Investor protection in a disclosure regime: an international and comparative perspective on initial public offerings in the Bangladesh securities market

S. M. Solaiman
University of Wollongong


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Investor Protection in a Disclosure Regime: An International and Comparative Perspective on Initial Public Offerings in the Bangladesh Securities Market

A thesis submitted in fulfilment of the requirements for the award of the degree

DOCTOR OF PHILOSOPHY

from

UNIVERSITY OF WOLLONGONG

By

S M Solaiman LLM (Western Sydney) LLM (Dhaka) LLB Hons (Raj)

FACULTY OF LAW

2003
THESIS DECLARATION

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CERTIFICATION

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(Signature)

S M Solaiman

Date...
To

The memory of my father for being my best teacher who would have enjoyed this thesis the most, and my mother who missed me the most during my pursuit of this study.
Abstract

The Disclosure-Based Regulation (DBR), a regulatory regime useful for the developed securities markets, was adopted in 1999 for an embryonic securities market in Bangladesh. The new philosophy came into effect without any significant changes being made in the old legal and regulatory framework of initial public offerings (IPOs).

Based on the structural and infrastructural growth achieved so far, the Bangladesh IPO market is unable to utilise the benefits of the DBR mainly because of the overwhelming dominance of individual small investors, a serious lack of full and fair disclosures, the non-availability and non-affordability of investment advisory services, and a critical lack of enforcement measures.

Laws governing liabilities for disclosures in prospectuses are flawed in multifarious ways with weaknesses such as ambiguities and shortcomings in identifying potentially liable persons, and softness in terms of the scope for defences and the extent of penalties. Such flaws ultimately favour the wrongdoers at the expense of the investors affected by the contravention of the legal requirements of disclosures. In the absence of an effective legal framework, the weaknesses of enforcement mechanisms have increased the vulnerability of investors.

The judicial enforcement measures for prospectus liabilities are so ineffective that no case law for the inclusion of misstatements or the concealment of material facts in prospectuses is found although such conduct has been legally prohibited since the inception of the market nearly 50 years ago. This prohibition was reportedly flouted on numerous occasions. The administrative enforcement of prospectus liabilities is also ineffective.
As the effects of these weaknesses accumulated, the DBR has turned counterproductive. The market is suffering from a profound lack of investor confidence due to the unethical and unscrupulous practices of the market participants. This confidence is the main impetus for the market. Providing legal protection to investors is the most accepted practice of fostering such confidence.

This study attempts to identify and to remedy the drawbacks of the legal and regulatory framework of the IPO market and its enforcement mechanisms from the perspective of investor protection. The legal provisions in Bangladesh which are relevant to the weaknesses mentioned above are examined in the light of their equivalents in some other selected jurisdictions as well as the principles of securities market regulation formulated by the International Organisation of Securities Commissions. Findings in this thesis suggest that although the DBR relies more on ‘cure’ than ‘prevention’, both the liabilities and enforcement regimes governing disclosures in prospectuses are ineffective in protecting investors from the misfeasance of other participants in the market. At the same time, preventive measures to combat such impropriety are virtually useless. In such a situation, the present study comes up with a number of specific suggestions for reinforcing the investor protection regime in the IPO market by strengthening the liabilities and enforcement regimes.
Acknowledgements

I am indebted to many individuals and institutions for their sincere support extended to me during the course of this study. First of all, I would like to express my gratitude to the University of Wollongong for offering me scholarships (International Postgraduate Research Scholarship and University Postgraduate Award) which enabled me to undertake this program. I am greatly indebted to the Islamic University, Bangladesh which granted me leave for prosecuting this study. I must express my deepest gratitude to Mr Charles Chew, my thesis supervisor, who provided me with the most effective guidance and supervision, and thereby taught me a lot about legal research. I would like to express my indebtedness to all members of academic and administrative staff of the Faculty of Law for their sincere cooperation extended to me in carrying out this research. The strong support for all of my academic needs provided by Dr Rick Mohr, the Postgraduate Coordinator, deserves to be gratefully mentioned. Professor Helen Gamble, former Dean of this Faculty, should be remembered for her help in the initial stage of this program. Special thanks are due to all staff members in the Library and the Office of Research of this university for their assistance.

I am grateful to a number of eminent academics, securities regulators, and stock exchanges of different countries as detailed in Chapter 2 (section 2.7) for their extended cooperation. In addition to these, my gratitude is due to the International Securities Services Association (ISSA), International Organisation of Securities Commissions (IOSCO), Standard & Poor's, United Nations Development Program (UNDP), and Harvard Institute for International Development for providing me with various updated information.
and research materials. The continued encouragement and inspiration of some of my respectable teachers are gratefully acknowledged.

With a feeling of my highest respect, I would like to pay the richest tributes to the life and work of my father who passed away in May 2002 in Bangladesh at a time when I was making a concentrated effort to finish this task on time here in Australia; yet he wanted to see me for the last time! Unfortunately, his desire came to me in the evening when he was no more! I tried to console myself by recalling his last advice given to me in July 2000 when I left him last for a qualification –‘please do not come to bury me if I die before your return with a Ph D’. He was 102. He was such a spirited ‘teacher’ for my doctoral study. I cannot express enough gratitude to my elderly mother who always hides her pains for my joys even at her age.

I am thankful to Dr Sarkar Ali Akkas, my friend, who helped me carry out this research in his own way. My gratefulness will suffer from incompleteness if it is not extended to my brothers who allowed me to be a law student 21 years ago in exchange for their austerity.

The incomparable appreciation is due to my wife, Afroza Begum, who is my colleague in home and abroad, for her love and support for this painstaking research. I feel guilty about depriving my children, Romman and Adnan, of my company during the last three odd years.

Finally, I take sole responsibility for opinions expressed and mistakes that may remain in this thesis despite my all out efforts to be accurate in every respect.
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<tr>
<td>AD</td>
<td>Appellate Court Division of the Supreme Court of Bangladesh</td>
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<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<tr>
<td>AGMs</td>
<td>Annual General Meetings</td>
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<tr>
<td>AIMS</td>
<td>Asset &amp; Investment Management Services of Bangladesh</td>
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<tr>
<td>ASIC</td>
<td>Australian Securities and Investment Commission</td>
</tr>
<tr>
<td>BAPLC</td>
<td>Bangladesh Association of Publicly Listed Companies</td>
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<td>BBC</td>
<td>Bangladesh Bar Council</td>
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<tr>
<td>BSRS</td>
<td>Bangladesh Shilpa Rin Sangstha</td>
</tr>
<tr>
<td>BSS</td>
<td>Bangladesh Sangbad Sangstha</td>
</tr>
<tr>
<td>CCI</td>
<td>Controller of Capital Issues (Bangladesh)</td>
</tr>
<tr>
<td>CDBL</td>
<td>Central Depository of Bangladesh Limited (Bangladesh)</td>
</tr>
<tr>
<td>CDS</td>
<td>Central Depository System</td>
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<tr>
<td>CIC</td>
<td>Capital Issues Committee (Malaysia)</td>
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<td>CMDP</td>
<td>Capital Market Development Program</td>
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<td>CMM</td>
<td>Chief Metropolitan Magistrate Court</td>
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<td>CMMC</td>
<td>Chief Metropolitan Magistrate Court</td>
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<tr>
<td>CPD</td>
<td>Centre for Policy Dialogue</td>
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<td>CSAARC</td>
<td>Chamber of South Asian Association of Regional Cooperation</td>
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<td>CSE</td>
<td>Chittagong Stock Exchange</td>
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<td>DBR</td>
<td>Disclosure-Based Regulation</td>
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<td>Developing Finance Institutions</td>
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<td>Dhaka Stock Exchange</td>
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<td>East Pakistan Stock Exchange Association Limited</td>
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<td>FBCCI</td>
<td>Federation of Bangladesh Chamber of Commerce and Industry</td>
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<td>FIR</td>
<td>First Information Report</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>IAS</td>
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<td>ICAB</td>
<td>Institute of Chartered Accountants of Bangladesh</td>
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</table>
ICB Investment Corporation of Bangladesh
ICGN International Corporate Governance Network
IFAC International Federation of Accountants
IIs Institutional Investors
IOSCO International Organisation of Securities Commissions
IPO Initial Public Offering
ISA International Standards on Auditing
ISSA International Securities Services Association
KLSE Kuala Lumpur Stock Exchange
LDCs Least Developed Countries
MBR Merit-Based Regulation
MCD Malaysian Central Depository
MOC Ministry of Commerce
MOF Ministry of Finance
MOL Ministry of Law
NFCD Non-Resident Foreign Currency Deposit
NSDL National Securities Depository Ltd (India)
NSE National Stock Exchange (India)
OECD Organisation for Economic Co-operation and Development
OTC Over-the-Counter
PO Presidential Order
QC Queen’s Counsel
RJSC Registrar of Joint Stock Companies (Bangladesh)
ROC Registrar of Companies (India)
SC Securities Commission
SEBI Securities and Investment Board of India
SEC Securities and Exchange Commission (Bangladesh)
SJC Supreme Judicial Council
SOEs State Owned Enterprises
TI Transparency International
UK United Kingdom
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Chapter 1
General Concepts and Terminology

1.1. Introduction

Investment is the primary impetus for the development of national economies worldwide in this age of market economy. In a free enterprise system, funds are generally directed to those areas which investors consider most profitable. The importance of portfolio investments to achieve economic development has increased further following the 'failure of socialism' which began in 1985.\(^1\) With the expansion of capitalism, the 'securities market'\(^2\) has been an essential mechanism for the rapid transformation of the financing model from the bank-based finance (Japan-German Model)\(^3\) to the market-based finance (Anglo-American Model).\(^4\) Between these two models of corporate finance, it is considered that 'Anglo-American markets are more conducive to innovation in finance'.\(^5\)

Most countries have established their securities markets for the purpose of mobilising funds in order to finance their firms. For the development of trading enterprises 'financial requirements of nascent nation-states nurtured the growth of

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2. The details of securities markets will be discussed in section 1.3.
3. The markets under the Japan-German Model are described as being ones where 'powerful private and/or governmental institutions dominate local markets through informal, cooperative relationships'. Thus this model aims at satisfying a few institutional investors in contrast to the Anglo-American Model which provides information to 'a broad, anonymous universe of investors': J B Baskin & P J Miranti Jr, *A History of Corporate Finance* (1997) Cambridge: Cambridge University Press at 324. For further information about these two models, see A Demirguc-Kunt & V Maksimovic, 'Funding Growth in Bank-Based and Market-Based Financing Systems: Evidence from Firm-Level Data' (2002) 65 *Journal of Financial Economics* 337
4. The Anglo-American Model is 'characterized by freely competitive markets, transparency in corporate affairs and regulatory structure to protect investors from the incompetency or dishonesty of agents [company directors]': Baskin et al (1997) id at 322.
broad, anonymous financial markets’. Being a segment of financial markets, the
securities market establishes and maintains a link between entrepreneurs and the
investing public. A securities market facilitates the allocation of capital amongst various
participants that include households, corporations and governmental authorities through
the market intermediaries.

'Initial Public Offerings' (IPOs) constitute that part of the securities market which
transfers capital from savers to firms. Recent studies on firm-level and industry-level suggest that the development of an 'equity market' is closely connected with the
national economic growth. The IPO market thus plays a substantial role in achieving
economic development. The main function of this market is to enable a company to
raise funds from the public for its growth and product innovations. Investor
confidence in the market operations and regulatory functions is the primary concern of
securities markets. The generation and maintenance of this confidence require investor
protection from the misfeasance of other market players.

The securities market is a broad area of knowledge. It involves multifaceted
concepts and terminology which are relevant to a number of disciplines, such as law,

5 Id at 325.
6 Id at 89.
8 For the meaning of IPOs, see section 1.3.1.
11 The term 'equity market' roughly means the share market. For details, see section 1.3.
14 Ibid.
finance, accounting and economics. As the title of the thesis suggests, its central focus will be on the protection of investors who invest in ordinary shares issued for the first time by companies in Bangladesh. The term 'protection' warrants the application of the law. Therefore, all relevant concepts will be considered from a legal point of view.

The objective of this chapter is to introduce mainly the concepts related to the issue market of ordinary shares in companies willing to go public. Currently, the government regulator in Bangladesh regulates the issuance of these shares in pursuance of the 'disclosure philosophy'. This chapter will therefore endeavour to explain some selective concepts and terminology in the light of general understanding and as these are enshrined in the relevant laws of Bangladesh.

The discussion in this chapter will be divided into nine sections. Section 1.1 (the foregoing) is the introductory section which highlights the importance of the securities markets. Section 1.2 will consider the definition of the term 'securities' and its traditional types. Section 1.3 will focus on the securities market and its typical classifications. Section 1.4 will deal with the companies' dilemma in going public and the methods of IPOs. Section 1.5 will concentrate on the regulatory aspects of securities markets with special reference to the market for IPOs. Section 1.6 will highlight the importance of investor protection and its relation with the development of securities markets. The section will incorporate, inter alia, the issues of disclosure philosophy for the regulation of IPOs. Section 1.7 will discuss the information to be disclosed in a prospectus for the purpose of an IPO. The meaning of 'material information' will be included in this section. Section 1.8 will deal with the concept of the 'disclosure regime' a term which will be used in this thesis. Finally, section 1.9 will present a summary and conclusions.

15 The term 'disclosure philosophy' has been explained later in section 1.6.2.2.
In discussing the above issues, emphasis will be given to those which are directly related to the present study. However, in the interest of a coherent presentation, some other pertinent issues will be discussed briefly. Further, it may be noteworthy that financial innovations which have emerged in recent times with respect to products and markets are still non-existent in Bangladesh, and the discussion will not cover these innovations.16

1.2. Securities and Their Traditional Types

There has been no single definition of the term ‘securities’. The statute of each jurisdiction usually defines the term as it is applicable to the jurisdiction concerned. However, there have been some common ideas about this term in the securities regulation regimes. In terms of general concepts, a ‘security’ is a ‘financial asset’17 issued by business entities or governmental authorities for the purpose of raising funds for business or borrowing money for the government from the public.18 The term ‘security’ includes some transactions which create obligations in addition to personal promises of its issuer to its holder.19 In the United States (US), the Court of Appeal for the Second Circuit in United States v Canton, defined a ‘security’ as the ‘evidence of indebtedness’.20 ‘Security’ can also mean some sort of protection of investors who subscribe to the capital of corporations or the borrowing of governments. According to

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16 For example, the financial products available in the Bangladesh securities market are only ordinary shares and debentures and mutual funds issued by companies. There has been neither Over the Counter (OTC) market nor the derivative market.


Black, a security is an ‘[e]vidence of obligations to pay money or of rights to participate in earnings and distribution of corporate assets’.  

In a general sense, then, a ‘security’ is a financial instrument representing an obligation or a debt of its issuer to its holder. Thus, a security entitles its holder some specific legal rights, for example, the right to share in the earnings of the issuer, and the right to get refund of its face value. However, these rights and obligations are subject to the terms and conditions attached to a particular security.

In Bangladesh, the term ‘security’ has been defined in s2(1) of the Securities and Exchange Ordinance 1969 (SEO'69). Section 2(l) provides a long list of financial instruments. It enlists two types of instruments. These include the instruments which are securities and which are not. For example, transferable shares, debentures and bonds have been mentioned as securities. On the other hand, a bill of exchange or a bank draft, for example, is not a security. In addition, government securities have been defined in s2(a) of the Securities Act 1920. This definition includes, inter alia, promissory notes, treasury bills, bearer bonds and other securities issued by the government.

1.2.1. General Classifications of Traditional Securities

Securities are generally classified as equities, debts, hybrids and ‘other instruments’.

1.2.1.1. Equity Securities

The basic characteristics of an equity security are twofold. These are: its holder is a residual claimant in the assets of its issuer, and it represents a share in the ownership of
its issuer. Although, securities may be issued by both ‘corporations’ and governments, equities are always issued by corporations alone. The best example of equities is ordinary shares.

In Bangladesh, s2(d) of the SEO’69 provides the definition of ‘equity security’ in the following terms:

‘[E]quity security’ means any stock or transferable shares (preferred or common) or similar security representing ownership; any security convertible, with or without consideration, into such a security, or carrying any warrant or right to subscribe to or purchase such a security; any such warrant or right itself; and such other security as may be prescribed.

Equities are popularly known as ordinary shares as well as the ‘common stock’ of a company. As observed in Colonial Bank v Whinney, a share is an intangible movable property called a ‘chose in action’ or thing in action. Farwell J in Borland’s Trustee v Steel Brothers and Co said that ‘[a] share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second’. His honour also added that a share ‘is an interest measured by a sum of money and made of various rights contained in the contract, including the right to a sum of money of a more or less amount’.

The American term ‘corporation’ and the British term ‘company’ will be used interchangeably throughout the thesis.


There has been no separate definition of debt securities and hybrid securities in any legislation relating to securities. Perhaps for this reason, equity securities simply include both preferred stock and convertible debentures.


Since a share is a creature of statute, it is a legal rather than an equitable chose in action, Colonial Bank v Whinney (1886) 11 App Cas 426 (per Lord Blackburn, para 17).

[1901] 1 Ch 279 at 288.
Ch 1: General Concepts and Terminology

Gambotto v WCP Ltd held that ‘[a] share in a company is property consisting of proprietary rights as defined by the articles of association’. In this case, the High Court also expressed the view that a share ‘is more than a “capitalised dividend stream”: it is a form of investment that confers proprietary rights on the investor’.

The rights and liabilities of certain shareholders depend on both the terms of the issue of shares and the provision of pertinent laws. However, the typical rights of shareholders are threefold. Firstly, during the operation period of the company, shareholders obtain the right to receive dividends if declared by the board of directors of the company. Secondly, shareholders have the right to vote in the general meetings. Thirdly, they have the right to take the residue of the assets of the company after meeting the legitimate claims of creditors and preference shareholders respectively when the company is liquidated or wound up. On the other hand, the basic liabilities of shareholders is to pay for their own shares, and at the time of the liquidation of a limited company, the shareholders can be held liable for the debts of the company to the extent of their respective holdings of shares. It is stated that the concept of this limited liability is the foundation of modern corporations.

31 (1995) 13 ACLC 342 at 349
33 S Vattiikuti, ‘Accelerating Towards Globalisation: Indian Securities Regulation Since 1992’ (1997) 23 North Carolina Journal of International Law & Commercial Regulation 105 at 110. The present thesis will be concerned with the shares in limited liability companies exclusively. Limited liability is the most common feature of publicly traded companies worldwide. The need to ease the concerns of equity investors led to the establishment of the limited liability company in the middle of 17th century: Baskin et al (1997) above n3 at 86. The conventional wisdom holds the view that limited liability is the ‘primary advantage of doing business’ on corporations: R A Booth, ‘Limited Liability and the Efficient Allocation of Resources’ (1994) 89 Northwestern University Law Review 140 at 140. For the advantages and reasons for limited liability, see at 143-145 of this article.
The relation between shareholders and the company is contractual. Although a company is a separate legal entity and distinct from its shareholders, the legal literature commonly considers shareholders to be the owners of the company.

According to the definition of equity security provided in the SEO'69 as stated in section 1.2.1.1, shareholders in Bangladesh are considered as being the owners of the company. An ambiguous definition of the term ‘share’ has been provided under s2(v) of the Companies Act 1994 (CA'94). It says, “‘share’ means a share in the capital of the company, and includes stock except when a distinction between stock and shares is expressed or implied”. In view of these two definitions of shares in Bangladesh, a share is generally considered to be a unit of the company capital which bears a part of ownership of its issuer.

Shares are commonly divided into two types, namely, ‘ordinary shares’ and ‘preference shares’. Ordinary shares are called common stock as mentioned earlier. Preference shares constitute preferred stock and these shares are not generally included in equities.

Like ordinary shares, ‘share warrants’ to subscribe to ordinary shares are also regarded as equities. Damodaran points out that warrant holders ‘receive the right to buy shares in the company at a fixed price in the future, in return for paying for the

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35 R Sappideen, ‘Protecting Debenture Holder Interests: A Delicate Art’ (1991) 4 Corporate and Business Law Journal 36 at 38. See also, R A G Monks & N Minow, Watching the Watchers: Corporate Governance for the 21st Century (1996) Cambridge: Blackwell Business at 75. The finding that a company is one legal person and a member is a different person was first decided in Salomon v Salomon & Co Ltd [1897] AC 22. In respect of the ownership of a corporation, Beach J in Re Humes Ltd in Australia strongly asserted that ‘the books and property of the corporation really belong to the shareholders, and the reality cannot be overthrown by the fiction of law that a corporation is an artificial person or entity apart from its members’: (1987) 5 ACLC 64 at 67.
36 P E Nygh and P Butt (eds), Butterworths Australian Legal Dictionary (1997) Sydney: Butterworths at 428. Preference shares will be discussed briefly in the discussion of hybrid securities in section 1.2.1.3.
37 Black (1990) above n21 at 1355-56.
warrants today'. Similarly, one writer states that a 'share warrant' refers to a certificate of a company stating that the holder of this certificate is entitled to the number of shares appearing on it. As observed in *Webb Hale & Co v Alexandra Water*, share warrants are transferable and the transferees will obtain all the rights conferred on its previous holders or transferors.

In Bangladesh, share warrants can be issued under s46 of the CA'94, but ‘in practice, it is rare to find the use of share warrants’.

The holders of equity or common stock or ordinary shares are known as the members of the company. These securities have no fixed life times.

**1.2.1.1. Debt Securities**

Both companies as well as governments may issue debt securities. Unlike equities, a debt security is a fixed life financial instrument which entitles its holder to receive fixed income (interest on principal amount) from the cash-flows and assets of its issuer. This claim is preferable to that of shareholders during the operation period of the issuer as well as in the event of its liquidation. The issuer is obliged to repay the principal amount upon the maturity of the debt instrument subject to the terms of the debt. Laws governing such debts in a given jurisdiction are also applicable to such claims. The holders of debt securities are known as ‘creditors’ or ‘lenders’ and the issuers are termed ‘debtors’ or ‘borrowers’.

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40 (1905) 21 TLR 572 at 572-73.
42 Damodaran (2001) above n38 at 483.
1.2.1.2.1. Debentures

Over the years, various types of debt securities have evolved. However, conventional debt securities are debentures and bonds. As defined by Redmond, '[a] debenture is the written acknowledgment of a debt owed by a company'. A debenture is a 'chose in action' and it may but not necessarily include a charge over the property of its issuer to secure the repayment. At common law, a debenture is an acknowledgment in writing of a corporate debt. However, the common law meaning of debenture does not include every debt instrument as debenture. For example, negotiable instruments such as bills of exchange or promissory notes are not debentures. The two generally agreed characteristics of debentures are that these financial instruments are issued by companies, and they acknowledge or create debts. These debts must be existing debts, as opposed to future debts. There are varieties of debentures.

In Bangladesh, s2(e) of the CA’94 vaguely defines the term ‘debenture’ providing that, a debenture ‘includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not’. As at February 2003, there have been the debentures of a total of nine companies in the market and the amount of issued debenture capital is ‘very insignificant’.

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44 See, for details, id at 155-64.
46 *Hendevel Pty Ltd v Comptroller of Stamps (Vic)* (1985) 157 CLR 177 at 196.
47 *Hendevel Pty Ltd v Comptroller of Stamps (Vic)* (1985) 157 CLR 177 at 195.
48 *Hendevel Pty Ltd v Comptroller of Stamps (Vic)* (1985) 157 CLR 177 at 196.
49 *Burns Philip Trustee Co Ltd v Cmr of Stamps Duties (NSW)* (1983) 14 ATR 482 at 484; *R v Findlater* [1939] 1 KB 594 at 599.
51 The amount of issued debenture is 543.8 million taka (approximately US$9.54 million): Investor Information Cell, Chittagong Stock Exchange (CSE), Mr K U Jalal <iic@csebd.com> email (24 Mar 2003).
Some clear distinctions between ordinary shares and debentures may be drawn from the above discussion. Shares represent residual claims, whilst debentures are fixed income securities. Shares are associated with ownership and shareholder are considered to be the members of the company, but debentures represent fixed debts of the company and they are not related to the ownership of its issuer. Shares do not have any maturity dates, but debentures are issued with a fixed life. Ordinary shares are associated with the control of the management of the company, but generally debentures are not.

1.2.1.2.2. Bonds

A bond, like a debenture, is a fixed income debt security having a fixed date of maturity. Company or governmental authorities may issue bonds. These are usually secured debts, although they may also be unsecured. Bonds are classified as different types depending on the terms and conditions attached thereto.

In Bangladesh, the term ‘bond’ has been included in the statutory definitions of ‘security’ and ‘debenture’ as has been shown earlier. It has not been separately defined in any securities law. Most importantly, as at February 2003, there have been no bonds in the Bangladesh securities market. However, the government has been contemplating issuing bonds in the market for long time. Therefore, the term ‘debt securities’ so far implies only debentures in Bangladesh.

52 Black (1990) above n21 at 178.
53 For details, see Damodaran (2001) above n38 at 489-92; Ross et al (2001) above n25 at 161-65
54 See sections 1.2 and 1.2.1.2.1 respectively.
55 The Bangladesh Government issued some bonds, namely, ‘premium bonds’ and ‘investment bonds’ in late 2002. But these bonds are not tradable in the securities market. For some details of these bonds, see ‘Dollar Bonds Launched’ The Independent, Dhaka (1 Nov 2002).
1.2.1.3. Hybrid Securities

A hybrid security bears the characteristics of both equity and debt securities. The US Court of Appeal for the Eighth Circuit in *J S Biritz Const v CIR* defined a hybrid security as having the elements of indebtedness as well as of equity stock. These securities are, for example, preference shares and convertible debts.

Preference shareholders have preferential rights to the cash-flow and assets of the issuer. Their claims come ahead of those of ordinary shareholders. Lopes LJ in *Re Brighton v Dyke Rly* stated that ‘[w]hat I understand to be the definition of a preference share is this - a right conferred upon the holder to receive interest in priority to the ordinary shareholders’. There are various types of preference shares, but these are beyond the ambit of this study.

As of February 2003, there has been only one issue of preference shares in the Bangladesh market and this occurred in October 2001. It was the second public offer of the company after issuing ordinary shares in its first offer. The whole offer is convertible into ordinary shares after three years from the date of the offer.

Convertible debts such as convertible debentures may be partly or fully converted into shares. A convertible debenture is one which can be converted into equities at the option of its holder.

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56 387 F 2d 451 (1967) at 455.
57 For details of preference shares, see Damodaran (2001) above n38 at 502-03.
58 (1890) 44 Ch D 28 at 38.
60 Securities and Exchange Commission (SEC) *Annual Report 2001-2002*, Dhaka at 15; M S Rahman, ‘Hatchery Co Planning to Float Preferred Share: First Effort to Explore Fixed Dividend Share Option’ *The Daily Star*, Dhaka (9 Sep 2001). The total issue was of 80 million taka (approximately US$1.40 million). Out of this amount, five million taka were raised from private placements and the remaining preference shares of three million taka were offered to the public.
61 For some details, see Lipton et al (2001) above n27 at 233-34.
In Bangladesh, the debentures are partly convertible into ordinary shares and partly redeemable by the issuing companies in most instances.62

1.2.1.4. Other Instruments

The law recognises two separate interests in securities—one which is legal and the other which is equitable. Although, the same person is generally entitled to both, these two interests may be held separately as well. The separate holding of interests in shares occurs in a situation where the securities in question are held in trust. The trustee retains the legal interest in the underlying securities, whilst the beneficiary obtains the equitable interest.63 There are three parties in such a trust. These are: sponsor company (settler), trustee company (trustee) and unit-holders (beneficiaries).64 The units of unit trusts and the certificates of mutual funds may be a good example of this kind of security. Basically, these are professionally managed pooled funds which are made up of a large number of diversified securities. Such a fund is divided into numerous units and these units are sold to the public. Securities are legally held by the trustee on behalf of the unit-holders (investors) who acquire equitable interests in these securities.65 The purpose of the trust as stated by Merriman is ‘to give the small investors the same benefits as those which were ensured by the purchase of a mixed bag of securities by a large shareholder’.66 These are popular securities to novices and small investors in general. Mutual funds are similar to unit trusts by nature.67 In the United Kingdom

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65 For further details, see Baxt et al (1996) above n27 at 24-25.
66 Merriman (1965) above n64 at 5.
(UK), these managed funds are called ‘unit trusts’,\textsuperscript{68} whilst they are termed ‘mutual funds’ in the US.\textsuperscript{69}

In Bangladesh, the funds are called ‘mutual funds’. As of February 2003, there were a total of 10 mutual funds out of a total 260 listed securities (the number of companies issuing shares, the number companies issuing of debentures and the number of issued mutual funds) in the securities market.\textsuperscript{70}

1.2.4. Position of Ordinary Shares in the Traditional Classifications of Securities

Diagram 1.1: Position of Ordinary Shares in the Traditional Classifications of Securities.

The asterisk (*) refers to the kind of securities that are the concern of this thesis.

1.3. Securities Markets and Their Typical Classifications

As has been mentioned in section 1.1, the securities market is a part of the financial

\textsuperscript{68} Merriman (1965) above n64 at 12.
\textsuperscript{69} ISSA (1999) above n50 at US17-18.
\textsuperscript{70} Investor Information Cell, above n51 (24 Mar 2003).
market in a country. According to Block and Hirt, '[f]inancial markets are the meeting place for people, corporations, and institutions that either need money or have money to lend or invest'. The financial markets thus comprise the multiple of financial instruments issued by governments and corporations alike. With respect to the maturity of tradable instruments, financial markets are divided into major two divisions. These are money markets and capital markets. The essential feature of money markets is that they deal with financial instruments issued by governments or corporations with a short-term maturity of one year or less. Short-term financial instruments, for example, are treasury bills, commercial papers and the certificates of deposits. In contrast, the capital market is the issuing and trading place of financial instruments which have a maturity of greater than one year. The typical instruments of a capital market are, for example, shares, debentures and bonds. The instruments tradable in the capital market are commonly called 'securities' and this market is generally known as the securities market. In modern corporate financing, securities markets are also called 'capital markets'. The term 'capital market' has been traditionally used for 'stock market' and particularly the market for new issues.

Depending on the types of securities, a securities market is broadly spilt into two segments, namely, the primary market and the secondary market. The primary market is also known as the new issue market or the issue market. Securities issued by a company or a government are called 'primary securities'. The primary securities market is thus a market where new or primary securities are issued. As defined by Agarwal, '[t]he

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primary market is a mechanism through which the resources of the community are mobilized and invested in the various types of industrial securities’.  

The secondary market is the trading place of the securities issued in the primary market. Unlike the primary market, the secondary market has a physical existence known as the stock exchange. Trading in this market is called ‘secondary’ because ‘funds flow among investors, rather than to the corporations’. Organised stock exchanges and over-the-counter (OTC) trading places comprise secondary markets. Listed securities are traded on stock exchanges, whilst unlisted or delisted securities are traded on the OTC. Although the OTC markets are in place in many countries, they have not been introduced in Bangladesh to date (February 2003).  

New issues are classified in various ways. The public issue of securities by a newly formed company or an old company for its conversion from private to a public company is called ‘initial issue’ or ‘initial offering’. Similarly, the public issue made by an existing publicly traded company for enhancing its capital is termed ‘secondary issue’ or ‘secondary offering’. The secondary offering is also termed as ‘subsequent offering’, ‘further offering’, ‘follow-on-offering’ or ‘seasoned offering’.  

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75 The OTC is a relatively new idea and it was first established in the United Kingdom in 1972: see Burgess (1985) above n72 at 26.  

76 Both the Securities and Exchange Commission (SEC) and the Dhaka Stock Exchange (DSE), the prime bourse of the country, agreed in January 2002 to introduce OTC trading for the first time. Eventually, the DSE could not introduce the OTC to date (February 2003) owing to a lack of interests amongst the investors as well as the DSE policy makers: see ‘SEC Okays OTC Trading on DSE’ The Daily Star, Dhaka (2 Jan 2002); D N Saha, ‘DSE Agrees to SEC Proposal to Start OTC Trading’ The Independent, Dhaka (11 Dec 2001), & R M Chowdhury, ‘Establishment of OTC Booth on DSE Becomes Uncertain’ The Financial Express, Dhaka (7 Jan 2003).  

77 Apart from the public issue, there are two most common methods of issuing primary shares to the existing shareholders by a public company. These are issuing shares as ‘bonus shares’ or ‘rights shares’. Bonus shares are issued as an alternative to cash dividends and these are issued at par value. Rights shares are offered to the existing shareholder to raise the capital of the company by avoiding the costs of capital. Rights shares are issued mostly at premium (above par value). The
1.3.1. Initial Public Offerings

The term ‘initial public offering’ which originated in the US simply refers to the issuance of shares (usually ordinary shares) to the public for the first time by a company. The IPO is also called ‘going public’ or ‘floatation’. One of the most important implications of going public for the company is the separation of ownership and control as it is characterised in common law jurisdictions. Thus it is generally considered that going public means ‘converting a proprietary company to a public company by offering shares to the public’. In the present study, an IPO will always mean the first public offer of ordinary shares by a company. It may be mentioned that the Bangladesh securities market is basically a market of ordinary shares as is evident in the figure given below.

 shareowners are entitled to renounce their rights. All of these methods are more or less used in Bangladesh.


One writer does not clearly mention that the securities for an IPO must be shares, but his discussion supports the view that securities should be shares: C R Gipson, *The MacGraw-Hill Dictionary of International Trade and Finance* (1994) New York: McGraw-Hill Inc at 201. Another writer says that floatation may comprise both shares and debt securities. However the latter can be differentiated from the former by identifying it as ‘float a loan: Shanahan (1997) above n39 at 84.


Shanahan (1997) above n39 at 94. See also, Black (1990) above n78.

It may be noted here that the first public offerings and secondary or subsequent offerings are regulated under the separate rules of the SEC. The first offerings are regulated under the PIR’98 and subsequent offerings are under the *Securities and Exchange Commission (Capital Issue of the Public Companies) Rules 2001*.

The details of the Bangladesh securities market will be provided in Chapter 3.
Figure 1.1: Market Shares of the Different Types of Securities in Bangladesh in Terms of Issued Capital (in million taka) as on 28 February 2003.\footnote{The figures are of the DSE. There is only one company (Dacca Dyeing and Manufacturing Company Ltd) which is listed on the CSE only. All other companies listed on the CSE are also listed on the DSE. Thus the DSE alone may well represent the total number listed securities in Bangladesh: Investor Information Cell, above n51 (25 Mar 2003).}
1.3.1.1. Position of the IPO Market in the Securities Market

Diagram 1.2: Position of IPOs in the Securities Market

The asterisk (*) refers to the kind of securities market that is the concern of this thesis.
Note: One could technically call both Hybrid and Debt Offerings as IPOs, because these offerings are initial ones and are made to the public. However, in this study, only the equity offerings will be considered as IPOs.
1.3.2. Origins of Securities Markets

The trading of debts as securities began a long time ago. It started with government debt securities in the Italian city of Venice in the early 14th century. The Amsterdam bourse was established in 1530. The trading of government debt securities started developing in the middle of 16th century in Holland. At the end of 17th century, England adopted this idea of the trading of government debt instruments and the ‘government issued its first long-term annuities’ in 1693. Later in 1694, the English government established the Bank of England which started borrowing from the public through tradable securities. Since then, the English government had largely relied on public loans, and had issued debt instruments which were traded in an active market.

‘Medieval shipping partnership’ is considered to be the first effort to divide a business into shares. The Russia Company of 1553, a foreign trading enterprise, may have been the first joint stock company in the English business. Trading in shares of these early companies was allowed to a considerable extent on freedom of shareholders. However, an explicit right to transfer shares was found in the charter for the Company of the Royal Adventures into Africa in 1662. The members of this company were granted the right to transfer their shares ‘to any person or persons

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85 Banner (1998) above n27 at 23. The present writer greatly owes to this source for the following description of the historical background of securities markets.
91 See J P Davis, Corporations (1905) New York: G P Putnam’s Sons at 114-56.
whatsoever'. Gradually, the number of joint-stock companies increased and the transferability of their shares became commonplace. Several coffeehouses in London lining 'Exchange Alley' provided the market place for 'stock' transactions.

In 1657, an advertisement was made in England 'for public subscription to the East India Company'. Thus, the formal IPOs were established in the middle of 17th century in England.

As time went on, various intermediaries, namely, 'stock-jobbers' and 'dealers' emerged. By the year 1700, the number of these market professionals increased significantly and they 'formed the first English institutional market for the new issues'. This market facilitated the frequent raising of funds from the public by joint-stock companies as well as the government.

America inherited the concept of securities trading from immigrants from England. The securities market in America came into operation for the first time in the 1770s. In the early part of the 19th century, securities trading began and continued to slowly grow until the 1830s. A notable development with respect to public subscription in

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93 C T Carr (ed), Select Charter of Trading Companies A D 1530-1707 (1913) London: B Quaritch at 180.
94 As mentioned earlier, until the 19th century, 'stock' included both shares and debt instrument. At present, 'stock' means only shares: see the text in above n27.
96 Banner (1998) above n27.
98 'Dealers in Stock' had been described by an editor of a commercial newspaper as being those persons who 'sell [shares] to one, and buy of another different Shares of the same Stock for different prices, and so make Advantages': quoted in Banner (1998) above n27 at 26.
100 Banner (1998) above n27 at 122.
the US was evident in the shares for the construction of commercial railroads. Thus, in
the later part of the 19th century, the trading in ‘railroad securities expanded rapidly’. 102

Following the example of the developed countries such as the UK and the US, several states worldwide established their own securities markets for financing their firms as an alternative to bank-based finance. However, the establishment of securities markets all over the world took a long time. The countries in continental Europe and Latin America as well as in Asia have been developing their markets for equity issues only since the 1980s.103 In one way, the recent rise in the number of IPOs is attributed to the dramatic increase in the number of firms over the last few decades.104 In Bangladesh, the first stock exchange was established in the middle of the 1950s.105

1.4. Going Public Decision and the Companies’ Dilemma

There have been no ‘hard-and-fast’ rules as to when a company should float.106 The decision to go public is perhaps the most crucial ‘dilemma’ in company management. Some writers describe this as being ‘truly a milestone in a company’s life- it makes a major change in the relationship between the firm and its owners’.107 In describing a company floatation, Sabine said that ‘[g]oing public represents a coming of age, a time of significant change for the company and its associates’.108 A company may decide to

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102 Id at 5-6.
104 For details, see id at 17-21.
105 Details of the historical background of the Bangladesh Securities market will be provided in Chapter 3.
107 Ibid.
float for mainly three reasons. These are for: expanding its business, off-loading the shares of the original or existing equity holders, and reducing borrowings. Corporate external capital involves some ‘costs and benefits’. Significant advantages and disadvantages associated with the floatation of a company are stated below.

1.4.1. Advantages

An IPO can significantly contribute to increasing the corporate equity capital which can be used for the expansion of a company’s business. The net worth of the company is increased through its status of being a publicly trading company. By virtue of this status, the company may borrow more capital either from the bank or from the securities market on more favourable terms. Usually, publicly traded companies pay lower tax on their profits than do unlisted companies. In addition, the company may avoid paying interests on the debt capital by increasing its equity capital which helps reduce its debts. In this way, the company may save its profits which can be reinvested or distributed as dividends amongst shareholders. Moreover, IPO funds may provide a unique opportunity for the company to save its working capital if the company fails to make profits in a particular year. This is because, in the case of debt financing, the company is obliged to pay the fixed interests on its debts regardless of its profits or losses. But, the company is not legally required to pay its shareholders anything if the company fails to make sufficient profits in a given financial year. Another important advantage is that

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109 The expansion of the business of a company may take place through increasing the production of its existing products or enhancing the scope and quality of its existing service, or introducing new products or services in the market.

110 These equity holders are mainly the company directors and promoters who intend to exit or reduce their holdings in the company.

111 In corporate finance, the fund raised from an IPO is regarded as external capital.

floatation paves the way for the appointment of efficient and expert executives in the company by the majority shareholders.

Apart from these advantages, an IPO benefits the original or controlling shareholders by providing them with opportunities. For example, an IPO enables original shareholders to offload their shareholdings in the company. They can realise their capital gains by selling their shares, and diversify their investment portfolios by investing in other securities.113

1.4.2. Disadvantages

The disadvantages of floatation affect more the interest of controlling shareholders than that of the company. From the perspective of the company, there are two major disadvantages. Firstly, the company has to bear some significant expenses. These expenses include the preparation and publications of a prospectus, fees and commissions payable to the market professionals and intermediaries involved, fees payable to the government regulator in order to obtain consent to the issue and listing fees payable to the stock exchange(s).114 Secondly, the company can claim tax rebate for the amount of interests paid on the debt capital, but this advantage cannot be claimed for the payment of dividends.115

The main disadvantage affecting controlling shareholders is the dilution of the ownership of the company. Depending on the number of shares issued to the public, an IPO may cause the loss of control of the existing management. This is because, the company directors are to be elected by its shareholders. In addition, the company may

113 Usually, the tax rate on capital gains is lower than that on the dividend income.
114 Intermediaries and professionals involved in an IPO will be discussed in section 1.4.5.
115 Interests paid on debt securities are tax deductible, but dividends paid on equity securities are not: see for example, Damodaran (2001) above n42.
be a target of takeover which may cause changes in the existing management. Directors are required to obey the requirements of corporate governance meaning transparency in the company affairs and the accountability of directors to shareholders. Directors must abide by the listing rules of the stock exchange(s) concerned. They need to disclose the business affairs as well as the financial status of the company to the public at the time of floatation. After this floatation, directors would have to keep disclosing the affairs of the company in two ways: by continuous disclosure and by periodic reporting depending on the applicable laws of a given jurisdiction. In Bangladesh, the listed companies are required to disclose material or price sensitive information to the SEC and stock exchanges within 30 minutes of adopting the resolution by the company. In addition, companies are obliged to make disclosures by half-yearly and yearly reports. Thus, the directors become liable for the 'increased level of disclosure of information' to the outside shareholders through which the information basically goes to the public domain. In some cases, the controlling shareholders 'may consider their privacy is paramount' and may avoid going public despite the need for external finance.

It is thus clear that an IPO affords some 'costs and benefits' to the company as well as its controlling shareholders. This being the case, 'the balance of advantage', according to Sabine, will be determined on the basis of 'the particular circumstances of the company and the personalities and ambitions of its directors and shareholders'.

1.4.3. Methods of Going Public

There have been five main methods of going public by a company. These are: firm

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118 Ibid.
commitment offers (US model), offers for sale (UK model), private placements, bookbuilding and introduction.\textsuperscript{119}

Amongst these methods, private placements and firm commitment offers are allowed under the \textit{Public Issue Rules} 1998 (PIR'98) in Bangladesh.\textsuperscript{120} The most common practice is to follow a combined procedure of private placements and firm commitment offers. However, some companies go public without private placements.

In a private placement, the company sells its shares to some sophisticated investors usually institutional investors without any prospectus. It is taken for granted that ‘sophisticated investors’\textsuperscript{121} have the expertise necessary to assess the value of an offer of shares through private communication with the company. In a firm commitment offer in Bangladesh, as it is generally practised, one or more underwriters shall fully underwrite the offer.\textsuperscript{122} The securities law has borrowed the term ‘underwriters’ from the insurance industry.\textsuperscript{123} An underwriter is basically an insurer for the company as well as for subscribers to the new issue when the offer is under-subscribed in the market. Underwriters provide a guarantee to buy all of the remaining shares in case of undersubscription after the expiry of subscription periods. The underwriters take this responsibility in exchange for a predetermined commission on the whole offer. Usually, a company willing to go public first raises a significant part of the total amount of intended capital through private placements. Thereafter, it issues a prospectus to the public after obtaining consent of the Securities and Exchange Commission (SEC) for

\textsuperscript{119} For details of these five methods of going public, see Jenkinson et al (1996) above n80 at 7-14.
\textsuperscript{120} The PIR’98 was given effect from 3 January 1999. Private placements and firm commitment offers are allowed under rules 8 and 15 respectively of the PIR’98.
\textsuperscript{121} The terms ‘sophisticated investors’ and ‘ordinary investors’ will be explained in section 1.6.1.
\textsuperscript{122} \textit{Public Issue Rules} 1998 r15.
\textsuperscript{123} Sabine (1987) above n79 at 33.
the IPO. Obtaining the consent of the SEC is obligatory. However, the SEC may grant exemption by a gazette notification. The issuer shall publish in bold in the prospectus that the consent of the SEC has been obtained. If any private placement is made, the prospectus shall disclose the details of such placements including the amount of capital privately subscribed and full addresses of such investors. In Bangladesh, a firm commitment issue is called ‘public issue’. This study is concerned with only firm commitment public issues.

1.4.4. Preparation, Approval and the Issuance of Prospectuses

In Bangladesh, the initial task of an issuer is to prepare a draft prospectus. The draft prospectus shall be submitted to the SEC for obtaining consent to the proposed offer. The prospectus must be checked by the stock exchange (s) for the purpose of post-offer listing. The published prospectus shall mention the name(s) of such stock exchange(s) and the conditions of listing, if any conditions are imposed by the exchange(s). After receiving the consent of the SEC, ‘the prospectus shall be published by the issuer in two national daily newspapers, within 10 days of such receipt’. However, the use of the consented prospectus within this stipulated period is subject to limitations imposed

124 The extent of investment by sophisticated investors through private placements usually provides a signal of the merit of the offer for ordinary investors in the market.
126 Securities and Exchange Ordinance 1969 s2D.
127 Public Issue Rules 1998 r7(B)(i).
128 Public Issue Rules 1998 r8. The identity of such investors helps the public make investment decisions.
130 Listing with at least one of the two stock exchanges is compulsory for the purpose of the secondary trading of the issued shares: Public Issue Rules 1998 r13.
131 Public Issue Rules 1998 r7B(17); ISSA (2001) above n129.
132 Public Issue Rules 1998 r4. The prospectus shall be published in two national daily newspapers (rule 4 of the PIR’98) and post on the SEC web site (SEC Notification of 28 April 1999 and gazetted on 3 June 1999).
under rule 6 of the PIR'98. The most important limitation is that there will be no material changes in the information embodied in the prospectus.133

1.4.5. Persons Involved in Initial Public Offerings

The preparation of a prospectus involves the participation of several persons who comprise the ‘IPO coalition’.134 Although the terminology may differ between countries, the coalition typically includes promoters, directors, auditors, underwriters, lawyers, and the issue manager or lead manager or lead underwriter.135 In addition to these, bankers to the issues are also involved in IPOs, but this study is not concerned with their role.136 Of these persons, auditors and lawyers are known as professionals. Auditors examine the financial position of the issuer and their due diligence reports are incorporated in the prospectus. The lawyers’ duty is to make certain that the prospectus has been prepared in compliance with the relevant law. In this way, auditors and lawyers play vital roles in making ‘full and fair and timely’ disclosures in the prospectus.

Promoters are commonly known as ‘the prime movers of the issue’.137 They are therefore closely connected with the disclosures made in the prospectus. Promoters are directors or existing shareholders of the company.138 In Lagunas Nitrate Co v Lagunas Syndicate, it was held that promoters also include persons who subsequently help

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133 For the details of limitations, see Public Issue Rules 1998 r6.
135 Id at 547; Sabine (1987) above n79 at 33-34.
136 Although, bankers to the issue have a role to play in an IPO, they are not involved in the preparation of a prospectus. They receive the subscription money on behalf of the issuer.
137 Sabine (1987) above n123.
138 Ibid.
promote the capital of the company. However, the statutory definition of ‘promoters’ in Bangladesh puts an absolute emphasis on the involvement in the preparation of the prospectus. Section 145(6)(a) of the CA’94 provides that:

[T]he expression “promoter” means a promoter who was a party to the preparation of the prospectus or of the portion thereof containing the untrue statement, but does not include any person by reason of his [or her] acting in a professional capacity for persons engaged in procuring the information of the company.

Directors are closely involved in the preparation of a prospectus. But the definition of a director is imprecise in Bangladesh. It says a director ‘includes any person occupying the position of director by whatever name called’. This definition seems to have been copied from s2(1)(5) of the Companies Act 1913, the predecessor of the CA’94. The impreciseness of the definition is evident from the equivalents of similar legislation in some other jurisdictions. For example, in Australia, the definition of a director under s9 of the Corporations Act 2001 (Cth) is as follows:

*director* of a company or other body means:
(a) a person who:
   (i) is appointed to the position of a director; or
   (ii) is appointed to the position of an alternate director and is acting in that capacity;
   regardless of the name that is given to their position; and
(b) unless the contrary intention appears, a person who is not validly appointed as a director if:
   (i) they act in the position of a director; or
   (ii) the directors of the company or body are accustomed to act in accordance with the person’s instructions or wishes.

Subparagraph (b)(ii) does not apply merely because the directors act on advice given by the person in the proper performance of functions attaching to the person’s professional capacity, or the person’s business relationship with the directors or the company or body.

Note: Paragraph (b) - Contrary intention - Examples of provisions for which a person referred to in paragraph (b) would not be included in the term "director" are:
* section 249C (power to call meetings of a company’s members)
* subsection 251A(3) (signing minutes of meetings)
* section 205B (notice to ASIC of change of address).

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139 [1899] 2 Ch 392 at 428.
140 *Companies Act* 1994 s2(f).
It is thus considered that the definition provided in the CA’94 lacks clarity in the identification of persons who are the directors of a company.

Underwriters play a decisive role in determining the price of the shares comprising a public offer.141 Similarly, managers to the issue or lead managers or lead underwriters, have a significant role to play in the process of an IPO. They prepare the prospectus in collaboration with other members of the IPO coalition. They are ‘responsible for ensuring full and fair disclosure about the issue and the issuer’ in Bangladesh.142 Their ‘due diligence certificates’ are included in the prospectus. Merchant banks and insurance companies act as underwriters and issue managers. Merchant banks are neither merchants nor banks in the true sense. A merchant bank ‘is an agency, retained by the company to advise and assist in capital structuring/restructuring and its mobilization within the prescribed regulatory framework’.143 Merchant banks are required to obtain a licence from the securities regulators of their respective jurisdictions in order to be able to carry out these functions. There is a by-law for the regulation of merchant banks in Bangladesh. The functions of merchant banks include portfolio management, underwriting, issue managing and providing advisory services with regard to issuing securities.144

1.5. Securities Regulators and Initial Public Offerings

1.5.1. Need for Securities Regulation

The regulation of IPOs is an important part of securities regulation. The term ‘securities regulation’ was first coined in about 1951 by Loss, considered to be the ‘intellectual

141 ISSA (2001) above n129.
142 Ibid.
143 Agarwal (1997) above n73 at 142.
father' of securities law. Loss contended that 'the general problems of fraud, share-pushing (to use a British term), and market manipulation' necessitated regulation. It is generally accepted that regulation is necessary because of the existence of informational asymmetry between issuers and their potential investors. In the words of Sappideen, 'information is costly, and in any case not all participants have equal access to information'. Loss went one step further and said that 'problems at which modern securities regulation is directed are as old as the cupidity of sellers and the gullibility of buyers'. The principal purpose of IPO regulation is thus the creation of a 'level playing field' in the market. Unfairness in securities trading is an old phenomenon. Referring to the trading in securities in the 18th century, Banner remarks that '[t]he idea that stock-jobbers were unusually deceitful, for instance, was a staple of anti-market thought throughout the century'. The growing incidence of fraudulent conduct with respect to securities issues was observed in the early 19th century. Lord Eldon described the situation in 1800 by saying 'that a jobber or dealer in the funds was always to be considered as a culpable person'. Similarly, during most of the 19th century, the commissions of deceits or frauds in securities trading were a common

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144 Securities and Exchange Commission (Merchant Bankers and Portfolio Managers) Regulations 1996, reg2(1)(j). It will be discussed further in Chapter 4.


146 Loss (1981) ibid.


149 Banner (1998) above n27 at 89.

phenomenon. Commenting on the situation during the first half of 20th century, a US circuit court observed that trading in securities ‘is one in which opportunities for dishonesty are of constant occurrence and ever present’. Although efforts were made to encounter the trend of deceiving and misleading securities investors, the dishonest behaviour of issuers, market professionals and market intermediaries in the securities trading is still evident worldwide in varying degrees.

As has been mentioned earlier, England is the pioneer of the development of a sophisticated market for corporate securities. England is also regarded as the place of the origin of modern securities regulation. England recognised ‘at an early point that some control was needed over companies selling securities to the public’. An unusual rise (800 per cent) of the share price of the South Sea Company occurred in the first half of 1720 and fell by ‘even greater amount’ before December of the same year. The ‘boom and bust’ ruined thousands investors and ‘[r]eputations in the financial and political world were destroyed wholesale’. As a consequence, the Bubble Act 1720 was enacted and enforced. The Act was ‘definitely regulatory’. The objective of the Act was to inhibit the promotion and operation of ‘dangerous and mischievous undertakings and projects, wherein the undertakers and subscribers have presumed to

153 *Archer v SEC* 133 F 2d 795 (1943) at 803.
156 Goodkind (1976) above n154.
158 Knauss (1964) above n155 at 611.
act as if they were corporate bodies. Since then many laws were enacted in the UK and its judiciary also played an important role in developing the securities regulation law.

America inherited the English concept of securities regulation alongside the idea of securities markets. The securities law in the US was first enacted at state levels. The statutory regulation of securities trading in the US began in 1852 through a Massachusetts statute. The statute aimed at regulating the issues of shares and bonds by common carriers. However, the first ‘state securities law’ which is commonly referred to as ‘blue sky law’ was enacted in Kansas in 1911. The legislation introduced prohibitive regulation for certain companies (weak in terms of economic fundamentals and business viability) willing to go public. This was in fact the ‘merit regulation’ of proposed public offers. Gradually, almost all US states followed Kansas. In Hall v Gieger-Jones Co, it was observed that the blue-sky laws were enacted to protect investors from promoters who would engage in selling stock in the blue sky itself. At the federal level, the Securities Act 1933 was the first legislation for the purpose of

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160 For example, Barnard’s Act 1934; another statute in 1766: see Banner (1998) above n27 at 109.
161 Early cases contributing to the development of securities regulation are, for example, Hall v Cupper (1693) 90 Eng Rep 174; Lancashire v Killingworth (1701) 88 Eng Rep 1498; Blackwell v Nash (1723) 88 Eng Rep 83; Wilkinson v Meyer (1722) 88 Eng Rep 127; Stent v Bailis (1724) 24 Eng Rep 705; Dutch v Warren (1720) 93 Eng Rep 598; Cud v Rutter (1719) 24 Eng Rep 521; Faikney v Reynolds (1767) 98 Eng Rep 79; Petrie v Hannay (1789) 100 Eng Rep 652; Sanders v Kentish (1799) 101 Eng Rep 1323; Child v Morley (1800) 101 Eng Rep 1574: see Banner (1998) above n27 at 111-16, and see also at 88-120 for a greater detail of the English approach towards securities regulation during the 18th century.
162 Banner (1998) above n100. See also, Loss (1988) above n148 at 1 & 3.
164 ‘Blue Sky Laws’ aimed to regulate ‘speculative schemes which have no more basis than so many feet of blue sky’: Hall v Gieger-Jones Co (1917) 242 US 539, 550.
166 Knauss (1964) above n155 at 615.
167 The term ‘merit regulation’ will be explained in section 1.6.2.1.
168 242 US 539 (1917) at 550.
Federal regulation came into effect as a complementary to the existing state regulation from a different philosophical point of view.\footnote{Loss (1988) above n148.}

1.5.2. Objectives of Securities Regulation

As is evident from the emergence of securities regulation, the principal objective of such regulation is to provide protection to ‘investors’\footnote{In terms of the whole securities regulation, investors include creditors.}.\footnote{Reducing systemic risks is the third of the total objectives as set out by the IOSCO. Systemic risks are associated with the secondary market as described by the IOSCO. Thus this objective falls outside the purview of this study. For details of the objectives, see International Organisation of Securities Commissions (IOSCO) Objectives and Principles of Securities Regulation: A Report of the International Organisation of Securities Commission (Sep 1998) <http://www.iosco.org/doc-public/1998-objectives-document01.html> (2 Jul 1999).} Similarly, the first objective of securities regulation is investor protection as set out by the International Organisation of Securities Commissions (IOSCO), whilst the second objective is ensuring market fairness, efficiency and transparency in the market operation.\footnote{Some historic debacles in securities markets are, for example, in England in 1720, in the US in 1929, in Bangladesh 1996. All these crashes greatly contributed to the need to legislate laws in favour of investor protection.}

The ultimate aim of investor protection is the development of the market by increasing investment through facilitating ‘fair games’ amongst the market players. The urgency of investor protection emanated from the stock market crashes which occurred several times in different countries.\footnote{See M H Cohen, “‘Truth in Securities’ Revisited’ (1966) 79 Harvard Law Review 1340 at 1351-52.} It is a historically proven fact that investors are not able to protect themselves.\footnote{Loss (1988) above n148.} Like the situation of the early stage of securities regulation, a 2001 survey reveals that ‘investors would be hopelessly idiotic if they...
relied on themselves'. Therefore they need government protection and the protection should militate against the fraudulent and unfair practices of other market players.

