated debentures to retirement, pension and education funds and to set the conditions which would allow the private sector to compete effectively with the government in the debenture market; 2) to stabilize the exchange rates; 3) to reduce inflation; 4) to lessen the linkage of salaries to price index; 5) to create a legal framework which would allow market forces to work efficiently and competitively; 6) to reduce the possibility of conflicts of interests between commercial banks and their customers and between interested parties and shareholders in public corporations; 7) to privatize enterprises owned by the government.

In 1986, a public committee of inquiry presented its conclusions concerning the events that led to the bank share crisis of 1983. Premised upon the assumption that the structure of the capital market prior to 1983 lay at the heart of the capital market crisis, another public committee suggested ways in which to apply the committee of inquiry's recommendations:

-- To separate commercial banking activities from the bank's activities in the securities market such as dealers, brokers, investment advisers, underwriters, and management of mutual and retirement funds.

-- To provide the Securities Authority with a more meaningful role in the capital market with a guiding principal of full disclosure. Full disclosure would find expression in the preparation of prospectuses containing all the information required by investors, and in the improvement of the quality of the information provided in periodic and immediate reports to the Authority.

-- To increase the punishment assessed on those who make use of inside information.

-- To equalize the voting rights of the various classes of shares issued by the same corporation.

Implementation of these recommendations was assigned to the Finance Ministry, the Securities Authority, and the Tel-Aviv Stock

Exchange. The Finance Ministry and the Securities Authority responded in 1987 and in subsequent years with a number of amendments to the Securities Law, most of which derive from the lessons learned from the 1983 crisis.

Beginning in 1986, the monetary measures taken by the central Bank of Israel and the fiscal policy adopted by the Finance Ministry, brought the three-digit annual inflation down to a level under 20%, and resulted in relative economic stability. Beginning in 1987, there was a reawakening in the secondary market followed by a revival of the primary market. Since that time the number of companies who listed their shares in the stock exchange doubled, and institutional investors demonstrated increasing interest in the securities market; the preliminary economic conditions were created to allow for fair competition between the government and the private sector. In the securities market, there were encouraging signs that the public's attitude towards investing in risky assets is changing and the crisis of confidence which had prevailed since 1983 had blown over. These changes can be attributed, to a large extent, to the amendments to the Securities Law that were initiated by the Finance Ministry and the Securities Authority, and as a result of additional steps taken by the Securities Authority and the Tel-Aviv Stock Exchange that contributed to fair and orderly trading on the securities markets. The brisk activity of the capital market brought about an increased number of offerings and significant positive returns to share holders. The stock index rose in 1990 by 15%, in 1991 by 55%, and in the first half of 1992 by 32%.

## 2. WHAT WAS THE GENERAL ATTITUDE OF POPULACE TOWARDS SECURITIES MARKET INVESTMENT BEFORE AND AFTER THE INTRODUCTION OF THE POLICY MEASURES?

The 1983 collapse of Israel's financial markets, as was previously noted, shares some similarities to the great American stock crash of 1929. Until 1983, a large segment of the population of investors, many of them non-professionals, did not understand the risks entailed in investing in shares traded at the exchange. The manipulation of bank shares contributed to this misunderstanding. In this period, institutional investors were virtually inactive in the share market. Retirement, pension and education funds, for example, invested only negligible portion

of their portfolios in equity. The enormous losses suffered by investors precipitated a profound crisis of confidence that kept them away from the capital market for years to come. Six years after the crisis, the value of capital listed on the exchange was approximately half the record value attained one month before the collapse. Researchers found that potential investors refrained from making risky investments, particularly in the share market.

The unwillingness to accept the risks was the result of the stock-market crisis, difficult economic situation, high rate of inflation, and the prevailing political instability. Only in 1987, two years after the economic reforms were unveiled, the rate of inflation declined and the relative economic stability returned, were there signs of revitalization. The market for new offerings revived, and share prices rose. With the exception of temporary setbacks relating to: the worldwide share crisis at the end of 1987, the Gulf Crisis in 1990, and other local incidents, this upward trend has continued until today. This renewed investor confidence is a product of intensive activity by the Finance Ministry, the Securities Authority and the Tel-Aviv Exchange in regulating the stock market, taking the appropriate measures to implement the economic reforms and securities amendments, supervision of fair and orderly trading at the exchange, in reduced intervention of the government in the capital market, and in an increase of institutional investors involvement in the securities market.

The amendments to the Securities Law included: rules which would allow trading with modern computerized facilities, reevaluation of listing requirements, and of Exchange bylaws. At the same time, the Securities Authority instituted thorough probing examinations of prospectuses, active enforcement of the Securities Law, and other measures noted below. At present, the market capitalization is 13 billion dollars, 2.5 times its value at the end of 1983. The number of listed companies has almost doubled over the past five years. Institutional investors have increased their stake in the capital market while private investors have reduced their position, in line with the global trend characterized by individuals investing their money in the capital market by way of mutual funds, portfolio managers, and retirement, pension and education funds.



### 3. WHAT FORMS OF ENLIGHTENMENT PROGRAMS WERE INTRODUCED TO INCREASE AWARENESS OF THE SECURITIES MARKET?

No specific program has been offered to encourage awareness and to foster the desire of investors to participate in the securities market. The approach has been to reform the capital market, allowing market forces to propel the market by increasing the competition between the government and the private sector, and by limiting the involvement of the banks in the securities market when there exists a conflict of interests between the banks and their customers. The intention was to instill confidence in the securities market by amending the law so as to allow for more comprehensive examinations pertaining to full disclosure, expanded enforcement activity, a revision of the Exchange bylaws, including rules for listing and trading, thorough reviews of prospectuses, periodic reports, immediate reports of interested parties, and so on.

To promote the foregoing, the Securities Authority publishes a quarterly bulletin that provides all the information concerning offerings on the primary market, and all changes in the requirements relating to corporations whose shares are traded on the Exchange and to investors. The Securities Authority makes certain that participants in the market are made aware of all relevant developments in the capital market. In addition, the Securities Authority often arranges conferences on topics that concern the capital market, thus bringing to the attention of the public all such developments. In certain instances, these conferences with various representatives from the capital market provide the basis for legislation. These conferences concern economic research, recommendations of the Securities Authority regarding accounting standards, and the work of public committees appointed by the chairman of the Securities Authority. Examples include conferences concerning: the question of equalizing share voting rights on the basis of economic research; a recommendation concerning the reporting of earnings per share; a public committee dealing with the possibilities of raising venture capital through the Exchange; a discussion paper on the exercise of voting rights

by institutional investors.

At the same time, the Tel-Aviv Stock Exchange publishes a monthly report which contains fundamental statistics of the secondary market. The monthly report also includes economic research intended to provide additional information to issuers and investors. The Exchange promotes conferences and courses intended to enlighten potential investors. For example, as a result of a plan to begin option trading at the end of 1992, the Exchange initiated a course on the subject of trading options and future contracts whose goal is to introduce to the potential investors, these new financial instruments, and to explain their advantages to the capital market as a whole, and to the potential investors in particular. In addition, the Exchange publishes daily all the figures and information of securities trading, including security prices, surplus in demand or supply, transactions that take place outside of the Exchange. The Exchange also publishes each quarter additional information including trading volume, statistical data on stocks and bonds trading and the decisions and directives presented by the Exchange board of directors.

#### **4. WHAT WAS THE ATTITUDE OF ENTREPRENEURS TOWARDS SEEKING QUATATION ON, OR BORROWING FROM THE STOCK MARKET?**

The attitude of entrepreneurs to raising capital in the securities market was influenced by the stability of the market and the interest of investors in the securities market. In the years preceding the stock market crisis of 1983, it was possible to find companies in dire economic straits that were raising funds in the capital market because they had difficulties raising any capital from other sources, not to mention low cost capital. From 1983 until 1985, there was hardly any activity in the primary market, principally because of the crisis of confidence in the securities markets and government issuance of designated debentures whose favorable terms prevented companies in the private sector from competing for available funds. In 1985, as a result of reforms in the capital market that increased competition between the government and the private sector and limited the issuance of designated debentures, there occurred a reawakening in the primary and secondary markets towards the end of 1986.

The revival of the primary and secondary markets can be attributed to a number of factors. First, the decline of inflation promotes the feeling of relative economic stability. Second, there are signs that the crisis in confidence has subsided. Third, the Stock Exchange's adoption of trading rules has led to a less volatile market. Fourth, the Stock Exchange has established an "Alternate List" intended for high risk issuances of small companies. Fifth, the absence of liquid short-term instruments, yielding positive real returns, encourages investors to look for alternative investments in the securities market. Last and most important, the active participation of the public in the stock market, in particular institutional investors, causes stocks to rise and thus lowers the issuing price (the cost of raising capital). For these reasons and as a result the initiatives of the Israel Securities Authority and the Stock Exchange, the number of listed companies is rising. The total number of offerings from the beginning of 1987 is about 500 of which about 100 are initial public offerings.

#### **5. WHAT PROMPTED THE INTRODUCTION OF INCENTIVES AND WHAT WERE THE OBJECTIVES FOR INTRODUCING THEM?**

The presentation of plans for the development and improvement of the securities market was based on the recognition that the Stock Exchange is the most effective tool for an efficient allocation of the resources of savers to investors in the various industries. Thus, an active Stock Exchange contributes to economic growth as it does in many developed countries in the world. On the one hand, the Stock Exchange provides an opportunity for saving with the possibility of high profits. On the other hand, it enables companies to raise low cost capital. As a result, there is increased competition among financial institutions that lowers credit costs. The lowering of the cost of capital is an essential and important condition for economic growth.

Moreover, gradual elimination of government involvement through privatization of government companies is more effective when accomplished through the securities market. Accordingly, one of the main goals which

stood before the capital market policy makers was to build a trustworthy, improved and efficient market that would promote broad-based participation as an alternative to the relatively dominant involvement of the banks.

**6. LIST IN DETAILS THE TYPES OF INCENTIVES THAT WERE INTRODUCED.**

At the root of the financial market reforms, lies the assumption that there is a need to define the trading rules of the securities market in an easy, clear and comprehensible way for all those who participate, while giving freedom to the market forces to perpetuate themselves and to focus on enforcing the securities laws. On this basis, one can identify the incentives which have been introduced for the improving the capital market: (1) in the area of securities law; (2) in the area of trading systems in the Stock Exchange (3) the structure of the capital market.

Following are a list of the principal changes:

**I. In the area of the securities law the following changes have been introduced:**

(A) The 9th amendment to the securities law of 1988 contains provisions concerning a wide range of subjects. The principal amendments are as follows:

**Prospectuses** - The list of subjects, which require an opinion of an advocate to be included in the prospectus, has been expanded. An opinion of an advocate shall relate to the description of the agreements mentioned in the prospectus and to which the issuer is a party; the description of the guarantees and encumbrances granted by the issuer, as mentioned in the prospectus, and which are outstanding at the time of publication of the prospectus; the description of the legal actions mentioned in the prospectus and to which the issuer is a party at the time of the publication of the prospectus. The civil liability for a misleading item contained in a prospectus has been expanded and it includes liability of signatories of prospectus not only to any person who has acquired securities from the offerer, but also to any person who has sold or

acquired securities on or outside the stock exchange, for any damage caused him by the fact that the prospectus contained a misleading item. The civil liability of experts (lawyer, accountants, appraisers etc) has been likewise expanded.

**Certificates of Indebtedness** - The amendment imposed an obligation to appoint a trustee for the holders of certificates of indebtedness offered to the public. The law defines the restrictions in regard to the appointment of the trustee, the duties of the trustee, and provides that the trustee shall represent the holders of the certificates of indebtedness on all matters pertaining to the obligations to the issuer toward them.

**Current Reports** - The Authority is empowered by the law to demand an immediate report not only on an occurrence but also on any matter, if in its opinion, information regarding the same is of importance to a reasonable investor considering the purchase or sale of securities of the company. The Authority is empowered by the law to demand any explanation, detail, information or document concerning items included in a report submitted to the Authority. Furthermore, the Authority may order the corporation to submit, financial reports or an auditor's opinion who audited the same, or by another auditor, instead of the same included in the report originally submitted to the Authority, if it is of the opinion that they were not in accordance with the generally accepted accounting principles.

**Supervision of the Secondary Market** - The amendment specifically provides that the Authority shall supervise the fair and orderly operation of the stock exchange. The Authority is empowered by the law to direct the stock exchange as to the proper manner of operation, if the Authority is of the opinion that the stock exchange is not operating in accordance with its rules and directives or in a manner contrary to fair and orderly operation. Moreover, if the Authority is of the opinion that in the interests of the fair and orderly operation of the stock exchange an amendment should be introduced in the rules of the stock exchange, it shall notify the stock exchange to such effect (such power was formerly vested with the Minister of Finance).

Liability for Violation of Provisions of Securities Law - Civil liability of an issuer, its directors, its general manager and the person holding a controlling interest in the same has been broadened. It is provided that the issuer (its directors, its general manager and the person holding a controlling interest in the same) is liable towards a holder of securities issued by him for any harm caused to the said holder by virtue of the violation by the issuer of the provisions of the Securities Law.

Class Action - One of the major innovations of the 9th amendment is the introduction of class action. It is provided that a holder of a security may sue, in the name of a group of security holders, on any cause of action for which he might have sued in his own name and against any dependent whom he might have sued in his own name. A class action is subject to leave of the court and such leave shall not be granted unless it is convinced that the conditions specified by law apply. If the Authority is of the opinion that the class action is in the interest of the public and that there is reasonable possibility that the same shall be allowed as a class action by the court, it may pay the costs of the action to an amount and on such terms as it shall determine.

(B) On the initiative of the Securities Authority, the Stock Exchange and the Ministry of Finance, the legislator decided upon equalization of voting rights. The stock exchange shall not register for trade thereon shares unless it is satisfied, in regard to a company the shares of which are registered for trade for the first time, that the share capital of the company shall consist of one class of shares only conferring equal voting rights in proportion to their nominal value. In regard to a registered company, any additional issue shall be in regard to the shares most preferred in regard to voting rights.

(C) Monetary reports would be given on a quarterly basis rather than semi-annually.

(D) A new law was proposed to supervise mutual funds. The proposed law included the possibility of issuing close-end funds and the possibility to issue trust funds which invest part of their money in assets which are not

liquid; for example, real-estate

(E) Rules for private placements.

(F) Update of stock exchange regulations in relation to rules for registration of securities to trade on the stock exchange.

(G) Issuing directives in respect to the manner of presentation of items in financial reports, including report on cash-flow and a uniform presentation of earnings per share.

In addition, the Securities Authority initiated themes whose goals are to make the securities market more effective and trustworthy. The principal initiatives are as follows:

(A) Appointing a public committee, whose role is to weigh amendments to be financial reports in accordance with accounting changes which occurred in Israel and in the world including the process of globalization of capital markets in the world.

(B) Appointing a public committees whose role is to weigh amendments of the regulations with respect to "soft information" included in prospectuses and periodical reports and management discussion and analysis.

(C) Appointing a public committee which will advise on raising venture capital through the securities market.

(D) initiatives concerning the creation of independent bodies responsible for the rules of financial reports, similar to F.A.S.B. in the United States.

(E) initiatives concerning rules for underwriting.

(F) initiatives concerning regulations in regard to restrictions regarding conflict of interest between a registered company and a person in control

market, institutional investors are required to invest at least 50% of their capital in government bonds, excluding pension funds, and as a result, their involvement in the securities market has increased.

(B) Decrease of the government involvement in the capital through issuing government bonds has resulted in an increase of bond offerings in the private sector.

(C) Liberalization in the foreign currency market which allows investors to invest in securities in foreign capital markets through trust funds. Recently it became permissible for an authorized individual investors to invest directly in foreign capital markets, within certain limitations. The trend has been to reduce the existing limitation of the movement of foreign currency from and to Israel.

(D) A lessening of the requirements of listing stock for trading in the stock exchange, for companies looking to raise venture capital.

(E) Initiatives of the bank's supervisor to separate between bank trading activities and bank activities as underwriters and investment advisors.

(F) By the Authority initiative, a proposed law for the supervision of portfolio managers and financial advisors has been drafted. The Knesset (the Israeli parliament) has not yet adopted the proposal.

(G) Privatization of government companies as part of a decrease of the government in the productive sector.

(H) General permit for Israeli companies to raise capital in the foreign stock exchanges.

(I) Initiatives for founding independent rating company for corporate bonds. The company was established by leading financial institutions in the capital markets.

The various programs are comprised of basic initiatives to encourage growth in the capital market, in order to develop public trust



of the same or a company under control of the said person.

(G) initiatives concerning regulations in regard to acquisition of control of a registered company and a tender offer for securities of the said company.

(F) since 1990, the Securities Authority has been conducting negotiations with the SEC in the United States concerning a Memorandum, of Understanding (MOU) for the cooperation of the two organizations.

## II. In the area of trading systems in the stock exchange:

(A) At the end of 1986 the stock exchange set up an additional list in order to facilitate raising of capital in small companies with a relatively high business risk.

(B) The stock exchange adopted a "floor" trading system. In accordance with this system, the stocks of the larger companies (80 companies) would trade a few times during the day, the public investing in securities would have the possibility to give orders during the trading.

(C) the stock exchange has gradually been adapting a system of many-side computerized trading in which stock rates are determined by a computer according to supply and demand orders given directly into the computer.

(D) The stock exchange is in the stages of developing additional trading list which is designated for trading options and futures, anticipated at the end of 1992. The trading will be on stock index Call and Put options.

## III. In the area of capital markets:

(A) Institutional investors up until the year 1985, were obligated to invest more than 90% of their sources in government bonds. Because of this requirement only a small portion of their investments found their way to the stock exchange. Today, because of the reforms in the capital

direct financing. The Government also improved the autonomous public offering base by allowing the companies to decide the public offering price.

During this period, the number of companies which went public increased steadily, amounting to 88.