1.6. Importance of Investor Protection for the Development of Securities Markets

Numerous studies suggest that there has been a strong correlation between investor protection and the development of capital markets. A group of writers namely, La Porta, Lopez-De-Silanes, Shleifer and Vishny (LLSV) have presented perhaps the most cited recent literature in connection with investor protection. Their empirical studies conducted by various teams covering numerous states of different legal systems all over the world demonstrate that investor protection is very crucial for the development of securities markets. Apart from these, there have been a good number of studies which concur with LLSV. Referring to the huge success of the Poland securities market, one recent study shows that the 'legal protection of outsider investors- both shareholders and creditors- from expropriation by issuers and financial intermediaries' contributed to that success. ‘Law definitely matters’ as argued by Johnson with respect to investor protection and the development of securities markets. He firmly expressed the view that

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'[t]he change may come slowly, and there may be setbacks..., but a sustained effort to
improve investor protection will definitely pay off'.\textsuperscript{178} Referring to the empirical
evidence, Black shows that greater investor protection contributes to the faster growth
of securities markets.\textsuperscript{179} Another empirical study carried out on 30 developing and
developed countries reveals that an 'active strong market' is related to the compliance
with 'legal norms' meaning investor protection.\textsuperscript{180} Yet another study of 16 emerging
economies concludes that adequate accounting standards and investor protection laws
are positively associated with 'better developed stock markets'.\textsuperscript{181} Pistor finds that
investor protection is the most important consideration for the development of capital
markets, the other consideration being for shareholders property rights and trading
rules.\textsuperscript{182}

It is thus a widely recognised fact that effective investor protection is a precondition
for achieving a vibrant national capital market. There are no good reasons to ignore or
underestimate the importance of the participation of ordinary shareholders who provide
not only capital but also market liquidity, both of which are essential for a sound stock
market. The presence of a sufficient number of ordinary investors is extremely
significant in emerging markets which usually lack an adequate number of institutional
investors as compared to that of developed markets. The extent of public participation

\textsuperscript{177} E Glaeser, S Johnson & A Shleifer, 'Coase Versus The Coasians' (2001) 116 \textit{Quarterly Journal of
Economics} 853 at 897.

1 at 14.

\textsuperscript{179} B S Black, 'The Legal and Institutional Preconditions for Strong Securities Markets' (2001) 48
\textit{UCLA Law Review} 781 at 835. For the summary of some empirical studies which advocate investor
protection for strong securities market, see also at 836-38.

\textsuperscript{180} A Demirg"uc-Kunt & V Maksimovic, 'Law, Finance, and Firm Growth' (1998) 53 \textit{Journal of
Finance} 2107 at 2134.

\textsuperscript{181} See Levine et al (1998) above nl2 at 1181.

\textsuperscript{182} K Pistor, 'Law as a Determinant for Equity Market Development: The Experience of Transition
Arbor: The University of Michigan Press 249 at 278.
in the equity market depends on the investor protection and the market development thus rests on the legal protection of outside shareholders.\textsuperscript{183} This protection appears to be of utmost importance in the Bangladesh market. This is so because, under the present state of affairs, ‘once the investor is duped and his [or her] money taken off him [or her] it will be difficult for him [or her] to avail of the remedies’, says Zahir who is the country’s most renowned securities lawyer and the government lawyer for securities cases.\textsuperscript{184}

1.6.1. Investors

Although investor protection is the main thrust of securities regulation, the legislation dealing with this protection does not usually define the term ‘investor’.\textsuperscript{185} The absence of this definition may imply that ‘investor’ is not a technical term having a precise legal meaning. Despite the fact that ‘investors’ can be referred to in other ways, for example, shareholders, stockholders, debenture holders, or bondholders, a specific definition of the term is advisable. It is stated that ‘the absence of a precise meaning is not satisfactory from a technical legislative standpoint where intervention justifies its own existence by expressly mentioning investor protection as one of its aims’.\textsuperscript{186} A clear concept of the term ‘investor’ may be helpful in determining the actual scope of the application of securities regulation.

One writer defines the term ‘investor’ on the basis of ‘action’ meaning ‘to invest’. The expression ‘to invest’ is best explained as meaning to spend money in something

\textsuperscript{184} Zahir (2000) above n41 at 130.
\textsuperscript{186} Id at 58-59.
with the expectation of getting returns from doing so.\textsuperscript{187} This definition covers all individuals and institutions who invest in any type of securities and thereby it is useful for securities markets.\textsuperscript{188}

The IOSCO defines ‘investor’ broadly by saying that, the term ‘is intended to include customers or other consumers of financial services’.\textsuperscript{189}

Investors have also been classified as ‘sophisticated’ and ‘unsophisticated’ depending on their knowledge of investment. An investor whether an individual or an institution may have sufficient knowledge or experience to properly assess the risks associated with a given security at the time of making an investment decision. In securities markets, such an investor is described ‘as “expert”, “experienced”, “qualified”, “accredited”, “professional” or “sophisticated” investor’.\textsuperscript{190} Institutional investors are generally considered to be ‘sophisticated’ and they invest significant amounts of money. They usually appoint people who are knowledgeable about investment in securities to organise the portfolio of the institution concerned. On the contrary, an investor who lacks the above qualities or, in other words, a person who is unable to properly evaluate the merit of a particular security is known as an ‘ordinary’, ‘general’ or ‘unsophisticated’ investor.

Investors may also be classified on the basis of their holdings of securities. Under this criterion, investors may be broadly identified as equity investors, debt investors, hybrid investors and other securities investors. Again, equity investors or shareholders may be roughly divided into two groups, namely, primary shareholders and secondary shareholders. As alluded to earlier, the IPO market is the market for primary shares.

\textsuperscript{187} New Shorter OED Vol I (1993) mentioned in id at 59.
\textsuperscript{188} Zufferey et al (1997) above n185 at 59.
\textsuperscript{189} ‘Foreword and Executive Summary’ in IOSCO (1998) above n172 (footnote 2).
This thesis is concerned with the protection of investors who invest in ordinary shares issued through IPOs. It may be mentioned here that currently no securities laws in Bangladesh define the term ‘investor’.

1.6.1.1. Investors Who are the Concern of the Present Study

Diagram 1.3: Position of Investors Who are the Concern of This Study.

Asterisk (*) refers to investors that are the concern of this thesis.

1.6.2. Methods of Providing Investor Protection in IPO Markets

The expression ‘investor protection’ in this thesis refers to saving investors from being misled, defrauded or deceived by defective prospectuses which are prepared by promoters and directors in collaboration with their intermediaries and market professionals. This can be achieved by preventing the members of IPO coalitions from

expropriating resources from investors. If any wrong occurs, investors should be adequately compensated and offenders should be brought to justice.

Effective regulation is considered to be the most useful mechanism of investor protection.191 Since the inception of securities regulation, various philosophies, methods or systems of regulation have emerged to regulate IPO markets. A single system of regulation is not suitable for all. A country should choose a particular philosophy depending on the characteristics of its financial market.192 The major systems of IPO regulation are the Merit-Based Regulation (MBR), the Disclosure-Based Regulation (DBR) and the Hybrid of the MBR and the DBR (Hybrid). The basic functions of regulation are twofold. Firstly, it prohibits frauds, and secondly, it requires companies to disclose information necessary to make informed investment decisions both at the time of the issuance of securities and periodically thereafter.193

1.6.2.1. Merit-Based Regulation

The MBR originated in the US through the blue sky laws in the early 20th century.194 The central concept of the MBR is that the regulator will consent to only those proposed public offers which are considered to be worthy of investment. The regulator assesses the merits of a proposed offer before consenting or refusing to consent to it. The MBR

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191 This view is commonly reflected in the works in which investor protection has been emphasised for the development of securities markets. See the sources mentioned in above n176. However, there have been some academic scholars who oppose securities market regulation: see G J Stigler, ‘Public Regulation of the Securities Markets’ (1964) 37 Journal of Business 117. For reply to Stigler’s observations, see I Friend & E S Herman, ‘The S.E.C. Through a Glass Darkly’ (1964) 37 Journal of Business 382; S Robbins & W Werner, ‘Professor Stigler Revisited’ (1964) 37 Journal of Business 406. Stigler responded to his criticism, see G J Stigler, ‘Comments’ (1964) 37 Journal of Business 414. Nonetheless, the idea is still limited to mere academic debate. This is because, to the best of the present writer’s knowledge, securities markets worldwide are regulated in one form or another with the primary objective of investor protection.


thus represents a paternalistic approach, because the regulator carries out the merit assessment on behalf of investors.

The theoretical basis of the merit regulation is that 'because of the nature of securities, a buyer cannot make an immediate value judgment, as he [or she] would with tangible items'. The MBR is based on a philosophy which presupposes that ordinary investors are not able to make prudent investment decisions even though companies disclose all 'material information' in relation to the issuers and their issues. It is also considered that issuers are in a better position than investors in respect of the knowledge of economic fundamentals and the potential of the business of the issuer and investment wisdom as a whole. Viewed from this perspective, the regulator assesses the merits of proposed offers and consents only to those offers which are considered to be 'fair, just, and equitable'. In this way, the MBR protects potential investors from 'unfair' offers and maintains market integrity for 'fair' ones. It is widely believed that the MBR is the best system for emerging markets where the market is dominated by unsophisticated retail investors. As per the assessment of the IOSCO, the MBR is a preferable system for developing markets especially those markets which lack professional analysts and advisers. It is noteworthy that there have been significant volumes of literature

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194 Loss (1981) above n145 at 36. Loss mentioned the MBR as 'homegrown regulatory or merit philosophy'.
195 Knauss (1964) above n155.
196 The term 'material information' will be discussed in section 1.7.2.
198 From the regulatory point of view, a public offer is considered to be 'fair' if it is assessed by the regulator as beneficial for the investing public.
concerning the debate on merits and demerits of both the MBR and the DBR.\textsuperscript{201} The Bangladesh securities market is still pre-emerging and it is overwhelmingly dominated by retailers who seriously lack investment knowledge and who are unsophisticated in the true sense.\textsuperscript{202} The market followed the MBR till the end of 1998, before the adoption of the DBR.


\textsuperscript{202} Based on the state of development (in terms of per capita Gross National Income as well as the market performance) securities markets worldwide have been broadly divided into two categories, namely, developed and emerging markets. The markets in the countries which have achieved the high per capita Gross National Income fixed by the World Bank are designated as developed markets and the remaining markets are said to be emerging ones. For details of the market classification, see Standard & Poor’s, \textit{Emerging Stock Markets Factbook} 2002 (2002) New York: Standard and Poor’s at 30 & 352. The market in Bangladesh falls under the broad category of emerging markets. However, there have been significant differences amongst the emerging markets in terms of their achievements and performance. In view of these differences, a new division was introduced in September 1996 and currently, a total of 20 of the emerging markets as covered by the Standard and Poor’s have been identified as ‘frontier markets’. The frontier markets are those which are relatively small and illiquid even by emerging market standards’: Standard & Poor’s, \textit{S & P Frontier Index Series} <http://www2.standardandpoors.com/NASApp/cs/ContentServer?pagename=sp/Page/IndicesIndexPg&r=1&b=4&s=6&ig=44&i=EN%i=64&xcd=FRONT> (19 Jun 2003). The Bangladesh market has been placed in the frontier market category: Standard & Poor’s, \textit{Emerging Stock Markets Factbook} 2002 (2002) New York: Standard and Poor’s at 33 & Standard & Poor’s (Apr 2002) \textit{Emerging Stock Markets Review} at 218. Similarly, the United Nations Conference on Trade and Development (UNCTAD) designated the stock markets of least developed countries ‘pre-emerging market’: UNCTAD, \textit{Investing in Pre-Emerging Markets: Opportunities for Investment of Risk Capital in the LDCs} (1998) New York: United Nations. Accordingly, the UNCTAD included the Bangladesh market as pre-emerging one. The stock market in Bangladesh is far behind many emerging markets (Table 3.8 in Chapter 3). In recognition of the smallness and the poor performance of the Bangladesh market as compared to other emerging markets (especially the markets in Malaysia and India) which will be referred to as the discussions proceed on, the Bangladesh market will be described as ‘pre-emerging’ market for the convenience of the discussions throughout the thesis.
1.6.2.2. Disclosure-Based Regulation

In contrast to the MBR, the DBR relies on making ‘full and fair disclosure’ to the public. The DBR differs fundamentally from the MBR in that it requires that any company may be allowed to go public if it discloses all material information necessary to make informed investment decisions in its prospectus. This regime relies entirely on compliance with the disclosure requirements instead of fulfilling any threshold ‘qualifications’ as envisaged in the merit regime. The regulator does not assess the merit of the public offer; rather it leaves the onus of the assessment to potential investors themselves. In the DBR, the regulator is thus least concerned with the merit of public offers. The regulator, in fact, does not take any responsibility with respect to the merits of an offer and such a disclaimer shall be published ‘bold type face’ (upper case) in the prospectus.203

As regards the theoretical basis for the DBR, the disclosure philosophy is that, once the facts about the issue and the issuer are made public properly, investors have no one but themselves to blame for their investment decisions. The sole responsibility of the regulator is ‘to ensure the full and fair disclosure’ in the prospectus in order to enable investors to make informed investment judgments.204 This is consistent with the prime objective of corporate disclosures which allow investors to make ‘informed, rational investment decisions as to the best estimate of the price of the securities’.205

The IOSCO considers that the DBR is beneficial for developed markets.206 However, the securities regulator in Bangladesh adopted the DBR by discarding the

203 See Public Issue Rules 1998 r7(B)(1)(i)
204 Public Issue Rule 1998 r7(B)(1)(i).
previous merit regulation system in January 1999, although the market is still a pre-emerging one.

1.6.2.2.1. Origins of the Disclosure-Based Regulation

The genesis of the DBR can be traced in the UK in the middle of the 19th century.\textsuperscript{207} English law first recognised the need for regulating public issues of securities and its initial enactment for such regulation was the \textit{Bubble Act} 1720 as has been mentioned earlier.\textsuperscript{208} Basically, the Act was not concerned with the regulation of corporate disclosures. The Act which was repealed in 1825 imposed restrictions on the formation of joint-stock companies to combat corporate frauds, and eventually halted the growth of joint-stock companies.\textsuperscript{209} Frauds in the securities market continued and a committee (Gladstone Committee) was appointed in 1841 to investigate the laws concerning joint-stock companies for the purpose of providing greater protection to the public.\textsuperscript{210} The \textit{Companies Act} 1844 was enacted following the report of the Gladstone Committee, and became the ‘real beginning of English corporations law’.\textsuperscript{211} The genesis of the modern disclosure requirements in a prospectus can be found in this Act.\textsuperscript{212} However, the contents of a prospectus were first detailed in the English \textit{Companies Act} 1867.\textsuperscript{213} To provide civil remedies against the violation of disclosure requirements, the British

\begin{flushleft}
\textsuperscript{207} Loss (1981) above n145 at 36.  \\
\textsuperscript{208} Knauss (1964) above n155. This source mentioned that the Bubble Act was of 1719. But many other sources show that it was an Act of 1720. For example, see Baskin et al. (1997) above n3 at 111; Loss (1988) above n148 at 2; Morgan et al. (1969) above n97 at 37; Redmond (2000) above n45 at 32. For the discussion of the Act, see section 1.5.1.  \\
\textsuperscript{209} Knauss (1964) above n158.  \\
\textsuperscript{210} Ibid.  \\
\textsuperscript{211} Ibid.  \\
\textsuperscript{212} Loss (1988) above n208. For some details of that disclosure requirements, see Knauss (1964) above n155 at 611-12.  \\
\textsuperscript{213} Knauss (1964) id at 612.
\end{flushleft}
Parliament enacted the *Directors Liability Act* 1890. This legislation modified the common law tort of deceits as expounded by the House of Lords in *Derry v Peek* with regard to the requirements of scienter.\(^{214}\) It made the directors and promoters of a company the subject of civil liabilities for untrue disclosures in a prospectus without the proof of scienter.\(^{215}\) The English *Company Act* 1900 further ‘tightened’ the civil liabilities of persons involved in a prospectus. The *Company Act* 1948 ‘established the hitherto most extensive legal disclosure requirements under English law’.\(^{216}\) However, the success of the disclosure requirements greatly owed to the corresponding listing requirements of the London Stock Exchange during the first half of the 1900s.\(^{217}\)

Although the US followed the UK in formulating its (US) securities regulation regime, the US did not adopt the disclosure philosophy until 1933. Securities regulation was the subject matter of state governments exclusively till 1933. Most of the state securities laws were enacted in order to follow the merit philosophy and still many states adhere to this philosophy in preference to the DBR.\(^{218}\) Following the unprecedented securities market crash in 1929, the US introduced securities regulation at federal level for inter-state offerings and adopted the DBR by enacting the *Securities Act* 1933.\(^{219}\)

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\(^{214}\) (1889) 14 App Cas 337.
\(^{217}\) See, for details, Knauss (1964) above n155 at 612.
\(^{219}\) *Securities Act* 1933 is the first federal securities law enacted for the regulation of the primary market. Before this enactment, the regulation of securities market was a concern of the state governments. These states governments mainly pursued the philosophy of merit-regulation under the respective 'blue-sky laws' (US state securities laws. See for detail, The Ad Hoc Subcommittee on the
Although the British *Company Act* 1844 incorporated the DBR for the first time in the modern history, the adoption of this philosophy by the US in 1933 significantly influenced the other nations to follow this suit. The US Supreme Court expounded the DBR as the substitution for the philosophy of *caveat emptor* for financial products. Justice Brandeis, might be called the ‘spiritual father’ of the *Securities Act* 1933 as suggested by Loss. In regard to corporate disclosures, Brandeis said in 1913 that ‘[s]unlight is said to be the best of disinfectants; electric light the most efficient policeman’. However, he recognised that ‘excessive sunlight can cause skin cancer’. A different view with respect to the justification of the adoption of the DBR was evident at its very beginning in the US. Commenting on the disclosure philosophy entrenched in the *Securities Act* 1933, Justice Douglas of the US Supreme Court in 1934, a few years before being the chairman of the US Securities and Exchange Commission, opined that:

[T]hose needing investment guidance will receive small comfort from the balance sheets, contracts, or compilation of other data revealed in the registration statement. They either lack the training or intelligence to assimilate them and find them useful, or are so concerned with a speculative profit as to consider them irrelevant.

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222 Loss (1988) above n148 at 32.


224 Loss (1985) above n218 at 331.

225 Ibid.
During the period of the 1990s, many countries have adopted this disclosure system. For example, Asian countries had been applying the MBR for a long time. Since the middle of the 1990s, some of these countries started adopting the DBR system as espoused in Western developed markets.226

1.6.2.3. Hybrid of the MBR and DBR

A hybrid system of regulation combines the characteristics of the above two systems, the MBR and the DBR. This system may be applied by allowing some relaxation in the merit requirements and exempting some selected public offers from the regulatory merit review. A securities regulator may adopt this hybrid approach as an interim arrangement during the shift from the MBR to the DBR. Malaysia, for example, adopted this system for the period of its transition from the MBR to the DBR during the period between 1996-2002.227

1.7. Information to be Disclosed in a Prospectus

There have been two standards for the determination of the contents of a prospectus

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under the DBR. One is ‘non-prescriptive’ or ‘general disclosure standard’ and the other is ‘prescriptive’ or ‘minimum disclosure standard’. The former standard does not have any strictly prescribed list of issues concerning disclosures and it requires the issuer to disclose all material information necessary to make informed investment decisions. Hence, it is the issuer, not the regulator, who is responsible for the contents of its prospectus. Usually, developed markets follow this standard. On the other hand, the latter, the minimum disclosure standard, provides for a specific list of information which must be embodied in a prospectus. Under such a standard, the securities regulator may ask for further information, if it deems necessary. This standard is well favoured in emerging markets, and is followed in Bangladesh.

1.7.1. Legal Requirements for Disclosures under the Bangladesh Law

Disclosures with respect to IPOs are regulated under the CA’94 and the PIR’98. Section 135 of the CA’94 prescribes the contents of the prospectus. These contents were formulated for the purposes of the previous merit regulation regime. The DBR requires greater disclosures which have been articulated in r7B of the PIR’98. Under r7B, the prescribed information to be embodied in the prospectus makes a long list. In brief, the prospectus shall contain: the basic particulars of the IPO such as the amount and type of securities being issued, offering price, commissions to be given to intermediaries etc; risk factors; the use of proceeds; the description of business; the description of property held by the issuer; the plan of operation and the description of financial condition; the description of directors and officers; the involvement of officers and directors in certain legal proceedings; certain relationship and related transactions between the company and the directors and officers; executive compensation, options granted to the officers, directors and employees of the company; transactions with promoters; the ownership of
the company's securities, the determination of offering prices, the plan of distribution of securities and their market; the description of securities outstanding or being offered; and financial statements.

The PIR'98 thus provides for the details of all material information in order to enable investors and their investment advisers to make informed investment decisions. Apart from these, the SEC may require the disclosure of additional information in a particular prospectus. In brief, it can be said that the PIR'98 covers the aspects of investors' considerations which a knowledgeable investor may wish to know before arriving at an investment decision. The PIR'98 actually complemented the CA'94 in order to meet the requirements of the new regime of disclosure regulation introduced in January 1999.

1.7.2. Material Information

There is no hard and fast rules as to which information is material with respect to investment in securities. In Cackett v Keswick the Court of Appeal in the UK held that, a statement will be material if it would have an impact on a reasonable investor, or such an investor is influenced or induced in making an investment decision on the basis of the prospectus. Lord Halsbury LC in Arnison v Smith made a classic formulation of inducement by saying that:

A person reading the prospectus looks at it as a whole.... You cannot weigh the elements by ounces...if a court sees on the face of the statement that is of such a nature as would induce a person to enter into the contact, or would tend to induce him to do so, or that it would be part of the inducement to enter into the contact, the inference is, if he [or she] entered into the contact, that he [or she] acted on the inducement.230

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228 See for the contents and format of a prospectus under the DBR, Public Issue Rules 1998 r7A(2).
229 [1902] 2 Ch 456 at para 2 (per Farwell J).
230 (1889) 41 Ch D 348 at 369.
In relation to the materiality of an omitted fact, the US Supreme Court held in *TSC Industries Inc v Northway Inc* that:

> It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is the showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholders. Put another way, there must be a substantial likelihood that disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.  

The above judicial observations suggest that a disclosed fact should be considered material if a reasonable investor considers the fact in question important in making an investment decision based on the prospectus. In the case of an omitted fact, the materiality would be determined on a substantial likelihood that a reasonable investor would consider the matter important in deciding on the offer if it were disclosed. Thus the materiality of information is consistent with the reasonability test.  

In Bangladesh, both the unfair disclosure as well as non-disclosure of material information are prohibited. However, there has been no statutory definition of the term ‘materiality’ in any of the relevant laws. In addition to the specifically required and additional information as alluded to earlier, the rule 7(A)(1) of the PIR’98 with regard to material information provides that:

> [T]he prospectus shall contain all *material information* necessary to enable investors and their investment advisers to make an informed assessment of the business engaged in, or to be engaged in, by the company, its assets and liabilities, its financial position, its profits and losses and its future prospectus and the rights attaching to the securities being offered and, in case of more than one project being included in the proposed initial public offering, separate full disclosure for each project [emphasis added].

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232 For the statutory meanings of the ‘concept of materiality’ as adopted in Australia, Belgium, Canada, France, Germany, Italy, Hong Kong, Japan, Luxembourg, The Netherlands, Spain, Switzerland, United Kingdom and United States, see IOSCO, *Comparative Analysis of Disclosure Regime* (1991) Appendix A. It is the report of the Technical Committee of the IOSCO submitted in September 1991.

233 Details of the prohibitions will be discussed in Chapters 6 & 7.
It is thus clear from the above discussion that a prospectus shall contain all information in relation to both the issuer and the issue that may be of the interest of investors in making investment decisions.

1.8. Meaning of the Disclosure Regime

As mentioned earlier, a public company is required to make disclosures in three phases. These are: initial disclosures which are made at the time of going public; continuous disclosures which are necessary in most jurisdictions and are made during the listing period of the company; and periodic disclosures which are made monthly, quarterly and yearly depending on the laws of a particular jurisdiction.

The term 'disclosure regime' in this study exclusively refers to initial disclosures. The regime comprises the disclosure requirements, and liabilities arising out of the contravention of these requirements, authorities involved in the enforcement procedure of these liabilities and those who are entrusted with the responsibility for investor protection in the Bangladesh IPO market.

1.9. Summary and Conclusions

The foregoing discusses the meanings of major concepts and terminology which will be used throughout this thesis. The discussion shows that securities markets are the principal vehicles in the present management of corporate finance by the public. In the realm of economics, investment and economic development are closely related to each other. Enhancing investment in securities entails the proper functioning of the IPO market. Market development is 'measured by the valuation of firms, the number of
listed firms (market breadth), and the rate at which firms go public'.\textsuperscript{234} All these are based on counting the outcomes of the IPO market which facilitates corporate floatation. The IPO market is thus crucial for the measurement of the development of the whole securities market.

Investor protection, in one form or another, is regarded as essential for the development of the IPO market as revealed from the many studies carried out worldwide in recent times as alluded to in this chapter (section 1.6). The degree of this protection depends on the pertinent laws and their proper enforcement.

The DBR aims to protect investors by enabling them to make informed investment decisions. This proposition is truer in theory than in practice. The best evidence of the limited usefulness of the disclosure philosophy may be seen in the fact that, despite the application of the modern DBR for a long period of time in some developed markets as in the UK and the US, the expropriation of investors' resources by issuers in collaboration with their intermediaries and market professionals is still prevalent. Investors in emerging and pre-emerging markets are more vulnerable than those in developed markets mainly because of the relative weakness of the former in respect of corporate governance, liability provisions and their enforcement mechanism. Thus the mere adoption of the DBR is not sufficient to provide investor protection. However, ensuring this protection to a reasonable extent is the ultimate way of attracting and retaining investors in the market. This is so because, it is a proven fact that investors are not able to protect themselves. It is also a recognised fact that investment in securities is a game between unequal players at least in terms of the possession and utilisation of material information. In such a situation, issuers take the advantage of the innocence of

\textsuperscript{234} La Porta et al (2000) 'Investor Protection and Corporate Governance' above n176 at 15.
investors.\textsuperscript{235} The IOSCO thus stipulates 'investor protection' as its first objective of the principles of securities regulation.\textsuperscript{236} Similarly, all securities regulators worldwide explicitly act as advocates of investors.

\textsuperscript{236} 'Foreword and Executive Summary' in IOSCO (1998) above n172 at 1.
Chapter 2

General Introduction

2.1. Introduction

Following the discussions of conceptual issues and terminology in the previous chapter, this chapter looks at some introductory and methodological issues which are relevant to the study. After giving a brief profile of Bangladesh as an independent country, this chapter introduces issues such as the problems prevailing in the Bangladesh securities market; the rationale for, and the aims, objectives, focus, methodology and central arguments of, this study. The discussions are divided into a number of sections. Section 2.1 is introductory. Section 2.2 will introduce Bangladesh, whilst section 2.3 will consider its legal system. Section 2.4 will identify the major problems prevailing in the Bangladesh securities market, and section 2.5 will focus on the rationale for this study. Section 2.6 will highlight the concerns, limitations, aims and objectives of the study, whilst section 2.7 will elaborate on the research methodology involved. Section 2.8 will draw on the central arguments of the thesis. Finally, section 2.9 will present a summary and conclusions.

2.2. Introduction to Bangladesh

The territory now constituting Bangladesh ‘formed an integral part of Indian civilisation’.

Hindu, Buddhist and Muslim administrators had governed it for centuries before the advent of the British colonial administration in the middle of the 18th

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century. It was known as ‘Bengal’ from ancient times. It was a British colony for nearly 200 years until the Indian subcontinent was divided into two separate states, namely, India and Pakistan, in 1947. At the time of this partition, the ‘Province of Bengal’, a province of the former colony of British-India, was divided into two separate provinces, namely, ‘East Bengal’ and ‘West Bengal’. The former joined Pakistan, whilst the latter remained with India. The 1956 Constitution of Pakistan renamed East Bengal as the ‘Province of East Pakistan’. West Pakistan (currently Pakistan) emerged as another colonial administrator of East Pakistan although these two provinces formed federal Pakistan with equal political status. Bangladesh Awami League, a major political party in the then East Pakistan, won the general election in 1970 with a landslide victory which entitled this party to form the Central Government of Pakistan. But the leaders of West Pakistan did not allow the Awami League to form the government. In the end, West Pakistan fought a losing battle to retain power. The then East Pakistan emerged as an independent state on 16 December 1971 after a nine-month’s long liberation war against West Pakistan.

In 1972, the country was constitutionally named the People’s Republic of Bangladesh which is currently governed in a Westminster-type parliamentary system. It is situated in South Asia. Bangladesh is a small country having an area of 144,000 square kilometres with the population of 130 million. Its literacy rate is around 50 per

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2 For details, see ibid.
3 The East India Company governed ‘Bengal’ for 100 years commencing 1757 and thereafter the British Government directly administered it until 1947.
cent. Some 85 per cent of its population are Muslims and 14 per cent are Hindus, whilst the remaining people are Christians, Buddhists and other religious sects. Bangladesh is one of the poor countries in the world and its per capita Gross Domestic Product (GDP) was US$362 in the fiscal year 2001-02.

2.3. Legal System of Bangladesh

The present legal system of Bangladesh owes greatly to the British colonial administration. In this respect, Alam remarks that ‘British influence proved to be the strongest and most far-reaching’. The existing court system was founded during the British regime which also initiated the codification of the law. The sources of law consist of legislation, case law, divine law (for example, Muslim personal law) and customs which have evolved from ancient times. Despite the prevalence of these various sources of law, the legal system of Bangladesh belongs to the common law family. A uniform law is applied across the country since it is a unitary state.

2.4. Major Problems in the IPO Market in Bangladesh

There are many problems prevailing in the Bangladesh IPO market. These are, for

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8 Ibid.
11 The legal systems of the world have been divided into a number families. For details, see R David & J E C Brierley, Major Legal Systems in the World Today: An Introduction to the Comparative Study of Law (3rd ed, 1985) London: Stevens & Sons at 17-31.
example, inadequate and ineffective laws and market regulation, the weak enforcement of securities laws, poor corporate governance, a lack of transparency and accountability in the activities of market intermediaries and professionals, the paucity of economically viable public offer of securities, a paucity of institutional investors, the predominance of unsophisticated investors and weak self regulation. Chapter 5 will elaborate on these problems. All these problems resulted in a serious lack of investor confidence which came to a head after the market collapse in 1996.

To remedy these problems, as will be seen in Chapter 3, a number of reform measures have been taken over the years to induce investment in securities, but the market failed to attract investors. Because of the non-existence of market makers, market liquidity and the activities of other market players considerably rely on unsophisticated or general investors. These investors have been staying away from the market for a long time. As will be evident in Chapter 3, most of the reform measures initiated so far have been aimed at providing incentives to both investors and issuers in the market. Some of the measures were intended to put ‘pressures’ on savers to invest in securities instead of depositing in banks or investing in government savings bonds which are not tradeable in the securities market. In recent times, as mentioned in the previous chapter, many empirical studies demonstrate that ‘investor confidence’ requires ‘investor protection’. Despite this fact, little has been done so far to strengthen investor protection measures in the Bangladesh securities market. As a result, there has been unanimity amongst the market regulators, commentators, stock

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14 Section 1.6.

15 Reforms will be discussed in Chapter 3.
exchanges and various participants that the chronic lack of investor confidence is the main problem in the market.16

2.5. Rationale for the Study

Despite the fact that the Bangladesh securities market has been operating for half a century, it remains in its embryonic form and fails to mobilise funds from the public to any reasonable extent.17 The government of Bangladesh has been striving in vain to make this market a credible place for investment for a long period of time. In response to the reforms initiated by the government during the years prior to the middle of the 1990s, the market had been making some progress from the early part of the 1980s to 1995 as can be seen in Chapter 3. Subsequently, despite a number of reforms introduced after the market crash in 1996, investor confidence has not been restored as yet.18 The reform measures aim to provide incentives to various market players, but the issue of investor protection which should have been placed above all other priorities appears to have been overlooked.

To the best of this writer’s knowledge, there have been no in-depth studies on investor protection in the Bangladesh securities market to date. Moreover, this writer has observed during the course of this study that in addition to the fact that there are

16 See, for example, M O Imam, ‘Capital Market Development in Bangladesh: Problems and Prospects’ (Oct-Dec 2000) Portfolio 43 at 51; M A Baqui Khalily, Professor and Chairman of the Dept of Finance, University of Dhaka, and an eminent share market analyst in Bangladesh, highlighted this lack of investor confidence in an interview with the BBC on 20 April 2002; The Prime Minister of Bangladesh has recently advised the DSE councilors to be more dynamic to restore people’s confidence in the share markets. See ‘Khaleda Urges DSE Men to Rejuvenate Market’ The Daily Star 26 Apr 2002). Investor confidence damaged after the crash in 1996 could not be restored to date - see ‘State of Share Market’ The Daily Jugantor, Dhaka (27 Apr 2002) (editorial-translated from Bengali.


18 This failure will be apparent in section 3.3.
only a few academic studies from the viewpoint of finance and economics, there has been a serious dearth of extensive legal research on the aspects of the Bangladesh securities market.\textsuperscript{19} To show the extent of the unfamiliarity with legal literature in this area in Bangladesh, it can be noted here that during the course of informal discussions between this writer and a number of university academics as will be seen in section 2.7 in this chapter, some experienced scholars have expressed their confusion about the relation between the law and the securities market. There is therefore ample scope for legal research on the Bangladesh securities market. However, it would be impracticable to look at all aspects of the whole market in a single study. The market for Initial Public Offerings (IPOs) seems to be the pivotal issue since it mobilises funds from the public for the companies. This study will concentrate on investor protection in the IPO market under the disclosure regime as has been alluded to in the previous chapter. It is hoped that this research will fill the longstanding gap in the legal aspects of the IPO market in Bangladesh.

\textbf{2.6. Focus and Objectives of This Thesis}

As mentioned above, the central focus of this thesis is the protection of investors in the IPO market in Bangladesh. Therefore, the legal issues concerning IPOs will be examined in this study from the viewpoint of investor protection. Emphasis will be given to aspects of prospectuses. A prospectus is prepared to provide all information

which a potential investor ought to take into account before arriving at an investment decision. More specifically, it is issued to invite as well as persuade the investing public to invest in certain securities. Provisions for prospectus liabilities and related enforcement issues are the cornerstones of investor protection in an IPO market under a disclosure regime. Accordingly, this thesis will focus on three broad issues these being the vulnerability of investors under the Disclosure-Based Regulation (DBR) in Bangladesh, civil and criminal liabilities for a defective prospectus, and the enforcement of such liabilities by the judiciary and administrative authorities.

Although this study will show the growth of the securities market in Bangladesh in Chapter 3, all of the subsequent substantive chapters will deal with the IPO market. The inability of investors to assess an IPO, and the lack of the structural and infrastructural support of the market required for the DBR will be highlighted in respect of investors' vulnerability to protect themselves. As regards prospectuses, this thesis is concerned with liabilities arising out of the disclosure of untrue or misleading information, and the non-disclosure of material facts in a prospectus, but it does not deal with the adequacy of the contents of the prospectus.20

It is difficult to address properly the issues concerning both government regulation and self-regulation in a single thesis. The central focus of this study is government regulation. However, the weaknesses of self-regulation in the Bangladesh IPO market will be discussed briefly in Chapter 5.

This study evaluates the present legal regime of the Bangladesh IPO market from the viewpoint of investor protection. Legal provisions regarding this protection in the


20 This is so because, as stated in section 1.7.1, it is taken for granted in this study that the current laws require the issuer to embody all necessary information that may be useful for making informed investment decisions.
market will be examined in the light of international principles and their equivalents in some selected jurisdictions. In order to achieve this aim, this research is carried out with some specific objectives in mind. These are to:

i. review the feasibility of the application of the DBR in the present context of the IPO market in Bangladesh;

ii. examine the prevailing provisions concerning the liabilities for a defective prospectus;

iii. assess the effectiveness of the existing enforcement mechanism for prospectus liabilities;

iv. identify the drawbacks, shortcomings and loopholes of the present liability provisions and their enforcement mechanism; and

v. provide suggestions for the improvement of the existing investor protection regime in the Bangladesh IPO market.

2.7. Research Methodology

This thesis draws on an archival analysis which is based on published materials. However, some current information is collected privately. The study relies on both primary and secondary sources. Laws dealing with the selected aspects of IPO markets of different jurisdictions are identified and analysed with a view to making suggestions for the improvement of corresponding laws in Bangladesh. The discussions throughout the thesis will emphasise the current laws of the selected jurisdictions.

As mentioned earlier, the drawbacks and shortcomings of laws governing IPOs in Bangladesh will be examined in an international and comparative perspective. In terms of the international perspective, the principles of the regulation of securities markets formulated by the International Organisation of Securities Commissions (IOSCO) will
be discussed. The IOSCO is the largest international organisation of the regulators of securities markets. Bangladesh as well as other countries whose jurisdictions are referred to in this thesis are the members of the IOSCO.

As regards the comparative perspective, no single jurisdiction has been considered as a standard for comparison. The laws of India and Malaysia will be commonly referred to in almost all the issues discussed, however, the scope of choosing ‘better’ examples will remain open. In referring to the laws and judicial precedents of other jurisdictions, emphasis will be given to those of common law countries. However, there will occasionally be a discussion of the laws in civil law countries.

The jurisdictions India and Malaysia have been chosen for a number of reasons. All these three countries, Bangladesh, India and Malaysia, belong to the common law family. There are similarities amongst these three nations in terms of socio-economic status. In addition, there are similarities as regards their securities markets. Firstly, although the organised securities market was first established in India, it could not achieve any significant growth until the later part of the 1980s. This was so mainly because the successive governments pursued a policy of encouraging public sector enterprises. All of these markets had their major growth in the last decade. Secondly, until the Second World War, the Indian IPO market was ‘free from all control’. The office of Controller of Capital Issues established under the Capital Issues (Control) Act 1947 would regulate the IPO market until the establishment of the present Securities

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21 Malaysia is also a former British colony which achieved independence in 1957 and its legal system is based on common law.


and Investment Board of India (SEBI) in 1988.\textsuperscript{25} Similarly, the Controller of Capital Issues established under the \textit{Capital Issues (Continuance of Control) Act} 1947 was the regulator of the IPO market in Bangladesh until the establishment of the current regulator, the Securities and Exchange Commission (SEC), in 1993. Likewise, the Capital Issues Committee (CIC) founded in 1968 would regulate the IPO market in Malaysia until the present Securities Commission (SC) came into being in 1993 under the \textit{Securities Commission Act} 1993.\textsuperscript{26} All of the above mentioned three former regulators came under the direct control of their respective governments. Thirdly, all of the above three present regulators are independent statutory bodies. Thus it can be seen that the three markets are similar to each other in respect of their regulation (regulatory regimes).

India is the closest neighbour of Bangladesh and both India and Bangladesh share a common legal tradition as a former British colony. There are some similarities in their company and securities laws. In addition, Bangladesh appears to have followed the example of India in moving from the previous Merit-Based Regulation (MBR) to the DBR in a single phase.

The success of the securities market in Malaysia is tremendous as compared with those in Bangladesh and India.\textsuperscript{27} There are considerable differences in the laws governing IPO markets in Bangladesh and Malaysia. These differences are evident in many important respects, such as, prospectus liabilities, the enforcement mechanism of these liabilities, and the roles of the securities regulators. Unlike Bangladesh and India,

\begin{footnotesize}
\textsuperscript{25} The SEBI was first established by the government of India as a non-statutory body and it was given statutory recognition by promulgating Ordinance in March 1992. Subsequently, the Ordinance was replaced by the \textit{Securities and Exchange Board of India Act} 1992.

\textsuperscript{26} The CIC was first established by the government of Malaysia under an administrative decision. Later it was made a statutory body under s5 of the \textit{Securities Industry Act} 1983: B J Anderson, ‘Venture Capital and Securities Market Development in Malaysia: The Search for a Functioning Exit Mechanism’ (1993) 12 \textit{Wisconsin International Law Journal} 1 at 21.
\end{footnotesize}
Malaysia moved gradually from the MBR to the DBR during a period from 1996 to 2003. Because of the notable development of the securities market in Malaysia in the last decade, the laws and regulation of this market can be considered to be good examples for the Bangladesh market to follow.

It is important to note that there is a serious dearth of securities case law in Bangladesh. Until 2000, there was ‘only one major judicial decision on the working of these [securities] laws’ and it was related to the preliminary procedure of filing a criminal case by the SEC following the share scam 1996. A similar lack also exists in India and Malaysia. Moreover, certain aspects of securities regimes in India and Malaysia have been found to be either inappropriate or insufficient in analysing their equivalents in Bangladesh. As a result, suggestions for the improvement of the laws of Bangladesh in such cases will be sought in the light of other jurisdictions. Such jurisdictions are, for example, the United States (US), the United Kingdom (UK), Australia, Canada, New Zealand, Hong Kong and Taiwan will be considered. These jurisdictions are selected on the basis of their improved securities regulatory regimes and the success of their markets. The laws of the developed markets, for example the markets in the US, the UK, and Australia, may not be readily applicable to Bangladesh, but these can be seen as benchmarks to be applicable to all securities markets generally.

Securities markets are centrally regulated in all of the above developed countries except for US and Canada. There are two different regulations in the US, one which works at the state level, and the other which works at the federal level. In respect of the US, federal securities laws which follow the DBR for the IPO market will be referred to

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27 See Table 3.8.
28 See section 1.6.2.3.
in this thesis with the exception of the references to the Securities Act of Arizona 1951 in regard to criminal liabilities for incorporating untrue statements in a prospectus. As regards Canada, Ontario is well known for the development of securities law, therefore, it has been chosen for the purposes of comparison in this thesis. From all other jurisdictions mentioned above, the laws of central regulation of their securities markets have been taken into account in this thesis.

It is to be noted that all of the above jurisdictions will not be referred to in each of issues to be discussed. They will be used selectively depending on the arguments that are advanced in this thesis.

In order to carry out a systematic study in an international and comparative perspective, a number of research methods have been adopted. These are to do with:

i. collection of all relevant primary and secondary materials;

ii. review of the secondary literature on laws relating to the protection of investors in the IPO market;

iii. analysis of the relevant statutes and by laws of various jurisdictions including amendments thereto, and explore appropriate case law in their proper perspective;

iv. analysis of relevant public records, regulatory notifications, and available statistical data;

v. examination of press media reports, commentaries and analysis on the operation and regulation of the Bangladesh securities market;

vi. consideration of the final report of the committee of enquiry which was formed to investigate the share scam 1996 in Bangladesh, and several annual reports of the securities regulators, and other institutions involved in the market;

30 With respect to the position of Malaysia, see K. Arjunan, Company Law in Malaysia: Cases and
vii. discussion of the various aspects of the Bangladesh securities market with some persons who are knowledgable and experienced in relevant areas.\textsuperscript{31}

As has been mentioned earlier, there is little academic literature on the legal aspects of the Bangladesh securities market. The writer spent the first half of 2000 collecting materials from various places across the country, but could not find materials that were directly concerned with the legal regime of the market. The writer met a number of experts and obtained their views on the operation and regulation of the market.\textsuperscript{32} These discussions were made on an informal basis. The writer also collected materials from a number of libraries in both Bangladesh and Australia.\textsuperscript{33}

\begin{footnotes}
\item[32] These persons are (as they were at the time of meeting):
\begin{enumerate}[i.]
\item Roughly 17 academics of several universities which include University of Dhaka, University of Chittagong, Islamic University, Kushtia. Academics were chosen from four departments which include Finance, Economics and Accounting and Law on the basis of their publications in relation to the securities market.
\item Two consecutive chairmen (incumbent chairman Mr Manir Uddin Ahmad and his predecessor Mr M A Syed), Securities and Exchange Commission (SEC); Director, Research and Development, SEC; and Deputy Director, Legal Services, SEC,
\item Chairman, Dhaka Stock Exchange and Secretary, Dhaka Stock Exchange.
\item Chief Executive Officer (CEO), Chittagong Stock Exchange; and Head of Finance and Company Secretary, Chittagong Stock Exchange, Chittagong.
\item Managing Director (current charge), Investment Corporation of Bangladesh (ICB), Dhaka.
\item Managing Director & CEO, Asset & Investment Management Services of Bangladesh Limited (the sole private sector mutual funds issuer).
\item Managing Director & CEO, Central Depository Bangladesh Limited, Dhaka.
\item The most renowned securities lawyer and government lawyer for securities cases (Dr M Zahir).
\item The Chief Officer, Legal Division, Beximco Group of Industries. It is the largest industrial conglomerate in the country representing roughly five per cent market share in the Bangladesh Securities Market.
\item A good number of securities investors from different professional backgrounds such as university academic, lawyers, and government officials who are considered to have some idea about the market.
\end{enumerate}
\item[33] These are libraries in:
\begin{enumerate}[i.]
\item Islamic University, Kushtia, Bangladesh
\item University of Dhaka, Dhaka.
\item University of Chittagong, Chittagong.
\item North South University, Dhaka.
\item Securities and Exchange Commission, Dhaka
\item Dhaka Stock Exchange, Dhaka
\item Chittagong Stock Exchange, Chittagong
\item Investment Corporation of Bangladesh, Dhaka
\item Bangladesh Institute of Bank Management, Dhaka
\item The Federation of Bangladesh Chambers of Commerce & Industry, Dhaka
\item University of Wollongong, Wollongong
\end{enumerate}
\end{footnotes}
For the purposes of obtaining information about the present position in regard to specific laws in particular jurisdictions, and collecting relevant published materials, a number of securities regulators were contacted.34

In analysing the issues in this study, confusion arose on occasion concerning the actual meanings of certain important terms. In such cases, academic views were sought for the clarity of their meanings from a number of scholars who are well known for their publications on securities markets.35

xi. The University of Sydney, Sydney
xii. University of Western Sydney, Sydney
xiii. The University of New South Wales, Sydney
xiv. Macquarie University, Sydney
xv. The Australian National University, Canberra
xvi. University of Canberra, Canberra
xvii. National Library of Australia, Canberra

These securities regulators are:
i. Securities and Exchange Commission (SEC), Bangladesh;
ii. Securities Commission (SC), Malaysia;
iii. Securities and Investment Board of India (SEBI), India;
iv. Australian Securities & Investments Commission (ASIC), Australia;
v. Securities and Exchange Commission (SEC), United States;
vi. Securities Commission (SC), New Zealand;
vii. Ontario Securities Commission (OSC), Canada;
viii. British Columbia Securities Commission (BCSC), Canada;
ix. Arizona Corporation Commission-Securities Division (ACC), Arizona, United States;
x. Securities and Futures Commission (SFC), Hong Kong;
xi. Securities and Exchange Commission (SEC), Thailand; and
xii. Monetary Authority of Singapore (MAS), Singapore.

In addition to these regulators, International Securities Services Association (ISSA), Switzerland, and the Chittagong Stock Exchange (CSE), Bangladesh, also assisted this writer in collecting some up-to-date information from time to time on request.

The scholars are:
i. Professor Joel Seligman, School of Law, Washington University;
ii. Professor Florencio Lopez-de-Silanes, Director of International Institute of Corporate Governance, Yale University;
iii. Professor Larry D Soderquist, Director of the Corporate and Securities Law Institute, Vanderbilt University;
iv. Associate Professor Eric Friedman, School of Operations Research and Industrial Engineering, Cornell University;
v. Associate Professor Katharina Pistor, School of Law, Columbia University;
vi. Professor Low Chee Keong, Director, Centre for Accounting Disclosure & Corporate Governance, The Chinese University of Hong Kong;
vii. Professor Ghon Rhee, K J Luke Distinguished Professor of International Finance and Banking, University of Hawai’i;
viii. Professor Enrico C Perotti, Chair Professor of International Finance Department of Finance, Universiteit van Amsterdam
x. Mr Samuel N Allen, Member of American Bar Association, Section on Corporations.
It should be noted here that pinpoint references are provided throughout the thesis wherever appropriate. The exception to pinpoint referencing is apparent in respect of newspaper references. The reason for this exception is that the newspapers referred to in this thesis are collected from the Internet, and they do not have page numbers. Pinpoint references of some other Internet materials cannot be provided because of the non-availability of page numbers. Each Universal Resource Locater (URL) will follow the date of access.

Materials used in this thesis are available mainly in English. In some cases, the author has translated materials from a number of Bengali sources and this is indicated in brackets (parentheses) after the details of such sources in footnotes.

This thesis will embrace the major reforms which took place in the Bangladesh IPO market until February 2003. Likewise, laws are discussed in this thesis as this writer knew them in February 2003.

2.7.1. Treatment of the Data

As has been mentioned earlier, this thesis will examine some specific issues of the IPO market. In the analysis in this thesis, the data will be used in raising and exploring problems which persist in the IPO market in Bangladesh. Issues that are discussed in the chapters relate to both the Bangladesh perspective and the general international perspective. The parts on the Bangladesh perspective are evaluated in comparison with the propositions and principles developed in the comparable parts on the general international perspective.

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36 This author however has kept on file all the copies of Internet materials referred to in this thesis.
2.8. Central Arguments of the Thesis

The central argument of the thesis is that investor confidence is the most important requirement for a vibrant capital market, and strengthening measures to protect investors is a prerequisite to restore and maintain this confidence in the market. Having regard to this central proposition, the thesis will endeavour to advance three main arguments. Firstly, the adoption of the DBR in Bangladesh in January 1999 by the SEC was a premature and inappropriate decision. For the justification of this argument, the critical analysis in Chapter 5 will provide evidence that the DBR is not helpful for investor protection in the Bangladesh IPO market mainly because of the overwhelming dominance of unsophisticated general investors, and the lack of full and fair disclosures. Secondly, prospectus liability provisions were drafted to protect investors under the previous MBR. The main characteristics of these provisions can be stated as being ambiguous in defining wrongs, unclear in identifying the wrongdoers, and 'soft and flexible' in imposing stringent liabilities on the members of IPO coalitions. The DBR requires clearer and more stringent liability provisions for defective prospectuses than those required in the MBR as will be seen in other jurisdictions as discussed in chapters 5-9. Very little has been done so far to improve prospectus liability provisions to accommodate the needs of the disclosure regime. Thus, it can be said that the present liability provisions for the preparation and the issuance of defective prospectuses are inadequate for investor protection in the IPO market. Thirdly, the enforcement regime for prospectus liabilities is ineffective. The discussion here will show that an efficient judiciary for the enforcement of these liabilities just does not exist in Bangladesh.37 Similarly, the administrative enforcement mechanism for these liabilities suffers from a

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37 In this respect, efficiency refers to the bench and the bar which are sufficiently trained in securities law and are able to dispense justice expeditiously.
considerable lack of efficiency and public confidence. The thesis as a whole will argue that the current investor protection regime is not suitable to protect investors in the IPO market in Bangladesh.

2.9. Summary and Conclusions

The lack of public confidence has been identified as the main problem prevailing in the Bangladesh securities market. It is contended that the lack of adequate investor protection resulting from the weak legal and regulatory framework constitutes the root cause of the problem. Despite the importance of investor protection for the development of capital markets, laws dealing with this protection in the Bangladesh market have never been studied extensively. Perhaps, due to the absence of legal literature on this area, the authorities concerned have endeavoured in vain to attract investment by offering incentives to investors and issuers in the market. This study is the first of its kind which examines the investor protection regime in the IPO market in Bangladesh from an international and comparative perspective.

The whole thesis will have due regard to the widely accepted argument that efficient regulation stimulates investor confidence in the market operation, and conversely that inefficient regulation will impede the effective functioning of securities markets.\footnote{See R Levine & S Zervos, ‘Capital Control Liberalization and Stock Market Development’ (1998) 26 World Development 1169 at 1179.} It will also be taken for granted that the disclosure of reliable information concerning the issuer and the issue would assist in promoting investments in equities.\footnote{Ibid.} In this analysis, account will be taken of laws that should be formulated to protect the
investing public against harm caused as a result of the lack of market regulation.\textsuperscript{40} Equal emphasis will also be given to the enforcement of these laws, because as has been observed by Sappideen, the recognition of rights 'without a corresponding right of enforcement is of no use'.\textsuperscript{41}

The benefits that come from the study are expected to be quite significant. For example, this research will fill the gap in the academic literature in the field in Bangladesh; contribute significantly to the concept and mechanism of investor protection in the IPO market; and provide specific suggestions for the improvement of the existing legal and regulatory provisions concerning investor protection.


Chapter 3

Inception and Growth of the Securities Market in Bangladesh

3.1. Introduction

This chapter will discuss the inception and growth of the securities market in Bangladesh. The objective of this chapter is to show that despite the long term duration of its operation, the market has not been able to grow to any reasonable extent. In this study, the growth of the market will be measured in terms of the growth pattern of listed companies in the secondary market, the number of companies going public and the amount of public issues. The chapter will demonstrate the gradual growth of the market from independence in 1971 to 2002. Major reform measures taken by the government in the last decade for the development of the market will also be discussed. It is to be noted that, no significant reforms in respect of the Bangladesh securities market were made until the early part of the 1990s.¹

This chapter will be divided into a number of sections. Section 3.2 which follows the introduction will deal with the establishment of organised stock exchanges in Bangladesh. Section 3.3 will focus on the growth of the market after the emergence of Bangladesh as an independent state. This section will show the market growth from the restoration of its operation after independence in 1976 to the unprecedented market crash in 1996. It also looks at reforms that were introduced to revitalise the securities market before the mentioned crash. Section 3.4 will highlight the reforms introduced during 1997-2002 to induce investment in securities after the market disaster. Section 3.5 will show the growth of the market after the reforms. Section 3.6 will provide a
graphic presentation of the market growth from 1976 to 2002. Section 3.7 will present the current position of the market. Section 3.8 will demonstrate the growth of the market for initial public offerings (IPOs) from 1977 to 2002. Section 3.9 will discuss the position of institutions other than stock exchanges involved in the securities market. Section 3.10 will highlight the performance of the securities market measured in terms of mobilising public savings. Section 3.11 will show the comparative position of the Bangladesh securities market amongst its selected Asian counterparts. Finally, section 3.12 will present a summary and conclusions.

3.2. Establishment of the Securities Market in Bangladesh

The Bangladesh securities market has two stock exchanges. These are: the Dhaka Stock Exchange (DSE) and the Chittagong Stock Exchange (CSE).