Year	'83	'84	'85	'86	'87
No. of IPOs	3	14	11	16	44

(D) Period of Expanding Autonomous IPO (1988-Present)

Since the announcement of the Plan for the Reinforcement of Capital Market Functions in July, 1983., the authorities continued implementing measures to extend the size of the capital market and its function as well as protecting the benefit of founders. Eventually, public companies were privatized along with the liberalization and internationalization of the securities market.

In Jan, 1988., a special favor in asset re-evaluation was given to the companies which planned to go public. In June, 1986, a public offering system favoring the benefit of founders consummated as the pricing of the public offering was autonomously determined by direct negotiations between the issuers and the lead managers. During the period, there was a surge in the number of companies going public.

Year	'88	'89	'90	'91
No. of IPOs	112	135	36	21

(2) Taxational Policy

The development of the Korean securities market is greatly attributed to the taxational policy.

Many tax benefits were given to the companies that went public. The Government lowered the corporate tax rate for listed companies starting from 1968 when IPOs started substantially. The listed companies' corporate tax rate was 10% lower than that of unlisted companies' in 1968. The gap widened to 20% in 1971.

Since 1972, however, in order to realize the fairness of wealth distribution through taxational equity and to remove preferential treatments for specific industries, the preferential tax treatments were reduced starting from 1972. In 1982, the tax gap narrowed to 5%.

Furthermore, to realize the equity and neutrality of taxes, preferential tax treatments were written out from the Corporate Tax Law in 1983. As a result, 30% corporate tax rate was applied to all companies except for the unlisted ones either with paid-in capital of more than 5 billion won or with shareholders' equity of more 10 billion won. However, a 33% rate was charged against these large private companies.

In addition, preferential tax treatments for individual income tax were introduced. Shareholders of going-public companies have received preferential tax treatments since 1968. The concept of going-public companies in tax laws having been eradicated since 1983, preferential tax treatments were given according to the companies' listing or not.

A 10% withholding tax was levied upon minor shareholders of listed companies.

### (3) Financial Policy

To promote direct financing through IPOs and the securities market, the Capital Market Promotion Law was revised in Nov, 1979. As a result, bond issuing limits were expanded by 2 times. Prior to its revision, public companies could not issue corporate bonds exceeding shareholders' equity or net assets.

According to the revised "Capital Market Promotion Law", listed companies and going-public companies were exceptionally permitted to issue guaranteed bonds within two times of the less amount of either the total of paid-in capital and reserves or the latest net asset value.

#### B. Capital Increase by Rights-Issue

For the purpose of improving the financial structure and earnings of companies, the Government has encouraged companies to perform rights issue instead of borrowings. The issue-at-market price system and tax deduction benefit contributed much to the improvement of the financial structure of companies. For a company with a rights issue, 18% of its capital increase was deducted from its annual taxable earnings. This tax deduction benefit is still effective at the present time.

#### C. Issuance of Corporate Bonds

Until 1972, the Korean bond market had been dominated by the public bonds, while private companies could scarcely raise funds by issuing corporate bonds. Equity financing was possible only for the companies which satisfied capital adequacy to some extent. This was because low profitability of companies and immaturity of capital market failed to attract investors' attention. As a result, under undeveloped conditions of the capital market, issuing bonds was the most effective and useful means for financing.

The government has taken a diverse strategic policy for boosting bond issuance as follows :

- ① To improve the environment of the bond market, guaranteed bonds have been introduced since 1972.

- ② In 1977, bond market promotion measures were prepared including diversification of bonds, allowance of public offering of bonds to registered corporations, endowment of flexible issuing terms, etc.

In addition, owing to the bearish stock market since 1978, the importance of corporate bonds as a means of fund raising has been more emphasized.

## 2. Demand-side Stimulation policies

Regarding the aforementioned diverse inducement measures in the primary market, the Government took various steps to promote securities trading such as increasing the number of investors, etc. In line with the supporting measures on the supply side such as beneficial treatment on tax and financing matters, the same measures were utilized on the demand side.

### (Systematic Side in the Securities Market)

- o Trying to promote the demand of securities investment by introducing and improving the subscription system for public offering
- o Introducing the securities savings system and employee stock ownership system for expanding the number of investors and developing investment demand
- o Implementing the margin trading in order to promote liquidity of stocks

### (Taxation)

- o Expanding the category of institutional investors stipulated in the corporate tax laws and levying non-taxation on a dividend income

The Korea Securities Finance Corporation, established in October 1955, plays a monopolistic role in providing capital to the securities market. It provides loans for securities underwriters, margin and stock loans, and loans with securities as collaterals.

## Measures for Promoting Initial Public Offering

	I P O		Measures relevant to IPO	Corporate Tax Rate			
	Year	Cos.		Year	Private	Public	Gap
Period of Induced and Compulsory IPO (1968 - 1976)	68	2	Enforcement of Capital Market Promotion Law ('68. 11)  Emergency Decree on Economic Stability and Growth ('72. 8) Public Offering Promotion Law ('72. 12) Presidential Direction on public offering and keeping the sound atmosphere of investment ('74. 5) Supplementary measures for public offering ('76. 8) All-out Revision of Securities & Exchange Law (76. 11)	68	45	35	10
	69	12		69	45	25	20
	70	9		70	45	25	20
	71	4		71	45	25	20
	72	7		72	40	27	13
	73	47		73	40	27	13
	74	19		74	40	27	13
75	62	75	40	27	13		
76	87	76	40	27	13		
Period of Selective IPO (1977 - 1982)	77	49	Enforcement of Regulations for Registered Corporations ('77. 4)	77	40	27	13
	78	33		78	40	27	13
	79	5		79	40	30	10
	80	1		80	40	30	10
	81	2		81	40	33	7
	82	0		82	38	33	5
Period of Making the Foundation of autonomous IPO (1983 - 1987)	83	3	Measures for Expanding the Function of Capital Market ('83. 7) Capital Market Promotion Measures ('85. 6) Measures for Promoting IPO and Rights Issue ('86. 3) Establishment of OTC market for stocks ('87. 4)	83	33	30	3
	84	14		84	33	30	3
	85	11		85	33	30	3
	86	16		86	33	30	3
	87	44		87	33	30	3
Period of Expanding Autonomous IPO (1988 - Present)	88	112	Allowing the Special Cases for Asset Revaluation ('88. 1) Autonomy of the Public Offering Pricing ('88. 6) Reinforcing the Public Offering Requirements ('90. 3)	88	33	30	3
	89	135		89	33	30	3
	90	36		90	33	30	3
	91	21		91	33	30	3

7.

Were the incentives introduced gradually or all at once?  
Please indicate the process and time sequence.

As previously mentioned, the incentives were introduced intensively but not all at once during the time period when the importance of the securities market was keenly recognized.

For the process and time sequence, please refer to Question 6.

8.

What impact did the incentives have on  
i ) the Securities Market  
ii ) the economy of your country

It is not an easy task to assess the impact of the incentives on the securities market with particulars for each incentive. Instead, one can evaluate the benefits of the various measures on a whole basis by observing the following table showing key statistics of the securities market. One point you should not overlook is the rapid growth of the number of listed companies between 1972 and 1977 which was obviously affected by IPO inducement policies.

for those who are investing in the stock market and to build an appropriate infrastructure for new issuing.

**7. WERE THE INCENTIVES INTRODUCED GRADUALLY OR ALL AT ONCE? PLEASE INDICATE THE PROCESS AND TIME SEQUENCE.**

Many of the programs noted above were introduced at different times beginning in 1986. The implementation of most of these programs was gradual. The following are some examples:

(A) As indicated, in 1986 the compulsory investment of institutional investors in government bonds decreased. Since that time, such compulsory investment has decreased from a level of over 90% to the level of 50% today. At the same time, the government ceased issuing designated debentures, thereby allowing companies from the private sector to raise capital by competing in the open market.

(B) The ninth amendment to the Securities Law broadened the power of the Authority. The exercise of the additional powers provided for by the amendment was gradual. During this time the Securities Authority introduced a corporate division including: department for monitoring trade on the Stock Exchange, accounting department and economic research department, and an enforcement division including: legal department and information gathering department. The contribution of these divisions is slowly being felt in the securities market.

(C) The equalization of voting rights in accordance with amendment eleven to the Securities Law was implemented gradually. As noted above, the amendment required new companies to issue one type of share only. Established companies were required to issue shares with preferred voting rights so as to foster unification of capital in time.

(D) The enactment of secondary legislation concerning a general revision of the Stock Exchange regulations has continued for a number of years and is still in process.



(E) Although there exists only a proposed law concerning investment in mutual funds, the supervision of mutual funds has gradually been implemented.

(F) After semi-annual reports became mandatory, quarterly reporting was also required.

(G) Trading in options on the stock index will be commenced only after all the preparations are completed including conference days and courses for teaching potential investors. A special stock index that provides the basis for trading options, has been published everyday since the beginning of 1992.

(H) The Stock Exchange has gradually adopted the methods of trading noted in the answer to the prior question.

(I) There has been a gradual liberalization with respect to foreign currency. In the first stage, Israeli companies were allowed to issue securities in foreign markets. In the second stage, international investments were only allowed through mutual funds. In the third stage, private investors were allowed within certain limitations to invest directly in securities traded on the foreign stock exchanges.