3.2.1. Establishment of the Dhaka Stock Exchange

The history of the securities market in Bangladesh predates the country’s independence. The foundation of this market goes back to early 1954 when an organised stock exchange was set up in Narayanganj, a nearby town of Dhaka, the capital city. The bourse was incorporated as the East Pakistan Stock Exchange Association Limited (EPSEAL) on 28 April 1954. It emerged as the first bourse of the then East Pakistan.1

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3 There was a separate stock exchange for West Pakistan. It was established at Karachi in 1948. The name of the bourse was the Karachi Stock Exchange: M F Ahmed, Capital Markets and Institutions in Bangladesh: Some Implications of Japanese Experience (1997) England: Ashgate at 87.
Although the EPSEAL came into being in 1954, it began its operation in 1956 in Narayangonj after having acquired necessary infrastructure. The bourse was shifted to the Narayangonj Chamber Building in the capital city in 1958, and relocated to the present premises in 1959. On 23 June 1962, it was renamed as the East Pakistan Stock Exchange Limited and its name was further changed as the Dhaka Stock Exchange Limited (DSE) on 14 May 1964.

The DSE is a public limited company and a non-profit self-regulatory organisation. Its management and policymaking bodies were not separated until 1998. To date, the DSE is the prime bourse of the country. It was formed with eight founding members. As of February 2003, there were 195 members. Of these, 157 members are active in the market. Provisions were made to increase the number of members to 500. The DSE allows both individual and corporate memberships. Foreigners are allowed to be members of the DSE. At present, the Equity Partners Securities Ltd is the sole foreign member in the DSE.

3.2.2. Establishment of the Chittagong Stock Exchange

The Chittagong Stock Exchange (CSE), the second bourse was incorporated on 1 April

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6 In 1962, the exact name was ‘Dacca Stock Exchange Limited’. In the middle of the 1980s, the spelling of the capital city was changed to ‘Dhaka’. Thus the exchange has become the present Dhaka Stock Exchange Limited.
9 For details of the founding members of the DSE, see DSE, *Memorandum and Articles of Association* (As modified up to 30 April 1998) at 32.
10 DSE, ‘About the DSE’ <http://www.dsebd.org/about.html#mem> at 1(23 Feb 2003).
1995. The CSE is situated in Chittagong, the second largest city which is unofficially known as the commercial capital of the country. Like the DSE, the CSE is also a public limited company and a non-profit self-regulatory organisation. The CSE began trading on 10 October 1995 with 30 listed securities and with the market capitalisation of 10,574 million taka (approximately US$176.23 million).

There were 70 founding members in the CSE, each member having one share. As at February 2003, the number of members stood at 129, of which a total of 84 members were active. The total number of members include three foreign members and two of them are active. Unlike the DSE, the CSE pursues a policy of corporate membership only, and has kept the policy making body separated from its management ever since its inception.

It is to be noted that in discussing the growth pattern of the market, only the data of the Dhaka Stock Exchange (DSE) will be shown with an exception that the data of both bourses will be presented in showing the dramatic boom and bust in 1996. The reason for not discussing the data of the CSE separately is that all of the securities listed on the CSE are also listed on the DSE except for one. Thus the securities listed on the CSE cannot be separately taken into account with respect to the growth pattern of the market or listed companies in the country.

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12 For details of the founder memberships, see Chittagong Stock Exchange (CSE), Memorandum and Articles of Association at 10-20.
14 CSE, ibid. The Head of Compliance of the CSE confirms that a foreign member named the Hong Kong Bangladesh Securities Limited has not been activated in trading as a member as yet: Mr M Atiquzzaman <atiq@csebd.com> email (23 Feb 2003).
15 The sole company which is listed on the CSE alone is the Dacca Dyeing and Manufacturing Co which was listed on 21 March 1998 with the issued capital of Issued Capital 44 million taka (approximately US$0.73 million): Investor Information Cell, Chittagomng Stock Exchange, Mr K U Jalal <iic@csebd.com> email (27 Mar 2003).
3.3. Growth of the Securities Market in Bangladesh

3.3.1. Market Growth During 1976-1996

The Bangladesh securities market could not make any significant progress in terms of its depth and breadth until 1976, although the DSE was established a long time before that. It is pertinent to note that the operation of the DSE remained suspended from the first quarter of 1971 to the middle of 1976.\(^\text{16}\) The suspension commenced automatically following the war of liberation of 1971, and it continued until 1976 due to the adoption of socialistic policies by the post liberation administration.\(^\text{17}\) Pursuant to this new state policy, the government started massive nationalisation of State Owned Enterprises (SOEs). All large and small-scale enterprises having assets valued at exceeding 2.5 million taka (approximately US$0.04 million) were nationalised by a Presidential Order (PO) in 1972.\(^\text{18}\) Such a gigantic step forced the DSE to cease its operations. This suspension impeded the growth of the market.

On 15 August 1975, a military coup de'etat took place which overthrew the then government and resulted in the assassination of the then President and most of his family members.\(^\text{19}\) The successive government opened up the national economy having regard to laissez-faire economics principles. The process of economic liberalisation

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\(^{16}\) The reasons for the suspension of the market operation will be given in section 3.2.

\(^{17}\) Constitution of the People Republic of Bangladesh 1972 art 8. The original constitution (before any amendments thereto) enshrined socialism as one of the fundamental principles of state policy. But it was amended by The Second Proclamations (Fifteenth Amendment) Order 1978. The amendment narrowed down the ordinary meaning of the term by adding a statutory meaning thereto. According to this amendment, the term 'socialism' means 'economic and social justice' not the 'socialistic economy' as it is generally meant.

\(^{18}\) Presidential Order 1972, PO No 27 dated 23 March 1972.

\(^{19}\) Sheikh Mujibur Rahman, the Founding President, was assassinated on 15 August 1975 along with 23 of his family members and close associates including all his three sons and wife. The only survivors were his two daughters who were abroad at the time. See for details, A G Chowdhury, ‘Bangabandhu Sheikh Mujibur Rahman’ <http://www.bangabandhu.org/about3.htm#5> (7 Aug 2001).
began in 1976 in independent Bangladesh. The DSE resumed its operations in the middle of 1976 with only nine listed companies. The total paid-up capital of these companies was 132 million taka (approximately US$2.2 million).

After reopening the market in 1976, the growth rate of the market was very slow until the early part of 1980s. In regard to the securities market, one writer commented in 1979 that '[a] capital market, in modern sense, does not exist in Bangladesh'.

The number of listed companies had been increasing slowly till 1982. The growth of the market suddenly got a boost after the military takeover in March 1982. The number of listed companies increased fairly rapidly in 1983, and these were 58 in 1984. This upward trend continued until 1988 as can be seen in the following table.

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21 Id at 12.
Table 3.1: Growth Pattern of Listed Companies in the Securities Market in Bangladesh During 1976-88

<table>
<thead>
<tr>
<th>Year (ended in June)</th>
<th>No. of Listed Securities *</th>
<th>No. of Tradable Securities (in millions)**</th>
<th>Paid-up Capital (taka in millions)</th>
<th>Market Capitalisation (taka in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>9</td>
<td>13.6</td>
<td>137.5</td>
<td>146.7</td>
</tr>
<tr>
<td>1977</td>
<td>11</td>
<td>14.7</td>
<td>230.5</td>
<td>248.5</td>
</tr>
<tr>
<td>1978</td>
<td>14</td>
<td>18.5</td>
<td>281.3</td>
<td>305.4</td>
</tr>
<tr>
<td>1979</td>
<td>18</td>
<td>21.2</td>
<td>365.1</td>
<td>393.7</td>
</tr>
<tr>
<td>1980</td>
<td>23</td>
<td>22.2</td>
<td>405.9</td>
<td>436.9</td>
</tr>
<tr>
<td>1981</td>
<td>26</td>
<td>26.6</td>
<td>528.1</td>
<td>603.2</td>
</tr>
<tr>
<td>1982</td>
<td>29</td>
<td>32.4</td>
<td>725.6</td>
<td>811.6</td>
</tr>
<tr>
<td>1983</td>
<td>44</td>
<td>44.4</td>
<td>1,001.5</td>
<td>1,211.3</td>
</tr>
<tr>
<td>1984</td>
<td>58</td>
<td>62.3</td>
<td>1,546.6</td>
<td>2,256.5</td>
</tr>
<tr>
<td>1985</td>
<td>69</td>
<td>80.7</td>
<td>2,017.5</td>
<td>3,048.1</td>
</tr>
<tr>
<td>1986</td>
<td>78</td>
<td>88.9</td>
<td>2,098.5</td>
<td>3,436.5</td>
</tr>
<tr>
<td>1987</td>
<td>92</td>
<td>105.3</td>
<td>3,149.7</td>
<td>12,670.9</td>
</tr>
<tr>
<td>1988</td>
<td>111</td>
<td>123.1</td>
<td>3,663.7</td>
<td>13,566.8</td>
</tr>
</tbody>
</table>

* The number of listed securities includes all companies issuing share capital, the number of companies issuing debentures and the number of mutual funds.

** The number of securities includes the total number of shares, debentures and certificates of mutual funds tradable in the market.

After the market had witnessed this growth, the listing rate again went down in 1989 adding only five new companies to the list of the DSE. The lessening of investor

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25 Information for the years from 1976 to 1984 has been taken from: DSE, Fact Book (1994 Dhaka: DSE at 41. Information for the remaining years (1985-1988) has been taken from: SEC, Annual
confidence resulting from the failure of issuers in holding AGMs, paying dividends and complying with the disclosure requirements have been cited as the reason for this decline in the listing of securities. Another reason may be attributed to the political unrest which aimed at ousting the political dictator of the day. In early 1991, the democratically elected government was sworn in. This government was elected through the national elections held under a caretaker government, the first of its kind in Bangladesh. The new administration paid special attention to the development of the securities market. It succeeded in attracting investments from both local as well as foreign investors to some extent. As a result, the number of listed securities reached 153 by the middle of 1993. Major reforms which were put in place to attract investments were:

i. abolishing capital gains tax and allowing foreigners to repatriate capital gains and dividend income;

ii. making the taka (Bangladeshi currency) convertible on current account;

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29 Martial law was declared by the Chief of Army Staff in March 1982. Martial law was withdrawn in 1986 after holding a disputed national election. The same military ruler continued in power until being ousted by mass upsurge in December 1990. For a legal analysis of this regime, see M R Islam, ‘The Seventh Amendment to the Constitution of Bangladesh: A Constitutional Appraisal’ (1987) 58 Political Quarterly 312.

30 For the first time in Bangladesh, the election was held under a caretaker government. The election was nationally and internationally acclaimed as free and fair.

31 During July 1993 -June 1994, foreigners invested in a total of eight IPOs. The total amount of capital raised through these eight IPOs was 673.1 million taka (approximately US$11.2 million). Foreigners invested 75.84 per cent of the total amount. For details, see SEC (1994) above n25 at 18.

Id at 20.
iii. withdrawing regulatory restrictions on foreign portfolio investors;\textsuperscript{32}

iv. offering tax benefits on dividends to all investors and listed companies;\textsuperscript{33}

vi. withdrawing restrictions on the sale of shares at premiums;\textsuperscript{34}

v. reducing bank interest rates.\textsuperscript{35}

The above-mentioned reforms encouraged entrepreneurs to some extent to raise capital from the securities market rather than borrow from banks. Investors were also encouraged to invest in securities because of the incentives offered to them.

The most significant regulatory reform in the Bangladesh securities market took place in June 1993. The SEC which was established on 8 June 1993 under the \textit{Securities and Exchange Commission Act 1993} (SECA’93) replaced the Controller of Capital Issues (CCI), the previous regulator, and emerged as the sole government watchdog of the securities market.\textsuperscript{36} The CCI was a government bureaucrat who worked under the direct control of the Ministry of Finance. The SEC came into being as an autonomous body with a view to fostering investor confidence and protecting investors in the securities market.\textsuperscript{37} The establishment of this new regulator stimulated investor confidence in the market. The market witnessed further growth from 1990 to 1995. The upward trend can be seen in the following table.

\textsuperscript{32} Foreigners were not previously allowed to invest in securities. In July 1992, the market was opened up for them for the first time: Ahmed (1994) above n1 at 41.

\textsuperscript{33} Withholding tax on dividends not exceeding 5000 taka (approximately US$83) was abolished for individuals. For the amount of dividends exceeding taka five thousand, withholding tax was reduced to 10 per cent for individuals and 15 per cent for companies. Dividend income not exceeding 30,000 taka (approximately US$526) was exempted from income tax.

\textsuperscript{34} Ahmed (1997) above n3 at 78.

\textsuperscript{35} For further details of these reforms, see SEC (1994) above n25 at 12.

\textsuperscript{36} The previous CCI was simply a government bureaucrat who worked under the Ministry of Finance. The CCI would primarily regulate the issues of securities. Details of the SEC and the CCI will be discussed in the following Chapter 4.

\textsuperscript{37} SEC (1994) above n25 at 5.
Table 3.2: Growth Pattern of Listed Companies in the Securities Market in Bangladesh During 1989-95

<table>
<thead>
<tr>
<th>Year (ended in June)</th>
<th>No. of Listed Securities</th>
<th>No. of Securities (in millions)</th>
<th>Paid-up Capital (taka in millions)</th>
<th>Market Capitalisation (taka in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>116</td>
<td>149.7</td>
<td>4,539.2</td>
<td>15,359.5</td>
</tr>
<tr>
<td>1990</td>
<td>134</td>
<td>161.1</td>
<td>5,561.1</td>
<td>11,485.9</td>
</tr>
<tr>
<td>1991</td>
<td>138</td>
<td>167.2</td>
<td>5,586.6</td>
<td>10,397.3</td>
</tr>
<tr>
<td>1992</td>
<td>149</td>
<td>172.3</td>
<td>6,020.3</td>
<td>12,299.1</td>
</tr>
<tr>
<td>1993</td>
<td>153</td>
<td>195.1</td>
<td>8,201.7</td>
<td>18,098.7</td>
</tr>
<tr>
<td>1994</td>
<td>156</td>
<td>214.4</td>
<td>9,268.0</td>
<td>32,715.0</td>
</tr>
<tr>
<td>1995</td>
<td>188</td>
<td>325.5</td>
<td>18,317.3</td>
<td>49,998.1</td>
</tr>
</tbody>
</table>

Governmental efforts to promote the securities market continued. In addition to the reforms mentioned, some other reforms were made during the fiscal year 1995-96. Some of these reforms were:

i. reducing corporate tax rate for listed industrial companies (not financial) from 40 per cent to 35 per cent;

ii. requiring the public companies having a paid-up capital of 10 million taka (approximately US$0.16 million) or more be listed on the DSE;

iii. creating public awareness of the market by broadcasting the market index through the government run television channel;

iv. allowing non-resident Bangladeshis (NRB) to invest in the issue market and ‘remit sale proceeds of, and capital gains and dividend on, these issues’;

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38 Id at 20. Information for the year 1995 has been taken from: SEC (1997) above n22 at 31.
v. allowing foreigners to underwrite IPOs and rights issues up to one-third of each issue;


In response to the foregoing reforms, the securities market was making gradual progress over the preceding few years. The DSE had provided an ‘open out cry’ market and trading was limited to its own premises situated in Dhaka. Thus the vast majority of the populace could not actively participate in the market. But investment in securities was a growing demand from both the government and the public alike. The situation was perhaps best described by Doebele who commented in 1996 that ‘I[f] [y]ou [w]ant to travel backward in time but forward in hope and expectations, take a tour of the Dhaka Stock Exchange’.\footnote{J Doebele, ‘Outcry and Tea Wallahs’ (1996) 158 Forbes 222 at 222.} In such circumstances where the DSE alone was not sufficient to meet the increasing demands of the securities market, the Chittagong Stock Exchange came into being in order to provide the enthusiastic investors with a new market place.

Both of the bourses had been running well until the middle of 1996. All of a sudden, the market experienced an unusual boom which ended up in an unprecedented bust in late 1996. Thousands of novices and small investors lost their life savings. Numerous small businessmen lost their entire capital. The market-crash was perhaps best stated by foreign analysts who termed it the ‘slaughter of the innocent’.\footnote{‘The Bangladesh Stockmarket: Slaughter of the Innocents’ The Economist (7-13 Dec 1996) 90 at 90. See also, Emerging Stockmarkets: Revenge of the Innocents’ The Economist (12-18 Apr 1997) 74.} However, ‘the flute was played by really matured and skilled players who … made the real fortune out of the innocence of [the] new generation of investors’.\footnote{Enquiry Committee, Enquiry Report on Share Market (Dhaka, Mar 1997) at 12.}
Political incidents preceding the turmoil may have some implications for the unusual movements of the market.\(^{43}\) A general election was held in June 1996 under a caretaker government, the second of its kind, in which a new administration, the erstwhile opposition party which was overthrown in 1975, was installed in power after 21 years in opposition.\(^{44}\) It was found in investigation that ‘aspirations and expectations picked up along with the political stability’.\(^{45}\) General confidence amongst the people in the new administration stimulated the stock market and resulted in an increased pressure to buy shares both in the primary and the secondary markets.\(^{46}\) But the supply side could not be strengthened proportionately in order to meet the increased demand, even though many companies issued shares at premium up to 100 per cent to take the advantage of the ‘unreasonable’ bullish trend in the market.

Because of the above dramatic increase in demand, the secondary market showed an unusual volatility during the second half of 1996.\(^{47}\) From July to November 1996, share prices multiplied by nearly four times the previous prices. The market capitalisation appreciated by 265 per cent; the average daily turnover increased by over

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\(^{43}\) There was a notable public unrest against the regime which was installed in 1991. All opposition political parties unitedly demanded the enactment of provisions for a neutral caretaker government to conduct future national elections. In defiance of the popular demand, the government in February 1996 managed an election which was boycotted by all major political parties. The election was vehemently criticised as being rigged and unfair one. The public unrest mounted and finally the government was compelled to accept the demand for a caretaker government and to resign from the power in March 1996: For details, see M R Islam, ‘Free and Fair General Elections in Bangladesh Under the Thirteenth Amendment: A Political-Legal Post-Mortem’ (1996) 26 Politics Administration and Change 18 at 18-21.

\(^{44}\) In this election, the Bangladesh Awami League emerged as the majority party in the country and formed government with the support of some minor parties. It may be recalled here that the Bangladesh Awami League achieved overwhelming majority in the general election held in 1970. It led the liberation war in 1971 and formed the first government in independent Bangladesh. The party also achieved a landslide election victory in 1973. But it was ousted from the state power by a military coup de 'etat in 1975 and could not assume power until this election in 1996.

\(^{45}\) Enquiry Committee (1997) above n42 at 13.

\(^{46}\) Ibid.

\(^{47}\) There were several factors leading to the unusual market behaviour. For an analysis of the major causes of the disaster and its impact on the market, see M N Alam & S B Jahan, ‘Impacts of Stock Market Debacle in 1996 on the National Economy of Bangladesh’ (1996) 21 Bank Parikrama 11.
1000 per cent; and the Share Price Index went up by 260 per cent. The market
capitalisation increased from eight per cent to around 20 per cent of Gross Domestic
Products (GDP).\textsuperscript{48}

Such an abnormal upward trend did not continue for a long time. Share prices
started falling in the middle of November of the same year, and to date the index has not
returned to its previous position from which the above-mentioned boom kicked off.\textsuperscript{49}
The index went below 500 points and it was 486.62 points on 21 April 1999.\textsuperscript{50}

The following table shows the unprecedented volatility which the securities market
in Bangladesh experienced in late 1996 (during the boom and bust).

\textsuperscript{48} SEC (1997) above n22 at 7.

\textsuperscript{49} DSE All Share Prices Index was 989.40 on 1 July 1996 and as on 16 February 2003 the Weighted
Average Index was 822.54:DSE, ‘Weighted Average Share Price’<http://www.dsebd.org> (17 Feb
2003). The SEC discarded the previous All Share Price Index and imposed Weighted Average Share
Price Index in November 2001 against the will of the stock exchanges. This new system brought
about some apparent changes in showing the index higher, because the transactions in the securities
of poorly performing companies are not counted in calculating this new index. As a result, the index
shows a higher figure than what it would have been if all transactions were taken into account. Both
the stock exchanges as well as investors criticised the SEC for imposing this new index which
basically helps suppress or hide the real movement of the market as observed by commentators: see
D N Saha, ‘Stock Exchanges Lodge Protest against Weighted Index: SEC Damaging Share Markets,
Allege Small Investors’ The Independent, Dhaka (10 Dec 2001); Editorial, ‘The Case for SEC
Reform’ The Bangladesh Observer, Dhaka (25 Jun 2002). Despite the cosmetic changes, the Index
is still lower than that was before the 1996 share boom.

\textsuperscript{50} The Daily Star, Dhaka, (22 Apr 1999). See also, S M Solaiman, ‘Securities Market in Bangladesh:
Table 3.3: DSE All Share Price Index During May-December 1996

<table>
<thead>
<tr>
<th>Trading Month -1996</th>
<th>High</th>
<th>Low</th>
<th>Change in Index points</th>
<th>Change in Index per cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>May</td>
<td>884.67</td>
<td>841.07</td>
<td>+29.93</td>
<td>+3.58</td>
</tr>
<tr>
<td>June</td>
<td>977.13</td>
<td>859.89</td>
<td>+94.18</td>
<td>+10.88</td>
</tr>
<tr>
<td>July</td>
<td>1156.18</td>
<td>967.70</td>
<td>+197.13</td>
<td>+20.55</td>
</tr>
<tr>
<td>August</td>
<td>1217.74</td>
<td>1109.85</td>
<td>+61.56</td>
<td>+5.32</td>
</tr>
<tr>
<td>September</td>
<td>1690.25</td>
<td>1390.85</td>
<td>+472.51</td>
<td>+38.80</td>
</tr>
<tr>
<td>October</td>
<td>2986.26</td>
<td>1688.88</td>
<td>+1296.04</td>
<td>+76.68</td>
</tr>
<tr>
<td>November</td>
<td>3648.75</td>
<td>3033.37</td>
<td>+78.70</td>
<td>+2.64</td>
</tr>
<tr>
<td>December</td>
<td>3012.97</td>
<td>2241.83</td>
<td>-764.84</td>
<td>-24.95</td>
</tr>
</tbody>
</table>

The bearish trend in the market continued. The following figure shows the movement of the DSE All Share Price Index during May 1996-July 1997.

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The CSE also experienced a similar boom and bust which can be seen in the following table.
Table 3.4: CSE All Securities Price Index During May – December 1996

<table>
<thead>
<tr>
<th>Trading Period-1996</th>
<th>High</th>
<th>Low</th>
<th>Changes in Index (points)</th>
<th>Changes in Index (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>May</td>
<td>421.59</td>
<td>395.27</td>
<td>-6.37</td>
<td>-1.58</td>
</tr>
<tr>
<td>June</td>
<td>409.05</td>
<td>392.65</td>
<td>+13.24</td>
<td>+3.34</td>
</tr>
<tr>
<td>July</td>
<td>467.94</td>
<td>458.51</td>
<td>+58.89</td>
<td>+14.40</td>
</tr>
<tr>
<td>August</td>
<td>506.58</td>
<td>466.45</td>
<td>+38.44</td>
<td>+8.21</td>
</tr>
<tr>
<td>September</td>
<td>701.35</td>
<td>514.75</td>
<td>+188.61</td>
<td>+37.25</td>
</tr>
<tr>
<td>October</td>
<td>1315.90</td>
<td>699.73</td>
<td>+620.91</td>
<td>+89.34</td>
</tr>
<tr>
<td>November</td>
<td>1730.53</td>
<td>1416.69</td>
<td>+165.78</td>
<td>+11.91</td>
</tr>
<tr>
<td>December</td>
<td>1400.87</td>
<td>1157.90</td>
<td>-314.78</td>
<td>-21.37</td>
</tr>
</tbody>
</table>

The declining trend as evident in the above table continued further. The unusual movement of the CSE All Securities Price Index during May 1996-June 1997 is shown in the following figure.

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The bearish trend in the CSE as is evident in the above figure continued after June 1997. There was a marked fall of the index and it was 209.46 points on 21 April 1999.\(^{55}\) The CSE could not yet recover to its normal position as it had been before the 1996 share scam.

In the aftermath of the turmoil in 1996, the SEC formed a committee of enquiry headed by a Vice-Chancellor in December 1996.\(^{56}\) The committee submitted its report on 27 March 1997. The report revealed the evidence of rampant manipulations in relation to trading in securities. The committee detected the cases of these irregularities

\(^{54}\) Ibid.

and identified the wrongdoers, so far as it was possible to do so. In pursuance of the report of enquiry, the SEC lodged a total of 15 criminal cases in 1997 against some companies, their directors and others for the violation of s17 of the *Securities and Exchange Ordinance* 1969. As at February 2003, all these cases are still pending in several courts.\(^{57}\)

After the share scam 1996, reform measures were intensified to bring the investor back to the market. Major reforms have been made under the Capital Market Development Program 1997 (CMDP). The CMDP was undertaken with the financial and technical supports of the Asian Development Bank (ADB) and the United Nations Development Program (UNDP).\(^{58}\)

### 3.4. Reforms Made During 1997-2002 in the Securities Market in Bangladesh

Major reforms made during 1997-2002 have been mentioned in the several annual reports of the SEC, the annual reports of the Bangladesh Bank, the central bank of the country, and other sources.\(^{59}\) These are:

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56 Professor Amirul Islam Chowdhury, Jahangir Nagar University, Dhaka.

57 Details of the cases will be discussed in Chapter 8.


In a separate program, the World Bank has provided financial assistance for a study on a potential bond market in Bangladesh. This study is underway.

i. strengthening market regulation and supervision;

ii. developing capital market infrastructure;

iii. modernising capital market support facilities;

iv. increasing the limited supply of securities in the market; and

v. developing the institutional sources of capital to improve demand for securities.\textsuperscript{60}

\textbf{3.4.1. Strengthening Market Regulation and Supervision}

The following measures have been taken to strengthen the securities market regulation and supervision.

i. The number of full-time members of the SEC has been increased from two to four.

ii. Previously the SEC was required to obtain approval from the government (Ministry of Finance) prior to making any rules or regulation (by laws) for the securities market. The SEC has been vested with the authority to make by laws within the purview of the SECA '93 without the prior approval from the government.

iii. From a situation of gross understaffing, the SEC has made some progress in increasing organisational strength.\textsuperscript{61}

iv. Previously the Registrar of Joint Stock Companies (RJSC) had the exclusive authority to grant registration to companies. A new rule has been made requiring the public companies to obtain the consent of the SEC before their registration by the RJSC.

v. The SEC Automation Systems have been implemented.

\footnote{The headings of reforms are chosen from the relevant report of the president of the ADB (RRP: BAN 24103 1997) above n58 at 21-28. See also F Narayan, ‘ADB Pushes Capital Market Reform Agenda’ \textit{The Daily Star}, Dhaka (16 Mar 1998).}

\footnote{As on 30 June 1998, the number of approved positions of officers and staff for the SEC was 77, of which the general staff (excluding officers) was a total of 46. The approved numbers of staff were appointed by 30 June 1998. But still some crucial positions are vacant like Director, Legal Division and Full-Time members. More positions needed to be created to strengthen the power of the SEC: SEC (1998) above n59 at 8.}
vi. The SEC has introduced a weekly investor education program to impart basic knowledge of the securities market to investors.

3.4.2. Developing Securities Market Infrastructure

Measures taken to develop the market infrastructure are stated below.

i. Previously the governing boards of the stock exchanges, the policy-making bodies, had dominant membership of brokers. It was regarded as contrary to the transparency and efficiency of the operation of the market. The boards of both the DSE and the CSE have been restructured in order to make them more acceptable to the public. Their present compositions include 50 per cent non-broker members.62

ii. The policy making body of the DSE has been separated from its management. Such a separation has existed in the CSE from its very beginning.

iii. Both of the DSE and the CSE have raised the minimum capital requirement for brokers. The minimum capital has been fixed at 2.5 million taka (approximately US$0.04 million).63

iv. Both of the stock exchanges have increased the number of their members to 500. In addition, the SEC has amended the provisions for the regulation of brokers to remove inactive members from the stock exchanges to make room for the pro-active ones.

v. The mandatory dual listing of securities (listing on both bourses) has been cancelled to promote competition between the stock exchanges.

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62 In July 2001, the CSE amended its Articles of Association in conformity with, as it termed, the Chittagong Stock Exchange (Board and Administration) Regulations 2000. Before this amendment, it was the SEC who would nominate half the number of the directors of both exchanges. Now the CSE would propose the names of its nominated directors to the SEC for the regulator’s approval: see CSE, CSE Holds EGM to Adopt New Governing Board & Administration Regulations (Press Release 7 July 2001). The amendment had been made in an Extra-Ordinary General Meeting held on 7 July 2001.

63 DSE (2000) above n2 at 8.
vi. Dealership operation has been partially separated from the brokerage function. This has been done in view of the potential conflict of interests between brokers/dealers and their clients.

vii. Both of the bourses have established Investors Protection Funds with uniform rules. These funds are aimed at compensating investors in the secondary market for their losses resulting from the default of member-brokers.

vii. All listed companies are required to prepare their financial statements to be filed with the SEC in compliance with the applicable International Accounting Standards (IAS). The statements have to be audited in compliance with the applicable International Standards on Auditing (ISA).64

viii. The SEC approved the introduction of the Over-the-Counter (OTC) trading in the stock exchanges in 2001. But, as has been mentioned in Chapter 1, it could not be implemented as yet due to the lack of interest of investors as well as of stock exchanges.

viii. The previous DSE All Share Price Index and CSE All Securities Price Index have been abolished. The SEC required the bourses to introduce a new Index which has been termed ‘Weighted Average Share Price Index’ in November 2001. As a cosmetic change, the new index has increased the index points abruptly. This is because the present index does not take into account the daily performance of poorly performing companies (Z group)) which constitute roughly one-third of the total listed companies.65

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64 The Institute of Chartered Accountants of Bangladesh (ICAB), the main statutory body for accountants and auditors, has adopted 15 of the 32 International Accounting Standards (IAS). Similarly it has adopted 15 out of 29 International Standards on Auditing (ISA) issued by the International Federation of Accountants (IFAC). Thus applicable international accounting or auditing standards refer to those adopted by the ICAB. It has so far adopted 23 of the new 40 IAS and 22 of the 46 ISA.

65 The meaning of the Z group will be explained in section 3.4.5.
3.4.3. Modernising Securities Market Support Facilities

The following measures were taken to modernise the securities market support facilities.

i. The previous antiquated trading system (open out cry) has been replaced by the automated trading system (screen based) in both the DSE and the CSE.

ii. In order to introduce trading in scripless shares, the Parliament enacted the *Depository Act* 1999. Under this law, a company called the ‘Central Depository of Bangladesh Limited’ (CDBL) was formed in 2000 but it could not start operating as yet. The successful operation of the CDBL will help eliminate trading in fake shares. This kind of trading is a real concern for it strikes at the integrity of the Bangladesh securities market.\(^{66}\)

3.4.4. Measures for Increasing the Supply of Securities

Reforms made with a view to increasing the supply of securities are enumerated below.

i. The previous Merit-Based Regulation has been replaced by the Disclosure-Based Regulation under the *Public Issue Rules* 1998. It was considered that the new philosophy will stimulate the floatation of public companies.

\(^{66}\) Recently the issue of fake shares has emerged as a major concern of the securities market in Bangladesh. A good number of shares in some companies, for example, Paragon Leather and Footwear Industries Limited, Shamarita Hospital, Atlas Bangladesh were found to be fake. In view of the fake menace, the turnover declined in both the bourses. Many of the fake shares holders borrowed money from commercial banks. These bank loans made the situation worse. To remedy the problem, the SEC sued the Paragon Leather and asked banks to verify shares before considering them as collateral. The securities regulator directed the *Shamarita Hospital* to announce book closure. For details see, for details, SEC, ‘Caution Notice Regarding Fake Shares’ <http://www.secbd.org/caution.html> (27 Aug 2001); M S Rahman, ‘SEC Sues Paragon Leather: Fake Shares Pumping Charge Frame’ *The Daily Star*, Dhaka (25 Jul 2001); M S Rahman, ‘Fake Share Menace Grips Bourses: Bank Sitting on Piles of Counterfeit Scrips Taken as Collateral’ *The Daily Star*, Dhaka (29 Jul 2001); M S Rahman, ‘Authentic Scrips before Giving Loans, SEC Asks Banks: Fake Share Makes Commission Alert’ *The Daily Star*, Dhaka (2 Aug 2001); M S Rahman, ‘SEC to Investigate Fake Shares of Shamarita Hospital’ *The Daily Star*, Dhaka (6 Aug 2001); M S Rahman, ‘SEC Directs Samorita Hospital to Announce Book Closure: Bid to Identify Number of Fake Shares’ *The Daily Star*, Dhaka (9 Aug 2001); ‘Forged Share Menace: Who to Blame?’ *The
ii. A package of tax benefits has been offered to all listed companies including banks, insurance companies and other financial institutions. These benefits include: (i) offering 10 per cent tax rebate to listed companies declaring at least 25 per cent dividends; (ii) extending the reduction of corporate tax rate from 40 per cent to 35 per cent to all listed industrial and financial companies.

iii. Registration charge for trust deeds with respect to bonds and debentures has been fixed at 2,500 taka (approximately US$42) instead of the previous charge of 2.5 per cent of the face value of each offer.

iv. As of 30 June 2002, a total of 23 merchant bankers were given licences for underwriting, issue managing and portfolio managing (fully fledged merchant bankers). In addition, a total of six merchant bankers were granted licences for managing issues of securities, whilst a single merchant banker obtained a licence as a portfolio manager.67


vi. With a view to fostering the issuance of mutual funds, the SEC promulgated the Securities and Exchange Commission (Mutual Funds) Regulations 1997.68 Private mutual funds have been exempted from the obligation of paying income tax.

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67 For the first time, the regulation for merchant bankers was promulgated in 1995. Since then, the merchant bankers are regulated by the SEC under the Merchant Banker and Portfolio Manager Regulations 1995. Before 1995, merchant bankers were not required to obtain any licence from the SEC.

68 Under these mutual fund regulations, Asset & Investment Management Services of Bangladesh (AIMS) issued the first ever private mutual funds in Bangladesh in 2000.
3.4.5. Measures for Improving Demands for Securities

Institutional investment is insignificant in the Bangladesh securities market. Some legal reforms have been made in order to increase institutional investment in the market. These reforms are discussed below.

i. The **Trusts Act** 1882 has been amended to enable trust funds to invest in securities of their choice. The trust properties consisting of money such as private pension funds and provident funds are now allowed to invest up to 25 per cent of their funds in any securities listed on the stock exchange(s) in Bangladesh. The application of this provision is subject to the trust instrument concerned. Before this amendment, the trust law allowed these funds to be invested in government securities alone.

Likewise, the **Insurance Act** 1938 was amended. The amendment provides that 30 per cent of any insurer’s funds shall be invested in government securities and the balance shall be invested in any other investment including in the securities market.

ii. The Investment Corporation of Bangladesh is the country’s sole investment corporation established in 1976 alongside the restoration of the operation of the DSE. The **Investment Corporation of Bangladesh (ICB) Ordinance** 1976 has been amended to split the ICB into three separate subsidiaries. The newly formed three subsidiaries are

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69 Section 20B of the **Trust Act** 1882 provides:

‘(1) Where the trust property comprises money and it cannot be applied immediately to the purposes of the trust, the trustee may, subject to any prohibition or restriction imposed in the instrument of the trust, invest an amount not exceeding 25% of such money, hereinafter referred to in this section as the maximum limit of investment, in any security listed with a stock exchange of Bangladesh.

(2) In determining the exact amount of money that may be invested under sub-section (1) at any given time, the money already invested, if any, under this section and also under section 20(f) shall be deducted from the maximum limit of investment at that time.

(3) Nothing in this section shall be construed to be a bar to authorize the investment of trust-money by the author of the trust beyond the maximum limit of investment.’

70 **Insurance (Amendment) Act** 2000 s 2.

71 The amended s 27 of the **Insurance Act** 1938 is as follows:

‘(i) thirty per cent of the sum referred to in the said sub-section shall be invested in Government securities; and

(ii) the balance shall be invested in any other investment including capital market in such manner as may be prescribed.’
entrusted with separate responsibilities, namely, merchant banking, mutual fund operating and stock brokering.\textsuperscript{72}

iii. Credit rating is an important consideration for the securities market, especially for the debt securities. To reduce the risk of investors in the debt market, a credit rating company, the Credit Rating Information and Services, was granted registration in April 2002 for the first time.

iv. There had been a total of eight saving bonds with varying terms and interest rates in Bangladesh. They were not tradable in the securities market. The government discontinued four of them. The closed four bonds were issued with higher interest rates as compared to the remaining bonds. The interest rates of the remaining four bonds were reduced and income tax was imposed for the first time on the interest of these saving bonds.\textsuperscript{73} These were done to ‘force’ small savers to invest in securities.

v. Stamp duty on the transfer of listed securities has been withdrawn.

vi. The tax exemption threshold amount on dividend income has been enhanced from 30 thousand taka (approximately US$500) to 40 thousand taka (approximately US$667).

\textsuperscript{72} Following an amendment to the \textit{Investment Corporation of Bangladesh Ordinance} 1976, three subsidiaries have already been established, each of which has obtained registration from the Registrar of Joint Stock Companies and started operation. In this regard, s10 of the \textit{Investment Corporation of Bangladesh (Amendment) Act} 2000 provides:

‘Each of the following businesses [ of the Investment Corporation of Bangladesh] shall be carried on only by one of the three separate subsidiaries established for this purpose, namely:
(a) Merchant banking business including issuing, underwriting and portfolio management of securities;
(b) Mutual fund operations; and
(c) Stock brokerage:.....’

vii. The maximum amount of tax free investment in IPOs has been increased from 0.20 million taka (approximately US$3,333) to 0.25 million taka (approximately US$4,167).

vii. Listed companies have been grouped into ‘A’, ‘B’ and ‘Z’. Companies which held AGMs regularly and paid at least 10 per cent dividends in the preceding year were placed in the ‘A group’. Companies which held their AGMs regularly but paid less than 10 per cent dividends are placed in the ‘B group’. Companies fell under the ‘Z group’ if they failed to hold the current AGM or did not declare any dividends in the last calendar year, or their operation remained closed for the last consecutive six months or more, or their accumulated loss, even after the adjustment of revenue reserves, if any, stood negative and higher than their net worth. This classification helps ordinary investors know about the current status of the listed companies.

3.4.5.1. Incentives Offered to Foreigners and Non-Resident Bangladeshis

In addition to the above reforms, incentives have been offered to attract portfolio investments from foreigners as well as from non-resident Bangladeshis.

The following incentives have been offered to foreign investors.

i. Foreign investors are treated equally with their local equivalents in terms of capital gains and dividends.

ii. Provisions have been made for the avoidance of double taxation on the basis of bilateral agreements.74

iii. They will be granted a six-month’s multiple entry visa.

74 Bangladesh has concluded bilateral agreements for the avoidance of double taxation with the following countries: Belgium, Canada, China, Denmark, France, Germany, India, Italy, Japan, Poland, Romania, Singapore, South Korea, Sri Lanka, Sweden, Thailand, The Netherlands, United Kingdom (including Nothern Ireland). Negotiations are going on with USA, Iran, Philippines, Qatar, Australia, Nepal, Turkey, Indonesia, Cyprus, Norway, Finland and Spain: Bangladesh Bank, ‘General Facilities/Incentives’ <http://bangladesh-bank.org/investpr/invesfac.html> (17 Aug 2001).
iv. Foreigners will be offered Bangladeshi citizenship for their individual investment of a minimum amount of US$0.5 million or by transferring US$1 million to any recognised financial institution (non-repatriable);

v. Permanent residentship will be offered for the investment of a minimum amount of US$0.75 million (non-repatriable).

Non-resident Bangladeshi investors are entitled to enjoy all the facilities accorded to foreign investors where applicable. In addition, they have been offered some extra incentives which are mentioned below.

i. A quota of 10 per cent in the new issue of securities has been reserved for non-resident Bangladeshi in order to enable them to invest in the primary market.

iii. They can maintain foreign currency deposits in Non-resident Foreign Currency Deposit (NFCD) account.

3.5. Market Growth During 1997-2002

Despite the above measures which are primarily aimed at persuading the potential investors of all categories of portfolio investment, the market has not experienced any impressive growth as yet after the stock market collapse in 1996. The trend of the market in response to the above reforms can be seen in the following table.
Ch 3: Inception and Market Growth

Table 3.5: Growth Pattern of the Listed Companies in the Securities Market in Bangladesh 1996-2002 (DSE)\(^{75}\)

<table>
<thead>
<tr>
<th>Year (ended in June)</th>
<th>No. of Listed Securities</th>
<th>No. of Securities (in millions)</th>
<th>Paid-up Capital (taka in millions)</th>
<th>Market Capitalisation (taka in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>201</td>
<td>375.3</td>
<td>21,754.1</td>
<td>67,727.6</td>
</tr>
<tr>
<td>1997</td>
<td>214</td>
<td>471.1</td>
<td>26,907.4</td>
<td>107,826.6</td>
</tr>
<tr>
<td>1998</td>
<td>224</td>
<td>523.2</td>
<td>30,211.5</td>
<td>62,264.4</td>
</tr>
<tr>
<td>1999</td>
<td>230</td>
<td>533.5</td>
<td>28,684.0</td>
<td>50,748.4</td>
</tr>
<tr>
<td>2000</td>
<td>239</td>
<td>685.7</td>
<td>30,717.0</td>
<td>54,004.0</td>
</tr>
<tr>
<td>2001</td>
<td>244</td>
<td>739.5</td>
<td>32,227.0</td>
<td>72,168.0</td>
</tr>
<tr>
<td>2002</td>
<td>257</td>
<td>1003.4</td>
<td>34,968.0</td>
<td>65,518.0</td>
</tr>
</tbody>
</table>

The above table shows that a greater number of securities were listed in 2002 in comparison with that of the preceding five years. This development is deemed to owe largely to some reforms accomplished by the new administration installed in October 2001. Small savers were ‘compelled’ to invest in securities. This is evident in that the meagre savers who were risk averse, and lacked confidence in the securities market, invested their money in fixed income savings bonds guaranteed by the government. The new administration at the end of November 2001 reduced the interest rates on various savings bonds by 1.5-2.00 per cent.\(^{76}\) The government also reduced the interest rates on bank deposits. As a result, the securities market witnessed increased demand to some extent. This demand by no means implied any rise in investor confidence in the

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\(^{76}\) Reduction of Interest Rates on Savings Bonds’ (30 Oct 2001) above n73.
The companies willing to go public took advantage of this demand which was intentionally created by the government as a result of the reforms mentioned earlier. The increase in the public issues of securities contributed to the corresponding improvement of the other data, such as, the amount of total issued capital and market capitalisation. Despite an upward trend in the Bangladesh securities market in 2002, the vast majority of investors are still staying away from the market, because of their market-shyness. The reasons for the lack of investor confidence in the market will be evident in all of the following chapters especially in Chapters 5 and 9.\textsuperscript{78}

It is noteworthy that the information regarding the securities listed on the CSE reflects a similar trend of the market as is evident from Table 5 above.\textsuperscript{79}

The growth of the market from 1976 to 2002 is shown below in two different figures. The first figure (Figure 3.3) depicts the growth of listed securities and the number of tradable securities, whilst the second figure (Figure 3.4) shows the growth of the amounts of paid-up capital and that of market capitalisation.

3.6. Graphic Presentation of the Market Growth from 1976 to 2002

The growth of the Bangladesh securities market from 1975 to 2002 is presented below in two separate figures.


\textsuperscript{78} The main reasons for this lack of confidence have been mentioned in section 2.4 in Chapter 2.

\textsuperscript{79} For the information regarding the companies listed on the CSE, see the same sources provided for the above Table 3.5.
Figure 3.3: Growth of the Bangladesh Securities Market During 1976-2002 Measured by the Number of Listed Securities and the Number of Tradable Securities

Figure 3.4: Growth of the Bangladesh Securities Market During 1976-2002 Measured by the Amounts of Issued Capital and Market Capitalisation

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80 Above nn25, 38 & 75. The figure contains the information of the DSE.
81 Ibid. The Figure contains the information of the DSE.
### 3.7. Present Position of the Bangladesh Securities Market

Table 3.6: Main Indicators of the Bangladesh Securities Market (as at 28 February 2003)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Dhaka Stock Exchange</th>
<th>Chittagong Stock Exchange</th>
</tr>
</thead>
<tbody>
<tr>
<td>No of Listed Companies</td>
<td>241</td>
<td>172</td>
</tr>
<tr>
<td>No of Mutual Funds</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>No of Debentures</td>
<td>9</td>
<td>3</td>
</tr>
<tr>
<td>No of Securities</td>
<td>260</td>
<td>185</td>
</tr>
<tr>
<td><strong>No of Shares</strong></td>
<td>955 million</td>
<td>804.2 million</td>
</tr>
<tr>
<td>No of Certificates of Mutual Funds</td>
<td>72.3 million</td>
<td>72.2 million</td>
</tr>
<tr>
<td>No of Tradable Debentures</td>
<td>0.6 million</td>
<td>0.1 million</td>
</tr>
<tr>
<td>No of Tradable Securities</td>
<td>1,027.9 million</td>
<td>876.6 million</td>
</tr>
<tr>
<td>Issued Share capital</td>
<td>34,448.2 million</td>
<td>30,646.9 million</td>
</tr>
<tr>
<td>Capital Issued in Mutual Funds</td>
<td>295.0 million</td>
<td>295.0 million</td>
</tr>
<tr>
<td>Capital Issued in Debentures</td>
<td>543.8 million</td>
<td>138.1 million</td>
</tr>
<tr>
<td><strong>Total Issued capital</strong></td>
<td>35,287.0 million</td>
<td>31,080.0 million</td>
</tr>
<tr>
<td>Market Capitalisation</td>
<td>68.30 billion</td>
<td>58.23 billion</td>
</tr>
</tbody>
</table>

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The number representing the variation of listed securities from one year to another does not usually denote the number of public issues in a given year. This is because, the number of listed securities is concerned with several factors, such as, new entries, re-entries, and the suspension and delisting of securities. The growth of the public issue market in Bangladesh measured in terms of the number of issues and the amounts of capital issued to the public is shown below.
**Table 3.7: Growth of the Public Issue Market in Bangladesh During 1977-2002**

<table>
<thead>
<tr>
<th>Year (ended in 30 June)</th>
<th>Number of IPOs</th>
<th>Amount Issued (taka in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1977</td>
<td>2</td>
<td>17.5</td>
</tr>
<tr>
<td>1978</td>
<td>1</td>
<td>14.7</td>
</tr>
<tr>
<td>1979</td>
<td>2</td>
<td>9.2</td>
</tr>
<tr>
<td>1980</td>
<td>2</td>
<td>5.2</td>
</tr>
<tr>
<td>1981</td>
<td>5</td>
<td>17.5</td>
</tr>
<tr>
<td>1982</td>
<td>2</td>
<td>5.9</td>
</tr>
<tr>
<td>1983</td>
<td>5</td>
<td>12.9</td>
</tr>
<tr>
<td>1984</td>
<td>12</td>
<td>323.9</td>
</tr>
<tr>
<td>1985</td>
<td>19</td>
<td>194.1</td>
</tr>
<tr>
<td>1986</td>
<td>9</td>
<td>81.1</td>
</tr>
<tr>
<td>1987</td>
<td>9</td>
<td>265.0</td>
</tr>
<tr>
<td>1988</td>
<td>21</td>
<td>302.9</td>
</tr>
<tr>
<td>1989</td>
<td>12</td>
<td>238.6</td>
</tr>
<tr>
<td>1990</td>
<td>11</td>
<td>158.3</td>
</tr>
<tr>
<td>1991</td>
<td>9</td>
<td>167.2</td>
</tr>
<tr>
<td>1992</td>
<td>11</td>
<td>115.0</td>
</tr>
<tr>
<td>1993</td>
<td>4</td>
<td>142.5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Value 1</th>
<th>Value 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>17</td>
<td>668.4</td>
</tr>
<tr>
<td>1995</td>
<td>27</td>
<td>2,560.0</td>
</tr>
<tr>
<td>1996</td>
<td>21</td>
<td>2,265.7</td>
</tr>
<tr>
<td>1997</td>
<td>18</td>
<td>1377.3</td>
</tr>
<tr>
<td>1998</td>
<td>8</td>
<td>506.6</td>
</tr>
<tr>
<td>1999</td>
<td>4</td>
<td>150.0</td>
</tr>
<tr>
<td>2000</td>
<td>10</td>
<td>277.5</td>
</tr>
<tr>
<td>2001</td>
<td>11</td>
<td>217.0</td>
</tr>
<tr>
<td>2002</td>
<td>8</td>
<td>173.0</td>
</tr>
</tbody>
</table>
3.9. Position of Institutions Other Than Stock Exchanges Involved in the Securities Market

The healthy running of a securities market requires effective support from some other institutions, for example, the institutions providing services such as merchant banking, investment banking, credit rating, market making and custodians for foreigners.

Bangladesh Bank, the central bank of the country, has a small role to play in the operation of the securities market. This role which may indirectly affect or influence the securities market is the determination of bank interest rate on deposits as well as on bank loan. Commercial banks act as 'Bankers to the Issues' in respect of IPOs. Although commercial banks have been allowed to work as merchant bankers, their role in the merchant banking services is insignificant. The number of merchant bankers has been mentioned earlier (section 3.4.4) and the issue of merchant banking will be further addressed in Chapter 5.

84 Ibid.
Developing Finance Institutions (DFIs) play a limited role in the securities market. Until February 2003, the Investment Corporation of Bangladesh (ICB), a DFI, and Bangladesh Shilpa Rin Sangstha (BSRS) established in 1976 and 1972 respectively had issued mutual funds. The government owns both of these two institutions.

Amongst the above two institutions, only the ICB has a clear concern with the development of the securities market. The preamble of the Investment Corporation of Bangladesh Ordinance 1976 under which the ICB was established provides that its objective is 'to encourage and broaden the base of investments, [and] develop the capital market ...'. In fact, this is the single DFI which significantly contributed to the operation and growth of the Bangladesh securities market.

The ICB has so far issued a total of eight mutual funds worth 95 million taka (approximately US$1.58 million) in the market. These funds have been issued from 1980 to 1996. In addition to the management of mutual funds (close ended), the ICB acts as an issue manager, underwriter, bankers to the issue and corporate financial adviser in the securities market. Furthermore, it has provided and continues to provide bridging loans to companies and maintains ‘Investors’ Account Schemes’ since 1977. Under the latter scheme, any adult citizen of Bangladesh can open an account with a minimum cash deposit of 5,000 taka (approximately US$83.33) and obtain a loan up to two times the deposit subject to the maximum limit of 0.2 million taka (approximately US$3,333). With a view to encouraging small and medium savers to invest their savings in a balanced and relatively low risk portfolio, the ICB established an open ended mutual fund in 1981. Only individual investors are allowed to buy the units of this mutual fund. An investor can buy a maximum of 10,000 units and attractive dividends have been declared every year since its inception. An investor may sell the units to the

ICB any time. In order to facilitate further investment by its unit-holders, the ICB introduced a new scheme in 1998. Under this scheme, unit-holders are allowed to borrow money from the ICB against their investments by depositing their unit certificates. Further, the ICB is an active member of the DSE and operates on the secondary market as a stockbroker. The measures undertaken by the ICB thus far show that it has assumed a unique and indispensable role in the development of the country’s securities market.86

The BSRS issued its sole mutual fund worth 50 million taka (approximately US$0.83 million) in December 1996. Its main function is to provide industrial loans and it contributes little to the growth of the securities market.

As regards the asset management companies in the private sector, there has been only one mutual fund worth 30 million taka (approximately US$0.5 million) issued in 2000 by the Asset and Investment Management Services Bangladesh Limited (AIMS). To date the above 10 mutual funds (eight ICB, one BSRS, and one AIMS) are traded in the market.

There have been no provisions for central depository and credit rating services in Bangladesh until recently. The bourses have their own settlement units for securities transactions. Although a central depository company was registered,87 it could not start functioning as yet. The credit rating company has started functioning in the banking sector and did not play any role in the issue market to date.88

The role of market makers is essential for the maintenance of market liquidity. Although a by-law called the Securities and Exchange Commission (Market Maker)
Regulation 2000 is in place, there have been no market makers to date in the securities market.  

Reliable custodial services are crucial for attracting foreign portfolio investment. Only the Standard Chartered Bank provides custodial services to foreign investors.

The above brief description shows that the capital markets supportive institutions are yet to grow in the Bangladesh securities market.

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88 Investor information Cell, above n15 (31 Mar 2003). For the credit rating company see section 3.4.5.
89 Ibid.
3.10. Performance of the Bangladesh Securities Market Measured in Terms of Mobilising Public Savings for Companies

It may appear from the above discussion of the growth of the securities market that the Bangladesh market has been growing slowly over the last three decades. In reality, the development of the market is not at all impressive. The market has substantially failed to mobilise funds for companies from the general public. This truth is evident from the enormous differences amongst the amounts of investment in securities, investment in government saving instruments and in term deposits in banks. For example, the amount of investment in securities was 2.47 per cent of the total amounts of investment in government saving instruments and bank deposits in 1976; 2.57 per cent in 1980; 2.98 per cent in 1991 and 7.28 per cent in 1997 (after the boom in 1996). Similarly, the ratios of market capitalisation to the GDP show the poor performance of the market. The market capitalisation was 0.20 per cent of the GDP in 1980, 0.56 per cent in 1985, 1.15 per cent in 1992 and 3.57 per cent in 1995. The figure went up (abnormally) following the stock market boom in 1996 and it stood at 6.22 per cent in 1997. The market capitalisation significantly fell in the subsequent years. It was 3.2 per cent of the GDP in 1998, 2.39 per cent in 1999, 2.36 per cent in 2000. The ratios in 2001 and

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91 For details of the amounts of investment in securities alongside the investment in government savings bonds and bank deposits (time deposits) from 1976 to 1997, see Ahmed (2000) above n24 at 186.

92 For details of these ratios from 1980 to 1997, see Ahmed (2000) above n24 at 184.


94 SEC (1997) ibid; SEC (1998) above n75; SEC (2000) above n75 & Bangladesh Bureau of Statistics (2000) ibid. It should be noted here that the calculation of market capitalisation used in this chapter is based on the year ending on 30 June. However, the calculation of market capitalisation used in Table 3.8 and Figure 3.6 is based on the year ending on 31 December.
2002 were 2.84 per cent and 2.41 per cent respectively.95 These amounts of investment in securities are very poor in comparison with those in many Asian countries as will be seen in the following section.

### 3.11. Comparative Position of the Bangladesh Securities Market Amongst Its Selected Asian Counterparts

The poor performance of the Bangladesh market is further evident from the comparative achievements of some selected Asian securities markets. The Bangladesh market is lagging far behind all of the markets included in this comparison.

It may be mentioned that Bangladesh, Pakistan and India (subcontinent) are historically very close to each other in respect of socio-economic status which is an important consideration in respect of portfolio investment. Most of the other selected countries included in the following table were not financially in a much better position a decade ago. Their securities markets have played a pivotal role in boosting their national economies, whilst the Bangladesh market has miserably failed to do so.

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Table 3.8: Some Key Indicators of Selected Asian Stock Markets\(^{96}\)

(Figures in US$ millions)

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of Listed Companies</th>
<th>Market Capitalisation (MC)</th>
<th>MC as Per Cent of GDP</th>
<th>Average Company Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>221</td>
<td>1,186</td>
<td>2.52</td>
<td>5.4</td>
</tr>
<tr>
<td>India</td>
<td>5,937</td>
<td>148,064</td>
<td>32.40</td>
<td>24.9</td>
</tr>
<tr>
<td>Pakistan</td>
<td>762</td>
<td>6,581</td>
<td>10.68</td>
<td>8.6</td>
</tr>
<tr>
<td>Malaysia</td>
<td>795</td>
<td>116,935</td>
<td>130.42</td>
<td>147.1</td>
</tr>
<tr>
<td>Thailand</td>
<td>381</td>
<td>29,489</td>
<td>24.14</td>
<td>77.4</td>
</tr>
<tr>
<td>Philippines</td>
<td>230</td>
<td>51,554</td>
<td>68.98</td>
<td>224.1</td>
</tr>
<tr>
<td>China</td>
<td>1,086</td>
<td>171,587</td>
<td>53.80</td>
<td>535.0</td>
</tr>
<tr>
<td>Indonesia</td>
<td>290</td>
<td>26,834</td>
<td>17.51</td>
<td>92.5</td>
</tr>
<tr>
<td>Korea</td>
<td>1,308</td>
<td>308,534</td>
<td>37.53</td>
<td>131.2</td>
</tr>
</tbody>
</table>

The above information regarding the MC as per cent of GDP is presented in the following figure.