(J) Privatization of government companies is being accomplished over a period of years. Since these companies are usually large, it is difficult to sell them on the Stock Exchange. For this reason and others, privatization has been gradual and slow.

## 8. THE IMPACT ON THE SECURITIES MARKET AND THE ECONOMIC ESTABLISHMENT

### The Securities Market

The capital market in Israel has undergone a revolution since the market crisis of 1983 that has included: reform of the capital market, major monetary and fiscal measures taken by the government and the Bank of

Israel, changes affecting the structure and supervision of the capital market stemming from appropriate legislation, and application of the law. These forces have exerted great influence on the securities market as can be observed in the following data:

(A) The number of companies listed for trading on the Stock Exchange in 1982 was 210. In 1989 approximately 260 companies were listed. Today the number of listed companies has reached close to 340.

(B) The market capitalization at the end of 1983 was 5 billion dollars, at the end of 1987 it was 10 billion dollars, and in the first half of 1992 reached 17 billion dollars.

(C) Return on stocks were on the average (according to the general stock index) in 1988 1.6%, in 1989 76%, in 1990 15%, in 1991 55% and in the first half of 1992 30%.

(D) As a result of the decision to equalize share voting rights, many companies decided to amalgamate their shares into one class. The number of these companies is steadily increasing.

(E) Institutional investors increased their stake in the stock market. In 1988, only one percent of institutional portfolios consisted of shares. Today, 6 percent of their portfolios consist of stocks, and they have increased their investments in private sector debentures.

(F) There is greater importance attached to the distribution of cash dividends to shareholders. The number of companies distributing dividends rose from 20% in 1989 to 40% in 1992.

### The Economic Establishment

The main problem facing the Israeli economy is the high immigration from the Soviet Union which has increased the population by 10% within two years and which is expected to grow in the next few years. This rapid population growth is coupled with a poor economy along with a lack of political stability characteristic of the State of Israel. For

these reasons, it is difficult to evaluate the influence of the various incentives on the economy. The growth which characterized the securities market is not sufficient and is not able to fulfill, for example, the needs for cutting unemployment. However, there is little doubt that the relative success of the securities market has contributed to lightening the burden on the economy. A growing and trustworthy securities market allows raising of a relative low cost of capital to initiators and also eases the process of privatization allowing the government to sell its enterprises to the public through the Stock Exchange for relatively good prices.

#### 9. HAVE THE INCENTIVES SUCCEEDED IN YIELDING THEIR DESIRED RESULTS?

In the last decade, the securities market has changed beyond recognition. The most prominent change being, that it has become a reliable market in the eyes of investors, issuers and other participants. Most of the aforementioned incentives had a significant and positive influence contributing to the success. Nevertheless, the job is far from being complete. The market is suffering from other problems, part of which have been going on for a long period of time and which need to be solved. One of the main problems of the capital market in Israel stems from it being a narrow market because many companies are relatively small, and many stocks are characterized by thin trading. Furthermore, the capital market in Israel has a specific problem arising from the special structure of corporate governance. In most of the public companies, a very small group of investors, many times members of the same family, hold more than 50% of the equity of the companies, therefore, having complete control of the company. This stresses the "agency" problem known to all who participate in the capital markets around the world.

In a number of instances the lack of success which was a result of the fact that the capital market is a relatively narrow and small market. For example, in spite of the willingness of many issuers to breakdown the monopoly of the Stock Exchange in Tel Aviv, as the only Stock Exchange, the establishment of an additional Stock Exchange is not economically feasible. The solutions to the problem were in the form of additional

listings that eased the demand for registering in the Stock Exchange.

Another example is the attempt to issue commercial papers. After the market conditions were set for issuing trading securities on the initiative of the Bank of Israel, and the Securities Authority, there were investors interested in purchasing securities of this type; however, those interested in issuing them have not yet been found. One of the reasons is the banking structure in Israel. The Commercial banking in Israel is universal and the separation between commercial bank activities and its aforementioned activities in the securities market, is not complete, probably because the capital market is narrow and small, and there are additional costs caused by the separation of these activities.

The last example being the limited use of class action by the public.

However, as was previously noted, the various incentives were responsible for improving the securities market and making it a more efficient one. The success of the market, reflected in an increased number of offerings and rising share prices, is an indication that the confidence crisis of the 80s has passed. According to various estimations and market specialists recommendations the present prosperity in the securities is not similar to that of the previous decade. The investor populace is more sophisticated, there are more investors that are looking for long-term investments, especially amongst the institutional investors. Also the awareness of risks inherent to investments in the Stock Exchange has increased. It seems that market policy makers in Israel need to continue to protect the interest of the public investors and work to build the public confidence through enforcing the securities law to create a more fair and orderly operation of the Stock Exchange.

## 10. SUGGESTIONS

The guiding lines should be: to establish rules in the securities market which are appropriate to all of the characteristics of the economic establishment, according to the size of the market, the mentality of the

investors, and to allow the market forces to follow their due course. In the transition to a free market, in which the market forces are acting, there are unavoidable costs. Gradual implementation of the incentives may reduce these costs considerably.

In light of experience in the Israeli capital market, it seems that co-operation must be created between the supervising authorities overlooking the capital market. Care should be given to co-ordinate between monetary policies and the proposed changes in the capital market.

Relative economic stability, stable exchange rates, lower inflation, and relatively open foreign exchange may contribute to a successful local capital market.

Progressive trading systems that are suitable for the market and the trading with different progressive financial vehicles contribute to market efficiency.

It seems that the securities market can benefit if a large part of the trading in the stock exchange would be by institutional investors, trust funds and brokers.

The separation between the various activities of the banks in the securities market and their commercial activities has had positive effects on the capital market. Such a separation lessens conflicts of interest between the banks and their clients.



# Stimulation Policies for the Securities Market Development in Korea

1.

The economic, political and cultural environment during which the policy measures were introduced. Please state in details the monetary, fiscal and other policy measures in place before and during the introduction of the incentives.

In Korea, major policy measures for stimulating the development of the securities market had been introduced in the late 1960s and early 1970s. During that period, the government implemented consecutive five-year economic development plans with major goals of developing a basic infrastructure, modernizing the nation's industrial structure, developing industries which supply key raw materials, and increasing exports.

In raising investment funds to achieve these objectives, Korea had to rely heavily on indirect financing via bank loans and foreign borrowings because it lacked an appropriate accumulation of capital. In this regard, bank interest rates were forced to remain at a low level, especially in the case of preferential loans to preferred sectors and projects.

At one time, this policy of an artificially low interest rate in the banking system became a cause of disintermediation through the unorganized money market and brought about the Presidential Emergency Decree of August 1972 freezing the underground money market.

Also, exchange rates were officially determined at an adequate level in consideration of payments balance and in terms of supporting exports.

On the fiscal side, the government took a fiscal expansion strategy through strengthening taxation to back the economic development.

Recognizing the limitations of fund raising through all the above

channels, from 1968, the government decided to foster the securities market and to maintain it as a place to raise efficient domestic funds for industry and to provide households with means to manage their financial assets.

To promote the development of the securities market, together with measures geared to increasing demand for securities, favorable tax treatment was given to publicly-held firms, and the government has been empowered to order select companies to go public.

Also, in this period, there was a firm commitment to economic development by the nation's political leadership with a centralization of power.

2.

What was the general attitude of the populace towards securities market investment before and after the introduction of the policy measures?

Prior to the introduction of the main policy measures, the populace regarded the securities market as too speculative of a place to participate in since there had been a series of extreme price fluctuations followed by widespread defaults in settlement and even the market closure for a substantial period of time.

For that reason, it was quite natural that almost all the money flew into the banking system or unorganized money markets rather than the securities market.

Eventually, however, the public's confidence in the securities market improved remarkably and the securities market fell into a groove as a place of sound investments thanks to the government's efforts to stimulate the securities market development and to provide investors with securities of



good quality.

Occasionally, the stock market overheated undesirably due to excessive participation by the public in trading securities.

3.

What forms of public enlightenment program did you introduce to increase awareness of the securities market?

As fostering the capital market came to the fore of government policies, more systematic public relations concerning the securities market became an urgent problem.

Thus, the "Public Relations Association", which was established in the KSDA(Korea Securities Dealers Association) around 1974, took diversified publicity activities such as P.R. through mass media including newspapers, magazines, radio and TV, and holding seminars and public lectures.

Later the association took charge of the daily "Securities Market Paper", which had been published by the Stock Exchange, and renewed the paper by inserting information about listed companies and other market movements.

Along with the association, every participant in the market has made an effort to induce the public to invest in the securities market through holding roadshows, distributing pamphlets which contained investment information etc.

4.

What was the attitude of entrepreneurs towards seeking quotations on, or borrowing from the Stock Market?

Despite the mandatory going public policy through the enactment of the new law - the Capital Market Promotion Law, enterprises were still reluctant to list their stocks or to raise funds through the capital market.

Behind the scene, of course, there were relatively low interest rates in the banking system, fears for losing control of an enterprise and unfamiliarity with the capital market to which that reluctance was attributable.

However, as fund raising through banking institutions faced limitations and the government strengthened the tax advantage and the protection of a management right, the attitude of enterprises gradually changed to seek funds from the capital market, even aggressively in some cases.

5.

What prompted the introduction of incentives and what were the objectives for introducing them?

With the inception of the second Five-Year Economic Development Plan in 1967 and limitations on capital mobilization through the banking system, the government recognized the securities market as an indispensable source of funds for financing corporate investments.

Therefore, it was not until 1968 when the Government began to take a series of measures to foster the securities market that the capital market, in the true sense of the word, was born in Korea.

The objectives for introducing the measures were basically to improve the investment climate of the stock market for the general public and to encourage private enterprises to go public.

6.

List in details, types of incentives that were introduced.

1. Supply-side Stimulation Plans

In order to develop the primary market which was very poor, the government gave financial support as well as it established various policies related to initial public offering(IPO), capital increase with and without consideration, and corporate bond issue since the end of 1960s.

A. Initial Public Offering(IPO)

(1) Policy for Stimulating IPOs

The process of the Government policies for stimulating the IPO is divided into 4 periods.

(A) Period of Induced and Compulsory IPO (1968 - 1976)

There was a need for the supply of long-term industrial capital via direct financing through the securities market in order to carry out the Five-year Economic Development Plan since 1962. The Government enacted the Capital Market Promotion Law in 1968, and the Public Corporation Inducement Law in 1972. A total of 249 companies went public during this period.

Year	'68	'69	'70	'71	'72	'73	'74	'75	'76
No. of IPOs	2	12	9	4	7	47	19	62	87

1) Enforcement of the Capital Market Promotion Law (1968)

The purpose of the Law was to develop the capital market by creating an investment environment through the extensive distribution of ownership.

Firstly, in an effort to improve the investment environment, the following measures were taken :

- ① Shareholders of listed companies were guaranteed a minimum dividend rate(% of par value) same as that of 1-year time deposit interest.
- ② To increase the liquidity of securities, securities could be used as an entrustment guarantee.
- ③ When a company offered new shares, employees of the company could subscribe up to a 10% stake of the newly issued shares.

Secondly, to encourage IPOs, the following measures were taken :

- ① Introduction of a differentiated corporate income tax system for the listed companies and a depreciation system for tax deduction
- ② Personal income tax cut for shareholders of listed companies
- ③ The chairman of the annual meeting of shareholders was given authority to stop filibustering by willful shareholders

2) Implementation of the Public Corporation Inducement Law since Jan, 1973.

The Government took continuous measures to provide the would-go-public companies with incentives. The concerns over the possibility of infringement on management control and intervention by general shareholders, however, deterred private companies from going public.

The sluggish reaction to the incentives resulted in only 34 companies' going public between 1968 and 1972. In view of the status of the national economy, the Government took strong measures by implementing the Public Corporation Inducement Law in 1973.

- o The Law empowered the Minister of Finance to select companies eligible for IPO, and order them to go public.

- o In order to encourage going public, favors were given to the companies which went public. Favorable treatments for corporate tax and shareholders' income tax were offered.
- o For example, in the late 1970s, the corporate tax rate for the private companies was 51%, while that of public companies ranged 35-43%, based on ownership distribution. Private companies had comparative disadvantages in corporate taxes and bank loans.

### 3) Other Special Measures by the Government

Direct financing sharply increased in amount after the Public Corporation Inducement Law was enacted. However, special measures were proclaimed by the President as some of the large companies did not actively participate in going public.

The contents of the special measurement were as follows :

- o Increased bank lending, preference in foreign borrowing and special tax incentives to the companies which go public.
- o Tightened supervision over bank credit extension to the major shareholders - especially those of private companies - and improvement of the bank lending system.

Other measures were issued on August 8, 1973. It had a three step process in choosing the candidates to go public as follows :

- o Step 1 : Announcement of eligible corporations selected for going public.
- o Step 2 : Formal request for going public by an assigned due date.  
If the company does not comply with the request, the Government would freeze the bank credit.
- o Step 3 : If the company does not go public by the due date, the IPO Deliberation Committee would penalize the company.

(B) Period of Selective IPO (1977-1982)

The volume of the capital market was expanded as a result of the Government's strong promotion policy, causing the revision of the Securities and Exchange Law in 1976 to meet the needs to administer the market accurately, to implement securities policies, to protect the stable management rights of major shareholders despite the distribution of ownership by going public.

After more than 30 companies were forced to go public by the Government and faced bankruptcy, the Securities Supervisory Board strengthened requisites for IPOs to prevent unhealthy companies' IPOs. Furthermore, the Government abolished preferential tax rate for publicly-held companies and pursued the selective IPO policy.

Year	'77	'78	'79	'80	'81	'82
No. of IPOs	49	33	5	1	2	—

(C) Period of Making the Foundation of Autonomous IPO (1983-1987)

The Government announced the Plan for the Reinforcement of Capital Market Function in July 1983. In this plan, the government eased the requisites for IPOs and listing : minimum paid-in capital and public offering ratio lowered to 500 million won and 20%, respectively.

After announcing the Measures for Boosting Going Public and Rights Offerings in June 1985 and March 1986 consecutively, the government revised the Securities and Exchange Law and the Capital Market Promotion Law. Under the amendments, the Government set up a system for public offering of recommended companies to help

<Major Indicators of the Capital Market>

End of Year	No. of Listed Cos.	Capital Stock Listed (bil. Won)	Total Market Value (bil. Won)	No. of Shareholders (ten thousand)	%, compared with the total population
68	34	96.5	64.3	4	—
69	42	119.9	86.5	5	—
70	48	134.3	97.9	8	0.2
71	50	141.4	108.7	8	0.2
72	66	174.4	246.0	10	0.3
73	104	251.6	426.2	20	0.6
74	128	381.3	532.8	20	0.6
75	189	643.4	916.1	29	0.8
76	274	1,153.3	1,436.1	57	1.6
77	323	1,492.4	2,350.8	40	1.1
78	356	1,913.5	2,892.5	96	2.5

Note : The number of shareholders is based on shareholders' lists.

In respect to the economic impact, without the development of the securities market boosted by the incentives, it would have been impossible to build up immense plants such as heavy chemical factories which needed large amounts of long-term capital. For instance, in 1977, the investment funds for a corporation raised through the securities market accounted, for the first time, for approximately 40% of the total funds supplied by the banking system.

9.

Did all the incentives yield the desired results? If any was not successful, what led to its failure?

Though there was no official evaluation concerning the adopted incentives, most of them were interpreted to have yielded the desired results in their own way. However, what you have to recognize is that some measures were followed by succeeding measures for the purpose of enhancing the effect of the measures to a higher level.

10.

Do you have any advice for countries that may wish to introduce any of the incentives you applied in your country?

In implementing all incentive measures, the importance of the overall balance between demand and supply of securities cannot be emphasized too much although, at the initial stage, supply of qualified securities can be more stressed.

Regarding the detailed measures of the incentives, a method of inducing voluntary participation is more strongly recommended than a compulsory method.

Also, the incentives should be designed to meet the need of the object of the incentives. In the case of policies creating the investment climate, it is a good example that the Korean Government tried to induce the public to invest in stocks by guaranteeing an annual dividend yield not less than the interest rate on time deposits.

There would be no need to reiterate the fact that the incentives should be in line with the economic development stages.



INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

DEVELOPMENT COMMITTEE

WORKING GROUP ON MARKET INCENTIVES

"THE MEXICAN EXPERIENCE ON STIMULATION POLICIES  
FOR SECURITIES MARKET DEVELOPMENT"

BY THE COMISION NACIONAL DE VALORES DE MEXICO  
(NATIONAL SECURITIES COMMISSION OF MEXICO)

JANUARY, 1992.



1. The economic, political and cultural environment during which the policy measures were introduced. Please state in details the monetary, fiscal and other policies measures in place before and during the introduction of the incentives.

The successful negotiation process of Mexico's foreign debt opened a new chapter in its economic history. In the last three years, efforts have shifted toward modernizing the role of the financial sector.

As a condition to succeed in this modernization process, the Mexican government has implemented an all encompassing reform of its economy, involving macroeconomic as well as microeconomic reforms. In general terms, the main efforts have been oriented to increase the levels of efficiency and competitiveness among the different sectors, as well as to restore the confidence of entrepreneurs and, maintain the stability of prices to foster a gradual recovery of economic growth.

A significant reduction in the government's deficit and interest rates have brought inflation from 150% in 1987 to 17.8% in 1991. The cornerstone of the modernization strategy has been the re-defining and the strengthening of the government's role in the economy, which has involved the privatization of non-strategic public enterprises and allowed the public sector to raise resources for 9 billion dollars. The latter have been used mainly to amortize the government's domestic debt.

Significant reforms have been introduced in the banking sector, including the liberalization of interest rates, improvement in its regulatory framework, a new banking law expanding the range of activities, and a Constitutional amendment allowing the privatization of commercial banks. The process has been accompanied by a fiscal reform involving reduced public spending, and a stricter enforcement of tax evasion rules. Moreover, on the income side, the tax base has been broadened and personal and corporate rates have been reduced, with a very favorable effect on public sector revenues. On the expenditure side, a more selective allocation of public resources has been attained.