\(^{96}\) Standard and Poor's, *Emerging Stock Markets Factbook* 2002 (2002) New York: Standard and Poor's at 131, 191, 259, 231, 307, 267, 151, 299, 195 & 215, & Standard and Poor's, *Emerging Stock Markets Factbook* 2001 (2001) New York: Standard and Poor's at 41 The information contained in this Table is correct as of December 2000. The information required for a further update is not available in full. The markets have been selected having regard to their closeness to Bangladesh in respect of socio-economic considerations. All of them, except for Bangladesh, are emerging markets: Standard and Poor's *Emerging Stock Markets Review* (April 2002) New York: The McGraw Hill Company at 76. The references to the developed Asian markets like the markets in Singapore and Hong Kong have been deliberately avoided because the Bangladesh market is still a pre-merging one. The comparison of the achievements of the Bangladesh market with those of developed ones may seem unrealistic.
Until 1986, market capitalisation in Bangladesh was far below one per cent (0.75) of the GDP. In 2000, it increased to 2.52 per cent, whilst it was 10.68 per cent in Pakistan, 32.40 per cent in India, and 130.42 in Malaysia. These figures clearly show that the performance and the achievements of the Bangladesh securities market are notably poorer than those of its counterparts in all of the selected South and East Asian countries.

### 3.12. Summary and Conclusions

Although the Bangladesh securities market started operating nearly half a century ago, its growth is not impressive. Potential investors prefer depositing in bank accounts or investing in government savings bonds to investing in the securities market. Investor confidence drastically declined after the stock market crash in 1996. The persons

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97 For details of the ratios of GDP and market capitalisation from 1979 to 1997, see Ahmed (2000) above n92.
98 See Table 3.8.
responsible for the scam have not been penalised as yet. Nor have the investors been compensated to date. Reforms introduced so far by the authorities appear to have failed to bring about any tangible development in the market, because investor confidence could not be restored.

Despite the importance of the adequate protection of investors for the development of securities markets, nothing significant has been done so far in this regard, especially for investors in the IPO market. Providing investor protection should be the best way of encouraging the public to invest in securities. The most notable reform made along these lines might be the adoption of the DBR for the IPO market. This reform however is contrary to the real need of such a protection in light of the overall market situation which will be analysed in Chapter 5. Another important reform may be the adoption of the International Accounting Standards (IAS) and International Standards on Auditing (ISA). This adoption is, of course, a welcome initiative, but sufficient attention has not been paid to the implementation of these standards. As a result, many companies have been raising funds from the public through defective prospectuses which contain untrue information or conceal material facts. More importantly, the wrongdoers could not be brought to justice to pacify the aggrieved investors. These practices of issuing defective prospectuses and the lack of investors' remedies are continuously diminishing investor confidence in the market. The situation is that the resources of investors cannot be recovered if these are once invested in a fraudulent or misleading IPO. From the practical point of view, the occurrence of these undesirable events cannot be completely eliminated. But these can be regulated up to a reasonable extent. In Bangladesh, the regulation of the securities market is ineffective as will be seen in the subsequent chapters in this thesis. Although the principal regulatory aim is to provide investor

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99 This issue will be explained in Chapter 5.
protection in the market, the present legal and regulatory regime is not conducive to such protection. Legal drawbacks and regulatory failures are considered to be the principal reasons for the poor performance of the market. A recent study shows that the securities laws describing investor rights and 'the quality of their enforcement by the regulators and courts, are essential elements of corporate governance and finance'.

Since this study is concerned with the protection of investors in the IPO market, the next chapter will introduce the present legal and regulatory framework for the IPO market in Bangladesh.

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Chapter 4

Legal and Regulatory Framework of Initial Public Offerings in Bangladesh

4.1. Introduction

This chapter aims to introduce the legal and regulatory framework of initial public offerings (IPOs) in Bangladesh. It will mainly discuss the present framework of the IPO market, however, the relevant historical background of the framework will also be considered. Having regard to the value of investor protection in the IPO market, the chapter will draw on the regulation of persons who are involved in the preparation of a prospectus. The discussion is divided into four sections. Section 4.1 is introductory. Section 4.2 will outline the laws regulating promoters, directors underwriters, issue managers, lawyers and auditors. In doing so, the relevant Acts and Ordinances will be discussed briefly to assess their relevance to an IPO. The by-laws promulgated by the authorities concerned to regulate certain participants of the IPO market will also be discussed. Section 4.3 will discuss the background and current regulatory framework of the IPO market in Bangladesh. It will look at the roles of various regulators in the IPO market. Section 4.4 will present a summary and conclusions.

4.2. Background and Outlines of the Legal Framework of IPO Market

The foundation of the legal framework of the IPO market is based on a number of Acts

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1 Details of these persons have been provided in section 1.4.5.
and Ordinances. To implement the purposes of these pieces of legislation, the Ministry of Finance and the Securities and Exchange Commission (SEC) have made some Rules and Regulations under their statutory authority. Together they constitute the legal regime of the IPO market.

Amongst the legislation, the *Companies Act* 1913 (CA'13), the *Securities Act* 1920 (SA’20), the *Capital Issues (Continuance of Control) Act* 1947 (CIA’ 47) and the *Contract Act* 1872 were applied for the regulation of the market up to 1969.

The CA’13 dealt with, inter alia, the aspects of corporate governance and corporate finance. Specifically with respect to the IPOs, the CA’13 governed the registration of the issuing companies as well as their prospectuses. It also incorporated some provisions which are applicable in this market. These provisions dealt with share capital and directors’ liability in relation to this capital (ss28-71); contents of prospectuses - their filing procedure and liability for statements provided therein (ss92-100); power to issue shares and to issue certificates of shares (ss101-8); auditors and auditing of companies (ss144-46); and registration of companies (ss248-69). The CA’13 was in operation till the early 1990s. In 1994, to consolidate and amend the law relating to companies and certain other associations, the parliament enacted a new law titled the *Companies Act* 1994 (CA’94) and repealed the CA’13. The new Act has brought about some changes in the provisions relating to the above issues. All these changes will be discussed in subsequent chapters where appropriate.

The SA’20 is concerned solely with government securities such as promissory notes including treasury bills, bearer bonds, etc. It mainly covers the definition and administration of government securities. Basically, they are not shares which are the subject matter of this research. They are instruments of the money market in Bangladesh. Therefore, the SA’20 falls outside the purview of this study.
The CIA’47 was the primary legislation regulating the issuance of securities to the public. As the title suggests, this Act concentrated on the issue market alone. Amongst its provisions, it provided for government control over the issue of capital and prospectuses (ss3-5); power of the government to exempt and condone the contravention of prescribed requirements for capital issues (s6); power to call for information by the government (s7); prohibition on false statements (s8); power of the government to make rules for carrying out the purposes of this Act (s12) and, finally, penalties for its contravention (s13).

Bangladesh inherited the CIA’47 from Pakistan. Although the Act literally vested all powers in the government, in practice, the Controller of Capital Issues (CCI) was entrusted with the responsibility of administering this law on behalf of the government. Since the regulator (CCI) was a civil servant, the government totally dominated the market. It has been noted that ‘[t]here was not much room for innovation and the growth of the capital market was very slow’. The accent was on the control of issues of capital rather than the protection of investors and ‘[a]s a result regulations were ineffective’.

All functions of the regulator were confined to a single person instead of a body corporate as is now the practice worldwide. The CCI had wide discretionary powers whether or not to give consent to a particular prospectus. On the other hand, the CIA’47 failed to provide the aggrieved person with any right to appeal against the refusal by the CCI to approve a prospectus. Such a law was inadequate to meet the needs of the issue market especially because of increased demand for investment resulting from the policy

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2 As has been mentioned in Chapter 3, the CCI was a bureaucrat under the Ministry of Finance.
3 T V Mohandas, ‘Capital Market Development: Indian Experience’ in the Institute of Cost and Management Accountants of Bangladesh (ICMAB) and Institute of Chartered Accountants of Bangladesh (ICAB), 10th SAFA Conference (Dhaka, 1995) 57 at 65. It has been mentioned in Chapter 2 that a piece of legislation identical to the CIA’47 was in force in India during that time.

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of economic liberalisation pursued by the government. Hence, the inadequacy and ineffectiveness of the CIA’47 coupled with the need for a separate and independent regulatory body ultimately led to the enactment of a new law, the *Securities and Exchange Commission Act 1993* (SECA’93). It was enacted with the main objectives of protecting investors and developing the securities market. Indeed, this could be termed as an initiative to protect investors, but it has not proven to be a perfect advocate for them to date. Even this legislation is not largely dissimilar to its predecessor, the CIA’47. A total of 12 sections (ss3-9, 12-15, 17) out of 27 are concerned with the composition, powers, functions, rights and liabilities etc of the SEC. Section 11 basically transferred the right and liability of the CCI to the SEC. Of the remaining 14 sections, six sections are similar in content to those of the CIA’47. In common with all other statutes, sections 1 and 2 cover the title, jurisdiction, and definitions of the terms used in the respective texts. This leaves a total of six sections of the SECA’93 which are not borrowed from the CIA’47. These six are concerned mainly with the powers of the government as well as the SEC. They provide that:

i. the government is empowered to issue directions that the SEC shall follow (s16);

ii. cognisance of offence punishable under this Act can only be taken by the court of sessions (s19);

iii. individuals shall be held liable for any contravention of this Act by companies (s20);

iv. aggrieved persons will have the right to appeal against the decision of any member or official of the SEC to the SEC itself (s21);

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4 Ibid.

5 These six are: delegation of power (s17); penalty provision (s18); protection of action taken in good faith (s22); power to exempt from the requirements (s23); power to make rules by the government (s24) and repeal of the ordinance which came first before the Act. The corresponding sections of the CIA’47 are ss10, 13, 15, 6,12 and 16 respectively.
v. the SEC may make regulations to carry out the purposes of the Act (s25); and
vi. the government may remove difficulties arising in giving effect of the Act (s26).

The basic reason for the non-existence of these six sections in the CIA’47 might be due to the difference in the nature of the regulatory authorities. Theoretically the government itself was the regulator under the CIA’47, which implies that the regulator had most of the above powers without explicitly being empowered by the Act.

The SECA’93 was subsequently amended in 1997 whereby ss17A and 17B were inserted. Section 17A empowers the SEC to conduct inspection of or investigation into the affairs of any person mentioned in s10(1).6 Section 17B provides for the power of the SEC to act as a civil court in a particular area.7

The most positive aspect of the SECA’93 is the establishment of the SEC, although this is not as yet an independent body in the true sense.8 The provision regarding the right to appeal is also a welcome addition. However, further improvement is needed to provide effective securities regulation.9

The SEC has been designated as the government watchdog for the whole securities market, ie, both primary market and secondary market. It is not clear why the SECA’93 did not include any provision for the regulation of primary issues. Instead, these

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6 Persons mentioned in s10 (1) of the SECA are: brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deed, registrar to an issue, underwriters, portfolio managers, investment advisers, and such other intermediaries who may be associated with securities market in any manner.

7 Stipulating the particular area, s17B states that: ‘(1) The Commission shall apply all the powers under the Code of Civil Procedure, 1908 (...) in connection with an investigation or inquiry under action 17A, viz. (a) To issue a summon to attend or warrant to attend and furnish statement on oath. (b) To submit of [sic] any information [or] necessary documents’.

8 The SEC is bound to follow the government’s direction and be accountable to the government for its activities: Securities and Exchange Commission Act 1993 ss15-16. The government appoints the members including the chairman of the SEC. It is also financially dependent on the government.

9 The drawbacks and loopholes of the SECA’93 will be explored in subsequent chapters especially in Chapter 9.
provisions of the CIA’47\textsuperscript{10} were inserted in Chapter IA of the \textit{Securities and Exchange Ordinance} 1969 (SEO’69) by an amendment to the SEO’69 on the same day of passing the SECA’93 by the parliament. At the same time, the SEC assumed the rights and liabilities of the CCI (s11) which was the regulator of the issue market before the SEC. Only s10 of the SECA’93, which is concerned with the regulation of intermediaries of the whole securities market, relates to the issue market. It should be acknowledged that the SEC has subsequently made some rules and regulations under its statutory powers for the regulation of the IPOs.\textsuperscript{11}

As regards the SEO’69, the President of the then Pakistan promulgated it on 28 June 1969. Therefore, it came into force long before the enactment of the SECA’93. The SEO’69 aims to provide protection for investors and the regulation of the securities market. It incorporates provisions for the regulation of both the primary as well as secondary markets. However, initially the SEO’69 did not include provisions to regulate IPOs specifically, although it paid attention to the regulation of issuers (Ch III of the SEO’69). Chapter III deals with the post-floating behaviour of the issuers but not the offer of securities. Chapter IA inserted in 1993 is concerned with the issue of capital.\textsuperscript{12}

Basically, the whole chapter (Ch IA-ss2A-2F) has been copied in the same order from the CIA’47 (ss3-8). In addition, two new sections (ss2CC and 2G)\textsuperscript{13} were incorporated in 1997. Section 2CC empowers the SEC to impose conditions in giving consent or recognition to any new issue notwithstanding anything contained in any other law for the time being in force. Section 2G allows for the continuity of orders made or deemed

\textsuperscript{10} Specially s3- control over issues of capital, s4- control over prospectuses, and s5 - purchase and sale of securities issued without the consent of the government.

\textsuperscript{11} The by-laws promulgated by the SEC will be discussed in section later in this section.

\textsuperscript{12} \textit{Securities and Exchange (Amendment) Act} 1993 s5.

\textsuperscript{13} \textit{Securities and Exchange (Amendment) Act} 1997 ss2-3.
to have been made under the CIA'47. It should be noted here that the CIA'47 was repealed in 1993; however orders made thereunder were approved in 1997 to remain in force. This disparity raises the question as to how these orders remained in place since the annulment of the CIA'47 in 1993 till the above approval in 1997. Another section (s 25A) was also inserted in 1993 under the same amendment Act. Again, this section was copied from the CIA’47 (s14) and provides that, in a prosecution for contravening any provision of the SEO’69, the burden of proof that a person has not contravened the provision(s) shall be on the accused.

The greater part of the SEO’69 is concerned with the aspects of the secondary market which include the regulation of the stock exchanges, dealing in securities and listing of securities (Ch II). As mentioned earlier, Ch III deals with the regulation of issuers. Although the issuers are the players of the primary market, the regulatory issues covered therein (Ch III) do not affect this market. Rather, they target the secondary market as the activities encompassed by the legislation suggest. Chapter IV of the SEO’69 imposes some prohibitions and restrictions which are basically applicable to the secondary market. For example, fraudulent activities in securities dealings are prohibited (s17). However the SEC’s powers to issue orders prohibiting any contravention of the SEO’69 or any by-laws made thereunder apply to both markets (s20). Section 18 which prohibits persons from giving false statement in any documents required under this Ordinance also applies to both markets. Chapter V provides the SEC

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14 **Securities and Exchange (Amendment) Act** 1993 s11(3).
15 **Securities and Exchange (Amendment) Act** 1993 s10.
16 The aspects of issuers covered in Ch III are as follows: i. submission of annual returns to the exchange, existing securities holders and the SEC; ii. submission of statements of beneficial owners of the listed equity securities; iii. prohibition of short-selling; iv. trading by directors, officers and principal shareholders; v. regulation of proxies: **Securities and Exchange Ordinance** 1969 ss11-15.
with some powers and imposes civil and criminal liabilities for the contravention of any of its provisions.\textsuperscript{17}

Miscellaneous issues are mentioned at the end in Ch VI of the SEO’69. This chapter is again predominantly concerned with the affairs of the SEC,\textsuperscript{18} most of which could have been incorporated in the SECA’93. More importantly, a wide power of exempting the market participants has been given to the SEC. It can exempt any person(s) from the operation of all or any of the provisions of the SEO’69 (s29). It appears to be a power that is too arbitrary for the SEC as the SEO’69 has not categorically mentioned any special consideration on which such exemption could be granted.

*Securities and Exchange Rules* 1987 (SER’87) is an important by-law governing the securities market in Bangladesh. It was made by the Ministry of Finance on behalf of the government in the exercise of powers conferred by s33 of the SEO’69. The SER’87 is mainly concerned with the secondary market. It deals with the affairs of the stock exchanges and the listing of securities (ss3-11). It requires the submission of annual and periodic reports by the issuers of listed securities (ss12-13). Actually, the

\textsuperscript{17} The powers provided for the SEC can be summarised as below:

i. conducting inquiries into the affairs of the stock exchanges, the transactions in securities by their members, directors, etc: s 21;

ii. penalising persons who failed or refused to comply with or contravene any provision of the Ordinance or order or directions of the SEC made thereunder: s 22;

iii. needing a report of the SEC before taking cognizance of any offense under this Ordinance: s25;

iv. review and revision powers on any order passed by any officer exercising powers of the commission: s26.

\textsuperscript{18} The SEC can delegate its power enjoying under this Ordinance (s28). An indemnity has been offered to the SEC from being sued for actions done in good faith under this Ordinance or any rules or order made thereunder (s30). The SEC can make rules for carrying out the purposes of this Ordinance (s33). Section 34 empowers the stock exchanges to make regulations, not inconsistent with the Ordinance, for their self-regulation, listing regulation etc. Under s34 (4)-(5), the SEC can direct the exchanges to make or amend or rescind any regulation within a specified period. In the case of failure by the exchanges in doing so, the SEC itself can do the same which will be deemed to have been made by the respective stock exchange. The last section (s35) enshrined some saving provisions which allow the existing stock exchange(s), listed securities and subordinate laws not inconsistent with the SEO’69 to continue in force without further satisfaction of requirements prescribed by the Ordinance.
SER’87 paves the way to implementing the provisions of the SEO’69. In doing so, it has prescribed the requirements of balance sheet (r12), profit and loss account (part II), and auditing financial statements.19 These rules which concern balance sheet, profit and loss accounts, and auditing are applicable to the IPO market in relation to preparing prospectuses, and to the subsequent activities of listed companies.

Until 25 January 1999, the Guidelines on Initial Public Offering to Local Investors 1995 (Guidelines’95) issued by the SEC would regulate IPOs. The Guidelines’95 were confined to the local investors alone and consisted of seven guidelines only. All of the guidelines essentially did the one thing, that of fixing the way of distributing the securities to be offered. For example, they laid down provisions regarding:

i. the minimum lot in the IPOs (g1);

ii. reservation for the applicants for minimum lot and other specific amounts (gg2-3);

iii. application for the minimum lot or multiplication thereof (g4);

iv. quotas in IPOs for non-resident Bangladeshis, Investment Corporation of Bangladesh20 Unit/Mutual Funds and employees (g5);

v. procedure of application by the non-resident Bangladeshis (g5A);

vi. procedure of refund of over-subscription money (g6); and

vii. holding of lottery for applicants for minimum lot, and proportionate distribution among the applicants for more than the minimum (g7).

A major reform took place on 25 January 1999 when the Public Issue Rules 1998 (PIR’98) came into effect. Since then, it has been the main by-law governing the issue of shares. It details the requirements of public offering to implement the provisions

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20 Some details of the ICB have been provided in section 3.9.
regarding the issue of capital enshrined in the SEO’69. The most important feature of the PIR’98 is the introduction of Disclosure-Based Regulation (DBR). The rationale for and justifiability of this sudden move from merit regulation to disclosure regulation will be critically examined in Chapter 5.

Unlike the former (Guidelines’95), PIR’98 regulates public offers as well as private placement to both local and foreign investors (r8). Its salient features can be identified as provisions in relation to: the lock-in on sponsors’ capital (r9); refund of over-subscription money (rr10-11); quotas for non-resident Bangladeshis and the procedure of distribution of securities (r12). Furthermore, it requires the issuers to obtain compulsory listing of securities (r13), and the appointment to issue managers and underwriters (rr14-15). The issues of approval or rejection of application for public offers and reviewing the decision of the SEC have been mentioned in rule 18. Rule 19 provides punishment for the violation of the PIR’98.

The SEC has made the Securities and Exchange Commission (Merchant Banker and Portfolio Manager) Regulations 1996 for the regulation of major intermediaries involved in the IPO market. The intermediaries covered by this by-law are underwriters, issue managers and portfolio managers. The issues concerning the regulation of these intermediaries will be generally examined in chapters 5-9.

Auditors have an important role to play in the IPO market. Although the involvement of auditors is imperative for any primary offer to the public, the securities regulator has no authority to regulate auditors. The SEC can only lodge a complaint with their statutory self-regulatory body. Auditors are regulated under the Bangladesh Chartered
Accountants Order 1973 and the Bangladesh Chartered Accountant Bye-Laws 1973.\(^{21}\)

Lawyers are an important part of an IPO coalition. The SEC does not have any regulatory authority over the practicing lawyers. The legal profession is regulated under Bangladesh Legal Practitioners and Bar Council Order 1972 (President’s Order No.46 of 1972) and the by-law titled Bangladesh Legal Practitioners and Bar Council Rules 1972 made by the government. All of the lawyers in the country are officially called ‘advocates’ under the above Order of 1972. They are regulated by a self-statutory body which will be discussed briefly in section 4.3.7.

All of the above laws together constitute the legal framework of the regulation of the IPO market in Bangladesh. However, some other statues are also applied to implement the purposes of this framework. For example, the Contract Act 1872 is generally applied to make or maintain any contract for the purpose of securities law. The Code of Civil Procedure 1908, the Code of Criminal Procedure 1898, and the Evidence Act 1872 are commonly used by the courts in trying the securities cases as well as other suits. Apart from these, tax incentives usually influence the market by offering some tax benefits to both of the issuers and investors. These benefits are regulated by the Income Tax Ordinance 1984. The laws listed here are prevalent municipal laws having no special treatment in respect of securities regulation. On this count they will not be specifically addressed as securities law. Similarly, they have not been embodied in the following diagram of the legal framework of IPO market.

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\(^{21}\) The regulation of auditors will be discussed in section 4.3.6.
Diagram 4.1. Legal Framework of the IPO Market in Bangladesh

Current Legal Framework of the IPO Market

Government Regulation

* Companies Act 1994
* Securities and Exchange Commission Act 1993
* Securities and Exchange Ordinance 1969
* Securities and Exchange Rules 1987
* Public Issue Rules 1998
* Securities and Exchange Commission (Merchant Banker and Portfolio Manager Regulations 1995

Self-Regulation

* Bangladesh Chartered Accountants Order 1973
* Bangladesh Chartered Accountant Bye-Laws 1973
* Bangladesh Legal Practitioners and Bar Council Order 1972
* Bangladesh Legal Practitioners and Bar Council Rules 1972
4.3. Regulatory Framework of the IPO Market

The administration of most of the laws mentioned in the previous sections is vested primarily in the Securities and Exchange Commissions (SEC). However, the whole regulatory regime consists of the House of the Nation (Parliament), the Ministry of Finance (MOF), the Ministry of Commerce (MOC), the Ministry of Law (MOL), the SEC, the Registrar of Joint Stock Companies (RJSC), the Institute of Chartered Accountants of Bangladesh (ICAB) and Bangladesh Bar Council (BBC). The SEC works under the guidance of the MOF. The MOC directly regulates the RJSC. The ICAB regulates the auditors involved in the issues of capital under the control of the MOC. The BBC which is placed under the administrative control of the MOL is the sole statutory body responsible for the regulation of advocates.

4.3.1. The House of the Nation (Parliament)

As regards the first task of regulation (making law), the Parliament being the country’s legislature is placed at the apex of the regulatory regime. Therefore, all of the securities laws in force in Bangladesh are either enacted or adopted (inherited after independence in 1971) by this Parliament or made under the authority of the respective enabling legislation. In addition, the Parliament works through some Standing Committees. The MOF, the MOC and the Parliamentary Standing Committees to both the MOF and the MOC are entitled to examine pertinent legal issues of the securities market. They can recommend the enacting of new laws, and the amending or repealing of existing ones. Furthermore, such committees can investigate the activities of the regulators concerned.22

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22 In a meeting held on 24 December 1998, The Parliamentary Standing Committee on the Ministry of Finance highly criticised the SEC for its inability to improve the capital market situation. The
4.3.2. The Ministry of Finance

Members of the SEC including the chairman are appointed by the government. The MOF is the concerned authority which deals with such appointments. Moreover, it can issue necessary guidelines to be pursued, and directions to be followed, by the SEC in administering securities law. Even until July 2000, the SEC could not make any subordinate laws without the prior approval of the government. Furthermore, the MOF is entitled to receive monthly activity reports from the SEC. The SEC is bound to furnish reports on its activities in addition to the regular reports if asked by the government. As a whole, the SEC is obliged to comply with the directions issued by the government to carry out the purposes of the SECA '93. Another major weakness of the SEC is that it is still financially dependent on the government.

4.3.3. The Ministry of Commerce

The MOC does not have any regulatory power over the SEC, nor is it involved in the functions of this government watchdog. However, the MOC directly regulates the RJSC which is responsible for the registration of companies and the issue of prospectuses. It is worth mentioning that the RJSC and his or her subordinates are government officials. In addition to the administrative control, the MOC has a similar role in respect of making or amending laws affecting the role and responsibility of the RJSC, as the MOF does in meeting was also critical of the 'unnecessary interference with the activities' of the DSE and the CSE. The members asked the SEC, specially its chairman, to allow the bourses, which are self-regulatory organisations, to work without unnecessary interference. The meeting also referred to two sets of recommendations advanced by the CSE and the DSE that contained the introduction of weekly netting system, amendments to certain provisions of the securities regulation, disinvestment of certain public sector enterprises, automatic renewal of brokers licences every year against the payment of required fees, brokers be allowed to underwrite IPOs: See 'SEC under Fire in JS Committee' The Daily Star, Dhaka (25 Dec 1998).

respect of the SEC. The MOC is the administrative ministry of the ICAB which regulates auditors.

4.3.4. The Securities and Exchange Commission (SEC)

The SEC is entrusted with the primary regulatory authority for the securities market as a whole. Under this authority, it has over all responsibility for the administration of the securities law. In compliance with government policies, the SEC works as a central regulatory authority having a wide range of functions covering the entire securities market. The functions of the SEC aim to establish its stated missions. These missions are to: i) protect investors in securities; ii) develop and maintain a transparent and efficient securities market; iii) ensure proper issuance of securities and compliance with securities laws by the market participants. For the purpose of implementing these missions, the SEC has been empowered to regulate various participants in the securities market. Thus it has the authority to regulate the aspects of the IPO market.

4.3.4.1. Composition and Working Procedure of the SEC

According to the SECA'93, the SEC is to be made up of seven members including the chairman, four full-time members and two nominated members representing the MOF and Bangladesh Bank, the central bank of the country.27

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27 Nominated members are separately chosen by the Ministry of Finance and the Bangladesh Bank, the central bank of the country, from amongst their officials. The nominated member of the Ministry of Finance shall not be below the rank of joint secretary of the ministry. In respect of the same of Bangladesh Bank, the officer should be one of its deputy governors.
4.3.4.2. Functions of the SEC Concerning IPO Market

The SEC is assigned to perform the following major functions in relation to the IPO market:

i. regulating the issuance of shares

ii. ensuring full disclosure in prospectuses;

iii. regulating market intermediaries;

iv. promoting public awareness about the securities market;

v. collecting and disseminating information about issuers, undertaking investigation and inspection, conducting inquiries and audit of various market players;

vi. settling disputes arising out of the issuance of shares.

4.3.4.3. Powers of the SEC Concerning IPO Market

The SEC has a wide range of powers in respect of the regulation of the IPO market. Its powers could be divided into five:

i. providing, suspending and cancelling the registration of the market intermediaries;

ii. approving IPOs;

iii. penalising persons involved in the market for non-compliance or contravention of securities law;

iv. issuing new guidelines and directions to the issuers as well as market intermediaries by way of notifications and circulations;

v. enquiring about alleged contravention or non-compliance of securities law.29
4.3.5. Role of the Registrar of Joint Stock Companies

The RJSC is entrusted with the responsibility to administer company law under which the issuers as well as the market intermediaries are registered. Obtaining registration is compulsory for companies before going public. Similarly, the financial companies like merchant bankers, issue managers and portfolio managers working as market intermediaries need to be registered too. Thus, the RJSC has the regulatory power on the registration of potential issuers and intermediaries of the market.

For the purpose of the registration of companies under the CA'94, two types of offices are established across the country at the central and regional levels. These offices are set up at such places as the government thinks fit. The company willing to be incorporated has to be registered by the office of the RJSC situated in its respective regional jurisdiction in which the registered office of the company is declared to be established.

Earlier, the RJSC had an exclusive authority to grant registration to companies. But the SEC imposed a new requirement on public companies in May 2001. According to this requirement, entrepreneurs are required to obtain prior consent from the SEC for the registration of a public limited company if its capital is 10 million taka (approximately US$0.18 million) or above.

In addition to the registration of companies, the RJSC is also responsible for the registration of those prospectuses which obtain the consent of the SEC for issuing to the public. More importantly, the RJSC is entrusted with the responsibility for the

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28 Bangladesh does not have any Over the Counter Market (OTC) as yet: see section 1.3.
29 The aspects of inquiring power will be critically examined in Chapter 9.
30 The Head Office is situated in Dhaka. Currently the three regional offices are located in Chittagong, Rajshahi and Khulna.
31 Companies Act 1994 (Bd) s 347 (1).
32 'Mandatory SEC Clearance for PLCs to Deter Investment, Says Businessmen' The Daily Star,
administration of the CA'94 which deals with the contents of a prospectus and remedies against the violation of the disclosure in a prospectus.\(^{33}\)

### 4.3.6. Role of the Institute of Chartered Accountants of Bangladesh

The ICAB is the national professional accounting body in Bangladesh and thus it is the main regulatory authority of auditors who are involved in the preparation of prospectuses. It is a statutory body established under the *Bangladesh Chartered Accountants Order 1973* (Presidential Order No. 2 of 1973). It is headed by an elected president who is the chief executive of the ICAB. The council of 20 members who are elected by the members of the institute is the ‘Supreme Authority responsible for the administration and management’ of this regulatory body.\(^{34}\) It has a significant role to play in respect of IPOs. All financial reports, financial statements, profit and loss accounts, etc incorporated in prospectuses are to be properly audited by the qualified auditors. False reports by auditors are detrimental to the interest of investors. This has the effect of reducing their confidence in the market. Hence the need for the regulation of auditors is important in order to create an environment conducive to investor confidence and thus investment in general.

Pursuant to the authority conferred by the above order, the government made the *Bangladesh Chartered Accountant Bye-Laws 1973*, to regulate the professional conduct of auditors. Thus, the ICAB governs the auditors under the *Bangladesh Chartered Accountants Order 1973* as well as under the above by-laws. The regulation of auditors will be a concern of the subsequent chapters in this thesis.

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\(^{33}\) Dhaka (18 May 2001).

\(^{34}\) Prospectus liabilities will be discussed in detail in Chapters 6 and 7.

4.3.7. Role of the Bangladesh Bar Council

The Bangladesh Bar Council (BBC) established under *Bangladesh Legal Practitioners and Bar Council Order 1972* (President's Order No.46 of 1972) is the single statutory body for the regulation of the legal profession in the country. It is an independent body and is made up of 15 members elected by the practising lawyers of the country. The Attorney-General of Bangladesh is the chairman ex officio of the BBC which regulates the affairs of legal profession, such as, entry to the profession, the professional conduct of advocates, and takes punitive measures for unprofessional activities. It follows the above Order of 1972 and the by-law called the *Bangladesh Legal Practitioners and Bar Council Rules 1972* made by the government.

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35 *Bangladesh Legal Practitioners and Bar Council Order 1972* s5(1).
Diagram 4.2. Regulatory Framework of the IPO Market in Bangladesh

Current Regulatory Framework of the IPO Market

Parliament

Ministry of Finance

Securities and Exchange Commission

Ministry of Commerce

Registrar of Joint Stock Companies

Ministry of Law

Institute of Chartered Accountants of Bangladesh

Bangladesh Bar Council

Regulates Issuers and Intermediaries (Procedure of, and Participants in the Issues of Shares)

Regulates Issuers and Intermediaries (Registration of Companies and Prospectuses)

Regulates Auditors (Registration and Professional Conduct)

Regulates Advocates (Registration and Professional Conduct)
4.4. Summary and Conclusions

The foregoing discussion explains the legal and regulatory framework of the IPO market in Bangladesh. It shows that the legal regime is composed of both statutes and by-laws. All by-laws concerning government regulation are made by the SEC except the SER’87. Outlines of these laws have been discussed and some shortcomings have also been briefly mentioned - the details of which will be examined in the following chapters. Similarly, a framework for the regulators has been canvassed and their roles outlined. The SEC is the main regulatory body having jurisdiction over all of the market participants except the auditors and the lawyers. The responsibility of regulating the auditors and lawyers is vested in the ICAB and the BBC respectively. The RJSC has the responsibility for the registration of companies (issuers), prospectuses. The RJSC has also the responsibility for the administration of the CA’94. It is worth mentioning that the SEC does not have any regulatory authority over the ICAB, the RJSC and the BBC. Some significant parts of the regulation of IPOs thus fall outside the ambit of the securities regulator.

The regulation of securities market is the core tenet of market development. A recent study reveals that the ‘strict enforcement of the securities law by a highly motivated regulator was associated with a rapidly developing stock market’. Generally, the regulation aims to protect investors. A proper law and regulatory framework can provide this protection. An empirical study on 49 countries across the world finds that ‘countries with poorer investors protections, measured by both the character of legal rules and the quality of law enforcement, have smaller and narrower

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capital markets'. Therefore, the legal and regulatory framework of the Bangladesh IPO market needs to be studied in respect of the development of the market through the protection of investors.

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Chapter 5

The Disclosure-Based Regulation and Its Applicability to the Market for Initial Public Offerings in Bangladesh

5.1. Introduction

The Securities and Exchange Commission (SEC) in 1999 adopted the Disclosure-Based Regulation (DBR) in place of the previous Merit-Based Regulation (MBR) for the market of Initial Public Offerings (IPOs). The regulator made this ‘total shift’ without any investigation of market-readiness to embrace this new regime. Further, the DBR came into effect in a market which had been suffering from a serious lack of investor confidence since the later part of 1996. The DBR has no success in restoring this confidence. This is so because the investors feel a profound lack of protection in the market. Hence, the shifting from the paternalistic merit approach to the market-oriented disclosure regime needs to be investigated in the perspective of investor protection.

This chapter will examine the feasibility of following the DBR for the IPO market in Bangladesh. The specific objectives of this chapter are to investigate the existence of the necessity for the DBR, and its usefulness in the present IPO market. The discussion will emphasise the issues that generally necessitate and facilitate the departure from the merit regulation for the adoption of the disclosure regime. The reason for this special emphasis is to determine the applicability of the DBR in this market based on the existence and/or non-existence of those issues.

The chapter has been divided into four sections. Section 5.1 is introductory. Section 5.2 will explore the elements of market development that necessitate the adoption of the DBR. Section 5.3 will critically analyse the core tenets of a useful disclosure regime
with regard to market realities in Bangladesh. Section 5.4 will present a summary and conclusions. The conclusion will demonstrate that the Bangladesh IPO market is not ready as yet to embrace the disclosure regime, as this is not as yet a useful philosophy for the regulation of this market.

5.2. Elements of Market Developments Leading to the Adoption of the Disclosure-Based Regulation

It has been contended that the BDR is a system of investor protection. The principal argument in support of the DBR is that it protects investors by providing them with all material information necessary to make an informed investment decision.

Although the DBR originated a long time ago, it has assumed wider acceptance in recent years following some developments in the securities markets worldwide. Some of the important developments can be described as follows:

i. greater participation of institutional investors;

ii. proliferation/ innovation of financial instruments; and

iii. efforts for securities markets globalisation.

5.2.1. Greater Participation of Institutional Investors

Over the past 20 years, institutional investors (IIIs) have increased significantly in numbers and in amount of capital invested especially in the developed markets. In

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1 See sections 1.6.2 - 1.6.2.2.
2 Section 1.6.2.2.1.
3 The United States securities market is one of the most developed markets in the world. There were only 427 registered public mutual funds in this market representing a total of $45 billion. The number of such funds reached at 5,305 in 1996 representing $2.6 trillion. See Investment Company Institute, *Mutual Fund Fact Book* (37 Ed 1997) mentioned in M Bradley, C A Schipani, A K Sundaram & J P Walsh, 'Challenges to Corporate Governance: The Purposes and Accountability of
some markets, IIs account for more than 80 per cent of all shares traded. They have a significant role to play in the improvement of ‘informational efficiency’ in the securities market as is evident in several empirical studies. These studies suggest that higher degree of institutional holdings of securities is conducive to fuller and greater information releases from companies. The institutional holding is also associated with more intensive research activities by securities analysts. This research is usually carried out by their own people for their own interest, but general investors can also benefit therefrom.

The amount of institutional investment has not increased in Asia as a whole as yet except in a few markets. However, some countries are making considerable progress gradually in attracting institutional investment. For example, IIs hold approximately 37 per cent of total securities listed with the Kuala Lumpur Stock Exchange (KLSE) as of September 2001 as disclosed by the chairman of the KLSE. In India, the cumulative amount of only foreign institutional investment was US$6.59 billion in July 1996 and

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5. A market is said to be informationally efficient if the share price reflects all the information including private information in respect of the underlying shares. For a detailed discussion of information efficiency, see R Sappideen, ‘Securities Market Efficiency Reconsidered’ (1988) 2 University of Tasmania Law Review 132.


7. Id at 181.

8. General investors may reap the benefit of research carried out by IIs by following the latter’s assessment of a given public offer and comparing the information found in such research with the disclosures in the prospectus, if the IIs make their research public.

US$12 billion in April 2000. The amount of investment in the Bangladesh market is ‘very poor’ as stated by a member of the SEC. In fact Investment Corporation of Bangladesh (ICB) is the largest II (in fact, the sole large II) in the Bangladesh securities market. Nonetheless, the total investment by the ICB is even ‘less than one per cent’ of total market capitalisation.

IIs generally appoint people having expertise in securities investment. Hence, their ability to assess the merits of public offers may be greater than that of regulators in some jurisdictions. Since IIs themselves are able to determine the merits of IPOs, they are more comfortable with the DBR than the MBR. The Bangladesh market is still far behind that of India and Malaysia in respect of institutional investment. Pension and provident funds are regarded as a major source of institutional investment worldwide, but these funds are still away from the securities market in Bangladesh. Although the Trusts Act 1882 and the Insurance Act 1938 were amended in 2000 to remove the barrier to invest by these funds in any listed securities other than government ones, the market could not attract these funds so far. In anticipation of the passivity of these funds, analysts suggested that the SEC beforehand take up a program to educate fund-holders, especially pension holders, on the benefits of investments in the capital market as compared to those in other areas. The SEC is yet to undertake such a program so far as this writer knows. It is clear from this that the SEC is not very serious about

11 ‘National Stock Exchange Soon’ The Bangladesh Observer, Dhaka (20 Mar 2002). The SEC member referred to here is Dr Iftekhar Gani Chowdhury.
12 For ICB, see section 3.9.
14 The amendments of these Acts have been discussed in section 3.4.5.
attracting IIIs. Whatever may be the reason, the fact is that institutional investment is very insignificant in this market to date. Such investment has not increased after the introduction of the DBR. Thus, the adoption of the DBR has not been able to attract even IIIs to the market. This indicates that the DBR could not help restore or create confidence even in IIIs. What this means ultimately is that the extent of institutional investment in Bangladesh does not require the introduction of the DBR in place of the MBR.

5.2.2. Proliferation or Innovation of Financial Instruments

Over the last three decades, various new financial products have proliferated for trading in the securities markets. The factors leading to these innovations are identified as: risk reallocation; enhanced liquidity; reduction in agency costs and taxes; and circumvention of regulatory restrictions. Finnerty has sorted out a total of 60 major innovations in securities offered by corporations between 1973 and 1991, and many more have been added to the list thereafter. Almost 40 of these products are offered as debt instruments. Perhaps, the most notable innovations have taken place in the derivative securities (options for example). As of June 1998, the estimated total value of these products was US$70 trillion. There are significant new products in the equity market too. Most of the new products are greater risk-bearing instruments. These are offered

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17 Debt products are, for example, collaterised mortgage obligation, commercial real estate-backed bonds, adjustable rate notes and bond linked to commodity prices: Finnerty (1992) id at 23-24, 29-32.
18 Id at 29-32.
20 New equity products are, for example, callable common stock, super shares, and unbundled stock units: Finnerty (1992) above n16 at 38.
in the developed markets that are dominated by the sophisticated investors. These investors are able to bear the risk associated with the products, and to assess the merits of the offer by themselves. Both Malaysia and India are far ahead of Bangladesh in terms of the availability of the variety of financial products. Various products such as shares, warrants, certificates of mutual funds/unit trusts, debentures, bonds, hybrid securities, and derivative instruments are available in these two markets (Malaysia and India). The financial products in the Bangladesh market are very limited, because only three types of instruments, namely, ordinary shares, company debenture, and certificates of mutual funds as has been discussed in Chapter 1 are available. Although there are some securities other than shares, a total of 97 per cent of securities are ordinary shares. Thus the market is basically treated as a share market. No new financial products are available to date in the market. Hence, it can be affirmed that the securities market in Bangladesh is still very conventional in respect of the variety of financial products tradable in the market. Thus the need for the DBR to argue on the basis of product innovations is not applicable to the Bangladesh market as yet.

5.2.3. Efforts for Globalisation of Securities Markets

The origins of the concept ‘globalisation’ can be found in some of the works of Wendell Wilkie and the Club of Rome. The globalisation of securities markets has been defined as ‘the international integration of markets and the increasing interdependence

21 Securities markets in the United States, United Kingdom, Japan, Germany, France, Australia, Switzerland, Canada, Hong Kong, Singapore etc.
22 Sections 1.2.1 - 1.2.1.4.
23 Section Figure 1.1 in Chapter 1.
of the economies of different nations. It is basically a factual process based on the dynamics of the markets.

The securities markets around the world have been witnessing profound changes since the middle of the 1970s. Such changes have been taking place in relation to the structure, operation and control of the markets. Mainly, the structure and identity of participating institutions; product innovations; techniques as well as technologies of trading and dealing in securities (such as Internet trading) have paved the way for the internationalisation or globalisation (both are used interchangeably in this research) of the securities market. The increase in the institutional investment is also a factor leading to globalisation. These changes are regarded as expeditions towards globalisation, because they enable the markets to go beyond national borders and prompt awareness of the necessity for trading and regulatory unification.

Although these changes have taken place in both India and Malaysia to a large extent, they are almost non-existent in the Bangladesh market to date. Some operational changes have happened in this market. For example, the DSE and the Chittagong Stock Exchange (CSE) have been providing screen based automated trading system since 1999 and 1998 respectively. The CSE, for the first time, introduced Internet trading in July 2002, but the bourse did not receive any positive response from the market. This is

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so because, there has been only one Internet transaction until April 2003. The DSE is yet to be able to offer this trading facility. The automated trading system could not extend the market (trading facilities) across the country. To date, the operation of the DSE is limited only to the capital city; whilst the CSE has gone a little further by making trading facilities available in three cities (Chittagong, Dhaka and Sylhet) out of 64 district cities. No national market is in place in Bangladesh. However, the government has been contemplating the establishment of a national stock exchange since for some time now, but such initiative may not be implemented soon. The reason for this delay is that the members of the CSE, the only bourse outside the capital city, is suffering from financial crisis due to thin turnovers for years. In this regard, the position of the DSE is little better, but is still unsatisfactory. Considering the poor turnover in the DSE, the Finance Minister recently expressed his concern, and put a question to its members-'How do you three hundred members manage to earn your bread?' Normally, the position of the CSE members is more vulnerable than that of the DSE members. Nevertheless, the CSE claims to extend their service throughout the country. Although both of the bourses have introduced a screen-based trading system for the last few years, this system has not contributed much to restore investor confidence. The system itself has proven to be flawed. Recently the key manipulation surveillance software of the DSE has been found to be faulty in a SEC investigation.

32 For details about this fund crisis, see K A Mansoor, ‘CSE is being Made White Elephant’ The Daily Janakantha, Dhaka (7 Apr 2002) (translated from Bengali).
33 ‘Finance Minister Exchange Views with the DSE-Govt Shares to be Offloaded, Energy to be First: Saifur’ The Independent, Dhaka (13 Feb 2002).
34 ‘CSE Claims to be De Facto National Bourse’ The Daily Star, Dhaka (22 Mar 2002).
The DSE has been procuring misleading information over the years by using this software. A mechanical problem is normally not considered to be a serious matter. However, it can become serious if it is created deliberately and allowed to persist. This is attested by one high-ranking official of the SEC, who alleged:

> At the very beginning, the DSE system engineers detected the fault and informed the management about it. But the CEO [of the DSE] continued to mislead the SEC when it made queries about the performance of the surveillance software.\(^{36}\)

The surveillance officials informed the SEC investigators that they had been conducting surveillance based on ‘assumptions’ for more than three years.\(^{37}\) This investigation testified that the DSE surveillance was ineffective resulting in the undermining of crucial aspects such as transparency and accountability. The DSE surveillance has further decreased investor confidence and will be a disincentive to the expansion of the market. It is thus evident that the Bangladesh market could not extend the securities trading facilities to the major part of the country to date. Its most important technological improvement so far, had proven to be defective and seriously harmful to the market transparency.

Whilst the operation of the Bangladesh securities market is limited to three metropolitan cities out of five (in other words, in three districts out of 64), both Malaysia and India have already set up their national stock exchanges. In Malaysia, the Kuala Lumpur Stock Exchange (KLSE) operates as the national exchange across the country, whilst in India the National Stock Exchange (NSE) works nationwide in conjunction with 23 recognised state stock exchanges operating in the various States.


\(^{36}\) The SEC investigation revealed that the software was faulty since its installation and at least on three occasions the concerned IT officials of the DSE reported this to the CEO. But the CEO failed to take any corrective steps or inform the regulators about the fault. The CEO admitted that it was faulty. For details, see M S Rahman, ‘Faulty DSE Fault Finder!’ *The Daily Star*, Dhaka (3 Apr 2002)

\(^{37}\) Ibid.
Another important technological development apart from the surveillance method that is needed for globalisation is depository system. The Central Depository System (CDS) is the need of time to dematerialise the share certificates.\(^{38}\) It is important for Bangladesh, where there is large scale trading in fake shares.\(^{39}\) It plays a pivotal role in bringing about transparency in securities trading, and in inhibiting dishonest people from forging share certificates. The CDS seeks to ensure this transparency through dematerialising the share scrips and carrying out electronic settlement of securities transactions. India and Malaysia have introduced the CDS in 1996 and 1990 respectively.\(^ {40}\) However, Bangladesh is yet to introduce it, although the Parliament enacted the necessary legislation in 1999 to pave the way of setting up a depository company.\(^ {41}\) Accordingly, a company named the Central Depository Bangladesh Limited (CDBL) has been registered.

The success of the CDS has been a matter of concern even before its introduction. The DSE, in the meantime, has threatened to shun the embryonic CDS, and the chairman of this bourse raised questions about some irregularities regarding its (CDBL) recruitment procedures and some of its crucial negotiations.\(^ {42}\) Expressing his doubts about the success of the CDS in Bangladesh, the DSE chairman pointed out that:

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\(^ {38}\) The term ‘dematerialise’ refers to changing physical certificates to electronic book keeping. Trading in dematerialised shares does not involve any transfer of physical certificates, rather shares are registered and transferred electronically.

\(^ {39}\) Section 3.4.3.

\(^ {40}\) In India, National Securities Depository Ltd (NSDL) was incorporated in December 1995 and commenced operating in November 1996. It is a separate company. The Malaysian Central Depository (MCD) started functioning in April 1990 as a subsidiary of the Kuala Lumpur Stock Exchange (KLSE). The CDS in Malaysia started functioning long before the adoption of the DBR. However, India introduced this system after the adoption of the disclosure regime.

\(^ {41}\) Sections 3.4.3 and 3.9.

\(^ {42}\) For details, see ‘DSE Threatens to Shun CDS’ The Daily Star, Dhaka (13 Jan 2001).
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We would like to make our position very clear in this regard that we cannot participate in a depository system that will not accommodate our needs and may be inconvenient to our members.43

It is an admitted fact that the survival of the CDBL would be at stake without the full support from the DSE, since it is the principal bourse of the country. The quantum present transactions in the CSE alone, cannot provide the necessary impetus for the survival of this depository because of its (CSE) poor turnover. Hence, an active role of the central depository service in developing the market is still uncertain even if it (CDBL) starts functioning sooner or later. This is because, if the DSE raises questions about the success of the CDS itself, then it is really a matter to be concerned about.

From the viewpoint of investors and issuers, the globalisation of the securities markets may necessitate a departure from the MBR mainly on two grounds. Firstly, from the investor point of view, most IIs invest in overseas securities and these investors are able to assess the merit of a particular offer by their own experts. Therefore they prefer the DBR to the merit regime. Admittedly, large or sophisticated individual investors may also be interested in investing overseas, but generally, professional managers who have expertise in securities trading manage their (sophisticated individual investors) portfolios. Thus such individuals may share the views of IIs in this regard. Secondly, from issuers' perspective, there is no uniform standard of the MBR. It varies between jurisdictions. Issuers usually favour the DBR for their own interest to widen their entry to the public. Thus, in the absence of the uniformity of merit regulation, issuers may choose full disclosure to investing in overseas markets.44

43 Ibid.
44 In the United States, the DBR was introduced in 1933 for federal regulation (inter-state offers). At the same time most of the states retain the MBR for their own.
As alluded to earlier, institutional investment is very insignificant in the Bangladesh securities market. In addition, foreign portfolio investment ‘is virtually nil after the late 1996 share market scam’.\(^{45}\) Hence, the lack of sophisticated investors is profound. In terms of issuers, the market could not attract any foreign companies to float in its market in the last 10 years, despite the adoption of the DBR in 1999.\(^{46}\) Conversely, like many other countries, India and Malaysia were able to attract many overseas companies to be listed in their respective stock exchanges during the period of merit regime. This tends to support the proposition that despite its importance, disclosure is not a panacea. On that account, the mere fact that there is a disclosure regime is not sufficient to attract foreign investors and issuers. Rather, the present study intends to argue that the attraction of local investors and issuers is more important than the efforts of the DBR to restore the confidence of foreigners. A securities market cannot be developed without investor confidence, and it requires the existence of an adequate and appropriate system of regulation.\(^{47}\)

The above discussion reveals that the necessity for the adoption of the DBR in response to market globalisation does not exist in Bangladesh. The infrastructural status, such as the non-availability of reliable automation of the trading system and central depository is not conducive to internationalisation of the market. Furthermore, even if the foreign investors and issuers come, they will leave if they lose their faith in the

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integrity of the market, a fact that is strongly supported by the chairman of the United States Securities and Exchange Commission.\textsuperscript{48}

Therefore, it can be concluded that none of the core elements that necessitate the adoption of the DBR, is currently in place in Bangladesh, nor did they exist before the adoption of the disclosure regime in January 1999.

5.3. Critical Analysis of the Application of the DBR in Bangladesh

The success of the DBR depends on eight important elements. These are:

i. full and fair disclosure;\textsuperscript{49}

ii. due diligence of the persons involved;\textsuperscript{50}

iii. improved corporate governance;\textsuperscript{51}

iv. effective self-regulation of the market participants;\textsuperscript{52}

v. adequacy of investor knowledge of investment;\textsuperscript{53}


\textsuperscript{49} The issuers of securities shall ensure that all material information necessary to make informed investment decision by the potential investors is provided accurately, completely and timely. The disclosure should be free from material omission or misleading elements. Material information means generally the information that would reasonably be expected by rational investors to facilitate their investment decisions.

\textsuperscript{50} Due diligence is a process by which inquiries are conducted to ensure that information to be disclosed is ‘true, sufficient and timely’. Specially the issuer, auditors, underwriters, and issue managers must undertake a due diligence exercise to verify and ensure the accuracy, completeness and timeliness of information to be disclosed to the public.

\textsuperscript{51} Primarily the directors of the issuer are responsible for disclosure as the primary source of information. The adequate and accurate disclosure of information is an integral part of good corporate governance. To make such disclosure, there should be transparency in corporate activities and transactions, which are core tenets of improved corporate governance. The directors of companies shall comply with both laws and regulations as well as Directors’ Code of Ethics.

\textsuperscript{52} There was no association of listed companies, merchant bankers in Bangladesh before the adoption of DBR.

\textsuperscript{53} Under the DBR, disclosures are made to the investors with the sole purpose to enabling them in making informed decisions. The contents of disclosure made in a prospectus are related to the issues
vi. competent market professionals;

vii. availability of retail research on potential issuers;

viii. active policing of the market, appropriate securities law and its effective enforcement.

5.3.1. Full and Fair Disclosure

The primary function of disclosure is to eliminate the informational asymmetry between issuers and potential investors. With this end in view, President Roosevelt proposed to introduce the DBR in the United States. He pointed out that:

Of course, Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained or that the properties which they present will earn a profit.

There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.

This proposal adds to the ancient rule of caveat emptor, the further doctrine ‘let the seller also beware’. It puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence.

Full and fair disclosure typically refers to complete, accurate and timely disclosure of the affairs of issuers as well as the underlying issues. An issuer of securities shall ensure that the prospectus contains all material information necessary to make informed decisions on accounting and economics. Investors need special knowledge of the issues to be able to evaluate the merits of the offer. If the investors do not understand the true meaning of the disclosed information, then the DRB brings no value without any professional advice. So the effectiveness of the DBR in a country rests on the investors’ intellectual ability to understand the disclosed information and their effects on the underlying shares, or affordability to obtain professional advice.

*Until the enactment of the Securities Act 1933, there was no central regulatory body for securities market in the US. It was the state responsibility to regulate the market in pursuance of the respective securities laws - the so-called blue-sky laws, of the state concerned (the first law of this kind was enacted in Kansas in 1911, which sought to protect investors). All the state laws followed the MBR. The above Act of 1933 introduced the current central regulation and, at the same time, adopted the philosophy of the DBR for the first time: Corporate Research Centre, ‘Disclosure-Based Regulation’ (2000) Regional Monitor <http://www.hkex.com.hk/library/reports/issue31.htm> (26 Nov 2001).

H R Rep No 85 73rd Congress, First Session 2 (1933) quoted in Corporate Research Centre (2000) ibid.
investment decisions by the potential investors. This information has to be free from any material omission or misleading elements.

The primary thrust of the DBR was to ensure truth in securities issuance. To achieve this goal, the new system imposes the burden of telling the whole truth upon the seller of securities. However, ensuring honest and diligent performance of the issuers and intermediaries in this respect is complex particularly in a country like Bangladesh. One of the most crucial objections against the disclosure regime is the difficulty of ensuring full and fair disclosure. Generally, an issuer is much more powerful than most investors. The issuer’s strength is measured in terms of professional knowledge, business techniques, and political support.56

Generally, the promoters and directors of companies have both institutional education and practicing experience in relation to business. In addition, each company is supposed to hire qualified people having expertise in law, finance, accounting and economics.57 In Bangladesh, the vast majority of investors have hardly any knowledge of investment.58 More importantly, they do not even have adequate financial solvency to get their portfolios managed by professionals, even if such a service becomes available. Moreover, investors are not able to bring issuers to the court to redress the violation of law mainly because of financial deficiency. Therefore, from a practical point of view, the issuers are superior to the general investors in terms of investment knowledge as well as financial ability. Perhaps for this reason, professional advisory service as

56 For example, the former two presidents of the Federation of Bangladesh Chamber of Commerce and Industries (FBCCI), Mr Salman F Rahman and Mr Abdul Awal Mintu, contested the National Election 2001 with the tickets from two major political parties (Bangladesh Awami League and Bangladesh Nationalist Party) respectively. It is widely believed that the businessmen used to pay considerable amounts of money to the fund of the political parties. Their financial superiority over the individual investors is needless to explain.