Finally, the modernization of the Mexican economy has been marked by gradual deregulation and liberalization of economic activities which attempts to enhance competitiveness and efficiency among firms. Perhaps the most important aspect of this policy is the opening of the economy to the international trade, and the current negotiation of a Free Trade Agreement with the United States and Canada.

2.- What was the general attitude of the populace towards securities market investment before and after the introduction of policy measures?

Uncertainty and reluctance towards investments in the securities market characterized populace attitude at a worldwide level after the stock market crash of 1987, and Mexico was no exception.

As part of a comprehensive economic strategy (see question #1), the securities market authorities introduced new prudential regulation to ensure an orderly market and to strengthen the public's confidence on financial intermediaries. These set the stage for the introduction of new instruments and participants in the market.

An important role in this process has been played by mutual funds, new investment alternatives, the participation of rating agencies and research companies in the market, and increasing competition among brokerage houses after the deregulation of fixed commissions.

Some of the figures that show these positive results are the following: the number of mutual funds and investors have increased; the number of investment alternatives has been diversified; information related to market and listed companies has been increased in quality as well as in quantity derived by the number of rating agencies and analysis companies operating in the market, and deregulation in aspects such as fees charged by intermediaries in providing their services has increased competition allowing investors to benefit by lowering their transaction costs.

3.- What forms of public enlightenment program did you introduce to increase awareness of the securities market?

All participants in the market have developed different but complementary strategies to increase the public's awareness about the securities market:

A) Comisión Nacional de Valores (CNV):

In 1990, the CNV launched its education program. In essence, it intends to spread information about stock market behavior, the characteristics of the legal framework, ethics and administrative principles, its structure, patterns, principal instruments and mechanisms.

To meet these objectives, special ties and exchange programs have been established with Universities and other institutions of higher learning, and the dissemination of market data through specialized publications.

A very close coordination is held between the CNV and the market intermediaries, as well as with organizations such as IMMEC (Capital Markets Institute of Mexico), Broker/Dealers Association, and several Universities. In this sense, the CNV has signed technical assistance agreements with institutions around the country, and conducted several specialized conferences and seminars.

In addition, CNV has participated in meetings around the country organized by different business associations to inform about the financial alternatives of the securities market.

B) Bolsa Mexicana de Valores

This institution has provided the authorities, member firms, the media and the general public with an important data bank of daily transactions carried out in the securities market as well as several published reports.

With a lot of success, they are reaching the business community and potential participants. with conferences being held in different parts of the country.

C) Brokerage Firms

Competition among these intermediaries has led to advertising strategies to reach both individual and institutional investors, with information about how they can better serve their financial needs, and the alternatives offered by the market. They have also improved the quality of their service in terms of investment advice and information to their customers.

4.- What was the attitude of entrepreneurs toward seeking quotations on, or borrowing from the stock market?

After the problems faced by the securities market in 1987, market ratios -price/earnings and price/net worth- were in many cases below the unit. This situation forced companies to obtain financial resources through short term debt instruments. This attitude was along with the level of real interest rates and expectations towards the macroeconomic environment. However, since the second half of 1989, an increasing activity has been observed in the capital market and it has been gradually growing up to date.

The companies' growing participation in market operations has been influenced by the macroeconomic achievements the Mexican economy in the 1988-1991 period, as well as by the policies adopted to accelerate the process of restructuring and modernizing the financial system (see previous questions).

This environment allowed companies to start new productive investment projects, and to consider the securities market as a complementary source of finance. The public debt maturity period has expanded from 116 days in 1988 to 1,042 days at the end of 1991. On the other hand, the private debt maturity period, in the average, has also increased because of the use of longer term instruments than in 1988. Additionally, new instruments directed to medium term financing have been implemented allowing companies and other firms such as leasing and factoring firms to participate, in the market.

Since the end of 1988, 51 new public offerings have taken place, and only in 1991, the number of new listings in the stock market was 28, amounting to 4.7 billion dollars. At the same time, the importance in financing private sector activities through instruments from the money and bond markets has been rising. The private and banking instruments outstanding at the end of 1991 amounted to 10.3 billion dollars, compared to 1.35 billion dollars at the end of 1988.

5.- What prompted the introduction of incentives and what were the objectives for introducing them.

The objective of the introduction of incentives is to impulse the conformation of a bigger and more dynamic market, where investors can direct its savings to productive investments, and enterprises can easily find resources to finance their activities. In Mexico, we are convinced that a healthy securities market is capable of providing flexible investment schemes that meet the needs of investors, that seek instruments with a diversity of characteristics, in terms of risk and maturity. Hence, it provides an efficient vehicle for allocating resources to productive activities.

In this context, the policies implemented to modernize the Mexican securities market aimed mainly:

-To increase a balanced demand and supply of securities through the creation of new investment instruments and mechanisms, that provide the market with higher turnover levels, increased depth and efficiency, as well as to promote the participation of a larger number of investors and encourage a broader set of enterprises to obtain resources through the securities market.

-To increase the confidence of investors in the market. This important task implies not just the reinforcement of regulatory activities of the National Securities Commission, but also the fostering of a market culture that encourages participants to enhance orderly operations and protect investors interests.

-To enhance the levels of efficiency and competitiveness of financial intermediaries.

-To create new channels of foreign investment in the securities market and participation of Mexican firms in foreign capital markets.

6.- List in detail the types of incentives that were introduced.

The incentives introduced since the beginning of the modernization process, started with legal reforms in subjects such as:

- 1) Redefinition and establishment of sanctions for the use of inside information.
- 2) The creation of non banking financial groups.
- 3) A revision of the arbitration procedures in securities legal conflicts.
- 4) The mandatory automation for brokerage houses, of the reception, registration, execution and allocation of orders systems; and
- 5) The internationalization of mexican intermediaries.

The Comision Nacional de Valores (CNV) has worked closely with the Exchange and the Brokers Association to foster the introduction of new instruments that provide the market with greater liquidity and flexible investment schemes. In this regard, the following policies have been pursued:

- 1) The official criteria of stock marketability was established as a previous step to short selling, limited to highly traded stocks, and the prudential re-establishment of margin credits.
- 2) The introduction shelf registration, repurchase of stocks and non voting stocks, enhance the desired balance between supply and demand of equity instruments.
- 3) The creation of rating agencies in the market.
- 4) The simplification of the registration procedures.
- 5) The introduction of short sales.
- 6) The liberalization of fixed brokerage commissions.
- 7) The introduction of medium term promissory notes, I.N.P.C. (Consumer Price Index) indexed instruments, options operations realized by Mexican Brokerage subsidiaries in foreign markets, international arbitrage, as well as other international operations.

Also with regard to the internationalization of the securities



market, during 1989, a comprehensive strategy was implemented in Mexico and abroad to increase the flow of external savings to our economy. Among the most important measures were:

- 1) The authorization of brokerage houses to establish subsidiaries abroad; the increase of alternatives to foreign investment in the Mexican Stock Exchange, as well as the authorization to the Mexican brokerage houses to operate securities abroad.
- 2) Under the new regulations of the Law to Promote Mexican and Regulate Foreign Investment, the government authorized the purchase of trust certificates representing "A" series shares (reserved exclusively for Mexicans), by Foreign investors through a neutral fund.
- 3) A neutral fund has been established by the national development bank (Nafin), which acts as trustee and recognizes the foreign investor as a beneficiary. Indeval, the central depository agency registers the foreign ownership and holds the shares in custody, while Nafin in turn issues a participation certificate.
- 4) The promotion of new country funds to be listed in London, Tokyo, Luxembourg and other financial centers, is considered a first step in the introduction of the Mexican securities to new investors not familiarized with our market.
- 5) For sophisticated investors and those already familiarized with the Mexican market, the strategy consists on encouraging the direct listing (ADR's) on international markets of specific securities of Mexican companies through simultaneous offerings as well as . Part of the positive experience of this process has been carried out by taking advantage of the SEC's Rule 144-A.

Other incentives include:

- 1) The designation of the Bolsa Mexicana de Valores by the SEC as a "designated off-shore market", and of some specific securities as "ready market".
- 2) The financial soundness of the issuers through the introduction of credit rating agencies in the market and financial information disclosure.
- 3) The development of secondary markets, the promotion of the securitization of credit and the use of asset backed securities.

- 4) Improvement in the design of financial plans for infrastructure with the dual purpose of increasing the availability of resources toward well-known areas in the market, such as tourism, highways, housing, and the formulation of new plans for projects related to potable water, agriculture, petrochemical industry and services, to cite a few examples.

Currently, two very important projects underway are the automation of the Exchange's trading system, which should increase the fairness and orderliness of the market, as well as decrease the costs of entering the market; and the introduction of an options market. These two projects may be complemented by the re-introduction of a margin credit regime that promises to inject an important degree of liquidity into the market.

7. Were incentives introduced gradually or all at once?  
Please indicate the process and time sequence.

The introduction of new instruments and the design of a new market structure are parts of a comprehensive modernization strategy. It entails legal and operational reforms that must ensure a fair and orderly market. Thus, the authorities have followed a gradual strategy of implementation of these measures, to allow participants to adapt and achieve an enduring stability of the market.