57 Knowledge on these subjects is most relevant for a public issue, and for defending the company for any pertinent fault.

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mentioned above is not available in the Bangladesh market. Thus it is easy to understand why, although the market is half a century old, it has been seen as an 'infant' market.

Generally speaking, most businesspersons in Bangladesh are involved in party politics directly or indirectly. By virtue of their political affiliation and financial strength, they might feel some sort of 'implied immunity' against any legal course of action (judicial or regulatory), and thereby become less honest in their preparation of the prospectus. The influence of their money and political alliance (or contribution to parties' funds) is best evident in the unusual delays of 15 criminal cases instituted by the SEC in 1997 pursuant to the inquiry report on the share scam 1996. In three out of 15 of these cases, the deputy chairman of the Beximco Group of Companies (Beximco), country's largest industrial conglomerate, amongst others, was implicated. None of the above cases has yet been finally disposed of. The Appellate Division of the Supreme Court in Shainpukur Holding Ltd v Securities and Exchange Commission (one of the above 15 cases) observed that:

It is true that in criminal matters the accused should get all protection under the law but it is also important that the law should not be stretched too far so that big companies against whom serious allegation of foul play concerning national economy is being

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59 Investor Information Cell, above n30 (10 Apr 2003).
61 A recent research shows that a total of 78 per cent of companies 'give donations to political parties or candidates': 'Corporate Funds Flow into Political Pockets: 78% Firms Pay Political Parties, CDP Research Reveals' The Daily Star, Dhaka (5 Aug 2002).
62 For details of these cases, see section 8.6.1.
63 Mr Salman F Rahman is the Deputy Chairman of Beximco Group of Companies, the largest private sector industrial conglomerate in Bangladesh having a total of 28 companies. This group has 11 companies listed with the DSE out of a total of 224 listed companies as at 30 June 2001. He was the president of the Federation of Bangladesh Chamber of Commerce and Industry (FBCCI), the apex body of the businessmen of the country, and the Chamber of South Asian Association of Regional Cooperation (CSAARC).
64 18 BLD (1998) at 61.
made before the Court by a statutory authority [SEC] can themselves overtake the law by raising ingenious contentions in order to frustrate the prosecution on the threshold.65

One of the main reasons for the delay is believed to be the financial strength and political connections of the accused. 66 More surprisingly, there are no reported cases in the last 20 years concerning the misstatement or concealment of material facts in prospectuses, although such statutory requirements 67 have reportedly been violated on several occasions.68 In this way, the issuers and investors cannot be seen as parties of equal status in respect of IPOs.

It should be pointed out that to take advantage of such weakness of investors, many issuers adopt unfair means in preparing prospectuses by concealing material facts and/or embodying false and misleading information. In support of this allegation, some eminent auditors of the country observed that ‘though financial reports is [sic] prepared by the management, very often auditors do not discharge their duties from the point of

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68 See for example, see below n72.
professional ethics'. The relationship between the companies and their auditors is so unethical that the SEC had to promulgate a new rule to combat professional unfairness and unethical conduct. In accordance with this new rule issued by the SEC on 26 November 2001, companies were barred from appointing the same audit firms consecutively for more than three years. The High Court Division of the Supreme Court on 20 May 2002 stayed the operation of this rule upon the petition from the Beximco.

There are reports to show that such unfair practices are rife. In so doing, either material information has been concealed, and/or false and misleading information has been furnished. Hence, the situation demonstrates that many issuers are issuing defective

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70 Ibid.
72 AIMS of Bangladesh Limited cancelled their commitment for underwriting the floatation of Modern Food Products Limited after the publication of the prospectus. AIMS decided on this cancellation after detecting that the audited account of the company provided to them by the Merchant Bankers and Issue Manager of the issue differed from the one published on the prospectus and concealed material facts. The audit report on the prospectus had been qualified by the auditors for not complying with Bangladesh Standard of Accounting (BSA) 4 and 16 on fixed asset schedule. It was also exposed that the sponsors of the issuer are bank loan defaulters. The bad loan liability and litigation against them have been understated and concealed at Taka 5.205m against actual Tk 13.465m: see AIMS, ‘AIMS Ditches Modern Food’ Weekly Market Review (10 Jul 2000) at 1; M S Rahman, ‘AIMS Backs Down on Pledge to Underwrite Modern Food: Audited Accounts Differ from Prospectus Statement’ The Daily Star, Dhaka (3 Jul 2000).

The SEC has sued the directors of Wonderland Toys Ltd and its issue manager (National Securities and Consultant Ltd) for allegedly ‘inducing the investors into purchasing its shares by artificially showing a rosy picture of the company’. The company went for an IPO of T$50 million. In its prospectus, the company showed that Wonderland's counterpart in Hong Kong had provided them with the plant and machinery as per a joint venture agreement and all the machinery had been installed. The SEC filed the case based on its inquiry reports. The SEC complaint stated that ‘[a]ll these claims are outright false, deceptive and an illegal bid to gain by providing false information with a view to luring investors into buying its shares’. It may be mentioned here that Wonderland failed to make any profit and pay dividend for two consecutive years. For detail, see M S Rahman, ‘Court Summons Wonderland Toys Directors for Alleged Deception: Fake IPO Info Make Investors Buy Scrips’ The Daily Star, Dhaka (19 Jan 2001).

Audit firm M/s Ata Khan & Co had been accused of certifying false statements by two companies on their balance sheets. The SEC inquiry as well as the investigation of the disciplinary committee of the Institute of Chartered Accountants of Bangladesh (ICAB), the professional statutory body of accountants, found the firm guilty for certifying balance sheets of two companies showing inflated amounts of bank liability. These two green field companies' sponsors sought to raise T$360 million from the IPOs. For details, see M S Rahman, ‘Auditing Firm under SEC-ICAB Fire’ The Daily Star, Dhaka (21 Apr 1998).

FU-Wang Ceramic Industry Limited, a Taiwanese-owned company, concealed a tax evasive information in its prospectus for an IPO to raise T$50 million which was revealed during the
prospectuses in collaboration with the other members of IPO coalitions.\textsuperscript{73} In a report by Khan, an experienced accountant, it was observed that, ‘most of the CA [Chartered Accountants] firms don’t bother to verify the books of records adequate enough to make their audit reports true and fair’.\textsuperscript{74} This report also claims that the ‘irresponsible signing of audit reports by most of the audit firms are discouraging the few firms that are still straggling to maintain auditing standard’.\textsuperscript{75} By reiterating the lack of confidence, very recently, the Finance Minister has advised the DSE officials to stop indulging in market manipulation. In response to this request, the officials highlighted the fact that the financial reports of companies lack transparency.\textsuperscript{76} Thus the submission of false or subscription period. Such information is required to be published under the prevailing law and international accounting practices, which have been adopted by Bangladesh: see T I Khalidi, ‘IPO to Raise Tk 5 cr by Taiwanese Tiles Producers: Fu- Wang Conceals Information’ \textit{The Daily Star}, Dhaka (11 Feb 1998).

Madina Shoe Industries Ltd submitted a petition for IPO for the SEC’s approval. The petition enclosed a due diligence certificate with the forged signature of a director. Later, the SEC turned down the application. The SEC detected the forgery when directly contacting the director: see M S Rahman, ‘SEC Turns Down Madina Shoe’s IPO Petition: Allegation of Submitting False Documents’ \textit{The Daily Star}, Dhaka (12 Jun 2000).

The SEC suspended the IPO of Raspit Data Management and Telecommunications Ltd by accusing the company of inflating its assets. An investigation conducted upon a complaint by some internet services providers led to this accusation: see M S Rahman, ‘SEC Suspends Raspit IPO, Orders Special Audits: Auditor to be Selected by the Company’ \textit{The Daily Star}, Dhaka (15 Sep 2000).

Keya Cosmetic Ltd, a reputed company, allegedly concealed the evasion of a huge amount of Value Added Tax (VAT) in its prospectus. The company offered IPO for TK 25 million whereas the alleged amount of evaded tax was Tk 390 million: see M S Rahman, ‘Alleged Tax Evasion by Keya: SEC May Ask Co to Issue Public Notice’ \textit{The Daily Star}, Dhaka (15 Jun 2001).

There are more cases supporting the adoption of unfair means by the issuers, intermediaries and/or auditors to raise fund for the firms from the public, but could not be mentioned due to space constrains.

\textsuperscript{73} For raising money from the public through unfair disclosers, see for example, K A Mansoor, ‘Share Scandal: Some Companies Looted 500 Crore Taka’ \textit{The Daily Janakantha}, Dhaka (15 Jun 2002) (translated from Bengali).
\textsuperscript{74} K A Khan, ‘Auditors’ Responsibility’ \textit{The Daily Star}, Dhaka (5 Jan 2002). The report further mentions that the auditors do not have propensity to maintain the auditing standard due to lack of accountability and supervision. Most of the firms are engaged in unjustifiable competition to increase the number of their clients. The writer is a well-known accountant and auditor of the country.
\textsuperscript{75} Ibid.
\textsuperscript{76} \textit{The Prothom Alo}, Dhaka (13 Feb 2002) (translated from Bengali).
misleading reports by auditors is one of the reasons for the prevalence of the lack of proper and adequate disclosure in Bangladesh.\(^{77}\)

In such a situation, it would be really difficult to ensure full and fair disclosure in prospectuses. If the information is not disclosed properly, the investors cannot make informed decisions even if they are able to utilise the disclosure in a prospectus. When the assurance of full and fair disclosure is frustrated, the whole objective of disclosure regime becomes futile, because, incomplete and inaccurate information cannot help investors make informed investment judgments. Instead, such disclosure can lead to deception. Since the vast majority of investors in Bangladesh are unsophisticated, they are unable to invest further, once they lose their life savings. Thus they stay away from the market. In such circumstances, the new investors cannot put their trust in the market, and as a result, the market suffers from investor confidence. All of these observations ensure that it would be unrealistic to expect full and fair disclosure in prospectuses in the prevailing circumstances.

5.3.2. Due Diligence of the Persons Involved in an IPO Coalition

The term ‘due diligence’ implies ‘[a] close examination, particularly in a legal sense, of a transaction and its related documentation’.\(^{78}\) In respect of disclosure, due diligence is a process by which inquiries are conducted to ensure that information to be disclosed is true, sufficient and timely. Persons involved in the preparation of a prospectus must undertake a due diligence exercise to verify and ensure the accuracy, completeness and timeliness of information to be disclosed to the public. They should demonstrate a

minimum standard of conduct which provides safeguards against the contravention of relevant regulatory provisions and adequate supervision ensuring that the system is properly carried out. The central point of due diligence is that the persons involved in a transaction or a documentation must exercise their powers and carry out their duties with care and diligence. Their role must satisfy a standard that a reasonable person would exercise his or her powers and perform duties in the same manner under the same circumstances.

Various persons adopt unfair means in various forms. The examples of unfair practices as noted earlier show that directors' signatures are forged; intermediaries and auditors provide due diligence certificates by concealing material information or embodying untrue and false information. At times, the issuers are getting auditors' reports prepared without exercising due diligence. Subsequently, such issuers are submitting these imperfect reports to underwriters to convince them that they should enter into an underwriting agreement. After obtaining underwriting agreements, the issuers publish in their prospectuses different financial statements which are at odds with the previous audit reports. For example, as discussed earlier, this happened in July 2000, when Asset & Investment Management Services (AIMS) withdrew its underwriting pledge with Modern Food Products Limited. Despite the existence of such prohibited practices, remedial action against the auditors is seldom heard of in Bangladesh. Until December 2000, the SEC has filed at least 12 complaints against

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79 *Universal Telecasters (Qld) Ltd v Guthrie* (1978) 18 ALR 531; 32 FLR 360. See also *SPCC v Kelly* (1991) 5 ACSR 607.
80 The SEC filed at least 12 complaints against auditors to their professional statutory body (ICAB) for punishment. The ICAB in one instance suspended one of its member for one year: see M S Rahman, 'SEC Draws the Line for Auditors: Firms Violating International Standard to be Black Listed' *The Daily Star*, Dhaka (24 Dec 2000).
different audit firms with the Institute Chartered Accountants of Bangladesh (ICAB), but the ICAB suspended in a single instance one of its members for one year only. Recently, speakers in a seminar on the Capital Market Development in Bangladesh have identified unfair disclosure as one of the fundamental problems that the market is currently encountering. Disclosing the hidden reality of the audit reports, a SEC official commented that:

Audit reports and balance sheets of many listed companies, approved at their annual general meetings, were found to have been tailored to suit the needs of the sponsors and deprive shareholders of dividends.

A similar comment is found in a study on investor protection. It says that ‘...audits of some companies are cooked up in tailor-made way’. Thus the fabrication of audit reports is a well established practice in this market.

In light of the above-mentioned malpractice, this analysis suggests that neither companies nor auditors are following legal and ethical standards in auditing companies' accounts to a reliable extent. This is happening although the SEC has made it compulsory that audited balance sheets of listed companies must be prepared in compliance with the International Accounting Standards (IAS) and International Standards on Auditing (ISA). The extent of unfairness concerns both the ICAB and the SEC. As an acknowledgment of the prevalence of the malpractice of auditors, two respective regulatory agencies (the ICAB and the SEC) in a meeting emphasised the importance of credibility of the auditors’ reports and audited financial statements for

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81 The ICAB has been discussed as a self-regulatory body in section 4.3.6.
86 See Securities and Exchange Rules 1987 (amendments). See also section 3.4.2.
promoting capital market development in the country.\textsuperscript{87} This observation is complemented by a recent study on investor protection across 31 countries (70,000 firms between 1990-1999 examined). This study reveals that the quality of financial reports has a positive impact on the increase in investor protection.\textsuperscript{88} The full exercise of due diligence is essential for quality financial reports; but in view of the reality in Bangladesh as noted above, providing due diligence certificate seems to be merely window-dressing on many occasions. Thus, from the investors' point of view, it would be another way of being deceived by being made to believe in such certificates. Therefore, ordinary investors are more willing to buy shares of reputed companies to avoid the risk of losing their savings. At the same time, they demonstrate their lack of confidence in the companies that are not well known to the public regardless of the real value of their offers.

5.3.3. Improved Corporate Governance

Corporate governance denotes a system whereby a company is governed. It is concerned with establishing a system in which the directors of the company are entrusted with responsibilities and duties to run the entity.\textsuperscript{89} According to Sheikh, an effective corporate governance system attempts to devise some mechanisms to regulate company directors 'to ensure that they act in the best interests of the company in its broad sense' and that they refrain from 'abusing their powers'.\textsuperscript{90} The systems of this


\textsuperscript{90} Ibid.
kind of governance ‘have evolved over centuries’ in the wake of corporate failures.\textsuperscript{91} Investors, both individuals and institutions, make their investment decisions depending on the issuer’s outlook, its reputation as well as its governance.\textsuperscript{92} The issue of corporate governance is regarded as a means of promoting enterprise and ensuring accountability.\textsuperscript{93} A recent empirical study conducted by the World Bank researchers strongly supports this view and shows that corporate governance and corporate performance are highly correlated.\textsuperscript{94} The study also maintains that companies practicing good corporate governance can provide investors with better protection.\textsuperscript{95} Improved corporate governance is thus an important consideration for the development of securities market.

The concept of good corporate governance relates to the relationship between the board of directors of the company and its stakeholders.\textsuperscript{96} Although the management is responsible for carrying out the regular/day-to-day business of the company, the board is entrusted with the tasks of formulating the corporate policy, recruiting the staff of the management, overseeing and evaluating the activity of the management and disciplining the staff. Thus the primary authority of the administration of the company lies with the board. Basically the board exists to serve and protect the stakeholders. There are ‘three groups of players’ in corporations. They are: ‘shareholders (and employees, if they have a governance role), boards of directors, and managers’. Good governance warrants


\textsuperscript{92} Id at 2.

\textsuperscript{93} Ibid.


\textsuperscript{95} Id at 21-22.

\textsuperscript{96} Stakeholders typically include: shareholders, creditors, employees, suppliers, customers, and communities
balancing the roles of these groups. However the way of accomplishing this objective is not uniform. ‘There is no single model of corporate governance’ and there is an ongoing debate about what makes up good corporate governance. In May 1999, the Organisation for Economic Co-operation and Development (OECD) formulated a set of principles for good governance known as the OECD Principles of Corporate Governance. These principles have gained international recognition as the minimum acceptable standards for companies and investors around the world. The fundamental tenets of these principles are: fairness, transparency, accountability, and responsibility. On the basis of these pillars, the OECD’s four basic principles can be identified as follows:

i. protection of shareholder rights;

ii. equitable treatment of shareholders;

iii. timely and accurate disclosure and transparency; and

iv. diligent exercise of the board of directors’ responsibilities.

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98 Id at 6.
99 Id at 3.
100 In April 1998, the OECD council meeting called upon the organisation to develop a set of corporate governance standards and guidelines. Following this resolution, the OECD formed the Ad-Hoc Task Force on Corporate Governance to develop a set of non-binding principles. In addition to its members states’ experience, the Task Force benefited from broad exposure to input from non-OECD countries, the World Bank, the International Monetary Fund, the business sectors, investors, trade unions, and other interested parties (see forewords of the Principles). The Task Force concluded its work in April 1999 and its submission was subsequently approved by the OECD and endorsed by the member nations at their annual general meeting on 26 and 27 May 1999 respectively. The OECD Principles are the first multilateral set of principles on corporate governance. These principles were welcomed by the G7 leaders in June 1999 and are likely to work as ‘signposts’ for corporate governance by the United Nations, the World Bank, the International Monetary Fund, and other international organisations: see for details, ‘Statement on the OECD Principles’ in International Corporate Governance Network (ICGN), ICGN Statement on Global Corporate Governance Principles (July 1999) <http://www.icgn.org/documents/globalcorpgov.htm> (2 Apr 2002); Iskander et al (2000) above n91 at 28 (note 9); Industry Canada, Questionnaire on the OECD Principles of Corporate Governance <http://strategis.ic.gc.ca/sc_mrksv/corplaw/oecd> (2 Apr 2002).
102 Ibid. The wording of the principles has been borrowed from the source.
To implement the OECD principles, the above mentioned pillars are to be established first. In fact, none of the above pillars exists in Bangladesh. Commentators describe poor corporate governance as one of the fundamental problem in the market. In this regard, the situation prevailing in Bangladesh is discussed below.

5.3.3.1. Fairness

There have been widespread allegations of unfairness in corporate activities. Annual General Meetings (AGMs) are the ultimate controller of the affairs of companies, because, an AGM can elect as well as remove the management of a company. There are some reasons which inhibit shareholders' participation in the activities of companies through the AGMs. Firstly, shareholders are deprived of their right to voice their opinions in respect of the irregularities of the company management since many companies do not hold their AGMs for several years. Secondly, the companies holding AGMs are not fair-minded enough to allow their members to elect the directors and claim their dividends. This passivity of these shareholders is partly attributable to their own unwillingness to take part in the AGMs, and partly to the offering of gifts to them by the management. An example of the lack of fairness in corporate governance can be seen in the AGMs of four companies of the ‘Apex Group’ (an influential group of industries in Bangladesh) where there is usually a noticeable absence of shareholders. The members who were present were offered gifts either in cash or in kind from the respective management. The gifts might be seen as a bribe to stop them from voicing

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their criticisms (opinions). In an interview with the Bangladesh Sangbad Sangstha (BSS) in October 2000 the SEC chairman identified ‘gifts in AGMs’ as one of the major problems. The SEC had to formally resolve that no benefit in cash or kind, other than in the form of cash dividend or stock dividend, shall be paid to the shareholders of a company. For the enforcement of this directive, the SEC on 3 January 2002 issued a rule directing the listed companies to deposit the video films of their AGMs to its (SEC) office. But the High Court Division suspended the operation of this rule on 20 May 2002 following a writ petition of the Beximco Group referred to earlier. Hence, the true participation of the shareholders in the election of the company’s board of directors and the discussion of other aspects of the company were hindered either by the lack of interest or knowledge of the shareholders themselves or malpractice pursued by the management.

The example of unfairness is also evident in the floatation of companies. It is observed that ‘the newly floated primary shares in the secondary market squeezed to less than half [of the issue price]’. More alarmingly, the market prices of shares of a significant number of companies had ‘fallen even to the extent of 10 per cent of their face value’. Furthermore, Ahmed, an eminent market analyst, observed that shareholdings of sponsors and directors as shown in balance sheets are false in many

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105 Ibid.
109 ‘Share Prices Rise’ The New Nation, Dhaka (24 Aug 2002). There were at least five companies the shares prices of which went below 20 per cent of the issue price: F Bari, ‘Market Price of 200-Taka Primary Shares Only 11 Taka’ The Daily Inqilab, Dhaka (22 Aug 2002) (translated from Bengali).
cases.\footnote{Ahmed, ‘Volatility in Share Bazar’ The Prothom Alo, Dhaka (12 Nov 2001) (translated from Bengali).} Potential investors are induced by such false information. Ahmed in another study finds that only 8-10 company shares (out of nearly 240 companies) are good and ‘many shares do not have any economic value’.\footnote{Ahmed (2002) above n46.} This implies that issuers were not fair in raising funds from the public in many cases.

### 5.3.3.2. Transparency

As argued by Mobius, transparency provides the best protection to investors against the malpractice of the company management especially in a situation where the management tries to act dishonestly.\footnote{J M Mobius, ‘Issues in Global Corporate Governance’ in L C Keong (ed), Corporate Governance: An Asia-Pacific Critique (2002) Hong Kong: Sweet & Maxwell Asia 39 at 43-44.} Transparency is a common problem in Bangladesh\footnote{Transparency International (TI) listed 91 countries in July 2001 on the basis of corrupt practices. Bangladesh was placed at the top of the list. Very recently, the joint report of the World Bank and UNDP released on 3 June 2002 reveals that the accounting process in Bangladesh is not transparent and corruption eats away 40 per cent of public funds. See ‘WB, UNDP Report on Bangladesh: Corruption Eats 40 pc Public Funds’ The New Nation, Dhaka (4 Jun 2002).} and the lack of transparency is a chronic problem in corporate culture. One of the causes of regulatory failure in securities regulation is argued as the lack of transparency in the market.\footnote{M Hossain, ‘Getting Back Investors’ Confidence’ The Financial Express (27 May 2002).} This problem is evident in many situations. For example, directors of some companies are involved in dishonest activities: such as misappropriation of subscription money; overpricing of company assets; forging company shares; and procuring many false audited reports and so on.\footnote{The SEC lodged a First Information Report (FIR) with a police station against three directors, auditors and issue managers of the IPO after necessary investigation. The investigation reveals that ‘…directors injected forged allotment letters into the stock market and siphoned huge amount of money by deceiving the general investors’. See for detail, M S Rahman, ‘Complaints Lodged with Motijheel Thana [police Station]; SEC Finds JH Directors, 3 Firms Involved in Share Forgery’ The Daily Star, Dhaka (22 Dec 1999); ‘SEC Files FIR against 5 JH directors in Share Forgery’ The Financial Express, Dhaka (22 Dec 1999).}

There are also...
allegations that company profits are not shown in the balance sheet so as to deprive the shareholders.\textsuperscript{117}

In the wake of such malpractice, the Chief Metropolitan Magistrate Court (CMMC) in Dhaka issued warrants of arrest against three directors of Mark Bangladesh Shilpa and Engineering Ltd, a listed company, for their alleged involvement in misusing investors’ fund.\textsuperscript{118} The SEC made allegations concerning the overvaluation of company’s assets, and misappropriation or improper use of IPO funds. The SEC’s allegations were based on several investigations.\textsuperscript{119} Clearly, the lack of transparency in corporate activities is evident and the transparency of transactions in the market is almost non-existent in the absence of effective legal, regulatory and supervisory functions.\textsuperscript{120}

5.3.3.3. Accountability

The management of a company is accountable to its shareholders in respect of using corporate ‘resources in the most efficient and desirable manner’.\textsuperscript{121} The best way of exercising corporate accountability to its shareholders is holding AGMs regularly. In a

\textsuperscript{117} Ahmed (2001) above n111.

\textsuperscript{118} For detail, see ‘Warrants of Arrest Issued against Three Mark Bangladesh Directors’ \textit{The Financial Express} (3 Jun 2000).

\textsuperscript{119} The accused persons were the directors of Mark Bangladesh Shilpa and Engineering Ltd. The SEC investigation reveals, amongst other things, that the ‘realistic value of the plant and machinery of the company was 53.51 million taka while the figure was shown as Tk 504.73 million in the audited balance sheets... and 523.61 million taka in another report submitted to the SEC...’. In addition to these, another enquiry discloses that the company has procured machinery in violation of conditions imposed by the SEC. And the activities of the company were also a deviation from the statements made in the prospectus about utilisation of IPO funds as evident from the inquiry: see for detail, Ibid. Another listed company, Mark Bangladesh Shilpa & Engineering, one of the top 30 companies based on value of share capital, has had transacted its own shares with its own funds (of more than Tk 20 million) as disclosed in an inquiry conducted by the Bangladesh Bank, central bank of the country. Such transactions are unlawful: see A Kibria, ‘Information of the Inquiry Report of Bangladesh Bank: Mark Bangladesh Has Got Its Shares Transacted with the Company's Funds' \textit{The Prothom Alo}, Dhaka (22 May 2000). See also for the company’s position in the Dhaka Stock Exchange (DSE), DSE, \textit{Annual Report} 1998 -1999 Dhaka at 79.

\textsuperscript{120} Hossain (2002) above n115.
Press Release on 21 November 2001, the SEC said that shareholders of a significant number of listed companies are not in a position to know the true state of affairs of their companies, because AGMs were not held. Legal provision in this regard is clear. The statutory law\textsuperscript{122} as well as the SEC directives\textsuperscript{123} require the companies to hold AGMs in each year, but in practice, the extent of not convening AGMs is adversely affecting the market as observed by the securities regulator.\textsuperscript{124} The SEC also added that under the present state of affairs, very often investors failed to make considered judgment about investment.\textsuperscript{125} In the same release, the SEC acknowledged that despite repeated efforts, the commission has not received any tangible results in this regard.

Many listed companies have been failing to hold their AGMs for several consecutive years.\textsuperscript{126} Even if some companies hold their meeting in time, there is evidence that the directors will be able to gain the favour of the participating shareholders by adopting unfair means (gifts in cash or in kind) as alluded to earlier.

Getting dividends, if declared, is an important right of shareholders. Non-holding of AGMs normally affects the declaration of dividends. Many companies do not declare dividends for several years and if declared, do not deliver on time.\textsuperscript{127} So accountability

\textsuperscript{121} Mobius (2002) above n113 at 41.
\textsuperscript{122} Companies Act 1994 s 81.
\textsuperscript{123} SEC (2001) above n107 at 40.
\textsuperscript{124} SEC, Press Release (21 Nov 2001).
\textsuperscript{125} Ibid.
\textsuperscript{126} The SEC decided to carry out audits of 25 listed companies which failed to hold AGMs for two or three years consecutively: see ‘Failure to Hold AGMs for Two to Three Years: SEC to Audit Financial Conditions of 25 Companies’ The Daily Star, Dhaka (12 Dec 1999).
\textsuperscript{127} Despite several steps taken by the SEC and the tax incentives to regularise dividends, the situation did not improve. During the FY1999-2000, 79 companies out of 192 listed companies of the DSE which held AGMs did not declare any dividends. The remaining 27 companies did not hold AGMs. So, a total of 106 out of 219 listed companies of the DSE did not declare dividend: see SEC, Annual Report 1999-2000 at 18-25 [hereinafter SEC (2000)]. During this year, the SEC received eight complaints from the investors against the companies for delayed or non-receipt of declared dividend: see above at 29.
to investors is still long way off.\textsuperscript{128} According to the chairman of the SEC, not more than 20 to 25 per cent of listed companies give dividend on a regular basis.\textsuperscript{129}

The above discussion demonstrates clearly that corporate accountability has not yet been established in Bangladesh.

\subsection{5.3.3.4. Responsibility}

The Board of Directors has the responsibility for properly monitoring the affairs of the company. The above discussions on fairness, transparency and accountability also refer to the lack of responsibility of corporate management towards shareholders. From the viewpoint of investor protection, corporate management is charged with the responsibility to maximise the benefits of the company rather than to increase the benefits of the persons involved in the management. The lack of responsibility of the corporate directors towards general investors is perhaps best evident in recent two correlated decisions of the Beximco Pharma, a listed company belonging to Beximco. The Board of Directors of the company declared 10 per cent dividends in April 2002 along with 10 other listed companies of the group. In declaring the dividends, the company allegedly violated securities law for which the SEC suspended the trading of shares of these 11 companies.\textsuperscript{130} After the resumption of trading, many ordinary investors offloaded their shares in a bearish market following the declaration of lower dividends as compared to those of the previous year. The company held its AGM in July 2002

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{128} For details in respect of companies failure in holding AGMs and paying dividends, see ‘41 Listed Companies Did Not Pay Any Dividends in Last Five Years: DSE Decided to Take Action’ \textit{The Prothom Alo}, Dhaka (21 Nov 1999) (translated from Bengali); ‘60 Companies Did Not Pay Dividends for Four Years’ \textit{The Daily Ittefaq}, Dhaka (20 Feb 2000) (translated from Bengali); F Bari, ‘Shares of 35 Companies Defaulting Dividends for Five Years are Instruments of Casino Board: Strength of Evil Powers’ \textit{The Inqilab}, Dhaka (8 May 2000) (translated from Bengali); Bari (1999) above n104.
\item \textsuperscript{129} See ‘SEC Chief Sees Market Turnaround by January’ (2000) above n106.
\item \textsuperscript{130} Details are provided in a case study in section 5.9.
\end{itemize}
\end{footnotesize}
and all of a sudden suspended its running AGM for 15 minutes and held an emergency meeting of the Board of Directors. The board decided to enhance the rate of dividends from 10 per cent to 15 per cent and the decision was immediately approved in the AGM which resumed after the above-mentioned suspension. Commentators observed that the enhancement of dividends in such a manner deprived the general investors of their due benefits since many of them already sold their shares. The company management harmed the market in general by its former declaration of dividends (April 2002), and its latter decision benefited the members of the board as large shareholders at the expense of small investors.

The foregoing discussion shows that the basic pillars of good corporate governance are not present in the corporate life in Bangladesh. The country does not even have any code for corporate governance to date. By contrast, India and Malaysia have adopted their respective corporate governance codes in April 1998 and March 2000 receptively. In Bangladesh, the SEC in 2000 emphasised the need for formulating the principles of corporate governance, and the necessity for amending the Companies Act 1994 to improve this governance. Nonetheless, no real progress has taken place so far in this regard.

The lack of good corporate governance is recognised by all. The SEC acknowledges that investors lack proper knowledge of investment, and the auditing

132 The declaration of lower dividends was allegedly intended to unfairly increase the holdings of the controlling shareholders: see section 5.3.8.3.
133 S M Rashid, 'Z-Share Issue Stirs up Troubles Putting the Cart before the Horse' The Financial Express, Dhaka (1 Sep 2002).
134 India- Confederation of Indian Industry (CII), Desirable Corporate Governance-A Code 1998; Malaysia- Malaysian Code on Corporate Governance 2000. Prior to this code, Malaysia accepted The Principles of Corporate Governance.
practices are not conducive to maintain investor confidence in audit reports.\textsuperscript{136} The problem of accountability is so acute that 10 listed companies have not been publishing their annual reports for three consecutive years, but have nevertheless quoted their shares on the exchanges.\textsuperscript{137} Clearly, such a serious lack of corporate governance does not support following the BDR for the IPO market as a method for providing investor protection.

5.3.4. Effective Self-Regulation of Market Participants

Self-regulation is an important component of securities regulation. In this regard, Loss, says that ‘...regulation of the ethics of an industry means a substantial degree of self-regulation, properly supervised by government’.\textsuperscript{138} In Bangladesh, self-regulation is not only ineffective, it is non-existent in some respects. This is because, there has been no statutory self-regulatory body for issuers and merchant bankers. Even there were no associations of issuers and merchant bankers until recently. The listed companies formed an association named Bangladesh Association of Publicly Listed Companies (BAPLC) in July 1999. Similarly, the merchant bankers formed the Bangladesh Merchant Bankers Association in 1998. Since their inception, neither of the two associations has punished members in response to complaints made against them. Instead, they seem not to be concerned about market development, and only about protecting their own interests rather than the interests of the investor. As has been alluded to earlier, there have been some specific allegations of contravention of the law and unethical conduct on the part of many of the issuers and some merchant bankers. A

\textsuperscript{136} Ibid.
\textsuperscript{137} Bari (1999) above n104.
\textsuperscript{138} L Loss, \textit{Fundamentals of Securities Regulation} (2\textsuperscript{nd} 1988) Boston: Little, Brown and Company at 615.
recent survey conducted by a national daily through the members of the stock exchanges on the role of merchant banks revealed that almost all investors blame, inter alia, these banks for the prolonged poor performance of the market.\textsuperscript{139}

As regards auditors, the Institute of Chartered Accountants of Bangladesh (ICAB) has done little in the interest of the market despite many specific allegations of professional misconduct levelled against the auditors as stated earlier.\textsuperscript{140} Even the government regulator, the SEC, has lodged a criminal case against only one chartered accountant firm so far.\textsuperscript{141}

Lawyers are other participants in the IPO market. The Bangladesh Bar Council (BBC) has both success and failure in regulating the professional conduct of lawyers. As far as the writer knows, an important issue is that so far this writer knows, there have never been any complaints against lawyers for their involvement in the preparation of a defective prospectus. The trend of accusing lawyers for their part in the preparation of prospectuses is yet to grow in Bangladesh. Actually, there have been uncertainties in respect of their liability under the current legal regime as will be discussed in Chapters 6 and 7. The effectiveness of the self-regulation of lawyers with regard to the IPO market is yet to be tested.

From the aforesaid, it can be concluded that there is no effective self-regulation for the players in the IPO market in Bangladesh.

\textsuperscript{139} M Rahman, "‘Dvil’ and Future of Share Market' \textit{The Prothom Alo}, Dhaka (18 Dec 1999) (translated from Bengali).

\textsuperscript{140} See section 5.3.2.

\textsuperscript{141} The SEC has, for the first time, made chartered accountant M A Malek Siddiki and Co a party of criminal case along with the five directors of the issuer and its issue manager for share forgery. See ‘SEC Files FIR Against 5 JH Directors in Share Forgery’ (1999) above n116.
5.3.5. Adequacy of Investor Knowledge of Investment

Investors’ ability to make an intelligent investment judgment ‘is a major assumption and is the cornerstone of the capitalistic economy’. Maintaining a similar view, the Technical Committee of the IOSCO has emphasised the need for investor education for their protection and an effective regulation of the securities market. In Bangladesh, the investment decisions of overwhelming majority investors are based on rumours instead of economic fundamentals of the issuers as revealed in a recent survey. This finding is supplementary to that of an important enquiry committee. Further, the SEC itself admitted on several occasions the fact that investors lack investment knowledge. Furthermore, international market analysts complement this admission of the SEC by characterising the investors as ‘innocents’. Hence, the DBR has imposed an exclusive responsibility on these unsophisticated investors for assessing the merits of IPOs based on disclosures made by the companies in unfavourable circumstances. Accepting the inability of investors to make a so-called informed investment decision, the SEC as well as stock exchanges have undertaken some programs to educate investors. However, these programs had no significant effect on imparting investment knowledge to the

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142 Testimony of Denise Voigt Crawford, Texas Securities Commissioner, before the U S Senate Banking, Housing and Urban Affairs Committee, on ‘The Importance of Financial Literacy and Education in America’ (6 Feb 2002) at 15 <http://www.nasaa.org/nasaa/abtnasaa/view_top_stories.asp?start=0&partition=1> (12 Feb 2002).


144 Rahman (1999) above n139.

145 Enquiry Committee (1997) above n58 at 17.


147 This is so because, all concerned including the SEC recognise that companies do not practice good governance, and auditors reports are not trustworthy: ‘Share Bazaar in the Eye of the SEC’ (2000) above n135.

148 The issue of investor education will be further discussed in Chapter 9.
investors.\textsuperscript{149} In brief, the programs of stock exchanges are limited to holding seminars and discussions. Only 257 people attended the SEC Weekly Investors’ Education Program introduced in June 1999 until June 2000.\textsuperscript{150} The participants in this program were 48 and 111 in 2001 and 2002 respectively.\textsuperscript{151} It can be easily understood that the total number of participants is insignificant as compared to the actual number of ordinary investors in the market.

The information disclosed in a prospectus is related especially to the disciplines of finance, accounting, law and economics. In addition, the investors must have knowledge of English because the prospectuses are published in English, the second language in the country. Thus, there is no plausible ground to believe that these ordinary investors are able to understand and properly analyse the information embodied in the prospectus.\textsuperscript{152} It is argued that if the ‘investors are given access to all material information, it is up to them to decide how to use the information and to accept the consequences of their investment choices’.\textsuperscript{153} This argument ignores the fact that investment knowledge is not something to be achieved with ‘divine inspiration’ and without sincere efforts.\textsuperscript{154} Moreover, securities literature is complex and technical and

\begin{itemize}
\item Despite numerous rigorous education programs over the last few years in the United States, Texas Securities Commissioner acknowledged on 6 February 1999 that ‘on average, the general public is financially illiterate’: Texas Securities Commissioner (2002) above n142 at 1. If this is the situation in US, then the situation of Bangladesh can be easily understood.
\item SEC (2000) above n127 at 49.
\item Investors in the United States are not yet able to rely on themselves. ‘Investor Ignorance’ Investment News (6 Aug 2001) at 4. If this is the situation in United States, then how could one believe that investors in Bangladesh are quite able to make their investment decisions prudently without any pertinent knowledge.
\item Securities analysis requires prophetic knowledge without divine blessings. ‘Basically, the security analyst must be a prophet without the benefit of divine inspiration’- B G Malkiel, A Random Walk Down Wall Street (1990) New York: W W Norton & Company at 121.
\end{itemize}
therefore not be readily understood. In view of the above reality, it can be said that investors in Bangladesh cannot have meaningful access to information furnished in the prospectus. The DBR offers no assistance to the investors. In fact it may, despite its good intentions, deprive the investors of benefiting from the assessment of the regulator (under a merit regime), resulting in further undermining the protection of investors in the IPO market.

5.3.6. Competent Market Professionals and Intermediaries

Apart from auditors and lawyers, professionals and intermediaries in the IPO market include issue managers, underwriters, financial advisers and portfolio managers. So far, no registered financial advisers are engaged in the securities market and ‘there is no practice [of seeking investment advice] in fact’. Actually, the SEC has not promulgated any regulations for them to date. The reason may be the lack of interest from both service providers and service users. However, the SEC has granted licences to 23 companies as full-fledged merchant banks until February 2003. Blaming the merchant bankers for their inactivity, the SEC chairman observed that, not more than four or five of them operate at a reasonable level. In another report on the continued depression in the bourses, merchant banks have been termed as ‘mere


156 Investor Information Cell, above n30 (10 Apr 2003).

157 The SEC started formulating regulations for the merchant bankers after receiving applications from the potential merchant bankers.

158 Investor Information Cell, above n30 (10 Apr 2003).

159 At the time of this comment, the total number of such banks was 25 or 26 as the SEC chairman mentioned. See ‘SEC Chief Sees Market Turnaround by January’ (2000) above n106.
spectators' in the capital market just a month before the adoption of the DBR. Moreover, these banks are not experienced and financially strong enough to function on a large scale. In addition, some of them meanwhile have allegedly been involved in market manipulation resulting in the SEC suspending brokerage licences of Equity Partners Securities Limited, a merchant bank. Therefore, the extent of merchant banking services is not in favour of the DBR.

The position of portfolio managers is not good either. Apart from the above merchant bankers, there has been only one merchant banker which is authorised to act only as a portfolio manager in the market as at February 2003. The SEC issued licences to merchant bankers who are entitled to act as portfolio managers in a downtrend market after the market debacle 1996 with an expectation that they would play a significant role in salvaging the market by generating fresh funds. But in practice, none of these banks lived up to the expectation. Acknowledging the difficulties of managing portfolios, the Managing Director of Industrial Development Leasing Company of Bangladesh (IDLC), a portfolio manager, said that '[w]e have to ensure profits before asking anyone to come and invest. And we are finding it a bit hard to ensure that'. Expressing their pessimism about the market performance, market analysts maintained that the beginning of portfolio management by merchant banks was uncertain.

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162 Business and management Company Ltd is the sole portfolio manager in addition to the full-fledged merchant bankers: Investor Information Cell, above n30 (10 Apr 2003).
164 Ibid.
165 Ibid.
The development of any professional service depends on its demand and continued honest practice. The demand for these professionals in the Bangladesh share market is very negligible, because of the absolute dominance of small individual retail investors. Hence, one of the major impediments to the development of investment advisory services in Bangladesh is the non-availability of sophisticated investors who usually look for such professional advice.

5.3.7. Availability of Retail Research on Potential Issuers

Another important consideration in relation to the introduction of the DBR is the availability of retail research. Retail research on potential issuers may help investors make informed investment judgment. They can compare the information disclosed in a prospectus with that which is found in private research on an issuer at the time of flotation. Institutional investors usually carry out this research. Because of the lack of institutional investors, there has been no retail research on the fundamentals and business prospects of potential issuers. As a result, investors have to rely exclusively on the information disclosed by the issuer concerned. The paucity of retail research thus leads the investing public to believe in the disclosures made in a prospectus regardless of their accuracy. In such a situation, issuers usually take advantage of the ignorance of investors by choosing their convenient time to float in a ‘share hungry’ market.

A study of Loughran and Ritter is regarded as ‘the most useful work’ on investment in IPOs.166 Their study concludes that IPOs are poor investments in the long run for investors, relative to stock in general.167 Shayne and Soderquist have identified two reasons for the conclusion arrived at by Loughran and Ritter. The reasons are: ‘(i) IPOs

are made in high markets; and beyond that (ii) IPOs underperform the seasoned stocks available in such markets\(^{168}\). In a bullish market, IPOs are very demanding, and thus investors buy primary shares in higher prices. The finding is fully consistent with the reality in Bangladesh. It becomes clear from the following table.

**Table 5.1: Correlation between Market-Trend and the Issues of Securities\(^{169}\)**

<table>
<thead>
<tr>
<th>Year (Year ended in June)</th>
<th>Dhaka Stock Exchange All Share Price Index/Weighted Average Price Index*</th>
<th>Number of New Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>296.2</td>
<td>9</td>
</tr>
<tr>
<td>1992</td>
<td>369.5</td>
<td>11</td>
</tr>
<tr>
<td>1993</td>
<td>418.8</td>
<td>4</td>
</tr>
<tr>
<td>1994</td>
<td>659.8</td>
<td>17</td>
</tr>
<tr>
<td>1995</td>
<td>776.9</td>
<td>27</td>
</tr>
<tr>
<td>1996</td>
<td>959.1</td>
<td>21</td>
</tr>
<tr>
<td>1997</td>
<td>1111.6</td>
<td>18</td>
</tr>
<tr>
<td>1998</td>
<td>676.47</td>
<td>8</td>
</tr>
<tr>
<td>1999</td>
<td>546.79</td>
<td>4</td>
</tr>
<tr>
<td>2000</td>
<td>561.00</td>
<td>10</td>
</tr>
<tr>
<td>2001</td>
<td>716.06</td>
<td>11</td>
</tr>
<tr>
<td>2002</td>
<td>819.74</td>
<td>8</td>
</tr>
</tbody>
</table>

* Weighted Average Price Index was introduced in November 2001 in place of the previous All Share Price Index.


Ch 5: Applicability of the DBR

It can be seen from the table that the noticeable inconsistency with the above proposition can be found only in 1997 and 2002, because the number of new issues decreased despite the apparent increase in the Index. There are plausible explanations of such exceptions. As regards the case of 1997, the reason is very clear. During the market crash in 1996, the Index jumped from 776.9 in 1995 to 3648.75 in the first week of November 1996. Thereafter the Index started falling drastically and became 2514.15 at the end of December 1996. Since then the Index maintained a declining trend for a long time. Therefore, although the table shows that the Index increased in 1997, it actually decreased. Thus the number of new issues was also lower.

The reason for the exception in 2002 is different. As noted above, Weighted Average Price Index replaced the previous Index. The introduction of this new Index system artificially increased the Index points, because it does not take into account the performance of poorly performing companies. Market participant strongly criticised the new Index. The stock exchanges and investors alike protested it with an allegation that 'SEC is damaging share markets'. There has been more criticism of this system. For example, pointing at the artificial improvement of the Index in June 2002, one commentator contended that with the introduction of the new Index, 'the small investors' dark days started, as the real movement of the capital market is not truly represented by the new system'. There are a number of reports that the market was performing poorly even in June 2002. Thus, in such a situation, the above-mentioned

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170 For detail, see SEC (1997) id at 21.
171 See section 3.4.2.
174 The Index points mentioned in the above table represents the Index of June 2002. For the reports of the poor performance of the market, see for example, K Rahman, ‘Capital Market Collapse: Massive Decline in Share Price-Transactions and Index Decreased’ The Daily Janakantha, Dhaka (1 Jun
increase in Index does not provide any acceptable evidence for an upward trend in the market in 2002 in the true sense.

It is therefore a fact in Bangladesh that issuers prefer to go public in a bullish market. In other words, issuers usually float in a market where the investors, especially the individual small investors, are hungry for shares and invest in IPOs regardless of their merits. In such a situation, investors are not able to make intelligent investment decisions. Thus the DBR is not regarded as an effective philosophy for the protection of such investors.

5.3.8. Active Policing of the Market, Appropriate Securities Law and Its Effective Enforcement

Chapter 9 will deal with the role of the SEC in policing the disclosure regime and issues of administrative enforcement of securities law in Bangladesh. Therefore, this section omits an in-depth discussion of these issues; however it briefly outlines the problems and legal lacuna in policing and enforcing the DBR.

The SEC is entrusted with the responsibility for policing the market and taking necessary action against any contravention of disclosure rules. The regulator is empowered to enforce these laws by taking some specific measures such as suspension and cancellation of the licences of market intermediaries, imposing fines on the issuers and issuers’ management. The SEC can also bring the wrongdoers to the court. Individual investors, on the other hand, are also entitled to go to court for compensation incurred as a result of misstatements in the prospectus. Theoretically, all these are legal...
provisions. In practice, as will be evident in Chapter 9, an effective policing in the IPO market and the administrative enforcement of laws concerning disclosure requirements are largely non-existent in Bangladesh. Likewise, judicial enforcement of the laws is alarmingly unsatisfactory which will be analysed in Chapter 8. More importantly, there have been considerable flaws in the legal provisions concerning prospectus liabilities which will be examined in Chapters 6 and 7.

5.3.9. Case Study to Show the Lack of Prerequisites for the DBR in Bangladesh

A study of a recent case demonstrates the lack of prerequisites for the DBR in the IPO market in Bangladesh.

5.3.9.1. Facts of the Case Study in Brief

The Beximco is the largest industrial conglomerate in the country as noted earlier. It has 11 companies listed with stock exchanges out of a total of 238 listed companies of the DSE as at June 2002.\(^{177}\) The market capitalisation of these 11 companies is 25 per cent of the country’s capital market.\(^{178}\) The Board of Directors of these companies declared the dividends of all companies on 29 April 2002 without any dates for the next AGMs and book closure. Announcements of these dates are required together with the declaration of dividends under a notification issued by the SEC on 10 December 2001 as well as listing rules of the exchanges. Upon receipt of a letter from the Beximco on 30 April 2002 regarding the declaration of dividends, the SEC, in a surprise move, suspended the trading of shares of all of 11 companies until further order. The SEC


alleged that the companies gave an incomplete disclosure of price sensitive information since they did not declare the dates for AGMs and book closure together with the announcement of dividends. Thus, the mere announcement of dividends without these dates is a violation of the SEC rule.\textsuperscript{179} The SEC requested the companies to explain the reasons for noncompliance with the requirements by morning on 2 May 2002 at its office.\textsuperscript{180} This is the most conspicuous incident in this market after the 1996 scam.\textsuperscript{181}

5.3.9.2. Reaction of the Suspended Companies

The representatives of the companies immediately keep silent and only informed the press media that they would explain their position to the SEC.\textsuperscript{182} However, their explanations appeared to be unconvincing to the regulator. Responding to the request of the SEC, these representatives met the SEC as scheduled with a legal notice, instead of explaining the reasons for the alleged noncompliance. The legal notice raised the question of the authority of the SEC to promulgate the rule under which the regulator suspended the trading of the companies’ shares. The notice clearly mentioned the fact that the rule was invalid. The legal notice addressed to the chairman of the SEC requested the SEC to delete the provision of its notifications relating to this suspension. It also required the SEC to report its (SEC’s) compliance with the Beximco’s notice by 10 a.m. of 8 May 2002.\textsuperscript{183} The legal notice stated that the Beximco would take the SEC to the court if it failed to comply with the notice. It also urged the SEC chairman would

\textsuperscript{179} ‘SEC Suspends Trading of Shares of 11 Beximco Group’ \textit{The Independent}, Dhaka (1 May 2002); ‘Share Trading of 11 Beximco Companies Suspended’ \textit{The New Nation}, Dhaka (1 May 2002).


\textsuperscript{181} Ibid.

\textsuperscript{182} Ibid.

realise how serious illegalities the regulator had committed and also what damage had been caused to the investors and the market. The notice further requested the SEC to work independently, not be directed by any other authority. The companies did not however provide any explanation as to why they have not announced the dates.

5.3.9.3. Response of the SEC to the Press and the Companies

Defending its action against the Beximco, the SEC argued that it had taken the decision in an emergency meeting in the greater interest of the people, investors and share transactions. It was reported that the SEC took the decision to prevent another market crash following the lower dividends of these companies. It was also claimed that the directors declared nearly half of their previous year’s dividends, the intention being that they would buy shares in their own names if the prices declined sharply.

Despite the legal notice, the SEC decided on 5 May 2002 to continue the suspension until the companies declared the dates for AGMs and book closure. However, the SEC did not mention in this decision about the violation of its notification concerning the requirements for which the SEC ordered this suspension. Instead, the SEC decision referred to the fulfillment of the listing rules of the stock exchanges under which the same dates are required. The SEC advised the exchanges to restore the

184 Ibid.
185 It is worth noting that Mr Salman F Rahman, the Vice-President of the Beximco Group, contested the October 2001 national election with the ticket of the opposition party to the parliament. 'Any other authority' may have meant the government.
186 'Share Trading of 11 Beximco Companies Suspended' (2002) above n179. The SEC chairman also defended the commission’s position in an interview with the BBC (Bengali) at the night session of 30 April 2002.
suspended trading as soon as that dates were declared. In view of this decision of the SEC, some analysts became sceptical about the legality of the SEC action. However, the SEC formally replied to the Beximco legal notice by claiming that its action was lawful. The weakness of the regulator is clearly evident in this case - in its silence about the original claim of violation of its notification. Market commentators strongly criticised the overall role of the SEC in the given case by characterising the regulator as inefficient, incompetent, and harmful to investors as well as the market.

5.3.9.4. Reaction of the Market

The share market reacted promptly by recording a sharp fall. The market continued to experience a declining trend subsequent to the SEC action and announcement of the above-mentioned dividends, although analysts and the SEC alike believed that the fundamentals of the companies were still good enough for dividends in higher rates than the declared ones. More specifically, the Investment Corporation of Bangladesh (ICB) and AIMS of Bangladesh (the country’s single asset management company and private mutual funds issuer), requested the Beximco to revise the proposed dividends. Taking the fundamentals of the companies into account, the ICB and AIMS were unwilling to welcome these lower dividends which were reduced by exactly 100 per cent from those

188 See ‘SEC Sticks to Its Gun; Suspension of Share Trading Not Withdrawn’ The Independent, Dhaka (6 May 2002); ‘SEC talks Tough on Beximco Conditionalities’ The New Nation, Dhaka (6 May 2002)
189 ‘Though the SEC claimed the move proper, timely and legal, it has now authorised the bourses to withdraw the suspensions if the companies announce the AGM and book-closure dates’: AIMS, ‘SEC in Beximco Straightjacket Weekly Market Review (4 May 2002) at 1.
190 ‘SEC Defends Suspension of Share Trading of Beximco Companies’ The Bangladesh Observer, Dhaka (7 May 2002).
of the previous year. The market reacted to the declaration of dividends and ignored the economic fundamentals of the companies. This again demonstrated that the market relied more on rumours than on the fundamentals.

5.3.9.5. Reaction of the Stock Exchanges

The DSE, in its initial response, expressed its inability to execute the SEC order. The DSE however later complied with the SEC order. The CSE complied with the SEC order without any express unwillingness to do it. Both of the exchanges favoured the immediate withdrawal of the suspension. The exchanges did not take any action against the companies for the alleged violation their listing rules.

5.3.9.6. Reaction of the General Shareholders

The small investors and stockbrokers were perturbed by the SEC order. They blamed the SEC for the arbitrary use of the rule under which the regulator had taken this action. They observed the action as discriminatory practice against the Beximco. This is so because, the regulator did nothing when some other companies committed the same wrong prior to the Beximco. Thus they explicitly accused the SEC for a double standard while dealing with the Beximco.

193 The average proposed dividend rate of this group for 2001 is 6.5 per cent whereas it was 12.5 per cent in 2000. For details, see R M Chowdhury, ‘ICB Urges Beximco Group to Revise Proposed Dividends’ The Financial Express, Dhaka (16 May 2002).


197 Ibid. For example, this source listed some companies, which have earlier declared dividends without the dates for AGMs and or book closure. These are: Bangladesh Lamps, Social Investment Bank, AB Bank, Islami Bank, HR Textile, UCBL, Water Chemicals.
A large number of investors considered suspension as illegal and staged a demonstration against the SEC and demanded immediate withdrawal of the suspension order.\textsuperscript{198} They also submitted a memorandum to the SEC chairman for such withdrawal.\textsuperscript{199} Notably, the investors did not blame the companies for their failure to announce the above-mentioned dates, instead they showed their agitation against the SEC. The role of the investors implies the lack of their confidence in the regulator.

### 5.3.9.7. Role of the Institutional Investors

The SEC met with the institutional investors on 4 May 2002 (suspension took place on 30 April). Six institutional investors\textsuperscript{200} attended the meeting and they expressed their concern and frustration at the market situation created after the suspension of trading of 11 Beximco companies. They also advised the SEC to withdraw the order immediately in the interest of investors as well as the market.\textsuperscript{201} The most noticeable point is that only six out of few hundreds institutional investors (although small) attended the meeting in response to the SEC request for solving a major urgency in the market. It proves their least concerns about a grave crisis of the market. Thus it could be inferred that they are not proactive enough to contribute to the development of the market.

### 5.3.9.8. Role of the Issuers' Association

The Bangladesh Association of Publicly Listed Companies (BAPLC) described the SEC


\textsuperscript{199} 'Small Investors For Resumption of Beximco Share Trading' The Independent, Dhaka (5 May 2002).

\textsuperscript{200} Investment Corporation of Bangladesh (ICB-the state-owned largest investor in Bangladesh), SABINCO, Green Delta Insurance, Delta Life Insurance, Pragati General Insurance, and Asset & Investment Management Services (AIMS).

\textsuperscript{201} AIMS (2002) above n189; 'SEC Term for Beximco' The New Nation, Dhaka, (5 May 2002).
action as illegal and as unfriendly to the market. In an emergency meeting on 4 May 2002, the executive committee of the BAPLC unanimously accused the SEC for violating its own regulations and blamed the SEC for its unilateral action. The meeting observed that the dates for AGMs and book closure were not price sensitive information. They urged for the immediate withdrawal of the suspension order. However, they said nothing against the companies. Their expressed anger was directed at the regulator alone.

5.3.9.9. Resumption of Trading and Suit Against the SEC

Finally the exchanges resumed the trading of suspended shares on 6 May 2002 following the announcement of the dates for AGMs and book closure by the respective companies. However, the Beximco filed a writ petition with the High Court Division of the Supreme Court of Bangladesh against the SEC. In this petition, the Beximco challenged the legality of the suspension order as well as the SEC notification which the companies have allegedly violated. The court issued a rule on 11 May 2002 upon the SEC, and directed the regulator to show cause as to why the impugned order and notification should not be declared to have been made illegally and without lawful authority. Nonetheless, the SEC did not sue the companies for the alleged violation and for their role in damaging investor confidence.

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202 AIMS ibid.

203 'Listed Companies Urge SEC to Lift Suspension of Share Trading of Beximco Companies' The Independent, Dhaka (5 May 2002).

204 Notification No. SEC/CMRRCD/2002-14/24/Admin/03-03 dated 10 December 2001.

205 For details, see 'Beximco Sues SEC, HC Issues Rule' The Independent, Dhaka (12 May 2002).
5.3.9.10. Implications of this Case for the Unsuitability of the DBR in Bangladesh

As has been argued in the foregoing analysis, the environment conducive to the DBR does not currently exist in the Bangladesh IPO market. The above-mentioned case is a perfect illustration of the non-existence of most of the prerequisites of the DBR as discussed earlier. These are, for example, the lack of good corporate governance, full disclosure and efficient regulation in the market. In addition, the case also shows that there is a paucity of, and an inactivity amongst, institutional investors, and exclusive support of the issuers’ association for the companies. Further, the case shows that there are influential companies which are not sufficiently careful about the SEC regulation and the interests of investors in the market. All of these factors militate against the disclosure regime.

5.4. Summary and Conclusions

A useful disclosure regime for an IPO market requires the existence of some basic prerequisites in the market. Some of the important prerequisites have been identified as: good corporate governance; transparency in financial disclosure; investors’ ability to make prudent investment decision by using the disclosure in prospectus; strong legal, regulatory and enforcement framework for investor protection; dominance of institutional investors, availability and popularity of investment advisory service, and retail research to verify issuer’s disclosure. The foregoing discussion reveals that none of the above requirements exists currently in the Bangladesh market. Moreover, factors, such as trading of newly proliferated financial products, spirit of market globalisation, presence of significant number of local and foreign institutional investors, and reliable intermediary and professional services that necessitate and facilitate the shift from the
MBR to the DBR do not exist in this market. Although India and Malaysia have made this move prior to Bangladesh, Bangladesh should not have adopted this new regime in early 1999. The reason for saying this is that taking prerequisites of the DBR into account, the overall condition of the markets of India and Malaysia is far better than that of Bangladesh. Further, unlike Bangladesh, these two countries introduced the disclosure regime in an orderly market, meaning a stable market. Bangladesh adopted this regime in a market which has been suffering from a profound lack of investor confidence after the 1996 market crash. Furthermore, Malaysia has advanced towards the DBR through a six-year plan depending on the market readiness, but Bangladesh has completed its sudden shift in just a single move without any consideration for the market readiness. Although India made this move in a single phase, the situation there was completely different in every respect in that there was dominance of institutional investment, and availability and affordability of professional advisory services, trading of various financial products etc. Nonetheless, the path Malaysia had taken is arguably better in respect of market development, because Malaysia has made more progress in developing its market than India had done in 1990s. The policies taken by the other Asian giants of securities markets also support the position of Malaysia. Amongst all these markets, only the securities regulator in Bangladesh adopted the DBR despite the fact that it is a pre-emerging market, whereas both India and Malaysia are ranked as emerging markets. These two markets earned the status of emerging markets before the adoption of the disclosure philosophy.

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206 This study does not intend to comment on the applicability of the DBR in India and Malaysia. It just shows that the position of their markets is far better than that of the Bangladesh market.

207 See, for the introduction of the DBR in some Asian markets, section 1.6.2.2.1.

208 Section 1.6.2.1.
A significant difference between the Bangladesh market and the other two during their merit regimes is evident from the extent of foreign portfolio investment in their respective markets. This implies that the DBR itself will not be a means of restoring investor confidence; rather the market will have to restore this confidence before moving to the DBR.

In Bangladesh, the issue of investor protection is crucial because, the issuers have the propensity to deprive investors, and this tendency significantly exacerbates the lack of investor confidence. General investors are ‘more vulnerable to expropriation, and more dependent on the law’ than the other stakeholders are. It is very clear that investors in Bangladesh are not able to protect themselves from the misfeasance of the members of IPO coalitions. Hence, investors are willing to finance firms when their rights are strictly enforced, and lack of investor protection in the legal system keeps the ordinary investors away from the market. In conformity with this proposition, a Harvard study shows that ‘the most developed financial markets are the ones in which investors are best protected from expropriation by the insiders’. Indeed, disclosure of material information appears to be a key element of investor protection, but ‘disclosure

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209 Bangladesh attracted only one international equity fund which first invested US$20m in 1994 whereas in the same year India and Malaysia secured international funds since long and the amounts of their international equity investments were respectively US$4,000 from 60 funds and 1,345 m from 20 funds. For detail, see United Nations Conference on Trade and Development (UNCTAD), ‘Consideration of Issues Related to the Mobilisation of the Private Sector for the Promotion of Foreign Investment Flows Towards the Least Developed Countries (LDCs)’ TD/B/SEM.2/2 (10 April 1997) at 5 (Table 1).


212 For detail, see id at 5.

is not sufficient by itself without the right of the shareholders to act on it’.214 It is
generally thought that equity markets are ‘most sensitive to the legal provisions in
favour of financiers’ and their enforcement.215 Chapters 6-9 will show that prospectus
liability regime and its enforcement mechanism are ineffective.

The DBR is thus proved to be ineffective in Bangladesh to provide investor
protection and thereby fails to restore investor confidence, although the restoration of
this confidence is the only way to revitalise the present ailing market. Therefore, the
adoption of the DBR by the SEC in 1999 was not a prudent reform, and from the
viewpoint of investor protection, the Bangladesh market is not yet ready to absorb this
philosophy. The best proof of its ineffectiveness is that the market did not make any
progress after its introduction, despite the fact that a number of incentives have been
offered to the investors and issuers alike to induce investment. The next chapter will
demonstrate the shortcomings and loopholes in the various aspects of civil liabilities for
defective prospectuses in Bangladesh.

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Moerland, T Raaijmakers & J Renneboog, Corporate Governance Regimes: Convergence and
Chapter 6

Civil Liabilities for Defective Prospectuses in Bangladesh

6.1. Introduction

The law defining the rights of both the shareholders and the quality of their enforcement is fundamental to corporate governance and finance. An empirical study reveals that the quality of the ‘legal environment’ in a market for Initial Public Offerings (IPOs) has a notable effect on raising funds by the firms from the public. ‘Good legal rules’ are of paramount importance in all successful examples of the development of securities markets. A strong regulatory framework to protect the integrity of the IPO market as well as the investors is essential for a successful Disclosure-Based Regulation (DBR). Generally, the regulation of securities markets is based on the liabilities for the infringements of regulatory provisions and their enforcement. One of core tenets of IPO regulation is the imposition of liability on the persons involved in the preparation of a prospectus. This regulation is necessary to ensure accuracy, adequacy and

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2 ‘Legal environment’ refers to the quality of legal protections for investors, the quality of laws and their enforcement: see R La Porta et al (1997) id at 1132.

3 Id at 1146.


6 In Bangladesh, the Companies Act 1994 does not define the term ‘prospectus’. However, its definition has been provided in rule 2(d) of Public Issue Rules 1998. According to this definition a prospectus means ‘any document prepared for the purpose of communicating to the general public a company’s plan to offer for sale [of] its securities’. For the convenience of discussion in this Chapter
timeliness of the material information in relation to both the issue and the issuer concerned.

Companies willing to go public are required to disclose to all potential investors information which is necessary to make informed investment decision. The availability of remedies against the violation of disclosure requirements primarily depends on "the suitability of liability regime". Civil liabilities have been imposed on certain persons for the inclusion of "untrue statements" in a prospectus. Civil liabilities for a defective prospectus in Bangladesh are comprised of the statutory liability as well as liability under the common law of torts.

With an objective to examine the inadequacy and loopholes of the current civil liability provisions for the prospectus in Bangladesh, this chapter will be divided into four sections. Section 6.1 provides an introduction and section 6.2 will focus on the objectives of civil liabilities for the prospectus. Section 6.3 will explore the civil liability provisions for disclosures in the prospectus in Bangladesh. Section 6.4 will provide a summary and conclusions. The concluding remarks will demonstrate that the civil liability regime for prospectuses is incompatible with the disclosure philosophy for IPO market in Bangladesh.

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as well as in this thesis, the term prospectus (es) inclusively includes the original prospectus, amendments to the prospectus and supplementary prospectuses.


8 In this analysis, 'the suitability of liability regime' refers to the liability provisions suitable to the needs of the IPO market in Bangladesh and effective machinery for the enforcement of these provisions.

9 For the interpretation of provisions in relation to prospectuses in Bangladesh, the expression 'untrue statements' includes the statements misleading in the form and context in which it is included, and any omission from a prospectus which is calculated to mislead: see Companies Act 1994 s143.
6.2. Objectives of Prospectus Liabilities

Liabilities for wrongdoing in any respect generally creates deterrence for the wrongdoers and the investors in the securities markets are best protected by the legal framework which is based on deterrence.\textsuperscript{10} Therefore the main thrust of imposing liability for a defective prospectus is to provide protection to investors.

In respect of raising funds for the companies from the public, the objectives of civil liabilities are twofold: firstly, to facilitate compensation for the victims of the defective prospectus; and secondly to deter the persons involved in the preparation of prospectuses from flouting disclosure requirements.\textsuperscript{11}

6.3. Civil Liabilities for Defective Prospectuses

The civil liability, in this discussion, refers to the compensation of investors or subscribers who may have sustained loss or damage by subscribing for an IPO.\textsuperscript{12} A public offering of shares involves several distinct areas of activity which commonly include promoters and directors of the issuing company, accountants/auditors, lawyers, underwriters, issue managers (IPO Coalition).\textsuperscript{13} The \textit{Companies Act} 1994 (CA’94) as well as the common law of torts provide civil liabilities for a defective prospectus.

The CA’94 as well as the \textit{Securities and Exchange Ordinance} 1969 (SEO’69) have imposed civil liability on certain persons to compensate the subscribers who sustained


\textsuperscript{11} Id at 405.

\textsuperscript{12} The terms ‘investors’ and ‘subscribers’ will be used interchangeably in this thesis.

\textsuperscript{13} For their functions in respect of IPOs, see section 1.4.5.
loss or damage from their subscriptions to an IPO on the faith of the prospectus.\(^{14}\) In addition to statutory liabilities, those persons are also liable under the common law of torts to compensate each investor who suffers loss or damage by investing in an IPO having relied on the defective prospectus. The SEO’69 and the common law also entitle the investors to rescind their investment contracts. This remedy is available against the issuer. The investors’ right to rescind their investment contracts is widely prevalent in common law jurisdictions and does not punish the persons involved in the preparation of the prospectus. Moreover, this remedy appears to be useless when the promoters and directors misappropriate the funds raised by the defective prospectus and the company goes into liquidation leaving inadequate or no funds to implement the rescission of investment contracts. Furthermore, as the residual claimants of the company, the shareholders are entitled to get equitable shares in the company’s remaining assets after meeting the claims of the creditors\(^{15}\). Therefore, the shareholders will be able to recover their money from the residual assets of the company if any are left after liquidation without any litigation for rescission of their investment contracts. In addition, the burden of the liability of an issuer ‘falls primarily on innocent shareholders’.\(^{16}\) For these reasons, the present thesis will not focus on the investors’ right to rescind their contract against the issuers. The thesis will concentrate on a discussion of the liability of the persons involved in the process of raising funds from the public for the company. It will not look at the issues concerning the liability of the company which are beyond its scope.

\(^{14}\) Companies Act 1994 s145; Securities and Exchange Commission Ordinance 1969 s23.

\(^{15}\) Creditors generally include the holders of debt securities such as debentures and providers of loans to the company. They are also called the fixed claimants of the company as opposed to the equitable claimants.

6.3.1. Persons Liable for Defective Prospectuses under the *Companies Act* 1994

Section 145(1) of the *Companies Act* 1994 (CA’94) imposes liability on certain persons for any ‘untrue statement’\(^{17}\) included\(^ {18}\) in the prospectus. It provides that subject to the provisions of this section the following persons will be liable to compensate the subscribers to a given public offer of securities:

- (a) every person who is a director of the company at the time of the issue of the prospectus;
- (b) every person who has authorised himself to be named and is named in the prospectus either as a director, or as having agreed to become a director, either immediately or after an interval of sometime;
- (c) every person who is a promoter of the company; and
- (d) every person who has authorised the issue of the prospectus.

This section clearly imposes liability on the directors, promoters, but it is unclear whether or not the other persons involved in the preparation of the prospectus such as auditors, lawyers, underwriters and issue managers fall within the ambit of this liability.

The above provisions of the CA’94 have never been interpreted by the courts in Bangladesh due to a dearth of cases, although there have been many allegations of the contravention of this section.\(^ {19}\) Therefore, the liability of various participants in an ‘IPO coalition’\(^ {20}\) other than the directors and promoters are yet to be determined under these provisions. The absence of specific mention of their liabilities in the legislation coupled with a lack of judicial interpretation may imply to the public the misunderstanding that all members of an IPO coalition are not liable for the untrue statements in the prospectus. This impression may induce the persons involved in the preparation of the prospectus.

\(^{17}\) According to the statutory interpretation of the term, an ‘untrue statement’ implies such a statement which includes a statement misleading in the form and context in which it is included and which omits to state information therein that is calculated to mislead: see *Companies Act* 1994 s143(1).

\(^{18}\) In respect of prospectus, the term ‘included’ denotes ‘included in the prospectus itself, or contained in any report of memorandum appearing on the face thereof or by reference incorporated therein or issued therewith’: *Companies Act* 1994 s143(2).

\(^{19}\) See section 5.3.1.
prospectus to commit wrongs and preclude the investors from seeking remedies under this section.

In pursuance of the articulation of s145(1) referred to, one may perceive that the persons other than the directors and promoters may fall within the expression ‘every person who has authorised the issue of the prospectus’ and thereby be liable for untrue statements included in the prospectus. But the CA’94 does not provide any explanation as to who authorises the issue within the meaning of the section. Moreover, the provisos added to s145(1) read with s138 of the CA’94 suggest that auditors, legal advisers, attorneys, solicitors and bankers to the issues of the company shall not be liable under this section as a person ‘who has authorised the issue’ merely because of giving consent to the issue of the prospectus as required under s138 of the CA’94. The provisos further state that they may be liable if their names are shown in the prospectus as experts and untrue statements in question purporting to be made by them are included therein. But the statutory definition of ‘expert’ provided in s139 (2) does not clearly include any of them.

In this respect, the corresponding provisions of s 62 of the Companies Act 1956 (CA’56) of India is exactly same as the above s145 of the CA’94. However, s46 the Companies Act 1965 (CA’65) of Malaysia is little different from the companies legislation of Bangladesh and India. Section 46(1) of the CA’65 imposes liability on the directors, promoters or every person who ‘authorised or caused the issue of the

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20 An 'IPO coalition' in this thesis includes all persons involved in the preparation of a prospectus.

21 The term 'expert' includes an engineer, a valuer, an accountant and any other person whose profession or reputation gives authority to a statement made by him. Prospectuses often include reports from valuers or geologists, who usually make reports on the viability of the businesses of the issuers. The term expert bears the same meaning in all the three jurisdictions, Bangladesh, India and Malaysia: See Companies Act 1994 (Bangladesh) s139(2) and Companies Act 1956 (India) s59(2), Companies Act 1965 (Malaysia) s4.
The same ambiguity exists in Malaysia too, because the CA’65 does not specify the persons who fall within the meaning of authorisation or causation under s46(1). Therefore, the question of liability of the persons other than the promoters and the directors for a defective prospectus is also unclear in Malaysia under company law. No case law has been found under this section for the judicial interpretation of this ambiguity in any of the three countries, Bangladesh, India and Malaysia. However, in a similar context, judicial observations in some common law jurisdictions show that directors fall within the purview of the meaning of the authorisation of issue of a prospectus. However, one writer observes that a ‘class of possible defendants’ would not be liable under s146(1) and ‘[s]uch a class would include the advising solicitors, merchant bankers and reporting accountants, who assisted in the preparation of the prospectus’. According to this observation, auditors, underwriters, issue managers and lawyers are not liable for defective prospectuses under the above section in Malaysia.

The ambiguity of the liability of those persons becomes more apparent from the comments of one writer on s62 of the CA’56 of India. According to this writer, s62 of the CA’56 restricts the civil liability to the promoters, directors and experts only. As a result, it can be said that a general perception persists in those countries including Bangladesh that the auditors, lawyers, underwriters and issue managers do not fall within the meaning of ‘authorising the issue of the prospectus’.

Those persons are not even considered to be liable within the meaning of ‘promoters’ as long as they are providing their professional services only. In Re Great

22 Companies Act 1965 (Malaysia) s46(1)(d).
23 For example, Registrar of Companies v Brierley (1965) NZLR 809 at 815. For more case references in this regard, see section 7.3.1.1.
Wheal Polgooth Co, it was held that 'a solicitor is not an officer of the company [and he or she] is not to be treated as a promoter of the company'.\(^{26}\) Hence, in absence of judicial interpretation, the academic views seem to suggest that s145 of the CA'94 of Bangladesh does not impose any liability on the lawyers, auditors, underwriters and issue managers, despite their crucial responsibility in the preparation of a prospectus. In fact, they are very influential in making disclosures in a prospectus through which they have an impact on the disclosure's capacity to deceive the investors.\(^{27}\) Although the above statutes of Bangladesh, India and Malaysia are unclear about the civil liability of persons other than the promoters, directors and experts; the *Securities Commission Act* 1993 in Malaysia contains very clear provisions regarding the liability of the persons in question. Section 57 of the Act imposes liability on all persons involved in the preparation of a prospectus to compensate investors for their loss and damages resulting from false and misleading statement in the prospectus. It clearly identifies the liable persons and these persons are, amongst other, directors, promoters, principal adviser, underwriter, auditor, and advocate of the issuer in relation to the issue.\(^{28}\) However, the defendants have a range of statutory defences against any claim of investors under this section. The defences\(^{29}\) are: due diligence\(^{30}\), expertisation\(^{31}\) reliance on public statement\(^{32}\), and withdrawal of consent\(^{33}\). All of these defences are available under company laws which will be discussed later in this chapter. It is therefore clear that, all

\(^{26}\) [1883] 53 L J Ch 42 at 42.
\(^{28}\) For details, see the text of s57 of the *Securities Commission Act* 1993.
\(^{29}\) All defences bear the same meaning as analysed earlier in the discussion on the civil liability under company laws.
\(^{30}\) *Securities Commission Act* 1993 s59.
\(^{31}\) *Securities Commission Act* 1993 s60.
\(^{32}\) *Securities Commission Act* 1993 s62.
\(^{33}\) *Securities Commission Act* 1993 s63.
of the above persons are liable for a defective prospectus in Malaysia, but there are no similar provisions in Bangladesh and India.\textsuperscript{34}

In addition to the legislation of Malaysia, there are some statutory laws as well as judicial decisions which clearly impose civil liability on the above professionals and intermediaries involved in the process of prospectus preparation. These laws are discussed below.

6.3.2. Persons Liable for Disclosures in the Prospectus under the Laws of Developed Countries

The liability of auditors, underwriters, lawyers and issue managers are investigated in the light of the statutes and judicial precedents of the United States (US), United Kingdom (UK), Australia and Canada. All of these countries have developed and better-regulated securities markets.

Sections 11 and 12 of the \textit{Securities Act} 1933 of the United States deal with the liability for disclosure in a prospectus. Section 11 imposes civil liability for untrue disclosure or nondisclosure of material facts on every person who signed the registration statement.\textsuperscript{35} Further, this section clearly declares the liability of directors, experts\textsuperscript{36}, underwriters\textsuperscript{37} and ‘any person whose profession gives authority to a statement made by him [or her], who has with his [or her] consent been named as

\footnotesize{\textsuperscript{34} The equivalent of the \textit{Securities Commission Act} 1993 (Malaysia) is the \textit{Securities and Exchange Commission Act} 1993 (Bangladesh) and the \textit{Securities and Exchange Board of India Act} 1992 (India).

\textsuperscript{35} A prospectus is a part of the registration statement filed with the Securities and Exchange Commission of the United States required for an IPO.

\textsuperscript{36} For this purpose, experts include accountants, engineers, or appraisers, or any person whose profession gives authority to a statement made by him or her, who has with his or her consent been named as having prepared or certified any part of the registration statement: \textit{Securities Act} (US) 1933 s11(a)(4).

\textsuperscript{37} Underwriters include managing underwriters. Managing underwriters are equivalent to issue managers in Bangladesh. It will be further explained later in this chapter.}
having prepared or certified any part of the registration statement...  

38 Section 12 of the Securities Act 1933 imposes civil liability on any person who is involved in the preparation of a prospectus which contains untrue statement or omits to state a material fact.  

In the UK, s168(1)(d) of the Financial Services Act 1986 imposes civil liability for a defective prospectus on the issuers, directors, and each person who accepts the responsibility for, or of any part of the prospectus. In addition to these, each person who has authorised the contents of the prospectuses or any part thereof, but does not fall within any of the above category is also liable under s 168(1)(e) of Financial Services Act 1986.  

In Canada, s130 of Securities Act 1990 (Ontario) imposes liability on the issuers, underwriters, directors and every person who has signed the prospectus. The expression ‘person who signed’ refers to the persons other than those who are already mentioned in the section by designation.  

Thus the Ontario Securities Act 1990 exposed civil liability for prospectus to every person who has signed the prospectus.  

Section 728 the Corporations Act 2001 of Australia sets out the liability for misleading or deceptive statements or material omission in a prospectus. Section 729 identifies persons who are liable to compensate the investors who sustained the resultant loss or damage from their investment in an IPO caused by the defective prospectus. The persons liable under s729 of the Act include: the person making the offer, directors, underwriters, persons named in the ‘disclosure document’ with their consent as having

38 Securities Act 1933 (US) s11(a)(4).
39 Like other jurisdictions, the company management, auditors, lawyers, underwriters and issue managers/underwriting managers are involved in the preparations of prospectuses in the United States.
40 Securities Act 1990 (Ontario) s130(e).
41 For an offer of securities, ‘disclosure document’ includes, among other things, a prospectus for the offer: Corporations Act 2001 (Australia) s9.
made a statement, and a person who contravenes or is involved in the contravention of
the prohibitions against the inclusion of misleading or deceptive statement or omission
of material information from the disclosure document.

6.3.3. Drawbacks of the Civil Liabilities for Prospectuses in
Bangladesh

The preceding description of the civil liability provisions of the US, the UK, Australia
and Canada shows that directors, promoters and experts are liable for a defective
prospectus in similarity with s145 of the CA’94 of Bangladesh. In addition, the laws of
these developed jurisdictions clearly impose civil liability on the persons other than
those mentioned in s145 of the CA’94. For example, underwriters have been explicitly
made liable in the US, Canada and Australia. Unlike Bangladesh, none of the above
laws of the developed markets includes the vague expression ‘every person who
authorised the issue of the prospectus’ to impose liability on those who are not
specifically named in the relevant sections. Instead, their expression is clearer than that
of the legislation in Bangladesh. For example, the US and Canadian laws impose
liability on the persons who signed the registration statements/prospectus; the UK law
expounds that the persons who accept the responsibility for the disclosure in the
prospectus are liable to compensate the investors who have sustained loss or damage
from their investments. The UK law also brings a person under civil liability, who has
authorised the contents of any part of the prospectus. In line with the US Securities Act
1933, the Corporations Act 2001 of Australia imposes liability on those who are ‘named
in the disclosure document with their consent as having made a statement’ and the
person ‘who contravenes, or is involved in the contravention of s728(1)’.\textsuperscript{42} Taking all these four developed jurisdictions together in the context of Bangladesh, s145 of the CA’94 is ambiguous and weaker in relation to the civil liabilities of underwriters, issue managers, auditors and lawyers. These legal lacunae result in the weaker protection of investors for which the current civil liability provisions are unhelpful to protect investors in the disclosure regime in Bangladesh. The DBR is avowed to be a system adopted for the development of securities markets, but as some commentators have stated, the shortcomings of the protection of the investing public have adverse effects on this development.\textsuperscript{43}

Underwriters, issue managers and auditors provide separate certificates to the effect that they have examined the prospectus issued to the public. Their certificates are published in the relevant prospectus. Similarly, lawyers have an important role to play in the corporate fundraising process. For their involvement in the IPO process, lawyers are also subject to the civil liability in other jurisdictions as will be discussed later in this chapter. The roles of underwriters, auditors, lawyers and issue managers with respect to a prospectus and the rationale for their liability for a defective prospectus are discussed below.

\textbf{6.3.4. Functions of Underwriters and Rationale for their Civil Liability for Prospectuses}

Pricing of shares in a public offer is very crucial for investor protection. In Bangladesh, underwriters justify the price of the shares in an IPO and provide a due diligence

\textsuperscript{42} Section 728(1) of the \textit{Corporations Act} 2001 (Australia) prohibits the disclosure of misleading or deceptive statements and non-disclosure of material facts in the prospectus.

certificate which is included in the prospectus. The imposition of civil liability on the underwriters has been emphasised to ensure prospectus integrity from the viewpoint of investor protection.44

The arguments usually advanced for the liability of the underwriters are stated below.

i. As the most independent person, an 'underwriters is in a position to evaluate and investigate' the various facets of the proposed issue, and the underwriter ‘must make some reasonable attempt’ to do it.45

ii. Investors reasonably rely on underwriters ‘to check the accuracy of the statements and the soundness of the offer’.46

iii. Underwriters are in a position to impose their will on the issuers in order to ensure the accuracy of disclosures in prospectuses.47

All of the above reasons for the prospectus liability of underwriters are related to the interests of investors. The liability of underwriters therefore becomes more desirable for the restoration of public confidence in the operation of the Bangladesh IPO market which has been seriously lacking in an environment conducive to the DBR for several years as alluded to earlier in Chapter 5. The absence of prerequisites for the DBR including shortcomings and ambiguities of the civil liability regime has prevailed in the Bangladesh securities market for years. Hence, the civil liability of underwriters is important for investor protection in the IPO market.

44 Golding (1993) above n10 at 431.
46 Chris-Craft Industries Inc v Piper Aircraft Corp 480 F 2nd 341 (1973) at 370.
6.3.5. Functions of Auditors and Rationale for their Liability for Prospectuses

The accuracy of disclosures in a prospectus largely depends on the role of the auditors who attach a due diligence certificate to the prospectus concerning the accuracy of the information in relation to the financial status of the issuer. Generally, the auditors are the people who are hired first for the prospectus and they ‘must observe inventory and confirm accounts receivable’ to furnish their reports. Auditors often have much influence over the contents of the prospectus that often deceive investors. They usually work behind the scenes and it is reasonable to impose liability on the auditors because ‘they have an impact on the disclosure’s capacity to deceive’ as is the case of underwriters. In the US, the Court of Appeals for the Ninth Circuit has suggested that primary liability be imposed on those who have a significant role in drafting fraudulent disclosure materials and that accountants have been directly identified as a source of these materials. A district court in California has expressed the view that the simple involvement or participation in a fraudulent disclosure is sufficient for liability to be imposed. A US court in Adam v Silicon Valley Bancshares observed that a defendant may be liable for participating considerably in a fraudulent scheme even if the misrepresentations are not made directly by the defendant. Thus, the participation of auditors in the preparation of a defective prospectus should attract liability.

51 Dannenberg v PaineWebber Inc, 38 F 3d 1078(1994) at 1090.
52 In Re ZZZZ Best Co Sec Litig 864 F Supp 960 (1994) at 970.
Further, from a different point of view, a study has shown that the level of effort of auditors in the performance of auditing depends on the extent of the liability.  

Similarly, another study suggests that the potential liability works as an incentive for the auditors to work hard and provide insurance for the investors.

The importance of the role of auditors in the preparation of a prospectus is evident in the reasons aforesaid. Therefore, the imposition of civil liability on the auditors for a defective prospectus is quite reasonable.

6.3.6. Functions of Lawyers and Rationale for their Liability for Prospectuses

A lawyer provides advice to the issuer on the requirements of disclosure and certifies the compliance with the law in preparing a prospectus. A lawyer is also responsible for guiding the issuer through various regulatory hurdles. A legal framework contributes to make the role of lawyers more credible by imposing potential liability on them for providing improper advice to the issuer and attaching untrue certification to the prospectus regarding the compliance of law. It is argued that lawyers are not generally regarded as experts in respect of IPOs. They may not be expert in relation to the whole contents of a prospectus, but the lawyers are expected to have expertise on the legal aspects of the prospectus. By virtue of their knowledge of the law, lawyers can provide opinions like experts on certain parts of the contents of a prospectus. For example, legal counsel may be held liable if an expert opinion is offered in the prospectus concerning

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the tax status of the issuer if the opinion is found to be inaccurate. Apart from offering expert opinions, mere participation of professionals (lawyers) like underwriters and auditors in the process of prospectus preparation 'can provide an implicit certification' to potential investors about the accuracy of disclosures. Thus simple involvement or participation of lawyers in a fraudulent prospectus should be considered sufficient for the imposition of civil liability on them as has been mentioned earlier in relation to auditors.

There may be some arguments against the liability of lawyers on the plea that the service provided by lawyers in respect of the prospectus is basically of an advisory nature. Actually their role is not limited to merely providing advice to the issuer, rather it extends to verifying the compliance with the legal requirements of the prospectus contents and regulatory barriers in obtaining the regulator's consent to the issue of the prospectus. Legally, an issuer is obligated to furnish only the true information in the prospectus. At the same time the issuer is required to refrain from incorporating false, misleading or deceptive information and non-disclosure of material facts as argued earlier. The lawyers get involved in the process of prospectus preparation at a much later stage than that of the auditors to verify the legal requirements for the prospectus. Lawyers have the opportunity to remind the issuer of the specific needs or shortcomings of the prospectus. It is therefore argued that the lawyers' role is not just 'blowing the whistle'. Their role is also a matter of helping the issuers commit wrongs. It can be further argued that had the lawyers warned the issuer of the flaws in the prospectus, the

59 See In Re ZZZZ Best Co Inc, Sec Litig 864 F Supp 960 (1994) at 970.
61 Harrison (1997) above n49 at 537.
issuer could not have issued the prospectus to the public and the investors would not have lost their money as a result of their investments in a ‘bad’ IPO. Because of the ‘historic lack of enforcement’ of the prospectus provisions, the issuers may find it rewarding to raise capital from the market by overlooking their liability, especially if the lawyers agree with the issuer to go public with the defective prospectus. Lawyers have the authority to control their issuers by not certifying a defective prospectus as a ‘clean’ one, and a person who controls the issuer is also liable for the contravention of legal requirements by the issuer. Lawyers ‘exercise discretion in deciding’ on the contents of disclosure in a prospectus. At times, a law firm can be regarded as a primary violator for material misstatements or omissions contained in the prospectus. From this point of view, civil liability should be imposed on lawyers too. In view of the above reasons, the imposition of civil liability on lawyers is necessary for the protection of investors in the IPO market in Bangladesh.

6.3.7. Functions of Issue Managers and Rationale for their Liability for Prospectuses

An issue manager has a significant role to play in the process of an IPO. The issue manager prepares the prospectus and is responsible for the accuracy of disclosures therein. The managers are required to provide a ‘due diligence certificate’ which

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63 See L D Lowenfels & A R Bromberg ‘Controlling Person Liability under Section 20(a) of the Securities Exchange Act and section 15 of the Securities Act’ (1997) 53 The Business Lawyer 1 at 1. Section 15 of the Securities Act 1933 (US) is applicable to ss11-12, which imposes liability on various persons including current and future or prospective directors of the issuers of IPOs. Hence, the controlling persons’ liability as set forth in s15 is quite relevant.
64 Barondes (2002) above n58 at 410.
65 See generally, Breard v Sachnoff & Weaver Ltd 941 F 2d 142 (1991); Molecular Technology Corp v Valentine 925 F 2d 910 (1991) at 913-14, 917-19.
confirms that the prospectus contains true, fair and adequate disclosures. They are also involved in the pricing of the shares offered. As a whole, the issue managers selected by the issuers control IPOs. It is also said that sometimes they have the most control over the issue. Further, the issue manager 'has de facto control over the actions' of the other participants in an IPO, for example, underwriters. Despite this obligation of certification of the adequacy and fairness of disclosures in a prospectus, the above mentioned prospectus liability laws of Bangladesh do not clearly impose any liability on the issue manager. Managers should be liable on several counts, ie, for getting involved in the preparation of prospectuses, providing confirmation of the fairness and adequacy of the disclosures, controlling their issuers, as well as other participants in an IPO coalition.

In the United States, the Securities Act 1933, expressly imposes civil liability on the issue managers. In addition, s12(2) of the Securities Act 1933 imposes liability in general on any person who is involved in the disclosure of untrue statements or omission to state material facts. This section has no limitation on liability for the prospectus and has wider scope of application than that of s11 (s11 discussed earlier). In Stokes v Lokken, the court held that a person is liable under s12 of the Securities Act 1933 if his or her participation is considered to be a significant and substantial factor in

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67 The ‘due diligence certificate’ is required under regulation 14 of the Securities and Exchange Commission (Merchant Bankers and Portfolio Managers) Regulations 1996. For an example of such certificate, see the Prospectus issued by the Fu-Wang Foods Limited in April 2000 at 2.


70 Allen (1991) above n68 at 331.

71 Section 11(a)(5) of the Securities Act 1933 (US) imposes liability on every underwriter with respect to the security issued. The manager falls within this category as underwriting manager.

the offering of securities.\textsuperscript{73} Courts have found the defendants liable under s12(2) for aiding and abetting the violation of disclosure requirements, when defendants knowingly and substantially assisted the violation.\textsuperscript{74} Investors may reasonably rely on the reputation of the issue managers in making their investment decision.\textsuperscript{75} Thus, the issue managers are held liable for the defective prospectus.

It is therefore clear that the issue managers play a very crucial role in an IPO for which civil liability has been imposed in some jurisdictions. However in Bangladesh, there has been no clear provision like s12 of the \textit{Securities Act} 1933, and the liability of issue managers for a defective prospectus is quite unclear and uncertain despite their part in the preparation of the prospectus. The ambiguity contributes to the exacerbation of the lack of investor protection, which is contrary to the prime objective of the DBR.

6.3.8. Defences Against Civil Liability for the Untrue Statements in Prospectuses

Section 145(2) of the CA'94 embedded some defences which are available to the persons liable for the disclosure of untrue statements in the prospectus under s145 (1). These defences could be divided into three which are: withdrawal defence, due diligence defence and expertisation defence.

6.3.8.1. Withdrawal Defence

In accordance with s145(2) of the CA'94, the withdrawal defence has two prongs. One

\textsuperscript{73} 644 F 2d 779 (1981) at 785.

\textsuperscript{74} See, for example, \textit{Monsen v Consolidated Dressed Beef Co} 579 F 2d 793 (1978) at 800-01; \textit{Lorber v Beebe} 407 F Supp 279 (1975) at 287-88; \textit{In Re Caesars Place Sec Litig} 360 F Supp 366 (1973) at 378-79.

\textsuperscript{75} See \textit{In Re Gap Stores Sec Litig} 79 F R D 283 (1978) at 299.
is applicable before the publication of the prospectus and the other is applicable after its publication but before the allotment of shares thereunder.

At the first stage, a prospective director is entitled to prove that he or she withdrew his or her consent to be a director before the issue of the prospectus and the prospectus was issued without his or her consent.

At the second stage, the defendants may prove that the prospectus in question was issued without their knowledge or consent, and immediately on becoming aware of the issue, they withdrew their consent and gave public notice to that effect. If their consents were not withdrawn immediately after the issue of the prospectus, the defendants may also prove that they withdrew their consent after the issue of the prospectus but before the allotment of shares thereunder. To rely on this defence, the defendants are required to give a public notice of withdrawal of their consents with reasons given thereof.

It is therefore clear that the withdrawal defence before the issue of the prospectus is applicable only to the prospective directors. After the issue of the prospectus, this defence is applicable to all defendants. The defendants may claim this defence only when the allotment of shares under the prospectus in question is not made and no such defence can be claimed once allotment is made thereunder.

The most important concern of the public about the withdrawal of consent by a defendant seems to be the public notice to make the potential investors aware of such a withdrawal. Without a public notice, the withdrawal of consent by the prospective director may not have any implications for the potential investors. In the present provisions of the Bangladesh legislation, there is room for misleading the potential investors about the identity of directors. For example, s145(2)(a) entitles a prospective director to withdraw his or her consent given to the prospectus to become a director before its issuance. But the prospective director is not required to make the withdrawal
public although he or she can rely on this defence of withdrawal in a legal suit regarding the truth of the disclosures in the prospectus. There may be many investors who subscribed for an IPO mainly because of the directorship of such persons who have already withdrawn their consent to be directors before the issuance, but after the preparation of the prospectus. The prospectus has also been published with his or her name and no public notice has been given during the subscription period. It may be argued that the notification of the withdrawal of consent of a proposed director may imply some serious problems with the IPO. The investing public may be sceptical about the particular public offer because of the public notice of the withdrawal of consent by the prospective directors.76 This is because, the investors may have had a general idea that the withdrawal of consent by the prospective director might have followed the finding of ‘weak fundamentals’ of the shares to be issued. This argument could be countered by saying that there might be some fatal problems with the truth of disclosures affecting the merits of the public offer which could make the offer unworthy of investment. To save the potential investors from being deceived by the defective prospectus, and for the sake of enabling the investors to make informed investment decision, the withdrawal of the consent of prospective directors with the reasons thereof should have been made public. The investing public must not be concerned about the offer if a proposed director withdraws his or her consent given to the prospectus to be a director on personal grounds not related to the merit of the offer. If the reasons for such a withdrawal are considered to be ‘degrading’ quality of disclosures, they must be published for the sake of investor protection as well as the integrity of the market itself. A defective prospectus usually exploits the general investors and diminishes investor confidence for which such disclosure is prejudicial to the healthy running of the market.

76 See G Golding, ‘Prospectus Misstatement Liability in the 1990s: Where Does the Director Really
The non-disclosure of the withdrawal of such a consent in the IPO market in Bangladesh itself is an omission to state facts and appears to be more harmful for a market which has been suffering from a severe lack of investor confidence for several years.

Further, it is not clear as to why the withdrawal of consent of prospective directors should not be made public in a regime where the withdrawal of the consent of other potential liable persons given to the prospectus is required to be disclosed with reasons thereof. The purpose of such notification is of course for the protection of investors and the integrity of the market. From the investor point of view, it is thus submitted that the requirement for a reasonable public notice should be equally applicable to the incumbent as well as proposed directors in respect of the withdrawal of their consent given to the prospectus. In the US, the prospective director who has withdrawn his or her consent to the prospectus before its issue is required to advise the Securities and Exchange Commission on such a withdrawal. In such a situation, the US securities regulator may give public notice with regard to the said withdrawal immediately after being advised by the prospective director concerned. It is to be noted that the regulation should be directed to protect the interests of the investors and the market, not to mislead them. A lack of the requirement for issuing public notice of the withdrawal of consent of a prospective director favours the issuer to exploit the ignorance and innocence of investors. This favour is strictly contrary to investor protection which is the main objective of the disclosure philosophy.


77 Companies Act 1994 s145 (2)(b) and (c).
78 Securities Act 1933 (US) s11(b)(1).
6.3.8.2. Due Diligence Defence

In a legal sense, the expression ‘due diligence’ means ‘close examination... of a transaction and its related documentation’. In *Universal Telecasters (Qld) Ltd v Guthrie*, it was held that ‘due diligence’ refers to a minimum standard of behaviour which is used to defend oneself against the violation of regulatory or supervisory provisions so as to ensure that the particular system was properly carried out. In *Martin v Hull*, the court observed that the ignorance of a defendant is no defence under the prospectus liability and that some degree of competence in the performance of due diligence is expected. Under this defence in Bangladesh, defendants can escape their prospectus liability for both untrue statement and omission in the prospectus. According to s145(2)(d)(i) of the CA’94 which deals with the due diligence defence, the claim of exercising due diligence by the defendants can be premised on personal belief of the defendants about the truth of the untrue statement incorporated in the prospectus. The defendants may prove that, although the statement in question was not based on any expert opinion or any official document, they had reasonable ground to believe until the allotment of shares thereunder that the impugned statement was true.

In keeping with judicial observation, mere personal belief may not be sufficient to establish the due diligence defence. In this respect, the court in *SPCC v Kelly* held that general precautions are unlikely to be sufficient to establish this defence; rather the defendants must show that their minds concentrated on the potential risks associated

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80 (1978) 18 ALR 531; 32 FLR 360.
81 92 F 2d 208 (1937) at 210.
82 *Companies Act 1994* s145(2)(d)(i).
with the transaction.\textsuperscript{83} The persons who seek the due diligence defence ‘must always conduct the due diligence investigation in person’.\textsuperscript{84}

Although the corresponding laws of India and Malaysia do not require investigation by the defendants to establish the due diligence defence, there are some countries especially the developed countries like the US, the UK and Australia which have clearly established the requirement of reasonable enquiries about the statements included in the prospectus (details in the next subsection). It is broadly recognised that financial transactions in those countries are much more transparent than those of Bangladesh.\textsuperscript{85} Despite this fact, reasonable inquiries by the defendants are required for this defence under the laws of those countries, even if they rely on experts, public documents or opinions of respective public officers. Details of requirements for reasonable queries are explored below in analysing expertisation defence in which the exercise of due diligence is relevant.

\textbf{6.3.8.3. Expertisation Defence}

Under s145(2)(d)(ii)-(iii) of the CA’94 in Bangladesh, the defendants of a suit for a prospectus containing an untrue statement may prove that the statement fairly presented the extract statement provided by the competent experts or respective officials or was based on public documents. These experts are required to show that they had reasonable ground to believe and did believe until the allotment of shares under the impugned

\textsuperscript{83} (1991) 5 ACSR 607 at 608-09.
prospectus that the providers of those statements were competent persons, and that they
did not withdraw their consent given to the prospectus until the allotment of shares.\(^86\)

Just like the flaws which are embedded in the due diligence defence discussed earlier, the weakness of this expertisation defence is the lack of reasonable inquiries by
the defendants about the competency of the experts, the truth of their reports and the
consistency between such reports and pertinent presentation in the prospectus. In this
respect, s11(3)(A)-(B) of the *Securities Act* 1933 (US) requires the defendants to carry
out reasonable investigation if they were to rely on the due diligence defence. In
Australia, s731 of the *Corporations Act* 2001(Cth) emphasises the requirement of
inquiry for the due diligence defence in respect of prospectus liability.\(^87\) The
requirement of queries by the defendants limits their scope to escape their liability for
the defective prospectus. The narrower scope of defences leaves little rooms for the
defendants to avoid liabilities, which in turn facilitates to widen the scope of remedies
for the plaintiffs. Thus, in the light of the above legislation of the US and Australia, the
laws of Bangladesh suffer from a clear lack of investor protection in that they provide
the defendants with the due diligence defence based on personal belief without any
Corresponding requirements for reasonable inquires to justify their belief in the untrue
statement incorporated in the prospectus. Judicial approaches about reasonable
investigations further narrowed down the scope of expertisation and the due diligence
defence as discussed below.

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\(^{86}\) *Companies Act* 1994 s145(2)(d)(ii) and (iii).

\(^{87}\) Emphasis has been given on the reasonable personal inquiries (if any) by the defendant: see
s731(1)(a) of the *Corporations Act* 2001 (Australia).
6.3.8.4. Position of Executive and Non-Executive Directors in Respect of the Due Diligence Defence

A company usually appoints executive or non-executive directors. According to the articulation of s145 of the CA'94, there is no distinction between the executive and non-executive directors in respect of defences against prospectus liability. However the courts of various Commonwealth jurisdictions have clearly drawn a demarcation by saying that the executive directors are not allowed to rely on the defence of expert reports. For example, in *J P Coats v Crossland*, the court rejected the due diligence defence and held that the blind acceptance of assurances regarding disclosures in a prospectus given by a ‘self-interested party’ will not be acceptable. On the other hand in *Stevens v Hoare* the court accepted this defence when a non-executive director had given evidence that the grounds of his belief of the truth of the statements made in the prospectus were the result of reasonable inquiries carried out by the director of the legal advisers to the issuer and management of the issuer. The court contended that such investigation justified in the given circumstances.

In *Adams v Thrift*, a leading English case, non-executive directors failed to establish the due diligence defence under the *Directors Liability Act* 1890 (UK). In this

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88 An expert is considered to be one of the self-interested parties.
89 (1904) 20 TLR 800 at 806.
90 In this case it was said that: ‘Had he reasonable ground for believing the statements in question to be true? It cannot be, and has not been, said that he had no ground for so believing. But the case has been argued on the part of the plaintiff as if the statute had required of a director not merely reasonable, but sufficient, grounds for his belief. Indeed, it was rather suggested that a director is not entitled to rely upon the assistance or advice of solicitors or clerks, but that with his own hands and eyes he must search out and read every relevant document, and with his own mind judge of its operation and legal effect, and that he is not entitled to state anything in a prospectus that could not depose to of his own knowledge in a Court of justice. If so he would be bound to do a great deal more than the most industrious and prudent man [or woman] of business could not think of doing, or in most cases would be able to do, in the conduct of his own affairs.... And upon consideration of his evidence and all the circumstances of the case it would in my opinion be wrong, and I cannot bring myself, to conclude that he had not reasonable ground for such belief. I am of opinion that the defendant had reasonable ground for believing the statements of the prospectus to be true’: (1904) 20 TLR 407 at 409.
case, the prospectus contained a number of misstatements concerning the business of the issuer. The judge was not satisfied with the requirement that the director believed that the statements furnished in the prospectus were true.91 The *Adams* case is authority for the proposition that the blind reliance on a report or valuation by experts for prospectus statements is not a reasonable ground to establish the due diligence defence. According to this case, directors must take positive steps to know about the truth of the statements embodied in a prospectus before authorising them.92 This case thus provides a clear direction for the company directors that the mere claim of the due diligence defence is not sufficient to avoid liability as stated in the statutes. Rather, the defendants need to be proactive to be familiar with the disclosures made in the prospectus even with the expertised portion of the prospectus.

Further, executive directors are generally expected to know much more than the non-executive directors about the affairs of the company. The burden of the executive directors is much more onerous than that of the non-executive directors in establishing the due diligence defence as is evident in *Escott v BarChris Construction Corp*, *(BarChris case)*, a leading American authority.93 It was also held that the two portions of the prospectus, expertised and non-expertised,94 cannot be treated alike for the purpose of the due diligence defence.95 The *BarChris* case imposed a stringent requirement of knowledge for the executive directors, which led to the conclusion that liability will lie in all cases of misstatements.96

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91 (1915) 1 Ch 557 at 565-571.
92 (1915) 1 Ch 557 at 565-571.
93 283 F Supp 643 (1968).
94 For example, the financial statements that had been audited and certified by the accountants are expertised part.
95 283 F Supp 643 (1968) at 683.
96 See *Escott v BarChris Construction Corp* 283 F Supp 643 (1968) at 684-692.
It would be more difficult to prove the due diligence defence for non-expertised portions. The analysis of BarChris case was strongly affirmed in Feit v Leasco Data Processing Equipment Corp. In Deloitte Haskins and Sells v National Mutual Life Nominees the Court of Appeal of New Zealand rejected an argument that the non-executive directors should be subject to a lower standard of care than that of the executive directors. In another US case, the court observed that the duty of a director to exercise due care, skill and diligence in overseeing the affairs of a company cannot be met entirely by relying on the other persons and he or she needs to be familiar with the business and financial condition of the entity. However, the approach of the court demonstrated in the BarChris case has been criticised by Folk. He argued that a ‘director should be protected’ if he or she depends on the specific opinion of an independent legal counsel, for example, that ‘the contested fact [is] immaterial or not false or [that] its omission [is] not misleading in the context’. However Folk pointed out that a director would not be relieved from the misstatement liability for relying on a vague opinion like ‘you need not worry about it’. There are also some arguments from academics that the dependence on the specific advice of a competent lawyer will be allowed as a due diligence defence even if the lawyer is wrong in providing opinion on the contested statement.

100 See Folk (1969) above n47 at 27-29.
101 Id at 78.
102 Ibid.
In Daniels v Anderson the court in Australia expressed the view that directors are under a duty to take necessary steps to know the affairs of the company concerned and they owe to the company a duty to exercise reasonable care in discharging their official duties. The duty of care and reasonable enquiry are closely related. The standard of care to be taken by a director has been prescribed in Adams v Thrift is to the effect that the director satisfies a requirement of appropriate enquiry based on the standard of a reasonable person. This proposition was emphasised by the High Court of New Zealand in R v Rada Corp Ltd. The court there treated the executive and non-executive directors differently in respect of their reliance on the due diligence defence. In this case, the position of executive directors has not been made clear, but the court held that the non-executive directors would likely be able to establish the defence.

The preceding analysis suggests that, although the due diligence defence has been in place in many countries, its scope of application is not wide enough to escape the liability unduly. From the practical point of view, in this age of accountability and transparency, a director should not be absolved from misstatement liability on the ground of the due diligence defence without exercising reasonable care. The application of this defence is subject to the exercise of reasonable care to verify the truth of the statements which are to be incorporated in a prospectus. The blind belief in the advice of other people will not be sufficient to establish this defence. Executive directors, ie, the insiders of the issuer have greater responsibility to carry out inquiries about the truth of the prospectus statements than that of outsiders.

105 (1915) 1 Ch 557 at 565.
106 (1990) 5 NZCLC 66,625.
However, in Bangladesh, s145 of the CA’94 does not require reasonable investigation by the defendants to establish the due diligence defence. In effect, the absence of this requirement has widened the scope of the defendants to escape the prospectus liabilities at the expense of investor protection in the IPO market. As regards the withdrawal defence, the lack of requirements for issuing public notice of the withdrawal of consent given by a prospective director to the prospectus has been shown to be prejudicial to the interests of investors. Therefore the due diligence defence without reasonable care and the withdrawal of consent without public notice will implicitly support the impropriety of the persons involved in the preparation of a prospectus which is prejudicial to the interest of the investors. These legal lacunae are contrary to the concept of protecting the interest of investors in the Bangladesh IPO market.

6.3.9. Requirements of Reliance by Investors upon Prospectuses and
the Elements of Causation for Compensation

In Bangladesh, under s145 (1) of the CA’94, investors are entitled to recover their loss or damage sustained by subscribing to an IPO from persons who are liable. The right of investors to get compensation is subject to two requirements. Firstly, the investors have to prove that their investment decisions were made on reliance of the prospectus and secondly, that the loss or damage claimed was the result of the untrue statements incorporated in the prospectus. Subscribers will have no remedy if they rely on anything else except the prospectus, such as, the reputation of the prompters, directors and underwriters.

The above conditions are regarded as obstacles to the enforcement of the investors’ rights to recover damages. This is so because, in practice, investors especially in a least
developed country like Bangladesh, usually make their investment decisions having more reliance to the name and fame of the persons involved in the issue rather than the quality of disclosures made in the prospectus. Nevertheless, under the current liability provisions, the investors are not entitled to seek compensation for their loss or damages caused by the untrue statement, unless the reliance and causation elements are proved.

Considering the importance of compensation to the investors and the difficulty of proving their reliance on the prospectus, in some developed countries, the investors are not required to prove such reliance. In this respect, it can be taken for granted that the investors in developed countries are better educated and trained on average and they generally invest in IPOs upon the advice of their investment advisers. Despite this fact, their laws do not require the investors to prove their reliance on the prospectus. For example, in Canada, s130(1) of the Securities Act 1990 (Ontario) does not require the element of reliance on the prospectus for the purpose of claiming compensation. Instead, the section provides that purchasing securities offered to the public through a prospectus containing a misrepresentation ‘shall be deemed to have relied on such misrepresentation if it was a misrepresentation at the time of purchase and [an investor] has a right of action for damages’. In the US, ss11 and 12 of the Securities Act 1933 which deal with prospectus liability do not provide for this reliance requirement. Actually, s11(a) of the Securities Act 1933 requires the plaintiffs to prove their reliance on the registration statement, ‘but such reliance may be established without proof of the reading of the registration statement by any person’. Therefore, this requirement is less restrictive than that of Bangladesh.

On the other hand, s12 of the above mentioned Act, which directly deals with the prospectus, has imposed the onus of proof of investors’ non-reliance on the disclosures upon the defendants. In accordance with s12 of the Securities Act 1933, defendants have
to prove that the compensation claimed by the plaintiffs is not the result of the ‘defect’ of the prospectus. Thus the plaintiffs need not prove their reliance on the impugned prospectus for the recovery of their loss or damage resulting from their investments in a ‘bad’ IPO in the US.

In Australia, s729(1) of the **Corporations Act 2001** imposes liability on certain persons to pay compensation to the investors. Such a person is liable ‘even if the person did not commit, and was not involved in, the contravention’ of disclosure requirements as set forth in s728. These persons, as mentioned earlier ‘are almost absolutely liable’ and the investors are not required to prove their reliance on the prospectus for claiming compensation.

The older cases showed that the plaintiffs were required to prove their reliance on the prospectus to recover their compensation, because the legislation at the time required it. At present, to prevent well-known business persons from using their names in a defective prospectus, the requirement for the reliance on the prospectus by the investors is completely irrelevant, and the purchaser is not required to prove due diligence. Therefore, although the laws of the markets having the majority of sophisticated investors and the availability of professional investment advisers no longer require the investors to prove their reliance on the prospectus to recover the loss or damage arising out of their investments in defective prospectuses, the law of Bangladesh still imposes this burden on the investors. This requirement ultimately

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109 **Corporations Act 2001** (Australia) s729.

110 See *Baty v Keswick* (1901) 85 LT 18. As to the meaning of ‘on the faith of’ see *MacLeay v Tait* [1906] AC 24.


precludes the investors a priori from their right to claim compensations from their investments in a defective prospectus. Moreover, the dearth of judicial interpretation of prospectus liability in Bangladesh may magnify the general perception that the reliance element is an obstacle for the recovery of loss or damages under s145 of the CA’94. In practice, the test of reliance on the prospectus is a subjective test which is very difficult to prove by evidence.

As regards the causation element, the onus of proof on the plaintiff that the loss or damage is the result of the untrue statement included in the prospectus is considered to be another hindrance to the investors’ right to be compensated for their investment in a ‘bad’ IPO. The imposition of this burden of proof of causation seems to be an extra burden for the investors particularly in Bangladesh. Such an imposition in the US market is understandable because sophisticated investors dominate it. In addition, professional advisory services are also available in the US market. But this is not the case in Bangladesh where the dominant unsophisticated investors, in practice, rely on the brand name of the issuer and the persons involved in the fundraising process. In such a situation, it can be seen that the present requirements in Bangladesh of proving investors’ good faith on the prospectus or their reliance on the disclosure in subscribing for an IPO as well as the element of proving causation of the loss or damage claimed by the investors can be perceived as obstacles to the rights of investors to seek civil remedy provided under s145 of the CA’94.

113 For reasons for such reliance, see sections 5.3.5 and 5.3.6.
6.3.10. Liability under the Common Law of Torts

The common law of torts imposes civil liability on all participants in an IPO coalition. These participants include directors, promoters, auditors, lawyers and the issue managers. Therefore, the persons who do not fall within the ambit of the civil liability referred to earlier, are liable to the investors under the common law of torts. The liability under the common law is based on the tort of deceit and the tort of negligence.

6.3.10.1. Liability under the Tort of Deceit

The remedy under the tort of deceit is available against a fraudulent misrepresentation where the person making the statement in question knew that the statement was false or, he or she was reckless as to whether it was true or false.