The time sequence of the most important incentives introduced recently in the securities market is the following:

1988-89

- Legislative Reform. The main objective was to achieve a climate of permanent trust, which is the cornerstone of financial markets.

- Introduction of an automated surveillance system.

- Shelf Registration. In order to facilitate access to the Stock Market, the pre-registration of issuers was implemented, allowing them to perform in advance the necessary steps for launching a primary offer of shares, and consequently determine the most favorable time for carrying it out.

- Financial Leasing Companies. The issue of debentures by financial companies was authorized, with the idea of channeling more resources to the productive plant, servicing corporations which by themselves could not have access to long-term finance.

- Hedge instruments. In support of the exchange-rate policy within the process of economic stabilization, and in order to reduce financing cost, provisions were implemented for the issue of Tesobonos (dollar-denominated Treasury Bonds) Debentures and/or Participation Certificates indexed to the free exchange rate and exchange, and the participation of Brokerage Houses on the short-term hedging market of exchange rates was authorized.

- Infrastructure. The criteria for financing infrastructure projects was established, and the first experiences were related to projects in housing, tourism, highway construction and building storage and distribution facilities.

- Concerning the Money Market, the simplification of registration of commercial paper in order to eliminate transactions being made in the informal market was carried out.

- The official criteria to establish an index to measure the marketability of the stocks traded on the Exchange was published. The provisions concerning lots, bids and suspension trading were also reviewed and amended, in order to maintain the orderliness under sudden fluctuations of the market.

- Special trusts were introduced as a vehicle to allow foreign investment.
- The reinstatement of international arbitrage transactions with securities.
- Support was offered to Mexican issuers of American Depository Receipts (ADR'S).
- The authorization to establish branches of brokerage firms abroad.

#### 1990

- The first Securities Rating Agency began its operations.
- Introduction of Asset-Backed Bonds, Dollar and Non-Dollar Indexed Commercial Paper, and Short Sales.
- The first stage of a feasibility study on the establishment and development of an over-the-counter market was concluded.
- A study and comparison of the specialist and/or market-makers in different stock exchanges around the world was carried out.

#### 1991

- Issuance of medium term promissory notes as a new financing alternative for companies interested in issuing one to three year debt instruments.
- The regulation of financial promissory notes by which the factoring companies and financing leasing companies can obtain resources from the stock market.
- The incorporation of securities linked to the free exchange rate as well as to the consumer price index.
- Authorization of brokerage houses to carry out international operations with securities issued by Mexican companies.
- Standardization of practices for simultaneous securities offerings in Mexico and the U.S.
- The deregulation of fixed commissions on services rendered by brokerage firms to their customers.
- The authorization of the second and third Securities Rating Companies.

8.-What impact did the incentives have on:

1) The securities market:

The achievements can be summarized in the next points:

\* The market has experimented a constant and accelerated growth which is evidenced by the real annual growth rates of the market capitalization value within the Mexican Stock Exchange. It grew in 14.4%, 72.1%, 30.2% and 117.7% during 1988, 1989, 1990 and 1991, respectively. In the same years, the Mexican Stock Exchange index grew at real annual rates of 32.0%, 65.5%, 15.5% and 91.6%. It is worth mentioning that from 1990 to 1991 the daily average volume at the Stock Exchange has increased from 43 to 97 million shares.

\* There is an increasing trend towards the use of long term investment instruments. For example, by the end of 1990, the average maturity of public instruments was of 264 days; by the end of 1991, the average maturity was of 1042 days.

\* The participation of government debt instruments in the securities market has diminished in favor of private instruments. In 1991, this participation in the capitalization value of the Mexican Stock Exchange decreased from 20.2% in 1990 to 3% in 1991.

\* There is a stronger linkage between the Mexican securities market and foreign financial markets, which has brought about a greater flow of foreign investment to the Mexican Stock Exchange, and it has allowed Mexican firms to obtain resources from international capital markets. In 1991, foreign investment in the securities market was 18.6 billion dollars, 311% higher than in 1990. This figure represents 18.3% of the total capitalization value of the Stock Exchange compared to 11% in 1990.

2) The economy of your country.

The improvement of the securities market has been reflected by the higher levels of productive investments channeled to the different sectors of the Mexican economy. The securities market has also become a mechanism to ease capital repatriation. Since 1990, 5.9 billion dollars have returned to Mexico through a favorable tax treatment called "timbre fiscal". The securities market has also supported the privatization process of the main public enterprises such as the privatization of Telefonos de Mexico and of commercial banks.

9. Did all the incentives yield the desired result? If any was not successful, what led to its failure?

In general, the results of the implementation of incentives have yield positive results. It must be mentioned that we are still in the process of finding out the results of many of these measures, for the main goal is to achieve an important degree of long term stability.

There remains much to be done, for the modernization of the Mexican financial system entails a constant revision of its instruments and mechanisms in order to meet the demands of the changing environment and dynamism of the market.

10.-Do you have any advice for countries that may wish to introduce any of the incentives you applied in your market?

Among some of the strategies used in Mexico was the creation and enhancement of the public sector debt market through the use of instruments such as the Cetes (similar to Treasury Bills). This policy has contributed to the soundness of the market and has had a positive effect as the government obtained resources at real market rates. Through the "Pact for Economic Solidarity", Mexico's current stabilization program, the government has successfully brought about a sharp fall in the inflation rate.

#### INFLATION RATES FROM 1986 TO 1991

YEAR	RATE %
1986	105.7%
1987	159.2%
1988	51.7%
1989	19.7%
1990	29.9%
1991	18.8%
EXPECTATIONS FOR 1992	9.9%

Step by step, the high inflation rates observed through 1982-87 allowed the brokerage houses to focus on the increasing demand for short term and liquid instruments. Therefore, we would advise to focus on the investors demand as well as on the issuers needs. New instruments should adapt to their needs, as it has gradually happened in México.

A useful tool for the development of the market is the authority's regulatory framework. This tool has contributed to the establishment of the internationalization rules applied to the securities market, as well as to the behavior, efficiency, and the competitive intermediation of the market. In consequence, the market is better prepared to meet the challenge of globalization and take advantage of the opportunities it provides.

The creation of a Securities Depository Institute for clearing, custody and a Contingency Fund, is fundamental to protect individual and institutional investors.

The promotion of foreign investment as an alternative for long term financial projects, which increase the opportunities of development for emerging markets to attract investment and channel resources to productive activities is also a good strategy.





CHAPTER X

SOCIAL AND CULTURAL MATTERS

ARTICLE 49

Co-operation in Social and Cultural Matters

Subject to any directions that may be given by the Council of Ministers, the Social and Cultural Affairs Commission shall examine ways of increasing exchange of social and cultural activities among the Member States and of developing them, provide a forum for consultation generally on social and cultural matters affecting the Member States and make recommendations to the Council of Ministers.



International Organisation of  
Securities Commissions

Working Group on Market  
Incentives.

The Nigerian Experience

By

Securities and Exchange  
Commission Nigeria.



## NIGERIA

*1. The economic, political and cultural environment during which the policy measures were introduced. Please state in details the monetary, fiscal and other policy measures in place before and during the introduction of the incentives.*

Following persistent recession in the economy, the Nigerian Government in 1986 introduced a Structural Adjustment Programme (SAP) which was meant to redress the structural imbalance which had plagued the economy and gear it towards sustainable growth and development. Key elements of the reform programme included the liberalization of interest rate and foreign exchange market, privatization and commercialization of state-owned enterprises, liberalization of trade, review of foreign investment policy, and rationalization of the public sector. The capital market as an integral part of the financial system is in the process of being deregulated, with the removal of official pricing of primary issues as the core of the capital market deregulation.

Prior to the reforms, both interest and exchange rates were officially determined. The former in particular was deliberately kept low to stimulate investment especially in the preferred sectors of the economy. In addition, credit by banks were sectorally determined by the Central Bank of Nigeria. With reference to exchange rate, the low prevailing rates encouraged imports. Industrial inputs were thus largely imported while little sourcing of domestic inputs was embarked upon by industrialists. The liberalization of the exchange rate has to some extent reversed this trend although there is still high reliance on foreign inputs. The deregulation of trade also saw to the abolition of the import licensing system which existed before September, 1986.

The deregulation of the economy has to a large extent succeeded in removing bottlenecks which were impediments to the development of the financial markets and indeed the economy. It has also stimulated competition as more financial institutions with innovative products and improved efficiency have evolved. The economic image of the country has improved abroad as it has been able to reschedule some of its foreign debt. In addition, a debt conversion programme is in place which has aided in reducing some of the country's debt while at the same time, inducing investments.

With deregulation, the role of the regulatory authorities has been strengthened to prevent abuses which might arise and to prescribe rules and regulations aimed at charting the economy through desired path. In 1991 for instance, a new law called 'Banks and Other Financial Institutions Decree' was promulgated which gave the Central Bank additional powers to regulate the financial system.

Politically, the country has enjoyed relative stability which has enabled the implementation of the reform programme. The cultural environment remains basically the same although attitude towards the capital market is improving.