Although the common law imposes liability on all of the participants in the process of prospectus preparation, the enforcement of the tort of deceit has become extremely difficult after the adoption of a fraudulent standard of behaviour for liability as set forth in Derry v Peek more than a century ago. In this case, Lord Herschell insisted on proof by the plaintiffs ‘that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false’. However, the representation need not be made directly to the plaintiff. In this regard, the decision of the House of Lords in Peek v Gurney also contributed to making it

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116 [1889] 14 AC 337.
118 Derry v Peek (1889) 14 App Cas 337 at 374.
difficult to prove deceit. The House of Lords restricted the scope of the liability arising out of a false statement in a prospectus as it presumes that the intention of the prospectus was not to deceive the investors but to enable the company to find people to acquire its shares. In an earlier case, *Polhill v Walter*, it was held that, to get a remedy under the common law of deceit, the plaintiffs will have to prove that the defendants must have lacked an honest belief in the truth of the statement in question. Even recklessness in the sense of gross negligence will not be sufficient to recover compensation unless the defendants are consciously unresponsive to the truth. Hence, seeking remedy under the tort of deceit is practically difficult for the investors and unenforceable to a great extent.

In the Madhya Pradesh High Court of India case in *S Chatterjee vs K L Bhave*, it was said that:

In order to sustain an action of deceit, there must be proof of fraud, and nothing short of that will suffice. Fraud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly careless whether it be true or false.

The court also pointed out that the tort of deceit is not completed unless the false report is acted upon and such a report has resulted in loss or damage. This interpretation of the tort of deceit is followed in the Indian subcontinent. The observation of the Indian High Court is similar to the decision in *Derry v Peek* in the sense that both of the cases dealt with the proof of fraud. In *Derry v Peek*, it was said that ‘...a man who

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119 *Commercial Banking Co of Sydney v R H Brown & Co* (1972) 126 CLR 337 at 343.
120 (1873) LR 6 HL 377.
121 *Peek v Gurney* (1873) LR 6 HL 377 at 400.
122 (1832) 3 B & AD 115 at 124; (1832) 110 E R 43 at 46.
123 *Lamb v Johnson* (1914) 15 S R (NSW) 65 at 74-75.
124 (1960) AIR (MP) 323 at 323.
makes a statement without care and regard for its truth or falsity commits fraud'.\textsuperscript{126} Seeking a remedy by a plaintiff under the tort of deceit is therefore practically difficult because of the problems involved in proving the elements of fraud.

Further, directors are not liable for misstatement in the prospectus if they claimed that they honestly believed the statement true at the time of making it. As it was held in \textit{Baron Uno Carl v Rolf de Mare}, it would be sufficient if a director honestly believed the statement to be true in the sense in which he or she understood it.\textsuperscript{127} Similarly, in this regard, the High Court of Australia held that, ‘[i]n order to succeed in fraud, a representee must prove, inter alia, that the representor had no honest belief in the truth of the representation in the sense in which the representor intended it to be understood’.\textsuperscript{128} Thus it depends on a subjective test. In such a situation, it should be very difficult for the plaintiffs to disprove the director’s claim of his or her honest belief in the truth of a statement which is actually untrue. In addition, as expounded in the above-mentioned \textit{S Chatterjee vs K L Bhave}, it is to be proved that the plaintiff acted upon the false statements and the loss or damage incurred by the plaintiff is the result of such statements. These requirements make the plaintiffs’ claims under the tort of deceit difficult to prove before the court. Commenting on this issue, Loss and Seligman said that it is very difficult for plaintiffs to get remedy on the basis of fraud or deceit.\textsuperscript{129} As a result, the remedy available under the common law of tort of deceit is not a useful remedy to investors in Bangladesh.

\begin{thebibliography}{99}
\bibitem{126} [1989] 14 A C 337 at 350.
\bibitem{127} [1959] 3 WLR 108 at 114.
\bibitem{128} Krakowski v Eurolynx Properties Ltd (1995) 183 CLR 563 at 578.
\end{thebibliography}
6.3.10.2. Liability under the Tort of Negligence

The essence of this liability is the duty of care. In *Mutual Life & Citizens Assurance Co Ltd v Evatt*, the Privy Council held that the duty of care is only imposed on a person who carries on a business, or profession, which involves providing advice of a kind calling for a special skill and competence.\footnote{130} In this regard, the High Court of Australia in *Shaddock & Associates Pty Ltd v Parramatta City Council* held that a duty of care arises ‘whenever a person gives information or advice to another upon a serious matter in circumstances where the speaker realizes, or ought to realize, that he [or she] is being trusted to give the best of his [or her] information or advice...’\footnote{131} Liability for negligence arises even though the misstatement is made honestly and regardless of the existence of fiduciary or contractual relationship between the parties of a suit concerning prospectus misstatements.\footnote{132} In accordance with these observations, every person who has an involvement in the preparation of a prospectus is under a duty of care to provide accurate information in the prospectus.

The liability for the tort of negligence in respect of prospectus misstatements is not of much importance in many countries. This is so because, the statutory liability in this regard imposes a negligence standard of conduct on every person involved in the public offering of securities.\footnote{133} The persons who are negligent in preparing a prospectus, will be held liable under statutory provision because of their failure to establish the due diligence defence. Conversely, if they successfully establish the due diligence defence in a suit filed under statutory laws, they can easily win the suit under the common law

\footnote{130} [1971] AC 793 at 803.
\footnote{131} (1980) 150 CLR 225 at 250.
\footnote{132} See *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465.
\footnote{133} As discussed earlier, statutory civil liability of persons involved in the preparation of a prospectus is subject to some defences such as due diligence. See also, *Ernst & Ernst v Hochfelder* 425 US 185 (1975) at 208.
of negligence depending on the same evidence used in the proceeding under the statutory law. Thus the negligence element under the common law is now of less significance because of its incorporation in the statutes. The common law of negligence therefore does not provide the investors with any extra means of remedy in reality for their loss or damage sustained from their investments in a defective prospectus. However, the discussion on the tort of negligence suggests that all persons involved in the preparation of a defective prospectus should be held liable to compensate the investors who have suffered loss or damage by investing in such a prospectus.

It can be seen from the above discussion that the common law remedies for untrue statements included in the prospectus are not of much help for the investors in Bangladesh. The common law remedies are available regardless of the regulatory philosophy (the MBR or DBR). These remedies do not warrant to be specially mentioned in looking for the protection for investors in the disclosure regime.

6.3.11. Counter-arguments against the Extension of the Civil Liability to All Persons Involved in the Preparation of Prospectuses

It may be argued that the imposition of potential civil liability on the auditors, underwriters, issue managers and lawyers will ‘chill’ their participation resulting in the reduction in the number of new IPOs. This may be partly true, because such a negative effect has been suggested specially in high risk and high technology industries. General investors are usually unable to assess the risks associated with the IPOs. Moreover, the complex and scientific nature of such an industry at times makes the prospectus more difficult to make an informed assessment. This is evident in *Klein v*
Computer Devices Inc in which the plaintiffs complained that the prospectus failed to disclose the technical reasons for which the primary product of the issuer was substantially unmarketable. If it is difficult for market professionals of a developed jurisdiction like the market in the US to discover the errors and complexities, it would certainly be impossible for the average investors in Bangladesh to discover these. If an IPO is really risky and the nature of risk is difficult to understand generally, the investors should be better off without such a public offer.

The impact of the lack of investors’ ability to make informed decisions in the true sense in a disclosure regime is evident in the reality of the share market in Bangladesh. It is a fact that many companies having poor economic fundamentals have been taking advantage of the innocence of the investors in Bangladesh in collaboration with the professionals and intermediaries of issuers’ choice. Further, a recent survey showed that companies listed after the introduction of the DBR have raised a huge amount of money from the general investors by making ‘palatable’ disclosures in their prospectuses and that funds have been reportedly misappropriated (by the management of the companies).

From the practical point of view, it can be said that only the securities with high risks are likely to be reduced as a consequence of the imposition of liabilities on the professionals and intermediaries involved in the preparation of a prospectus. Such a decline in IPOs will not be detrimental to the market in the long run and the impediment to the issue of shares associated with high risks is desirable from the viewpoint of

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135 591 F Supp 270 (1984). The primary products in this case were portable computers which used 3.5 inch disks drive rather than 5.25 inch drive.

136 See section 5.3.3.1.
investor protection especially in a country like Bangladesh. The reason is that once the confidence of investors is impaired by the ‘bad offers’, the ‘good offers’ will fail to attract the investors in some cases. Thus the bad offers eventually reduce the IPOs and cannot contribute to the development of the share market. In respect of corporate fundraising, Coffee observes that statutory ‘liabilities …give this person a strong incentive to monitor for law violation by others and little incentive to cheat itself’. An appropriate legal regime and its effective enforcement help establish the rule of law which can contribute largely to increase IPOs. Coffee observes that ‘[l]iability must be addressed legislatively’. Hence, the statutory liability has been argued to be more useful to accord better protection to the investors in IPO markets, than liability based on the common law of torts. This is more important in Bangladesh, because the culture of litigation under the common law of torts is yet to be developed. At the same time, the passivity of investors in relation to suing under the statutory law for the recovery of their loss or damages resulting from the defective prospectus is clearly evident from the paucity of reported cases. In such circumstances, the expectation for the enforcement of liability under the common law of torts for prospectuses seems to be unrealistic.

138 In the case in 1998, a total of 20 companies obtained consent from the SEC to float, but only five companies went public and the remaining 15 companies could not float because of the lack of investor confidence in the market. The Managing Director of one of the 15 companies said that ‘[w]e did not take risk to float shares in the depressed market where investors continuously rejected the IPOs’. Two of the five companies which floated were rejected by the investors and another one narrowly escaped undersubscription. See for details, M S Rahman, ‘Many Companies Unwilling to Float IPOs Fearing Undersubscription’ The Daily Star, Dhaka (12 Apr 1998). Further, at the end of 1999, eight insurance companies suspended their plan to go public because of lack of investor confidence in the country’s primary share market: see M S Rahman, ‘Eight Insurance Companies Shelve Their Plans to Go Public’ The Daily Star, Dhaka (12 Dec 1999).
140 La Porta et al (1997) above n1 at 1143.
6.4. Summary and Conclusions

The DBR has emerged to meet the needs of the developed markets and Bangladesh has adopted the disclosure philosophy following the path of developed markets without any commensurate amendments to the laws pertinent to the prospectus. The foregoing discussion demonstrates that the civil liability regime for the defective prospectus in Bangladesh is ambiguous, unclear and narrow as compared to that of other selected countries, such as the US, the UK, Australia and Canada. This weakness has been measured in terms of the extent of the scope of civil liabilities and, defences available to escape from these liabilities. The analysis shows that the civil liability of auditors, underwriters, lawyers and issue managers for the prospectus is unclear in the current statutory liability provisions in Bangladesh. Even their position in respect of prospectus liabilities has never been clarified by the courts due to the dearth of cases. The existing uncertainty regarding their statutory civil liability is considered to be unfavourable to investor protection in the IPO market. Any ambiguity would help create confusion about the scope and applicability of the law concerned. In recognition of the importance of the role of those professionals and intermediaries involved in the IPO markets, civil liability has been imposed on them in some jurisdictions as has been discussed earlier.

Although liability has been specifically imposed on the directors and promoters of the issuing companies in Bangladesh, the statutory defences have further weakened their liability to compensate the investors.

It is widely conceded that the above professional and intermediary services are fairer in the developed countries as compared to those of many developing and least developed countries. The situation in Bangladesh is worst in respect of transparency, as
is evident from some recent studies. The Berlin based Transparency International has placed Bangladesh at the top of the list of 102 most corrupt countries in the world in the last two years.\textsuperscript{142} In line with the Transparency International, another recent survey conducted by the Centre for Policy Dialogue (CPD), a leading research institution in Bangladesh, reveals a similar finding implying that one of the major impediments to investment in Bangladesh is corruption.\textsuperscript{143} Further, in June 2002, a joint report of the World Bank (WB) and the United Nations Development Program (UNDP) on ‘Bangladesh Financial Accountability for Good Governance’ showed that the country’s accounts and auditing processes still lack transparency and accountability. The report also mentioned that financial management is still not up to international standards.\textsuperscript{144}

Another alarming piece of information which has been published recently is that the various banks and credit unions have disbursed a huge amount of money as loans against the deposition of fake shares of different listed companies. The amount involved was about one billion taka (approximately US$17.5 million) in the period between 1996 and 2000,\textsuperscript{145} whilst the total market capitalisation of the Dhaka Stock Exchange (DSE) was 54 billion taka as of 30 June 2000.\textsuperscript{146} As has been stated in Chapter 5 company officials, amongst others, are also involved in procuring fake shares. Even the business

\textsuperscript{142} In carrying out the survey, Transparency International has used a total of 15 surveys from nine independent institutions, and at least three surveys from the country concerned: see Transparency International (2002) above n85. See also, ‘TIB Report: Bangladesh Stays Most Corrupt Country for Second Year’ The Bangladesh Observer (29 Aug 2002).

\textsuperscript{143} The other major impediment is violence/terrorism: see ‘Report on CPD Survey’, The Daily Jugantor, Dhaka (28 Aug 2002). The Centre for Policy Dialogue carried out the survey upon the recommendation of the World Economic Forum (WEF) as a test of eligibility to take part in the 2003 Competition of World Economic Forum. The survey report of the CPD was released just a day ahead of the report of the Transparency International.


leaders themselves have testified that corruption has been eating away the economic growth of the country.\textsuperscript{147}

It goes without saying that the current chronic lack of investor confidence in the securities market in Bangladesh is the result of the various malfeasant practised by companies in collaboration with their intermediaries and professionals.\textsuperscript{148} Despite this reality, the statutory civil liability of the professionals and intermediaries involved in corporate fund raising process is unclear and uncertain. Although, civil liability may be imposed on them under the common law of torts, the implications for the liability under the common law have been shown to be insignificant for investor protection. Hence, statutory liability is considered to be of paramount importance for the protection of investors. The uncertainty surrounding the liability of the professionals and intermediaries working with the IPO coalition displays legal lacunae with regard to the liability for the prospectus. The obligation created by law for securities regulation must be clear and ‘easily understandable’.\textsuperscript{149}

The shortcomings of the CA’94 in imposing liability on the members of the IPO coalition in association with a wide range of defences provided by both the statutes and the common law have made the whole liability regime difficult to enforce.

In addition, the investors’ onus of proof of their reliance on the prospectus and the loss or damage was caused by the untrue statement included in the prospectus have been further impediments to the recovery of compensation for their investments in an IPO. The fact that this onus has not been imposed on the investors in some developed jurisdictions has been discussed.


\textsuperscript{148} For a SEC rule which was aimed at combating unacceptable nexus between the issuers and their auditors, see section 5.3.1.
The ambiguity of the law in imposing liability for the contravention of disclosure requirements, provisions for the broad scope of defences and difficulties in proving the onus imposed on investors have ultimately lessened the usefulness and the scope of the application of prospectus liabilities in Bangladesh. As a consequence, the civil liability regime has appeared to be inappropriate for the DBR. It is to be taken into account that the '[l]aw's effectiveness depends initially on its drafting, and later on the interpretation given to it by judges and commentators'. The drawbacks of criminal liabilities will demonstrate further weaknesses of the law relating to the prospectus. With this end in mind, the next chapter will investigate the provisions of criminal liabilities for the contravention of disclosure requirements in the IPO market in Bangladesh.


Chapter 7

Criminal Liabilities for Defective Prospectuses in Bangladesh

7.1. Introduction

The previous chapter demonstrated the drawbacks of the civil liability regime for a defective prospectus in Bangladesh. This chapter will endeavour to show the flaws of the criminal liability provisions in dealing with a ‘defective prospectus’\(^1\) from the perspective of investor protection. Chapter 6 argued that the imposition of civil liability on the issuing company would not be of real help for the investors. In line with those arguments, this chapter will also concentrate on the liability of individuals associated with the preparation of a prospectus rather than with the company itself. This is because, the remedies under criminal liability are usually either imprisonment or fine which comes as a penalty. A company cannot be jailed, and fines have to be paid out from the fund of the entity in which the shareholders have a legal residual claim. Fines will go to the relevant governmental authority and the investors will not get any financial benefits from those fines. From that point of view, the criminal liability of the company will ‘harm’ the investors, instead of benefiting them. This is so because, any decrease in the assets of the company by the payment of a fine will ultimately reduce the amount of the residual claim of the investors. Moreover, such an obligation of the company seems more likely to save the individuals from their liability for committing

\(^1\) In this chapter, the expression ‘defective prospectus’ refers to those prospectuses which include untrue, misleading, fraudulent or deceptive information or omit to include material information in a prospectus.
wrongs than to deter them. But the stated objective of securities laws is to protect investors and to deter the misfeasance which is perpetrated by individuals. Therefore, the imposition of liability on individuals involved in the preparation of a prospectus is the preferred approach. This chapter will thus focus on the criminal liability of those persons and exclude the concern for the liability of the issuing company itself. The imposition of appropriate liabilities on the members of an IPO coalition and proper enforcement thereof will generate motivations amongst the investors for investment with a spirit that their investment will have no probability of bad outcomes.

The discussion in this chapter will be divided into four sections. Section 7.1 provides an introduction and section 7.2 will explain the objectives of the imposition of criminal liability for a defective prospectus. Section 7.3 will explore the various aspects of criminal liability for a prospectus and section 7.4 will deal with the analysis of the issues and some concluding remarks.

From the viewpoint of investor protection, liability provisions will be examined as follows: persons liable for a defective prospectus, penalties that can be awarded for the contravention of disclosure requirements, and defences available to escape criminal liability.

7.2. Objective of Criminal Liability

The main objective of criminal liability for a defective prospectus is the creation of deterrence for the potential violators of the disclosure requirements. The term ‘deterrence’ is defined as the avoidance of a particular action or omission through fear

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3 See ibid.
of the perceived consequences.\(^5\) In order to deter certain undesirable conduct, the
criminal law has traditionally imposed some sanctions which include imprisonment,
fines or penalties, and the stigma of criminality. Early criminological theory suggests
that ‘sufficiently repugnant punishments will inhibit individuals from committing
crimes’.\(^6\) The current literature submits that people can be deterred by criminal
sanctions.\(^7\) Even one writer in respect of corporate misfeasance says that ‘[a]t present,
criminal penalties are the only viable deterrent’.\(^8\) In support of those propositions, the
recent evidence reveals that ‘a substantial deterrent effect [of criminal liability] is much
firmer than it was two decades ago’.\(^9\)

With a view to reducing crimes through judicial and extra-judicial means, recent
studies devised six categories of remedial measures for policy purposes. One of the
most important of these measures is incapacitation of the offenders to commit crimes
usually through imprisonment or capital punishment.\(^10\) Fines are also regarded as an
effective deterrent to prevent crimes.\(^11\) Although criminal sanctions in penal law may be
seen as controversial in a general sense, their effectiveness has been persuasively argued

\(^{4}\) R Schwartz, ‘Legal Regime, Audit Quality and Investment’ (1997) 72 The Accounting Review 385
at 397.

\(^{5}\) See generally, D Beyleveld, ‘Identifying, Explaining and Predicting Deterrence’ (1979) 19 British
Journal of Criminology 205 at 205-24.

\(^{6}\) D L MacKenzie, ‘Criminal Justice and Crime Prevention’ in L W Sherman, D Gottfredson, D
Promising (1997)- A Report to The Untied States Congress by the National Institute of Justice, United States at 9-11.

\(^{7}\) A V Hirsch, A E Bottoms, E Burney and P O Wikstrom, Criminal Deterrence and Sentence

\(^{8}\) S Calkins, ‘Corporate Compliance and the Antitrust Agencies’ Bi-Modal Penalties’ (1997) 60
Law & Contemporary Problems 127 at 165.

\(^{9}\) D S Nagin, ‘Criminal Deterrence Research at the Outset of the Twenty-First Century’ (1998) 25

\(^{10}\) Id at 9-12
as deterrence to corporate crimes. Similarly, to combat the offences concerning securities, Calkins argues that 'as a matter of theory and fact, penalizing individuals is singularly effective'. It has been further argued that crimes could be deterred by punishing either the company or its officers. It is probably a sound proposition to have criminal liability hand in hand with civil liability as a means of deterring offenders from violating disclosure requirements as well as remedying the investors' grievance. For example, in Australia, criminal sanctions are emphasised for securities regulation 'with additional remedies being available' to the securities regulator as well as civil liability to the injured persons. It is widely recognised that 'investors are best protected' by a criminal liability regime that is based on deterrence.

All of the above findings underpin that criminal sanctions are necessary to create deterrence. The objective of imposing criminal liability for a defective prospectus is thus to deter the persons violating rules in the preparation of disclosures for an IPO.

7.3. Criminal Liability

Criminal liability for a defective prospectus has been imposed under the Companies Act 1994 (CA'94) and the Public Issue Rules (PIR'98) in conjunction with the Securities and Exchange Ordinance 1969 (SEO'69) in Bangladesh.

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15 Id at 1374.
7.3.1. Criminal Liability under the *Companies Act 1994*

Sections 146 and 147 of the CA’94 deal with criminal liability for a defective prospectus. These two sections create liability respectively for an ‘untrue statement’ in a prospectus which fraudulently induces people to invest their money. Neither of the sections imposes liability on the issuing company. The above sections impose liability on individuals but the identities of the individuals who are potentially liable for a defective prospectus are unclear. This will be examined in the following section.

### 7.3.1.1. Persons Liable for Untrue Statements in a Prospectus

Section 146(1) of the CA’94 provides for penalties for the inclusion of any untrue statement in a prospectus. This section imposes liability on ‘every person who authorised the issue of the prospectus’, but the section does not provide any explanation for individuals who fall within its scope of application. It is therefore unclear as to who is actually liable under this section.

In construing the expression ‘authorise or cause the issue’ judicial decisions of some common law jurisdictions in the same context have expressed the view that directors will be liable for the authorisation of a prospectus. Along with the directors, promoters are also liable. This is so because, it is generally agreed that the term ‘promoter’ is used only for the purpose of the prospectus. A promoter identifies the first

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18. The meaning of the untrue statement in respect of a prospectus has been described in s143. According to that description: ‘(a) statement included in a prospectus shall be deemed to be untrue, if the statement is misleading in the form and context in which it is included; and (b) where the omission from a prospectus of any matter is calculated to mislead, the prospectus shall be deemed in respect of such omission to be a prospectus containing untrue statement’.

directors of the company and brings the entity into existence.\(^{20}\) In *Weavers Mills Ltd v Balkis Ammal* the court held that ‘certain fiduciary duties have been imposed’ on the promoters.\(^{21}\) Thus in respect of fiduciary duties, directors and promoters are treated equally and promoters are liable together with the directors.\(^{22}\) Hence, it appears that only the directors and promoters may be penalised under s146(1) of the CA'94. The liability of auditors, lawyers, underwriters and issue managers is uncertain.

Section 146(2) of the CA'94 makes their position more ambiguous by saying that:

A person shall not be deemed for the purpose of this section to have authorised the issue of a prospectus by reasons only of his [or her] having given-
(a) the consent required by section 137\(^{23}\) to the inclusion therein of statement purporting to be made by him [or her] as an expert; or
(b) the consent required by sub-section (4) of section 138\(^{24}\).

According to s139(2) of the CA'94, the term ‘‘expert’’ includes an engineer, a valuer, an accountant and any other person whose profession gives authority to a statement made by him [or her]’. It is again ambiguous, because the CA'94 does not stipulate the professions which fall within the ambit of the professions implied in s139(2). On the other hand, s138(4), as referred to in s146(2)(b), provides that the prospectus will not be registered by the Registrar of the Joint Stock Companies (RJSC) unless, amongst other persons, the respective auditors, legal advisers and attorneys of the company give their consent in writing on the registration of the prospectus.\(^{25}\) Thus s146(2)(b) in


\(^{21}\) (1969) AIR (Madras) 462 at 469.

\(^{22}\) See Agarwal et al (2001) above n20 at 638.

\(^{23}\) Section 137 is as follows: ‘Expert’s consent to issue of prospectus containing statement by him [or her]: - A prospectus inviting persons to subscribe for shares in or debenture of a company and including a statement purporting to be made by an expert may be issued, if—
(a) he [or she] has given his [or her] written consent to the issue thereof, with the statement included in the form and context in which it is included, and has not withdrawn such consent before the delivery of a copy of the prospectus for registration; and
(b) another statement that he [or she] has given and has not withdrawn his [or her] consent as aforesaid appears in the prospectus’.

\(^{24}\) Section 138(4) is discussed below the quotation.

\(^{25}\) The RJSC has been discussed in section 4.3.5.
conjunction with s138(4) imply that the auditors and lawyers are not liable for their consents to the prospectus under s146(1).

The corresponding provision in India, s63 of the Companies Act 1956 (CA’56) is exactly the same as s146 of the CA’94. However, s47 of the Companies Act 1965(CA’65) of Malaysia is partially different from s146 of the CA’94. Under s47(2) of the CA’65, experts are not deemed to have authorised or caused the issue of a prospectus, and therefore are not liable for a defective prospectus. The section does not explain the position of other participants such as auditors, lawyers, underwriters and issue managers. No judicial pronouncements by the Malaysian courts with regard to the criminal liability of these other participants are available.

The enforcement of any liability regime depends greatly on the identification of the persons who are liable for a particular offence. Ambiguities with regard to the identity of the persons who should be liable for an alleged contravention of disclosure requirements tend to give advantage to wrongdoers. All such uncertainties preclude the investors from access to justice and inhibit the prosecutors and regulators from taking punitive actions against the contravention of the disclosure regulations. Although the laws of Bangladesh, India and Malaysia are ambiguous in this regard, there are statutes which have more certainty in relation to the imposition of criminal liability for a defective prospectus on the persons involved in an IPO coalition. These are the laws of other jurisdictions and will be discussed later in section 6.3 in this chapter. In the meantime, all other pertinent provisions currently in operation in Bangladesh will be examined to determine whether or not any securities law imposes criminal liability for defective prospectuses.
7.3.1.1.1. Penalty for Untrue Statements in Prospectuses

In addition to the ambiguity of the scope of application of s146 of the CA’94 in identifying potentially liable persons as stated above, the section provides for much lesser penalties as compared with its counterparts in other jurisdictions such as India and Malaysia. The penalties stipulated under s146(1) are imprisonment for a term not exceeding two years or a fine which may extend to 5,000 taka (approximately US$88) or both. In terms of imprisonment, s63 of the CA’56 of India is identical to the above s146(1), but largely different in respect of fines. For example, the fine under s63 of the CA’56 may extend to 50,000 rupees (approximately US$1,035) as opposed to only US$88 in Bangladesh. At the discretion of the court, the fine may be lower than this small fixed amount. The corresponding laws of Malaysia are far more stringent than those of Bangladesh and India. Section 47 of the CA’65 prescribes for imprisonment of five years and a fine of 0.10 ringgit (approximately US$26,330). The figures clearly show that the maximum pecuniary penalty in Bangladesh is too little to be a penalty having deterrent effect for an offender in the true sense. Similarly, the laws in Bangladesh are ‘soft’ in terms of the term of imprisonment too. For example, the judge in Bangladesh may punish an offender under s146(1) with imprisonment for any term not exceeding two years. But in Malaysia, the penalty has to be exactly five years. Its Indian counterpart is similar to the provision in Bangladesh.

Further, the court in practice may punish any liable person either with imprisonment or with a fine or with both. If the court opts for a fine only, the offender shall have to pay a small amount not exceeding 5,000 taka. In the real sense, therefore it may not be an exaggeration to say that s146 (1) in Bangladesh does not provide for a

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26 The CA’94 is a company law. There are some securities laws which separately deal with the prospectus apart from the company law.
sufficient penalty to work as deterrence. If the court chooses imprisonment, the term may even be less than a day or few hours since there is no minimum threshold limit. Thus the penalty very much depends on the honesty and efficiency of the courts. At the same time, the honesty of the judiciary, especially in the lower judiciary has been a serious concern as reported by the national and international media. Even the judiciary has been described as one of the most corrupt organs of the government. The fact is, that providing wide discretion mentioned above is perceived to be detrimental to the protection of investors.

7.3.1.1.2. Defences against Criminal Liability for Untrue Statements in Prospectuses

Two defences are available to the accused in respect of untrue disclosure in a prospectus under s146. One relies on an objective test and another rests on a subjective test. The objective test requires the accused to prove that the untrue statement which the prosecution has presented is immaterial. There is no explanation or specification of the information which should be regarded as ‘immaterial’ under the CA’94. It is difficult to determine the materiality of a statement and there is no single definition of the term ‘materiality’. From that point of view, the defence is ambiguous and favours the accused. This is so because, according to the general principle of criminal law, any benefit of a doubt helps the accused to escape liability.

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27 In India, the fine was five thousand rupees until the end of 2000. This amount has been substituted by the Companies (Amendment) Act 2000 under s23.
28 Details of the judiciary will be discussed in the next chapter in which the judicial dishonesty and continued erosion of public confidence in the present judiciary will be illustrated.
29 The Berlin based Transparency International found the judiciary as the most corrupt government organ in Bangladesh. Details of the references will be provided in the next chapter.
30 See section 1.7.2. See also R v Rada Corp Ltd (1990) 5 NZCLC 66,624.
The subjective test requires the accused to prove that the accused ‘had reasonable ground to believe and did, up to the time of the issue of the prospectus, believe that the statement [in question] was true’. It is difficult to prove whether or not the person did believe in the truth of the impugned statement.

In the absence of judicial interpretation, it is submitted that an illustrative list of information which can be regarded as ‘immaterial’ would be effective for the purpose of protecting the investors in Bangladesh. Otherwise, the term ‘immaterial’ remains unclear and confusing for the participants in the IPO market. As regards the second defence, that of providing a reasonable ground to believe in the truth of the impugned statement, there is wider scope for the accused to escape criminal liability for producing a defective prospectus. This defence, in other words, implies that the accused can be punished only for wilful disclosure or non-disclosure. The ‘willful’ defence will be examined in section 6.3 in this chapter. It will be shown that this defence has been omitted from the statute in some jurisdictions and the availability of this defence is not considered to be necessary for imposing criminal liability for a defective prospectus. It is thus argued that the defence of personal belief of the accused in an untrue statement serves to protect the accused against the interest of investors.

As a whole, s146 of the CA’94 is an unclear and ambiguous in terms of the identification of persons who are potentially liable for untrue statements in a prospectus. The section is very ‘weak’ or ‘soft’ with regard to penalties as compared with its counterparts in India and Malaysia. Further, defences provided in the section are conducive to potential offenders escaping liability. This is so because of the lack of explanation about the immateriality of information and difficulties of proving the personal belief of the accused in the truth of the untrue statement in question. Taking

31 Companies Act 1994 s146(1).
these factors into account, it can be said that s146 of the CA’94 is not a useful provision for the protection of investors in the IPO market in Bangladesh.

7.3.1.2. Liability for Fraudulently Inducing Persons to Invest in Securities

Section 147 of the CA’94 imposes a penalty for fraudulently inducing persons, inter alia, to subscribe for, or underwriting, shares. The section prescribes penalty for ‘knowingly or recklessly making any statement, promise or forecast which is false, deceptive or misleading’ or any dishonest concealment of material facts to induce any person to invest in securities. In other words, to be punishable under this section, the inducement should be the result of a false, deceptive or misleading statement made knowingly or recklessly; or dishonest concealment of material facts in the prospectus. The most distinctive feature of this section is that, it is not a requirement that a statement or omission must induce a person to invest in securities. The person who is involved in the above prohibited actions or omissions shall be punished merely for attempting to induce another person. Section 147 of the CA’94 is self-explanatory to some extent in respect of its scope in covering various offences. For example, it is an offence to attempt to induce another person to invest his or her money. However, there are some flaws in the section. Those flaws will be analysed in the following discussion.

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32 Section 147 of the CA’94 provides that: ‘Any person who either by knowingly or recklessly making any statement, promise or forecast which is false, deceptive or misleading, or by any dishonest concealment of material facts, induces or attempts to induce another person to enter into, or to offer into-
(a) any agreement for, or with a view to acquiring, disposing of, subscribing for, or underwriting shares or ...; or
(b) any agreement, the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of shares or ..., or by reference to fluctuation in the value of shares or ...; shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to fifteen thousand taka or with both’.
7.3.1.2.1. Persons Liable for Fraudulently Inducing Others to Invest in Securities

Section 147 of the CA’94 does not mention any particular person who is liable under this section. Rather, it imposes liability on a person regardless of their relation with the issuer of securities. It stipulates that any person who is involved in inducing or attempting to induce another person to invest in securities will be punished. A similar provision can be found in the legislation of some developed jurisdictions in imposing criminal liability on wrongdoers in the IPO market. Nonetheless, it is argued that certainty about the persons who are liable for a contravention of the law generally works better than any ambiguity or uncertainty in respect of the identification of the potential accused. Moreover, the enforcement of s147 of the CA’94 will be more convenient for both the judiciary as well as the prosecutors inexperienced in dealing with securities cases in Bangladesh, if the potentially liable persons are categorically mentioned in the section. However, an illustrative list of those persons is more advisable than the exhaustive one, so that unlisted persons, if any, involved in an inducement in question can be included as accused in dealing with a given case. A clear identification of the members of the IPO coalition as potentially liable persons in the legislation would automatically work as an inhibition to the commission of an offence to some extent. It will also be useful for the enforcement the liability enshrined in s147 of the CA’94.

7.3.1.2.2. Penalties for Fraudulently Inducing Others to Invest in Securities

In Bangladesh, a person may be punished with imprisonment for a term which may extend to five years or with a fine which may extend to 15,000 taka (approximately US$263) or with both under s147 of the CA’94. The amount of the fine seems to be
very low to work as deterrence to the wrongdoers as it is discussed above in relation to s145 of the CA’94. The relative smallness of that fine becomes apparent from those of India and Malaysia.

Section 147 of the CA’94 seems to be a true copy of its Indian counterpart, s68 of the CA’56 except for the recent amendment to the amount of fine therein. Section 68 has been amended in 2000 and the maximum fine has been increased from 10,000 rupees (approximately US$207) to 0.10 million rupees (approximately US$2,070). However the term of imprisonment has not been enhanced, and at present, it is exactly same as prescribed under s147 of the CA’94 of Bangladesh.

The CA’65 of Malaysia does not contain any provision which is similar to the above section. However, in this respect, s86 of the Securities Industries Act 1983 (SIA’83) prohibits the inducement of any person to sell or purchase securities knowingly and recklessly by false or misleading statement. Section 86 of the SIA’83 of Malaysia seems to be the equivalent of s147 of the CA’94 and s68 of the CA’56 in Bangladesh and India respectively. Section 88B of the SIA’83 provides for a penalty for the contravention of s86. Unlike its equivalent in Bangladesh, s88B of the SIA’83 prescribes concurrent penalties of fine and imprisonment leaving no option for the court to choose one or the other. Under the above s88B, the penalty may extend to a fine of not less than one million ringgit (US$263,296) and to imprisonment for a term not exceeding 10 years. The distinctiveness of the provisions is evident from the minimum threshold of the fine and the maximum limit of imprisonment. The SIA’83 fixes the minimum fine in Malaysia and leaves the discretion of determining the maximum

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33 See, for example, Securities Act 1933 (US) s24; Corporations Act 2001 (Australia) Parts 6D.3 and 6D.4.

34 Companies (Amendment) Act 2000 s25.
amount of fine with the court. Conversely, the CA’94 of Bangladesh limits the maximum amount of fine and empowers the court to determine the minimum fine.

The penalties for fraudulently inducing persons to invest in securities in the three jurisdictions stated above demonstrate that the Bangladesh law provides for the lowest penalty in terms of both imprisonment and fine for the same offence. The term of imprisonment in Bangladesh is just half of that in Malaysia and the maximum amount of fine is negligible as compared with those in other two countries. The law of Malaysia is significantly stringent being needed to protect the investors in the IPO market. But in Bangladesh, the provision of penalising the accused with any minimum amount of fines without imprisonment should not reasonably have any deterrent effect on the wrongdoers. In addition, the discretion of judges to choose either an insignificant term of imprisonment or negligible amount of penalty may have some frustrating implications on the prosecutors as well as on the investors. Such discretion of judges is not conducive to investor protection as alluded to earlier in respect of s146 of the CA’94.

In addition to the above weaknesses of s147 of the CA’94 Bangladesh, there is an uncertainty about the onus of proof. No judicial interpretation regarding this uncertainty is available in Bangladesh owing to a dearth of prosecution under s147 of the CA’94, although there have been many allegations for fraudulent inducement in respect of public issues. Neither of the identical provisions of s147 of the CA’94 and s68 of the CA’56 explicitly imposes the burden of proof on anyone. In this regard, the Rajasthan

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35 The maximum amount of fine in India is nearly 8 times higher than that in Bangladesh. In Malaysia, the minimum amount of this fine is 979 times higher than that in Bangladesh. Moreover, in Bangladesh, the courts may choose either imprisonment or fine or both, but the courts in Malaysia do not have such a discretion: Securities Industries Act 1983 s88B.

36 Such an implication is, for example, the prosecutors and the victims of the contravention of the law may feel discouraged to take the offenders to the courts.

37 For instances of the violation of prospectus requirements, see section 5.3.1.
High Court in Indian in *Dahanukar v Khaitan* observed that the onus of proof lies on the investors who have been induced by the statement in question under s68. The court held that the complaint could not be admitted as it was not proved that the investment decision of the plaintiff was caused by any fraudulent inducement.\(^{38}\)

In the absence of judicial interpretation by the courts in Bangladesh, the participants in IPO coalitions may have regard to the judicial observations of the Indian courts. Pursuant to the Dahanuka decision, the accused persons will be in advantageous position since the onus of proof is vested in the victims. The onus of proof, thus, ultimately goes against the spirit of the protection of investors. From that point of view, the liability and remedy provided in s147 of the CA’94 have not been an effective recourse to protect investors from the fraudulent inducement for subscribing to, or underwriting of, IPOs in Bangladesh.

**7.3.1.2.3. Defences against Penalties for Fraudulently Inducing Others to Invest in Securities**

There is no statutory defence as such under s147 of the CA’94. However, the terms ‘unknowingly’ and ‘recklessly’ as envisioned in the section in connection with disclosures imply that the defendants under this section have two defences. These include ignorance defence and due diligence defence. In addition, ‘honesty’ may be a defence with regard to omission to disclose any information in the prospectus, because, only ‘dishonest concealment’ has been made an offence under the section. The Indian equivalent of s147, namely s68 of the CA’56, provides for exactly the same defences. In Malaysia, although the wording of s87 of the SIA’83 is little different from that in the

\(^{38}\) (1996) CrLJ 1569 (Raj) at 1575-76.
Bangladesh and Indian legislation, the defences are similar.\textsuperscript{39} Thus, all the three jurisdictions provide for the same three defences for the act of fraudulently inducing persons to invest in securities.

None of the terms, 'unknowingly', 'recklessly' and 'dishonestly' have been defined in any of the above three statutes.\textsuperscript{40} Therefore, the meanings of those terms have to be understood from their ordinary meanings as well as from judicial interpretations.

The Central Criminal Court in \textit{R v Bates} in a similar context held that the word 'recklessness' should be understood in its ordinary meaning and to prove guilt, the word should not be restricted to involving dishonesty.\textsuperscript{41} In this case, the court further explained that '[t]he ordinary meaning of the word reckless in the English language is careless, heedless, inattentive to duty'.\textsuperscript{42} In the present context, the House of Lords in the celebrated case \textit{Derry v Peek} expressed the view that the term 'recklessness' refers to 'carelessness' regardless of the truth or falsity of the impugned statement.\textsuperscript{43} In this respect, Cotton LJ in \textit{Derry v Peek} strongly held that '… a man who makes a statement without care and regard for its truth or falsity commits a fraud'.\textsuperscript{44} The Australian court observed that recklessness is something which is less than 'intent' but more than 'mere negligence'.\textsuperscript{45}

The above case law implies that a person cannot be punished under s147 of the CA'94 unless he or she is careless in inducing or attempting to induce another person to invest in securities. Actually, the term 'recklessness' is a complex word and half a

\textsuperscript{39} See \textit{Securities Industries Act} 1983 (Malaysia) s87(1)(a)-(c).
\textsuperscript{40} \textit{Companies Act} 1994 (Bangladesh), \textit{Companies Act} 1956 (India) and \textit{Securities Industry Act} 1983 (Malaysia).
\textsuperscript{41} [1952] 2 All ER 842 at 845.
\textsuperscript{42} [1952] 2 All ER 842 at 845.
\textsuperscript{43} (1989) 14 App Cas 337 at 350.
\textsuperscript{44} (1889) 14 App Cas 337 at 350.
century ago, the Court in the above-mentioned *R v Bates* pronounced that ‘[r]eck is simply an old English word, now, perhaps, obsolete, meaning heed, concern, or care’.

Further, in *R v Mackinnon*, it was held that ‘...the word “reckless” is capable of either of two rival meanings for which the Crown and the defence respectively contend’. In view of such conflict, Salmon J said that ‘I know of no canon of construction that compels the court to adopt the wider of the two meanings merely because it is the wider’.

From the interpretation of the term ‘knowingly’ as provided by Cockburn CJ in *Twycross v Grant* with regard to the issue of a prospectus, it means ‘neither more or nor less’ than making a statement in a prospectus ‘with a knowledge of the existence of contract’ and ‘the intentional omission of them from the prospectus’. It clearly refers to the exact knowledge of the impugned statement of the person who was involved in the inducement complained of under s147 of the CA’94. By confirming the penalty awarded by the trial court, the Chancery Division in *Tait v Macleay* held that the defendant should have tried to know the fact before making the statements in the prospectus, but he did no inquiries for which judgment in appeal should be affirmed. The ignorance defence is therefore subject to reasonable inquiry.

The term ‘dishonesty’ is commonly ‘associated with lying, stealing or cheating’. In other words, ‘dishonesty’ implies a deliberate choice to flout a known law. In respect of a prospectus, in a context similar to s147 of the CA’94 the court held that:

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46 [1952] 1 All ER 842 at 845.
47 [1959] 1 QB 150 at para 7 (per Salmon J).
48 [1959] 1 QB 150 at para 7 (per Salmon J).
49 [1877] 2 C P D 469 at 542.
50 [1904] 2 Ch 631 at 642.
If the omission is dishonest, it can only be dishonest because the person who makes it known that what he [or she] has said is false, misleading or deceptive by reason of the omission.\

A relation between personal care and honesty is found in *Derry v Peek* in which the court strongly suggests that a statement made not caring whether it be true or false is a dishonest or fraudulent statement as distinct from one which is made with an honest belief in its truth.54

The defence of honesty is thus a subjective test. This test involves individuals’ awareness of the law and related facts embodied in a statement included in a prospectus, and an awareness that the impugned conduct will contravene that law.55 The court in *R v Mackinnon* indirectly conceded the difficulty of proving the non-existence of an honest belief in a forecast of company business (in a prospectus).56 Therefore, the subjective test of ignorance of an accused person would preclude criminal liability, and the restriction on the liability is unacceptable in criminal law. For example Bowen L J in *Hutton v West Cork Railway Co* held that:

*Bona fides* cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly *bonâ fide* yet perfectly irrational.57

In terms of implementation, the above ‘concepts are complex’.58 For the sake of clarity and smooth enforcement, legal provisions should be drafted in simple language.59 Over the decades, the momentum of plain language is bearing its principles into the affairs of

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53 *R v Mackinnon* (1959) 1 QB 150 para 11 (per Salmon J).
54 (1889) App Cas 337 at 350.
56 [1959] 1 QB 150.
57 (1883) 23 Ch D 654 at 671.
corporate investments worldwide.\textsuperscript{60} The demand for plain language in corporate functioning is now regarded as law.\textsuperscript{61} In dealing with the language similar to s147 of the CA'94 which involved inducement to invest in securities, it was observed that ‘...the courts are now slow to construe a statute as creating a criminal offence unless the statute does so in the plainest terms’.\textsuperscript{62} Because of the complexities and terms like- recklessly, knowingly, dishonestly-, the prosecution failed to establish the case for inducement to invest in securities.\textsuperscript{63}

None of the above terms, ‘recklessness’, ‘unknowingly’ and ‘dishonestly’ exits in the relevant laws of many developed countries.\textsuperscript{64} As is evident from the above discussion on the ‘recklessness’, ‘unknowingly’ and ‘dishonestly’ a common ‘reasonable’ inquiry is required before there can be a reliance on such defences. At the same time, a clear and simple language in corporate law has to be ensured. All the above three defences may be substituted by a single ‘due diligence’ defence. The application of the due diligence defence in accordance with the qualifications as analysed in section 6.3.8.2 of Chapter 6 will satisfy the requirement of ‘exercising reasonable care’\textsuperscript{65} and avoid the complexities or obsoleteness of the above three terms as encapsulated in s147 of the CA’94. It can be seen that s147 of the CA’94 as it stands is ambiguous and complex in respect of defences. An ambiguity in law is regarded as an impediment to investor protection.


\textsuperscript{62} \textit{R v Mackinnon} [1959] 1 QB 150 at para 7(Salmon J).

\textsuperscript{63} See for example, \textit{R v Mackinnon} [1959] 1 QB 150.

\textsuperscript{64} See, for example, \textit{Securities Act} 1933 (US) s24; \textit{Securities Act} 1990 (Ontario) ss122-29.
7.3.2. Criminal Liability under the *Public Issue Rule* 1998

In addition to the CA’94 as stated above, the *Public Issue Rules* (PIR’98) contain a penalty provision. Rule 19 of the PIR’98 imposes liability on the issuers and their representatives for furnishing ‘false, incorrect, misleading information or suppressing any information’ required thereunder.66

7.3.2.1. Persons Liable under the *Public Issue Rule* 1998

Although Rule 19 of the PIR’98 imposes liability on the ‘issuer’ of securities and ‘its representative’, it defines neither of the terms. Moreover, it does not only omit to define these terms, it also fails to adopt their definitions from other law(s) in force.

In contradiction to other legislation discussed so far in this chapter, rule 19 of the PIR’98 imposes liability on the issuer. Apart from the rule 19, the issuer’s liability has been limited to rescission of the investment contracts under common law as alluded to briefly in Chapter 6. Although an explanation of issuer’s liability can be found in the *Securities and Exchange Ordinance* 1969 (SEO’69), the expression ‘its representative’ (issuer’s representative) has not been defined in any of the above laws pertinent to the issuance of securities in Bangladesh. Thus rule 19 of the PIR’98 is also unclear and suffers from ambiguities in the identification of persons who are liable under this rule for putting out a defective prospectus. The omission of incorporating the definitions of those two terms is regarded as a vital flaw of the PIR’98. A rule cannot be implemented if its applicability remains at best uncertain.


66 Rule 19 of the *Public Issue Rules* 1998 is as follows: ‘Penalty - If any issuer or its representative violates any of the provisions of this rule or furnishes false, incorrect, misleading information or suppresses any information, the Securities and Exchange Commission may impose penalty as prescribed under the *Securities and Exchange Ordinance* 1969’. 
Rule 19 of the PIR’98 refers to the SEO’69 only for the description of penalties that can be imposed by the Securities and Exchange Commission (SEC) under the PIR’98. Presumably, the definition of the term ‘issuer’ as provided in the SEO’69 should be applicable to impose penalties under rule 19 of the PIR’98. According to s2(g) of the SEO’69 an ‘issuer’ is ‘any person who has issued or proposes to issue any security’. Under s2(j) of the SEO’69, a person includes, amongst others, an individual, a company and every other juridical person. From the above description of ‘issuers’ and ‘persons’ the term ‘issuer’ as used in rule 19 of the PIR’98 embraces both individuals and companies that issue securities. As will be discussed in the next section of this chapter, s24 of the SEO’69 will be applied to impose penalties mentioned in rule 19 of the PIR’98. Section 24(2) of the SEO’69 states that if an issuer is found guilty, then every director, manager or other officer responsible for the conduct of the affairs of the issuer shall be deemed to be guilty unless he or she proves that the offence was committed without his or her knowledge or that he or she exercised all diligence to prevent its commission. The section, thus, imposes liability on directors, managers or other officers of the issuer, but it does not impose any liability on any professionals or intermediaries like auditors, underwriters, lawyers and issue managers. It means that PIR’98 in conjunction with the SEO’69, imposes liability only on the management and the officials of the company. It also implies that the liability is not strict, but is subject to some defences which will be addressed later in section 7.3.2.3 below.

The Indian securities law dealing with the criminal liability for disclosures in a prospectus is different. Section 15A of the Securities and Exchange Board of India 1992 Act (SEBIA’92) imposes penalty on any person who is required under the securities laws to furnish any document, return or report to the Securities and Exchange
Board of India Board (SEBI). A company is required to submit its prospectus to the SEBI for its (SEBI) consent before making any public offer of securities. Therefore, any person as mentioned in the above §15A may refer to the company and its representative.

The Securities Commission (SC) of Malaysia promulgated the *Policies and Guidelines on Issue/Offer of Securities 1999* (Guidelines’99) as guidelines for the issuance of securities. Chapter 6 of the Guidelines’99 deals with the corporate disclosure policy for a public issue. Section 55 of the *Securities Commission Act 1993* (SCA’93) imposes criminal liability for a defective prospectus in Malaysia. The section provides that ‘[n]o person shall authorise or cause the issue of a prospectus’ with a false or misleading statement or material omission in its contents. Section 55 does not specify the persons who shall be deemed to have ‘authorised or caused the issue of the prospectus’. The absence of the explanation of the expression ‘authorised or caused the issue of a prospectus’ in the Malaysian law brought about ambiguity in relation to the identification of persons liable for offence under s55 of the SCA’93 as has been discussed earlier.

A clear identification of persons who are liable for a particular violation of the law is always crucial for the facilitation of the remedy of that wrong. The prevalence of the inexperienced judiciary in adjudicating securities cases and the lack of experience of the regulator in dealing with securities malpractice are additional factors that provoke soliciting for clear laws in Bangladesh. The clarity of the law appears to be more important for the market for IPOs, where public confidence in the operation of the

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67 Details of §15A of the SEBI’92 as well as criminal liability under the securities law will be provided later in this chapter.

68 In brief, similar to Bangladesh and India, a public company in Malaysia is required to make full disclosure of the affairs of the issuer and the issue. See *Policies and Guidelines on Issue/Offer of Securities 1999* guideline 6.01. Section 44 and 46 of the *Securities Commission Act 1993* (SCA’93) stipulate the information that needs to be included in a prospectus.
market is essential. Any legal ambiguity or vagueness creates confusion amongst the public. In regard to criminal liability, any scope for doubt protects the offenders at the expense of the legitimate interests of investors.  

7.3.2.2. Penalties for Defective Prospectuses under the Securities Law

As has been mentioned above, the PIR'98 does not provide any description of the penalties. Instead, its rule 19 states that the SEC may impose a penalty as prescribed under the SEO'69 for the contravention of any of the provisions of the PIR'98. As regards the disclosure requirements, only the disclosure of ‘false, incorrect, misleading information or suppression of any information’ has been identified as offences under rule 19. The SEO’69 provides for penalties for some of the above mentioned wrongs (discussed below). In addition to these, the SEO’69 makes fraudulent or deceptive inducements in relation to securities trading punishable but the PIR’98 does not prohibit such conduct. The mentioned exemption from penalty under the PIR’98 has implications for investors in IPOs and appears to be another shortcoming that exists in the PIR’98.

The SEO’69 does not directly refer to the penalty for the violation of the PIR’98. However, the SEO’69 contains two sections (ss22 and 24) with regard to the penalties for the violation of securities laws, but neither of the two sections directly relates to the

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69 The Securities and Exchange Commission (SEC) of Bangladesh is made up of some high profiled bureaucrats and university academics. None of them was involved in the activities of the securities market. Details of the SEC will be discussed in Chapter VIII.

70 The offenders get advantage pursuant to the general principle of criminal law that the benefit of doubt goes in favour of the accused

71 Securities and Exchange Commission 1969 s17(d).

72 The PIR’98 provides for administrative penalties, whilst the CA’94 refers to judicial remedies. Therefore, they both are in place as complementary to each other.
disclosures in a prospectus. Section 22\textsuperscript{73} seems to be applicable to the regulation of the secondary market. If any person is penalised under this section, no prosecution can be lodged for the same offence committed against the SEO’69. Section 24 provides for penalties for the contravention of s17 of the SEO’69.

Section 17 basically prohibits fraudulent and some ancillary acts in relation to the sale or purchase of securities. Of these, only the disclosure of untrue statement\textsuperscript{74} and suppression of fact\textsuperscript{75} fall into the previously mentioned exhaustive description of offences provided in rule 19 of the PIR’98. On the other hand, the disclosure of misleading information has not been listed in s17, although it has been prohibited under rule 19 of the PIR’98.

Therefore, only the disclosure of untrue statement and non-disclosure of known facts regardless of their materiality are punishable under rule 19 of the PIR’98 in conjunction with s17 of the SEO’69. For these two offences, a person may be punished with imprisonment which may extend to five years or with a fine which shall not be less than 0.50 million taka (approximately US$8,772) or with both\textsuperscript{76}.

\textsuperscript{73} ‘Penalty for certain refusal or failure:- (1) If any person-(a) refuses or fails to furnish any document, paper or information which is required to furnish by or under this Ordinance; or (b) refuses or fails to comply with any order or direction of the Commission made or issued under this Ordinance; or (c) contravenes or otherwise fails to comply with the provisions of this Ordinance; the Commission may, if it is satisfied after giving the person an opportunity of being heard that the refusal, failure or contravention was willful, by order direct that such person shall pay to the Commission by way of penalty such sum no exceeding ten thousand rupees as may be specified in the order and, in the case of a continuing default, a further sum calculated at the rate of one thousand rupees for every day after the issue of such order during which the refusal, failure or contravention continues’. The word ‘Commission’ has been substituted for ‘Central Government’ in 1993 under s2 of the Securities and Exchange (Amendment) Act 1993. Penalties have been increased in 2000 by substituting ‘not less than 0.10 million taka’ for ‘not exceeding 0.10 million taka’. The previous maximum fine 0.10 million taka was fixed under s8 of the Securities and Exchange (Amendment) Act 1993.

\textsuperscript{74} Securities and Exchange Ordinance 1969 s17(b).

\textsuperscript{75} Securities and Exchange Ordinance 1969 s17 (c).

\textsuperscript{76} The penalty was increased from three years’ imprisonment to five year and a fine from 10 thousand rupees to 0.50 million taka in 2000 under s9 of the Securities and Exchange Act 1993. Rupee is the currency of Pakistan and the SEO’69 was promulgated by the then President of Pakistan when Bangladesh was the eastern province of the federal Pakistan. It was amended again under s6 of the
The penalty provisions under the securities law in India are different from those in Bangladesh. Chapter VI of Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines 2000 (SEBI Guidelines 2000) sets out the contents of prospectuses. The SEBI Guidelines 2000 does not include any penalty provision for the violation of prospectus requirements. However, the penalty for any violation of disclosure requirements has been provided in s15A of the Securities and Exchange Board of India Act 1992 (SEBA’92). Section 15A of the SEBIA’92 provides that:

If any person, who is required under this Act or any rules or regulations made hereunder, (a) to furnish any document, return or report to the Board [Securities and Exchange Board of India], fails to furnish the same, he[or she] shall be liable to a penalty not exceeding one lakh and fifty thousand rupees [0.15 million rupees/approximately 3,108 US dollar] for each such failure.

The SEBI Guidelines 2000 has been issued by the SEBI itself under the authority of s11 of the SEBIA’92. The above penal provisions are therefore applicable to penalise the violators of the disclosure requirements under the SEBI Guidelines 2000.

In Malaysia, s55(3) of the SCA’93 seems to be the equivalent of the above-mentioned provisions of Bangladesh and India. Penalties for the contravention of prohibitions as set forth in s55(3) are fines not exceeding 3 million ringgit (approximately US$789,785) or imprisonment for a term not exceeding 10 years or both.

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78 Section 15A of the SEBIA’93 has been inserted by Securities Laws (Amendment) Act 1995.


80 This applicability is understood on the basis of the fact that companies willing to go public are required to submit their prospectuses to the SEBI for its consent before the issuance of their prospectuses as has been mentioned earlier.

81 As mentioned in section 6.3.1.2.1, s55 of the Securities Commission Act 1993 has created criminal liability for a defective prospectus.