*2. What was the general attitude of the populace towards securities market investment before and after the introduction of the policy measures?*

The attitude of the populace towards securities market investment has improved since the reform programmes. Specifically, the privatization exercise has popularized capital market investment as more Nigerians seek to own shares in these enterprises. However, the increasing interest is not being met with increase in supply of securities, thus many investors who own securities particularly in the blue-chip companies are still reluctant to sell them off for fear that they might not find suitable replacements. Also, due to certain infrastructural problems and inadequate supply of securities, speculative activities are virtually absent. Most investors still

buy for keeps especially when the company is noted for declaring good dividend income. Most securities on offer at the Stock Exchange are therefore, those with poor financial performances. The attitude of "buy-and-hold" towards portfolio investment has thus not changed despite the reforms. It is hoped that as more securities are listed this attitude will be considerably reduced. The introduction of new instruments such as Unit Trusts (Mutual Funds) has also enhanced participation of the populace although indirectly in the capital market.

Other instruments such as investments trusts are likely to evolve soon. With intensive public enlightenment programmes, present attitude towards capital market investment is likely to change for the better.

*3. What form of public enlightenment programme did you introduce to increase awareness in the market?*

Various public enlightenment programmes have been carried out by the SEC, the Nigerian Stock Exchange, Market Operators and other organizations. The most popular medium of enlightenment has been the creation of public fora such as seminars, workshops and conferences on market-related issues. The SEC alone has organized since inception in 1980 over twelve conferences\seminars. Such gatherings are also given considerable publicity to enable effective dissemination of information on issues discussed and decisions reached to the general public. Decisions at these conferences are usually also brought to the notice of government for policy action where necessary. In addition, the proceedings of such fora are usually published and made available to those who might require them at any time.

Besides conferences, there are a variety of regular publications on the capital market albeit some are incorporated in economic journals. The activities of the SEC are most notable in this regard. For instance, the

SEC has periodicals which cover monthly events, quarterly and annual reports as well as journals which focus on scholarly articles on the capital market. Also there are pamphlets which are aimed at explaining certain basic capital market terms and issues to those who know very little about the market. The SEC is currently in the process of producing a video tape on the market. When completed, it will be distributed to television stations and educational institutions.

Public enlightenment in Nigeria has also taken the form of radio and television programmes by both regulators and operators in the market. Occasionally, these institutions also host visiting university students during which speeches are made on the workings of the capital market.

The Stock Exchange also transmits daily and weekly information on prices and transactions on the exchange which are vital information to both investors and market analysts.

*4. What was the attitude of entrepreneurs towards seeking quotations on, or borrowing from the Stock Market?*

Before the deregulation of the economy, enterprises were generally reluctant to use the facilities of the capital market or seek listing. The low money market rate of interest vis-a-vis obtainable cost of funds in the capital market significantly encouraged borrowing in the money market even for long term projects which should have ideally been funded through the capital market. Since money could be cheaply obtained from the money market, many enterprises did not see the need to seek listing on the Stock Exchange which they feared would erode their control and holdings in the enterprises.

The deregulation of interest rates brought about market-determined rates which were much higher than what previously existed. Consequently, many companies had to seek funds from the capital market. The number and value of new issues have grown remarkably since 1986 while new equity



listing on the Nigerian Stock Exchange has risen by about 40 per cent. Indeed the attitude of indigenous entrepreneurs is gradually changing towards seeking quotation on the Exchange as evident by the number of such companies which have been quoted in recent years.

The quotation of indigenous companies has also been encouraged by a second market on the Stock Exchange known as the Second-tier Securities Market (SSM) which was established with less stringent listing requirements for the quotation of small-scale businesses.

*5. What prompted the introduction of incentives and what were the objectives for introducing them?*

The incentives were introduced firstly as part of the package to reform the economy and secondly to stimulate the capital market. Although the reform policy was not specifically targeted at the capital market, a number of the programmes impacted positively on the capital market. In particular, the privatization and debt conversion programmes as well as the liberalization of interest rates as earlier mentioned stimulated the capital market considerably.

The desire to promote a virile and active capital market also induced the introduction of certain measures.

*6. List in details, types of incentives that were introduced.*

As stated earlier, some of the policies were not deliberately introduced to boost the capital market but they turned out to stimulate activities in the market. For instance, the deregulation has been a major stimulant of the market. Thus, the number and types of financial intermediaries have grown considerably, providing investors with more efficient services. In addition, many have introduced innovations in form of heavy computerization which has enhanced their efficiency. The issuing houses have also introduced various innovative products (instruments) to attract

customers. The number of market operators has for example, grown from 48 in 1985 to 150 presently.

Another incentive to the market which was also part of the general deregulation of the economy is the privatization programme which has so far brought to the Stock Exchange a total of twenty-four companies. In addition to this number, equities in some quoted companies in which government had interest were also divested. The privatization exercise is on-going and it is expected that many more government enterprises will find their way to the Stock Exchange.

Commercialized government enterprises are also being encouraged to source their long-term financial requirements from the capital market in the absence of funds from the government. Indeed many of them are currently being restructured to enable them operate efficiently and have access to the capital market. Also, States and Local Governments are being encouraged to use funds from the capital market to finance their numerous projects and be less reliant on the Federal Government. As a matter of fact, while some states have taken advantage of the market's facilities, many other states and local governments have shown eagerness to use the market.

The debt conversion programme has also had some positive impacts on the market albeit not as significantly as the afore-mentioned.

Realizing that small investors need to participate in the capital market, the SEC initiated the introduction of Unit Trust (Mutual Funds) Schemes in the country in 1990. Currently, there are 12 unit trusts authorized by the SEC.

The government in 1991 reduced the corporate tax rate from 45 per cent to 40 per cent. By this gesture, more money is now available in form of dividend in some companies.

In 1985 a Second-tier Securities Market (SSM) was introduced by the Stock Exchange to encourage the listing of small companies which could not be listed on the main market for reasons of stringent listing requirements. The market thus has a much less stringent quotations requirement. Although it was slow in starting, the number of companies has picked-up reasonably in recent times to 18 companies while 3 others have graduated to the main market. In 1991 as an incentive to encourage small indigenous companies to seek quotation, cost of raising capital on the SSM was made tax deductible.

*7. Were the incentives introduced gradually or all at once? Please indicate the process and time sequence.*

The policies were introduced at various times. The first of them was the Second-tier Securities Market which as indicated earlier was introduced in 1985. The process was quite simple as all the Nigerian Stock Exchange needed to do was to formulate separate listing requirements for companies to be quoted on this market. The requirements were however, approved by the SEC before they became operational.

The second incentive was the deregulation of the economy and financial system which commenced in 1986. This followed the promulgation of a decree bringing into effect the Structural Adjustment Programme which as part of its tenet had the liberalization of the foreign exchange market, interest rates and trade. The second policy consequently had favourable influence on the capital market.

In 1988 the Government promulgated the Privatization and Commercialization Decree identifying enterprises for privatization and those to be commercialized. A Technical Committee on Privatization and Commercialization was consequently set up to see to the implementation of the programme. The Committee has been very active and done reasonable work in respect of its assignment.

Also in 1988 a Debt Conversion Programme (DCP) was adopted and guidelines introduced spelling out inter-alia eligible investment and the mode of operation of the programme. Through the programme, the country has been able to convert about US\$619.2 million of its external debt as at end of March 1992 and some of the debts so converted were directed at quoted companies.

In 1990, Unit Trust Schemes were formally introduced into the Nigerian capital market following the promulgation of the Companies and Allied Matters Decree which vested on the SEC the power to approve and authorise such schemes.

*8. What impact did the incentives have on*

- i) the Securities Market?*
- ii) the economy of your country?*

The policies have enhanced the growth of the securities market considerably. The number of companies increased from about 100 in 1986 to over 140 presently. Similarly, the market capitalization of securities has grown over three-fold from N6.7 billion in 1986 to N23.7 billion during the same period. The number of market operators has risen rapidly, intermediation functions have assumed increased importance and sophistication. New instruments have emerged and more people now participate in the market as the number of shareholders has also grown. Market awareness by the general public has improved. More corporate bodies are utilizing the facilities of the capital market to raise funds. Corporate new issues for instance, rose from only N800 million in 1986 to almost N10 billion at the end of the decade.

It is obviously more difficult to assess the benefits of the incentives to the economy. However, some of the issues raised through the capital market have facilitated industrial production and invariably the gross domestic

product. The privatization of state-owned enterprises and the stoppage of regular subventions to such enterprises has reduced government fiscal burden and provided it with additional fund to improve infrastructural facilities in the country to the benefit of all but more particularly to industries. Since privatized enterprises now operate more efficiently and profitably, more money is expected to accrue to government in form of taxation. The efficiency of these companies would also invariably impact favourably on the economy.

*9. Did all the incentives yield the desired result? If any was not successful, what led to its failure?*

All the incentives yielded the desired result although some had more positive effects than others. It should also be noted that while some of the policies had immediate impact on the capital market, it took some time for others to be felt in the market.

*10. Do you have any advice for countries that may wish to introduce any of the incentives you applied in your country?*

Yes. Gradual introduction of incentives may yield the best result. For countries which may wish to introduce privatization programmes, we advise that such exercises be implemented through the capital market, that is, by requiring that such divestment be effected through listing of the companies on the Stock Exchange.

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