82 Securities Commission Act 1993 s55(3).
As has been seen in respect of penalties under company law, the penalty under the PIR'98 in conjunction with the SEO'69 in Bangladesh is also very low as compared with that of Malaysia.\(^{83}\) However, the actual penalty greatly depends on the honesty and dignity of the court having wide discretion in this regard.

### 7.3.2.3. Defences against Criminal Liability for Defective Prospectuses under the Securities Law

Rule 19 of the PIR’98 does not mention any defence against offences concerning disclosures in a prospectus. However, two clear defences are available in s24(2) of the SEO’98. Those defences are: commission of the offence without the knowledge of the accused, and exercising all diligence to prevent the commission of the offence. Simply, the defences are ‘ignorance’ and ‘due diligence’. The Chancery Division in *Broome v Speak* held that ignorance of the law can never be pleaded as a defence and knowledge always refers to the knowledge of the facts.\(^{84}\) In *Tait v Macleay* it was said that in respect of a company prospectus that the defendants need to conduct inquiries before they include any information in a prospectus.\(^{85}\) The Chancery Division in *Watts v Bucknall* observed that without further inquiry about the facts included in the prospectus, the defendant cannot claim the ignorance defence and here (without inquiry) the defendant is said to have prepared the prospectus with knowledge of the facts.\(^{86}\) In *Tait v Macleay*, the Court of Appeal held that a person cannot properly claim ignorance

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\(^{83}\) In Bangladesh, the maximum term of imprisonment for issuing a defective prospectus is five years, but is 10 years in Malaysia. Courts have been given discretion in both jurisdictions to fix the pecuniary penalties depending on the merits of each case. In Bangladesh, the penalty is not less than 0.50 million taka (approximately US$8,772), and in Malaysia it should not exceed 3 million ringgit (approximately US$789,785).

\(^{84}\) [1903] 1 Ch 586 at 613-14.

\(^{85}\) [1904] 2 Ch 631 at para 2 (per Cozens-Hardy LJ).

\(^{86}\) [1902] 2 Ch 628 at para 3(per Byrne J).
of a fact to which he or she has not directed his or her attention. The above judicial observations imply that ignorance defence cannot be relied upon without reasonable care. This defence has thus become a part of the due diligence defence in practice.

In India, s15A the SEBIA'92 provides for a penalty for the contravention of, inter alia, the disclosure requirements in a prospectus as alluded to earlier. The section offers no defences in respect of disclosures.

In Malaysia, the criminal liability for disclosures as set forth in s55 of the Securities Commission Act 1993 (SCA'93) is subject to the three standard defences. These defences are: withdrawal of consent (s63) due diligence (s59), expertisation (s60). The applications of all of these defences have been analysed in Chapter 6 in the discussion of civil liabilities. That analysis is equally relevant to criminal liabilities too in respect of reliance on those defences by the defendants.

The foregoing demonstrates that the 'ignorance defence' is available only in Bangladesh. The impact of that defence greatly depends on the honesty of the defendants and the way the courts deal with the pleading of ignorance by the defendants. If the courts allow the defendants to rely on the ignorance defence only after proving due care, such a defence can be used in respect of criminal liability. It is submitted that in Bangladesh, the requirement of reasonable care should be placed in the statute so that the non-availability of case law would not imply that there is no necessity for such a requirement.

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87 [1904] 2 Ch 631 at para 2 (per Cozens-Hardy LJ).
88 For details, see the text of s15A of the SEBIA'92.
89 The honesty and dignity of the courts in dealing with such ignorance defence have been emphasised.
7.3.3. Criminal Liability of Professionals and Intermediaries for Defective Prospectuses

As can be seen from the above discussion, the laws of Bangladesh creating criminal liability for a defective prospectus are unclear about the identification of persons on whom criminal liability is imposed. The provisions of company law and securities laws impose liability on ‘every person who authorised the issue of the prospectus’ and on ‘the issuer or its representative’ respectively without defining these imprecise expressions. However, the criminal liability of directors and promoters is certain in view of judicial interpretations referred to earlier. Thus ambiguities exist in respect of the liability of other members of an IPO coalition.

In Australia, to provide for criminal liability for a defective prospectus, the expression ‘authorise or cause the issue’ was used in s996 of the Corporations Act 1989 (Cth). Taking the ambiguity of the meaning of this expression into account, the Prospectus Law Reforms Sub-Committee of the Companies and the Securities Advisory Committee recommended specific mentions of the persons who are criminally liable for a defective prospectus. Section 996 was repealed in the 2000 legislation and the expression ‘authorise or cause the issue’ has been dropped in the relevant present

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90 The reasons for such apprehension are that both the bar and bench are inexperienced in dealing with securities cases and the judiciary significantly relies on the case law of the Indian sub-continent. It would be very hard to find case law in relation to the above references in the sub-continent.

91 See Adams v Thrift [1915] 2 Ch 21; Henderson v Lacon [1867 L R 5 Eq 249; Barrow v De Garis (1926) 29 WALR 4; Flavel v Giorgio (1990) 2 ACSR 568; Stewart v Montgomery (1967) 116 CLR 220.

provisions in the *Corporation Act* 2001. Likewise, the *Securities Act* 1933 of the United States (US) has deleted a similar expression because of its ambiguity.

In support of the imposition of criminal liability on the persons involved in the preparation of a prospectus, it has been said that ‘[i]n the interest of effective deterrence and fairness, ... a parallel set of criminal sanctions against individuals, including jail sentences, should remain as a supplement to the set of civil fines’. The rationale for the imposition of criminal liability on the professionals and intermediaries is similar to that for the imposition of civil liability in Chapter 6.

Under the Disclosure-Based Regulation (DBR) the members of the IPO coalition are required to meet in preparing disclosures in a prospectus. This requirement implies the regulatory objective that the participants not only compile but also verify the disclosure materials. The standard of corporate disclosure for IPOs will not be raised adequately unless the participants in that process have effective incentive to disclose the required information. From that point of view, it has been argued that all major participants should face penalties for the non-compliance with the disclosure requirements.

The criminal liability of the members of issuer, underwriters, accountants, attorneys and other professionals or technical persons for a defective prospectus has been clearly mentioned in s32 of the *Securities and Exchange Law* 1968 (SEL’68) of Taiwan. Under s32 of the SEL’68, the issuer is strictly liable and the others’ liabilities are subject to

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93 The provisions of the *Corporations Act* 2001 concerning prospectus liability will be discussed later in this section.
95 ‘Developments in the Law - Corporate Crime (1979) above n14 at 1374.
97 Ibid.
98 Id at 119.
due diligence. The laws of some other jurisdictions such as the US and Australia do not specifically mention by any name who should be held criminally liable for a defective prospectus. Instead, the Securities Act 1933 (US) and the Corporations Act 2001 (Australia) imposes criminal liability on every person who is involved in the violation of disclosure requirements.\textsuperscript{99} Those two Acts have used two different terms which are 'any person'\textsuperscript{100} and 'a person'\textsuperscript{101}. The expression 'any person' or 'a person' seems to be much wider in ambit than 'who authorised the issue of prospectus' as used in s146 of the CA'94 in Bangladesh.\textsuperscript{102} This is because, the expression 'any person' or 'a person' emphasises the involvement or participation of a person in the preparation of the disclosure documents, whereas the term 'who authorised the issue of the prospectus' underscores the involvement in the authorisation of the prospectus. Due to a lack of statutory as well as judicial exposition of the latter expression, the imposition of liability has become uncertain.

Criminal liability under rule 19 of the PIR’98 has been confined to only the issuer and its representative. The shortcomings of that rule can be seen in the light of what is said above especially regarding the above s32 of the SEL’68 (Taiwan).

In respect of criminal liability for dealing with securities, the US courts took the issue of involvement in the preparation of a prospectus into account as a crucial consideration.\textsuperscript{103} For example, in the US Court of Appeal for the Ninth Circuit underscored the need for participation in the alleged offence in order to establish a

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\textsuperscript{100} This term has been used in s24 of the Securities Act 1933 (US).

\textsuperscript{101} The expression 'a person' has been used in ss726-36 of the Corporations Act 2001 (Australia).

\textsuperscript{102} Section 146 of the CA '94 provides penalty for untrue statement in a prospectus.

prima facie case against the accused. A similar view was taken in Christoffel v Hutton & Company. As can be seen in Chapters 1 and 6, the underwriters, issue managers, auditors and lawyers are very much involved in the preparation of a prospectus. It is said that civil liability of these persons ‘supplemented with criminal enforcement is probably the superior rule’. What this means is that the above mentioned persons involved in the preparation of a prospectus should also be liable criminally. However, the issuers’ liability is strict having no defence, but the above-mentioned persons have a defence to act in good faith, ie, the violation in question was not ‘wilful’. In construing the term ‘willful’ in the present context, the court in United States v Schwartz said that a violation is wilful even if there is no ‘bad purpose’ or no ‘specific intent to violate the law’. In a similar context, the Court of Appeals of Arizona in State v Tarzian construed the term ‘wilfully’ by saying that:

...when applied to the intent with which an act is done or omitted, implies simply a purpose or willingness to commit the act, or make the omission referred to. It does not require any intent to violate law, or injure another or to acquire any advantage.

The requirement for ‘willful violation’ had been omitted in 1998 (under s44-1992) from the Securities Act of Arizona 1951 although the requirement still persists in the Securities Act 1933 (the US federal law). Thus the criminal liability has been made strict without any defence in Arizona since 1998 providing better protection to the investors. The rationale for the criminal liability of the professionals and intermediaries is further amplified from the following judicial pronouncements that will complement

104 Kersh v General Council of the Assemblies of God 804 F 2d 546 (1986) at 449.
105 588 F 2d 665 (1978) at 668.
107 Court interpreted the term ‘wilfully’ under s32(a) of the Securities Exchange Act 1934 (US) and criminal liability provisions are analogous to s24 of the Securities Act 1933 (US).
109 665 P 2d 582 (1983) at 585.
those arguments which have been advanced in Chapter 6 in the discussion of civil liabilities.

In respect of lawyers, it was said in *Mercer v Jaffee* that a lawyer is a primary participant in the offering of corporate securities.\(^{110}\) In *SEC v Spectrum Ltd* Irving R Kaufman CJ in considering the liability of lawyers observed that:

> The securities laws provide a myriad of safeguards designed to protect the interests of the investing public. Effective implementation of these safeguards, however, depends in large measure on the members of the bar who serve in an advisory capacity to those engaged in securities transactions.\(^ {111}\)

His honour further stated that ‘the legal profession plays a unique and pivotal role in the effective implementation of the securities laws’. The smooth functioning of those laws will be seriously interrupted if the public cannot trust in the expertise proffered by the attorneys when they render opinions in relation to the compliance with securities laws.\(^ {112}\)

The most influential judicial decision on the liability of lawyers was made perhaps in *Escott v BarChris Construction Corp* in which the US District Court for the Southern District of New York pointed out that a lawyer is obliged to make reasonable investigation about the information included in the prospectus. The court went on to say that the failure of such investigations exposed lawyers to liability because they hold the ‘unique position’ for assuring the accuracy of the disclosures.\(^ {113}\) In *United States v Benjamin*, the US Court of Appeal Second Circuit rejected the defence of ignorance claimed by the lawyer involved in the offering process of securities.\(^ {114}\) The US District Court for the District of Oregon in *Blakely v Lisac* made an attorney liable for drafting

\(^ {110}\) 713 F Supp 1019 (1989) at 1025.

\(^ {111}\) 489 F 2d 535 (1973) at 536.

\(^ {112}\) *SEC v Spectrum Ltd* 489 F 2d 535 (1973) at 541-42.

\(^ {113}\) 283 F Supp 643 (1968) at 690,692.

\(^ {114}\) 328 F 2d 854 (1964) at 856.
the prospectus and other disclosure documents which contained misleading financial information. \(^{115}\) In that case it was also said that the attorney should have investigated the truth of the information set forth in the prospectus. \(^{116}\) In another case the US Court of Appeal for the Second Circuit clearly concluded that lawyers preparing disclosure documents for securities offerings owe 'a duty of disclosure to investors'. \(^{117}\) Another court imposed primary liability on the lawyers for false and misleading information in the securities offering document and suggested that a lawyer who prepares a misleading disclosure document is a primary participant in the offering of securities by a company. \(^{118}\)

The US Securities and Exchange Commission (SEC) emphasised several times that the task of enforcing the securities laws overwhelmingly rests on the lawyers. \(^{119}\) The SEC further added that when a lawyer has a significant role in fulfilling the disclosure requirements and the issuer fails to provide adequate information, then the lawyers' continued involvement in the preparation of the prospectus constitutes 'unethical or improper professional conduct'. \(^{120}\) The US Court of Appeal for the Second Circuit in *SEC v Frank* rejected the lawyer's claim-'I am only a scrivener'- by stating that:

> A lawyer has no privilege to assist in circulating a statement with regard to securities which he [or she] knows to be false simply because his [or her] client has furnished it to him.... [A] lawyer, no more than others, can escape liability from fraud by closing his [or her] eyes to what he [or she] saw and could readily understand. \(^{121}\)

The above case law vividly establishes the criminal liability of lawyers in respect of a defective prospectus.

\(^{115}\) 357 F Supp 255 (1972) at 266

\(^{116}\) 357 F Supp 255 (1972) at 266

\(^{117}\) *Breard v Sachnoff & Weaver Ltd* 941 F 2d 142 (1991) at 143.

\(^{118}\) *Mercer v Jaffee PC* 713 F Supp 1019 (1989) at 1025.


\(^{120}\) Federal Securities Law Report (CCH) (18 Feb 1981) p 82, 847 at 84,172 quoted in id at 397.

\(^{121}\) 388 F 2d (1968) at 489.
As regards accountants, the Court of Appeal of Arizona in *State v Tarzian* affirmed the criminal conviction of the accountant who audited the accounts of the company for filing misleading information with the securities regulator.\(^{122}\) Emphasising the investigation by the accountants, the US Court of Appeals Second Circuit in *United States v Benjamin*, a criminal case observed that the certificates of accountants in relation to corporate disclosures ‘can be instruments for inflicting pecuniary loss’ on investors and rejected the plea of ignorance.\(^{123}\)

Further, it is generally argued that the profession of auditors plays a crucial role in presenting a distorted financial position of the issuer.\(^{124}\) Similar to the position of lawyers aforementioned, the accountants and auditors have been held primarily liable by several courts for a defective prospectus.\(^{125}\)

Because of the critical role played by the underwriters in the corporate fundraising process, they should incur criminal liability for issuing a defective prospectus.\(^{126}\) As regards the criminal liability of issue managers, the central reason for their liability is their responsibility for assuring of the accuracy of a prospectus. This proposition has been reinforced in the landmark case, *Escott v BarChris Constr Corp*, which held that the lead underwriter or issue manager is ultimately responsible for the truth of disclosures in a prospectus.\(^{127}\)

Having regard to the arguments advanced in Chapter 6 and the reasons stated above, all major participants in the preparation of a prospectus should be held

\(^{122}\) 665 P 2d 582 (1983) at 583.
\(^{123}\) 328 F 2d 854 (1964) at 863.
\(^{125}\) For example, see *SEC v Seaboard Corp* 677 F 2d 1301 (1982); *Bradford White Corp v Ernst & Whinney* 872 F 2d 1153 (1989); *Adam v Silicon Valley Bancshares* 884 F Supp 1398 (1995).
\(^{126}\) Golding (1993) above n17 at 404.
\(^{127}\) 283 F Supp 634 (1968) at 696-97.
criminally liable for a defective prospectus. A clear set of provisions concerning criminal liability of prompters, directors, auditors, lawyers, underwriters and issue managers for a defective prospectus can contribute significantly to the improvement of investor protection in the IPO market in Bangladesh.

7.4. Summary and Conclusions

The foregoing supports the proposition that the present legal provisions dealing with criminal liability for a defective prospectus are flawed on several counts. First of all, the expression 'who authorised the issue of the prospectus' appears to be one of the major impediments towards the identification of persons liable for a defective prospectus. So far as it is understood from the analysis, no members of an IPO coalition except for directors and promoters fall within the ambit of such an expression in respect of criminal liability for a defective prospectus. Because of a considerable ambiguity and uncertainty about the applicability of such an expression, it has been omitted from the relevant statutes of some other jurisdictions. The legislation in Bangladesh should be amended by inserting clear provisions of criminal liability of all persons involved in the preparation of a defective prospectus.

Low penalties and the wide discretion given to judges to soften the penalties further in most cases are considered to be contrary to the need for investor protection. The penalties prescribed by the various laws in Bangladesh are significantly lower and less stringent than those of other jurisdictions such as of India and Malaysia. The stringency has been measured in respect of both the terms of imprisonment and the fines imposed. Leaving an extensive discretion with the judges to choose the minimal extent of imprisonment and fines or selecting either of the two seems to be unsuitable for the Bangladesh IPO market.
The prevalence of a broad range of defences to escape liability is another concern for law enforcement mechanism as they ‘encourage’ the violation of disclosure requirements. Such defences have made the criminal liability provisions ‘weaker’ to bring the offenders to the book. Amongst the defences, the requirement of wilful violation of disclosure provisions by the defendants has been omitted from the Securities Act of Arizona in 1998 considering its negative impact on the prevention of corporate crimes. Other defences, such as due diligence, ignorance and acting in good faith have been made conditional in some jurisdictions. Pursuant to those conditions, reliance on any defence can be justified by the exercise of reasonable care concerning the truth of the information included in a prospectus. The boundaries of the defences have been narrowed down in some selected jurisdictions for the sake of investor protection. This is not the case in Bangladesh. At the same time, the defences are not only more in number, they are wider in the scope of their application.

Investor protection in the IPO market requires stringent liability provisions. For the regulation of the business community, the ‘need for so-called ‘draconian’ sanctions’ is generally recognised.¹²⁸ Lack of investor protection keeps the investors away from the market resulting in the impairment of the ability of firms to raise equity capital from the market.¹²⁹ To make the criminal liability regime effective in deterring wrongdoers, criminal sanctions against them should be in place together with a civil remedies regime.¹³⁰ In a disclosure regime, the disclosure of accurate information is essential, because investors cannot make informed judgments based on untrue, misleading and fraudulent disclosures. To bring about investment confidence amongst the investors, an

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effective liability regime and its proper enforcement are sine qua non, and will assure the investors that there are effective remedies against the contravention of disclosure requirements.

A stringent liability regime for the malfeasance of the other players (except investors) of the IPO market is considered to be important for investor protection. The stringency of the liability regime has become more crucial in view of the adoption of the DBR. Criminal liability provided in the CA’94 was included to protect the investors in the MBR. The DBR entails more stringent penalties for the wrongdoer for whom many countries like India and Malaysia have amended their respective penalty provisions. Bangladesh has adopted the DBR without changing the provisions concerning liability for the prospectus. A strong legal liability regime can reduce violation of the law by creating ‘stringent standards’ of liability for persons who are involved in IPOs. By virtue of the DBR, companies have acquired freedom to raise funds from the public without extra risk of incurring liability. Following the adoption of the DBR, investors in Bangladesh do not have advantage of a paternalistic merit assessment which should be provided by the regulator. They do not seem to have the incentive to demand justice and seem ‘helpless’ in view of the fact that the liability regime is going to remain unchanged.

The availability of legal remedies against the violation of any law primarily depends on the quality of liability provisions as well as the effective enforcement thereof. The previous chapter showed the inadequacy of the civil liability for investor protection whilst the present chapter has exposed the shortcomings and drawbacks of

130 ‘Developments in the Law - Corporate Crime’ (1979) above n14 at 1374.
131 Malaysia has done so even before the adoption of the full disclosure philosophy as a part of its move towards the complete disclosure regulation.
132 See Herman & MacLean v Huddleston 459 U S (1983) 375 at 381-82.
the criminal liability provisions for a prospectus. These flaws demonstrate quite clearly that the whole regime for prospectus liability is in need of reform, as it is inadequate for the protection of investors in the current disclosure regime.

In addition to the flaws of the liability provisions, weaknesses exist in their enforcement mechanisms as well. The next chapter will concentrate on the investigation into the judicial enforcement of the disclosure requirements in a prospectus to show further weaknesses in investor protection in the IPO market in Bangladesh.
Chapter 8

Judicial Enforcement of Disclosure Regime

8.1. Introduction

Law enforcement denotes the realisation of the ends clearly stated or inherent in a given law. The judicial enforcement of law refers to the realisation of those ends through the judiciary of a government. The benefit of a particular law depends on either its voluntary compliance or its compulsory enforcement by competent authorities in an efficient manner.\(^1\) A recent analysis of transition economies shows that the effectiveness of legal institutions is much more important than the quality of the law in the books.\(^2\) In other words, the quality of enforcement is more crucial than the legal texts. The quality of law enforcement refers to the efficacy of the judicial system in redressing the violation of law.\(^3\) Pistor observes that the effectiveness of any good law largely depends on the efficacy of its enforcement institutions.\(^4\) A study of 49 countries selected from different legal systems worldwide demonstrates that effective law enforcement has a significant positive impact on the number of initial public offerings (IPOs).\(^5\) The study concludes that countries having a poor record of law enforcement are disadvantaged in

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\(^1\) In this chapter, the expression ‘efficient manner’ means the speedy and cost effective delivery of judgments which provide justice to the litigants.


the development of their securities markets.6 Expressing a similar view, Johnson maintains that ‘[l]egal institutions are strongly correlated with the financial development’ of a country.7 In analysing the recent corporate collapses in the United States (US) and Australia, Tomasic advocates strengthening the enforcement of corporate law to avoid future debacles.8 In reality, companies alone are unable to replicate a good legal environment for investment mainly because of agency problem, that is, the conflict of interests between the corporate management and corporate shareholders. Management is regarded as the agent of shareholders. Management is usually more interested in maximising its own benefits whilst the shareholders want the maximisation of the wealth of their corporations. Both issuer and investors, therefore, depend on an efficient judicial system to maintain a balance of interests between the ownership of a corporation and its control.

The Disclosure-Based Regulation (BDR) relies on ex post litigation instead of the ex ante prevention of the issuance of a defective prospectus. In a disclosure regime, judicial enforcement is thus crucial for the protection of investors from the misfeasance of other participants in the process of an IPO. It has been argued that issuers may find it rewarding to raise capital from the market following the historic lack of the enforcement of prospectus liabilities.9 In practice, this has been happening in the Bangladesh IPO market.10 The situation is so depressing that recently, aggrieved investors have submitted a memorandum to the Prime Minister describing the malpractice of issuers in raising corporate funds from the IPO market by disclosing false and misleading information in their prospectuses.11 Commenting on the situation in Bangladesh, the

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6 Id at 1149.
most prominent securities lawyer in the country pointed out that the enforcement of law is very loose and once the investors become victims of any defective prospectus, it would be difficult for them to avail themselves of the remedies.¹²

Two issues are most important for the enforcement of any law. These are: clarity in the law of its purpose and purview, and efficiency and honesty of the enforcement institutions. As can be seen from the preceding two chapters, the provisions concerning prospectus liabilities in Bangladesh are ambiguous. This ambiguity is an impediment to the enforcement of those provisions. Institutional investors usually play a vital role in enforcing the securities law. But the Bangladesh IPO market critically lacks such investors. A recent study reveals that outdated laws and ineffective enforcement of existing laws are largely responsible for the non-participation of institutional investors in the securities market of Bangladesh.¹³ The judiciary suffers from a serious lack of public confidence. Some of the important reasons for this lack of confidence are believed to be an inordinate delay in the disposal of cases, corruption of the judges and lawyers alike, and undue interference of the executive in the functions of the judiciary.

As a result, most of the violations of securities laws go without judicial remedy and

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such unfettered violations result in a severe lack of investor confidence in the market for IPOs.

Except for self-regulation, securities laws are usually enforced by two separate agencies, namely courts and government regulators. This chapter will examine the aspects of the judicial enforcement of disclosure requirements in Bangladesh.

The discussion of this chapter proceeds as follows. Section 8.1 provides an introduction. Section 8.2 will focus on the goals of the judicial enforcement of the disclosure regime. Section 8.3 will investigate the functions of the courts which deal with securities litigation in Bangladesh. Section 8.4 will concentrate on the lawyers who are engaged in the trial procedure of securities litigation. Section 8.5 will address the issues of delayed justice and the serious lack of public confidence in the existing judiciary. Section 8.6 will provide an account of judicial enforcement of securities litigation in Bangladesh. Section 8.7 will underscore the need for separate courts to ensure judicial remedies against the violation of securities laws and outline the composition and functions of the proposed courts. Section 8.8 will solicit for the empowerment of the securities regulator to sue wrongdoers for the compensation of investors. Finally, section 8.9 will present a summary and conclusions in which it will be evident that the present judicial enforcement of the disclosure regime in Bangladesh is ineffective to protect investors in the IPO market and reforms in this regard are imperative.

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8.2. Goals of the Judicial Enforcement of the Disclosure Regime

The principal goal of the enforcement of law is to maintain order in a country. It is widely accepted that the proper enforcement of law has a deterrent effect on potential wrongdoers. There are divergent opinions regarding the goals of the enforcement of securities laws. Some of the prominent goals are: protecting investing public, ensuring honesty in corporate behaviour, maintaining public confidence in corporations, and protecting society from the negative externalities of corporate actions. In one Australian study, the judges' perceptions of such goals focus on the need to ensure honesty and adherence to the proper standard of conduct in corporate activities. These judges also stress the implications of corporate law enforcement for public confidence in the corporate area. In particular, one judge of the Supreme Court of Victoria observed that 'the primary goal is to achieve morality in business with a view to protecting shareholders and the investing public'.

Private legal practitioners undertaking corporate law litigation expressed a similar view to that of the judges in terms of the need for investor protection. According to their observations, the principal goal is generally seen to be erecting boundaries for corporate behaviour and maintaining those boundaries for the protection of the assets of
The views of public prosecutors are broader than those of the judges and private practitioners. The prosecutors observed that the goal of the enforcement of corporate law is similar to that of criminal law, and that it is the preservation of society. In respect of corporate law, some prosecutors contend that enforcement aims to protect the society from corporate fraud.19

The above observations suggest that the protection of investors is the central goal of the enforcement of securities laws. However, the actual protection of investors very much depends on the judiciary. An honest and efficient judiciary as suggested earlier is essential for the effective judicial enforcement of securities laws for investor protection. In Bangladesh, there are widespread allegations of dishonesty and inefficiency against the judiciary. The flaws that exist in the judiciary appear to have significant negative impacts on the disposal of securities cases in the country. For the development of the IPO market, it is essential to strengthen the law enforcement regime and restore public confidence in the market. A successful enforcement program can foster greater compliance with the law and increase public confidence in the enforcement machinery.20 It is also argued that a securities market cannot be developed without honest and efficient courts.21

8.3. Courts Dealing with Securities Cases in Bangladesh

Currently several ordinary courts deal with the cases under securities law.

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18 For details, see id at 200-01.
19 Id at 204-05.
8.3.1. A Brief Overview of the Present Courts System in Bangladesh

The courts in Bangladesh are constitutionally divided into two broad hierarchies which include the Supreme Court of Bangladesh (Supreme Court) and the subordinate courts. The Supreme Court is comprised of two divisions, namely, the Appellate Division (AD) and the High Court Division (HCD). The AD is the country’s highest court of justice. However, the President of the country has the prerogative of mercy.

There are subordinate courts across the country. The location of these courts has been determined on the basis of administrative units, such as divisions, districts and thanas (police stations). There have been no ordinary courts of law in the divisions. A court of special divisional judge has been established in each division under the Criminal Law Amendment Act 1958 to try and punish offences specified in the schedule of the Code of Criminal Procedure 1898 (CrPC’98). These special courts, for example, try corruption cases under the Prevention of Corruption Act 1947. Districts are the major administrative units which have all the ordinary courts of law, whilst thanas are the lowest units of administration which have both civil and criminal courts. Although, unions stand at the bottom of the administrative structures of government, there have been no regular courts of law at the union level.

The higher judiciary, the Supreme Court, is functionally separated from the executive. But, the executive and judicial functions are not completely separated at the

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22 Constitution of the People’s Republic of Bangladesh 1972 arts 94 & 114.
23 As at 11 October 2002, the AD consisted of seven and the AD may work in a single or two separate benches. At least three judges are required to form a bench of the AD: Supreme Court of Bangladesh (Appellate Division) Rules1988, Order XI rule 1.
24 As at 11 October 2002, there were about 50 judges in the HCD. A bench may consist of at least one judge.
lower judiciary, the subordinate courts. Parallel to the judges of subordinate courts, magistrates are entrusted with the responsibility for adjudicating certain criminal cases specified by the CrPC’98.\textsuperscript{26} The magistrates are appointed as executive officers and charged with both administrative and judicial functions. The magistrates exercising judicial functions are constitutionally required to be controlled (in terms of posting, promotion and grant of leave) by the President in consultation with the Supreme Court.\textsuperscript{27} But, in practice, however, the executive alone controls those magistrates in defiance of the constitutional provisions. In this regard, the Supreme Court has strongly asserted in several cases that controlling the magistracy by the executive without consulting the Supreme Court is unconstitutional.\textsuperscript{28} Despite this being a clear violation of the Constitution, the executive has been exercising such powers, contributing to the weakening of the fair exercise of judicial powers by the magistrates.

The courts system of Bangladesh is divided into two main categories, namely, civil and criminal. There are some courts and tribunals of special jurisdictions at various levels in addition to the ordinary civil and criminal courts. These special courts have no jurisdictions over securities cases. Therefore, they fall outside the purview of this thesis. However, penalties awarded by the SEC are executed through the general certificate

\textsuperscript{25} The President, under this prerogative power, has the authority to ‘grant pardons, reprieves and respites and to remit, suspend or commute any sentence passed by any court, tribunal or other authority’: Constitution of the People’s Republic of Bangladesh 1972 art 49.

\textsuperscript{26} Code of Criminal Procedure 1898, Schedule II.

\textsuperscript{27} Constitution of the People’s Republic of Bangladesh 1972 art 116. The 1972 Constitution confers the powers of controlling the magistrates on the Supreme Court, but it was transferred to the President under s20 of the Constitution (Fourth Amendment) Act 1975. It should be mentioned here that the 1972 Constitution provides for a parliamentary democracy which was replaced by the presidential form of government in 1975 under the said amendment to the Constitution (Fourth Amendment) and the President assumed exclusive executive powers to control the subordinate courts. In 1978, the Second Proclamation (Fifteenth Amendment) Order 1978 theoretically curtailed these exclusive powers of the President and inserted the requirement for consulting the Supreme Court. But this consultation is not practised.

\textsuperscript{28} Aftabuddin v Bangladesh (1996) 48 DLR 1; Rahman v Shahiduddin (1999) BLD 291; Secretary, Ministry of Finance v Hossain (2000) 52 DLR (AD) 82.
courts. These are not ordinary courts, but courts of special jurisdiction. The existing ordinary courts excluding special ones are shown below.
Diagram 8.1: Hierarchy of Ordinary Civil Courts

Diagram 8.2: Hierarchy of Ordinary Criminal

* Arrows indicate appeals in both figures
8.3.2. Need for an Independent and Experienced Judiciary for the Adjudication of Securities Litigation

An independent and impartial judiciary is a cornerstone of justice. Bari points out that judicial independence is a sine qua non for the rule of law. But the judiciary is not an end in itself. Nor does it possess any intrinsic value. It is a means for the administration of justice in accordance with the rule of law. Providing justice under a particular law requires a clear understanding of the law. Securities laws are inherently complex. Special training and experience are necessary for appropriately dealing with the complex cases. Weak judicial enforcement is therefore considered to be the most 'deceptive' impediment to the implementation of corporate laws.

In a democratic government, the judiciary is entrusted with the responsibility for interpreting legislation enacted by the legislature. The main objectives of such an interpretation are twofold. Firstly, the judiciary interprets a law to determine the intention of the legislature in making the law which has been allegedly flouted. This interpretation aims to ascertain whether a disputed act or omission constitutes any violation of the law in question. Secondly, the judiciary stands to deliver justice to the parties of litigation. Achieving these two objectives calls for a sound, honest and efficient judiciary. The weaknesses of judges and lawyers may hinder the enforcement of securities laws in various ways. Some of the most important of them are described below in the light of the existing situation in Bangladesh.

i. The law under which remedies have been sought may be unclear and ambiguous in identifying the persons who are liable for the contravention in question. A judge may

30 See section 5.3.5.
dishonestly interpret such a vague law in a manner which gives advantage to the defendants or accused.

ii. A law may have shortcomings in explicitly proscribing the disputed conduct of the defendants. If such a legal lacuna exists, a judge may afford an interpretation of the law with an intention to acquit the violators.

iii. The remedies available in the legislation may not have been explicitly defined and judges may have a wide discretion to decide on the extent of penalties. In such a case, judges may adopt the minimalist approach and impose the lowest penalty allowed by the law.

iv. Inefficient case management by judges causes delay in the delivery of judgments. The disposal of the most significant cases may be delayed due to the backlog of ordinary cases. But a judge who is efficient in case management may give precedence to those cases, the disposal of which has considerable impacts on the securities market.

v. Judicial corruption may deprive the victims of justice. In civil cases, the victims may be deprived of compensation for their loss or damage resulting from their investment in a defective prospectus whilst in criminal cases, corruption may influence the acquittal of the violators of securities laws.

vi. Corrupt judges may purposefully appoint dishonest people to carry out unfair investigations into certain cases. Such investigations may significantly harm the merits of those cases.

vii. In an adversarial system of trial, lawyers have an important role to play in the administration of justice. Experienced lawyers may assist the court in interpreting the securities law by presenting juristic arguments and citing case law of other jurisdictions wherever appropriate. The lack of experienced lawyers in dealing with securities laws deprives the bench of the assistance of the bar in disposing of securities cases.
viii. Dishonest public prosecutors or lawyers may take money from both parties in a particular case and may refrain from playing their due roles against the wrongdoers during the hearing of the case.

Taking into consideration the above implications of dishonest and inefficient judiciary for the administration of justice, it can be inferred that the existence and operation of a judiciary free from all such flaws are needed for an effective investor protection regime in the IPO market.

8.3.2.1. Honesty of the Judges in Bangladesh

Unlike other officials, judges are expected to have 'special technical education' and intellectual expertise, as well as exceptionally high moral standards. Judges cannot deliver justice if they lack independence. Handsley points out '[judicial independence serves the rule of law by protecting judicial processes from improper influence'. This independence is measured in terms of personal independence and institutional independence. Personal independence implies that a judge should be free from dishonesty and 'fear or favour, affection or ill-will'. Institutional independence denotes that the judiciary shall function without executive or any other extraneous interference. The existence of these requirements is essential for building public confidence in the judiciary and such confidence is regarded as the main impetus for the

34 The quotation is a part of official oath (affirmation) which a judge of the Supreme court is required to swear in: Constitutions of the People's Republic of Bangladesh 1972 art 148 read with Third Schedule.
administration of justice. Referring to the continual erosion of this confidence, a recently retired Chief Justice of Bangladesh observed that the country’s judiciary is losing the confidence of the common people that it once enjoyed.

The higher judiciary is closely involved in maintaining discipline in the subordinate courts. In *Khatoon v State of Bihar*, it was observed in India that in a hierarchical judiciary, the higher courts usually control subordinate courts to avoid deviations from the higher standard of judicial behaviour, preventing damage to public confidence in the judiciary. In Bangladesh, the HCD is empowered to supervise and regulate the subordinate courts under Article 109 of the Constitution. But there are reports that the higher judiciary itself is not completely free from corruption. The honesty of judges has been questioned on several occasions in recent years. For example, Mr Latifur Rahman, a judge of the HCD, has been found guilty of engaging in a telephonic conversation with General Ershad, a former President and convict of the *Janata Tower* case (a graft case). During that conversation, the convict reportedly offered a bribe to the judge. The judge, in reply, assured the convict that he would consider the case sympathetically as a judge of the appellate court. Someone secretly recorded the conversation and *The Daily Manavzamin*, a leading tabloid, published a story on the basis of the record without mentioning the names of the persons involved in the incident. Referring to that conversation, a retired judge of the HCD and Law Commission Member went on to say that:

> Like many other fields, values of the judges have also eroded ….In our country, a few days ago, the newspapers published about a conversation between a judge [HCD judge] and a

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37 (1979) Cr L J 1045.
38 Cassette Scandal Case. The convict was former president General Ershad and the judge was Mr M Latifur Rahman.
convict and there were indications that money played a role in changing the verdict. But despite such a serious allegation, the court did not issue any *suo motu* rule.  

Two months after the publication of the story, the Attorney General filed a contempt suit, alleging that the convict tried to influence the appeals court for money. The verdict of the HCD on the contempt suit, known as the *Cassette Scandal case*, generated considerable public controversy because the court found the judge guilty of unbecoming behaviour but he was not penalised. However, the HCD did impose penalties on the convict as well as the chief editor and editor-publisher of the newspaper which published the story concerning the conversation.  

In another case, Mr N K Chakavarty, a judge of the HCD, had to relinquish his position in May 2002 after not being recommended by the Chief Justice to regularise his tenure/position after the expiry of his two-year period as an additional judge. The allegation of corruption was raised against him at the time of his appointment in May 2000 to the HCD from a permanent position of a District and Sessions Judge.

Apart from the above allegations against judges of higher judiciary, the dishonesty of the judges of lower judiciary has contributed enormously to the erosion of public confidence in courts. A survey conducted by Transparency International Bangladesh showed that 88.5 per cent of households agreed that it is almost impossible to get quick and fair judgment from courts without money and influence. The survey also revealed that 63 per cent of the households who are involved in litigation had to pay bribes to the

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41 As usually practised in Bangladesh, judges in the HCD are appointed first as additional judges for two years. Their positions are confirmed after the expiry of this two-year period on the basis of the recommendation of the Chief Justice.

court officials. Another survey conducted by Transparency International Canada revealed that 97 per cent households think that the judiciary is corrupt. Recently, the Law Minister himself publicly posed the question: why should the people keep their confidence in the judiciary? The minister asserted that corruption has infiltrated the judges. Recognising the truth of the assertion, Justice Mostafa Kamal, a former Chief Justice, opined that ‘[c]orruption has entered the judiciary and open discussion on corruption in the judiciary should not be stopped in the name of contempt of court’.

Public unhappiness with the judiciary is further evident from some recent incidents. The District Bar Association of Chittagong, the second largest city in the country, strongly protested against the appointment of a particular judge (equivalent to a district judge) to a labour court. The lawyers publicly characterised the appointee as corrupt. His corruption was alleged to have become apparent from his previous work place. The Bar Association declared him persona non grata and demanded immediate withdrawal of the appointment. In another recent case, many colourful posters were put up across the district against the District and Sessions Judge of Shariatpur. These posters were printed in the name of the ‘suppressed and oppressed inhabitants’ of the district and alleged corruption and various misdeeds by the judge. The local Bar Association decided to boycott his court for an indefinite period. The lawyers alleged that the judge

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47 The Chittagong District Bar Association protested the appointment of Mr Abdur Rashid Mian to the First Labour Court of Chittagong. For further details, see ‘Ctg Lawyers Boycott First Labour Court’ The Independent, Dhaka (9 Sept 2002).
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in collaboration with some senior lawyers granted bail to a number of people accused of serious crimes in exchange for bribes from them.49 Supporting these impressions of corruption of the bench, the US State Department Report 2002 on Bangladesh also notes that criminals have not been punished owing to the corruption of the judges of lower courts.50 Over the last few years, the tenure of a number of judges of subordinate courts have been dismissed or terminated on the grounds of corruption.51

Thus, it has been recognised that many judges in Bangladesh, especially those of the lower courts lack honesty which is an elementary requirement for the fair trial in securities cases. Black, in this regard, observes that an honest judiciary is fundamental to provide investors with meaningful remedies against their grievance.52

8.3.2.2. Independence of the Judiciary

Judicial independence is essential for the administration of justice in the true sense. In addition to corruption, the lower judiciary is subject to the direct influence of the executive as alluded to earlier. Lower courts are the courts of first instance in trying securities cases. There is a strong allegation that the lower judiciary in Bangladesh is impeded in functioning independently by some extraneous factors. One of the most notables is the frequent intervention of the executive with the judiciary.53 Constitutionally, the lower judiciary has an unequivocal mandate for its independence under Articles 109,115,116 and 116A of the Constitution. Yet the executive asserts

49 'Lawyers to Boycott Court at Sariatpur from Today' The Daily Star, Dhaka (16 Nov 2002).
51 For example, Mr S M Badrul Islam was dismissed from his office of a Joint District Judge of Dhaka in July 2000, after the charge of misconduct and corruption was proved against him: Ministry of Law, Justice and parliamentary Affairs, Justice Section – 3, Order No Justice-3/1-D-5/95, 17 July 2000.
52 Black (2001) above n21 at 64.
significant control over the lower judiciary, especially the magistracy which enjoys little independence in performing judicial functions.\textsuperscript{54} Because of such interference, Justice Kamal referred to earlier, has argued that the Bangladesh judiciary will not be acceptable at home and abroad unless it is separated from the executive.\textsuperscript{55} The separation of judiciary from the executive has become one of the few issues on which national consensus has been achieved. In December 1999, the AD in \textit{Secretary, Ministry of Finance v Hossain} issued a 12-point directive for the virtual separation of the judiciary from the executive.\textsuperscript{56} The court directed the executive to implement the verdict within a stipulated time. Unfortunately, the executive did not implement the rulings except for one which concerned the financial remuneration of the judiciary. Instead of enforcing the landmark verdict, the executive sought and obtained the extension of time limits more than 10 times since 1999. As at February 2003, the latest extension for a period of three months was granted on 26 January 2003.\textsuperscript{57}

The Supreme Court in \textit{Farooq v Government of Bangladesh} was of the view that the ‘Court being a vehicle, a medium or mechanism devised by the Constitution for the exercise of the judicial power of the people on behalf of the people, people will always remain focal point of concern’ of the court in performing its functions.\textsuperscript{58} Similarly, Justice Doyle observes that the primary responsibility of the judiciary is to serve the people through the administration of justice in a country.\textsuperscript{59}

\textsuperscript{54} See the judgments of the cases referred to in above n28.


\textsuperscript{56} (2000) 52 DLR (AD) 82.

\textsuperscript{57} ‘Separation of Judiciary: Govt Asked to Implement Modifications Given by SC’ \textit{The Independent}, Dhaka (27 Jan 2003).

\textsuperscript{58} (1997) 49 DLR (AD) 1 at 15.

In practice, this is not the case. As a result, the judiciary has been the subject of continually diminishing public confidence. A 2002 survey revealed that 92 per cent households are not satisfied with the present judicial service.\(^{60}\) The Chief Justice publicly conceded that the entire judiciary is now under more scrutiny than ever before.\(^{61}\)

The above discussion shows that the Bangladesh judiciary is not independent, rather it is under the control of the executive. Procrastination in relation to separating the judiciary and the executive in spite of the verdict of the highest court casts a considerable doubt as to the bona fide of the government in fostering an impartial and independent judiciary. A subservient judiciary is unhelpful for the enforcement of the disclosure regime. The independence of the judiciary is more crucial for the securities cases which involve financially rich and politically high profile people.\(^{62}\) They are in a position to use political influence. In addition, they can cause delay in the trial of a particular case by initiating miscellaneous petitions without genuine grounds. The accused of the share scam cases of 1997 have been pursuing such a policy which has caused delays in the trial of those cases. In other words, their role in dealing with the cases implies their ‘disregard’ for the law as it is generally believed. In support of this view, a recent public statement of the Law Minister may be quoted. The Minister said:

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\(^{60}\) The World Bank in collaboration with Proshika, and Survey and Research System conducted the survey. Proshika is a leading non-governmental organisation. Survey and Research System is a private company with technical assistance from Public Assistance Centre of Bangalore, India. The survey was financed by the AUSAID (Australia), CIDA (Canada), the Netherlands and USAID (USA). It was carried out on 2400 urban households in four major metropolitan cities of the countries. See ‘Survey on Quality of Service Delivery: Only 2pc Urbanites Satisfied with Police’ *The New Nation*, Dhaka (24 May 2002). See also, ‘Police and the Judiciary’ *The New Nation*, Dhaka (28 May 2002) editorial.


\(^{62}\) In 1997, 15 criminal cases were filed after the 1996 share scam. None of the cases have been disposed of to date. The reasons for such a delay are considered to be the financial and political influence of the accused as has been argued in Chapter 5.
‘... in our country there is a tendency of ignoring the law; specially those who are powerful in society prefer to remain above the law’. 63

For the effective enforcement of the disclosure regime, the institutional independence and personal honesty of the courts have to be ensured. 64 Considering the urgency of judicial independence in Bangladesh, the World Bank Country Director reiterated the need for a judiciary effectively separated from the executive branch of the government. 65 Similarly, the September 2002 report of the United Nations Development Program (UNDP) submitted that separation of the judiciary should be effected. 66 Thus the separation of the judiciary has become long overdue. But the executive is very reluctant to lose its influence over the judiciary. As a result, the much-talked-about separation remains elusive.

8.3.2.2. Experience of Judges in Dealing with Securities Litigation

Education and training are two prerequisites which are imperative for achieving efficiency in any profession. Obtaining formal legal education is not compulsory for a person wanting to be a magistrate who is entrusted with the responsibility for the trial of selected criminal cases pursuant to the CrPC'98. Currently, the magistracy which includes magistrates with no formal legal education is empowered to impose imprisonment for a term which may extend up to 10 years. 67

64 Personal honesty is very crucial in this regard because the rich plaintiffs may seek to influence the court by offering bribes.
67 Code of Criminal Procedure 1898 s29(C).
It should be noted that, a law degree is not a requirement for a position of the judge of the Supreme Court. In the late 1980s, for example, Mr Shahabuddin Ahmed became the Chief Justice without having a degree in law. However, law graduates are appointed as the judges of the courts of assistant judge, the lowest courts of the civil justice system.

Apart from the lack of a law degree, judges in general lack proper training. The UNDP study reveals that 80 per cent of judges and magistrates think that judicial officers should receive proper training to improve their efficiency. The judges and magistrates are of the view that they do not have sufficient law books and that this situation should be remedied. The UNDP study further shows that over the last 65 years (from 1931 to 1996) the efficiency of the courts have deteriorated to a significantly low level in Bangladesh. A former president of the National Lawyers Association recently commented that a shortage of trained lawyers and judges has left the judiciary in a vulnerable situation. He strongly asserted that '[t]here was a very good judicial system even under the British Colony, but now we don’t have that situation because we are missing properly educated, trained, honest lawyers and judges'. In early 2002, the Chief Justice submitted a formal proposal to the executive government for raising the retirement age of the judges of both subordinate courts as well as the

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UNDP (2002) above n66 at 76.

Ibid.


Supreme Court. The proposal was premised on the ground of 'continual shortage of experienced judges on the benches'.

The above assertions mirror the need of education and training of judges for an efficient dealing with the cases under 'ordinary' laws which are applied frequently. Securities law constitutes a relatively new and special branch of law which calls for a special and sophisticated consideration of all the relevant facts. Tomasic is of the view that the judiciary needs to be experienced in the adjudication of complex securities issues in a timely way.

A serious scarcity of case law regarding the violation of disclosure requirements implies that judges are not practically experienced in dealing with cases under prospectus liabilities. Despite the violations of disclosure provisions, violators have not been sued or prosecuted. There has been only one major judicial decision in relation to the securities law to date. This decision clarifies 'the preliminary procedure to be followed by the Securities and Exchange Commission' (SEC) before lodging a criminal case under the Securities and Exchange Ordinance 1969 (SEO'69). This general lack of case law indicates that the practice of the judicial enforcement of securities laws is a relatively new or rare phenomenon in Bangladesh. Therefore, neither the bench nor the bar is experienced in handling securities cases because hardly any come before the courts.

The effect of inexperience in dealing with securities cases may be seen from the decision of the lower court regarding the procedure to be followed by the SEC in instituting a criminal case. The details of the case will be discussed in section 8.6.1. The

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73 'Justice Mahmudul Amin's Farewell Speech' *The New Nation*, Dhaka (18 Jun 2002). The Chief Justice proposed to rise the retirement age of the Supreme Court judges and the judges of the subordinate courts from 65 to 68 years and from 57 to 60 years respectively.
75 For the instances of alleged violations, see section 5.3.1.
central issue of the case in relation to judges’ experience is that the District and Sessions Judge was of the view that the sensational share scam cases were not maintainable. The judge contended that the SEC failed to observe due process of law which was required for lodging a case by it. The Supreme Court reversed the findings of the sessions court upon appeal. A lack of experience might have led the judge of the lower court to arrive at the wrong decision. But the implications of the decision for those securities cases were enormous. It took the Supreme Court more than a year to finally settle the legality of lodging cases by the SEC.\textsuperscript{77} The result was that those cases have not been decided after nearly five years from the date of filing them. This unusual delay has frustrated the investing public and accelerated the erosion of public confidence in the market as well as in the judiciary. Experienced judges are thus needed for the efficient delivery of justice. The legal system in Bangladesh lacks not only experienced judges, but also experienced lawyers required for effective securities regulation. These weaknesses are unfavourable to investor protection in the IPO market as it is evident from the following discussion.

8.4. Bars Dealing with Securities Litigation

8.4.1. Need for Trained and Experienced Lawyers

As an integral part of the judicial system, an honest and efficient bar is a fundamental requirement for the enforcement of securities law.\textsuperscript{78} As of November 2002, there are a

\textsuperscript{76} Zahir (2000) above n12 at 257.
\textsuperscript{77} For details, see Shinepukur Holding v Securities and Exchange Commission (1998) 18 BLD (AD) 189.
\textsuperscript{78} See Black (2001) above n21.
total of 27 thousand lawyers belonging to 58 bar associations in Bangladesh.\textsuperscript{79} However, no law schools in the country so far teach securities law. Only the business schools and schools of economics include the study of securities markets in their curricula. They teach the subject from the perspective of business and economics. Therefore, lawyers in general have not been trained locally on securities laws. Very few lawyers, however, have studied securities law overseas as a part of their postgraduate course work programs, and the majority of these have completed their courses on securities law in recent years. To the best of the present writer’s knowledge, however, no lawyers in Bangladesh have a degree or diploma exclusively in securities regulation to date. As regards the availability of reading materials, there have been no books exclusively on securities laws thus far. However, these laws have been embodied in a minor part of a recently published book on company and securities laws.\textsuperscript{80} This book appears to be the first of its kind in the country. In such circumstances, it might be said that the lawyers in Bangladesh are likely to be critically lacking in an adequate knowledge of securities laws.

Company law, on the other hand, partly deals with the disclosure requirements and prospectus liabilities. Even this law is not taught extensively in any law school in the country. Company law, in most cases, is a part of a single subject designed to cover all mercantile or business laws. The law schools teach company law without any special emphasis on its importance in relation to the securities market. Law graduates in Bangladesh have little opportunity to carry out an in-depth study of company law at law schools unless a research degree is undertaken. More importantly, as is known to this writer, no academics in the country presently have higher degree in either companies or


\textsuperscript{80} Zahir (2000) above n12.
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securities laws. Hence, the law of securities regulation is an area of less importance or of less interest there. Perhaps, the lack of interest in the field shown by academia has ensured that securities laws remain unfamiliar to law students in Bangladesh.

8.4.2. Honesty in Legal Profession

The honesty of the bar is crucial, especially in a common law jurisdiction which follows the adversarial system of trial. Recently, the role of lawyers has been the subject of public criticism. It is an open secret that some lawyers take money from both of the contesting parties. A survey by Transparency International Bangladesh shows that 16.3 per cent of households pay bribes to the opponents’ lawyers.81 The UNDP study mentioned earlier reveals further information in this regard. That study finds that a total of 70 per cent of the victims of the violation of law are reluctant to seek remedies because of their concern about giving money to the public prosecutors who are legally paid by the government.82 Further, not all victims who initiate legal actions against offenders can continue with their cases. The UNDP study also mentions that a total of 52 per cent of litigants are reluctant to proceed with their cases due to the demand by lawyers for money in the name of the courts (bribes to be given to the courts) in addition to their fees.83 In recent times, a new device of dishonest practice by lawyers has been unearthed. Some dishonest lawyers have reportedly forged the signatures of some judges of the Supreme Court and prepared fake bail orders of the courts to release their clients (convicts) from jails.84 The extent of the lawyers’ dishonesty seems to have

81 Transparency International – Bangladesh above n43.
82 UNDP (2002) above n66 at 70.
83 Ibid.
84 The lawyers have prepared the forged orders in collaboration with the court employees. Eventually, they managed to release their clients on bail from the jail by procuring fake orders of the courts: see ‘Law-breaker Lawyer: Colleague Beaten for Freeing Convict on Bail Using Fake Documents’ The
caused public concern and prompted the Chief Justice to advise the lawyers to work with utmost honesty and sincerity to avert further erosion of public confidence.\textsuperscript{85}

The honesty of prosecutors is always emphasised in order to establish successful prosecutions. Referring to the unbecoming role of the prosecutors, the Law Minister publicly asserted that the appointment procedure for prosecutors is not transparent and their appointments are largely based on political consideration.\textsuperscript{86} This implies that the present role of public prosecutors is not conducive to the fair administration of justice.

It would be difficult for the bench to administer justice without the honest, prudent and sincere cooperation of the bar. Lawyers are very much involved in the judicial system. Litigants depend on their lawyers in contesting their case. A fiduciary relation exists between lawyers and their clients. The honesty of lawyers is essential for the benefit of their clients and to build up public confidence in the legal profession. Any deviation from the proper conduct of their role impairs their credibility to the public.

The Bangladesh Bar Council, the sole statutory regulatory body for lawyers, should take necessary steps to ensure discipline in the legal profession before the deterioration becomes extreme. This can be achieved through transparency and accountability in the profession. The ethical conduct of lawyers has to be maintained in the interest of investor protection in the IPO market.


8.5. Delay in the Delivery of Justice and the Public Confidence

Crisis in the Judiciary

The essence of the judiciary is the dispensation of justice and 'justice means grant of expeditious and inexpensive relief to the persons who approach the court with legal problems'. The right to get speedy trial is guaranteed under Article 35(3) of the Constitution as a fundamental right in Bangladesh. But a chronic delay has become synonymous with injustice and is a major systemic flaw in the justice system. Of nearly one million cases pending in the country as of June 2002, a total of 4,946 cases are pending in the AD and 127,244 in the HCD. Moreover, a total of 344,518 civil and 95,689 criminal cases are awaiting trial in the judges courts (subordinate courts), whilst the magistrate and metropolitan magistrate courts are overwhelmed by 296,862 and 99,043 criminal cases respectively. Giving an indication of the extent of the problem, the Law Minister argues that at the present rate, the existing courts would take as many as 86 years to dispose of these cases, even given that no new cases are taken into account.

Many cases have been pending for more than a decade. For example, in the State v Deputy Commissioner of Shatkhira, the HCD held that the detention of a minor boy, was illegal after he had spent 12 years in jail, suffering unspeakable inhuman treatment.

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88 'Pending Cases Now Stand at 9,68,305: Settlement Will Need 86 Years' The Independent, Dhaka (1 Nov 2002).
90 For example, Falu Mia was arrested on suspicion without any case against him and released after 23 years in jail. This happened because the authority forgot to proceed with his case. To date, he does not know why he had served the jail for more than two decades with inhuman sufferings and he wanted his youth back! 'The Daily Star Dialogue on Arrest and Police Remand' The Daily Star, Dhaka (23 Jun 2002). This is not strange news in Bangladesh. Recently a young man has obtained bail from the court after serving 19 years in prison without any trial and no charge was framed
for no fault of his own, but because of malafide action of some interested persons and administrative negligence of the government.\textsuperscript{91} This is not unusual news in Bangladesh. Recently a young man has obtained bail from the court after serving 19 years in prison without any trial and no charge was made against him until his bail.\textsuperscript{92} In another case, a person arrested on mere suspicion without any specific allegation against him, was released after 23 years in jail without any trial. He managed to get released with the help of a human rights organisation. The organisation instituted a compensation suit on behalf of the victim. The court took two years to decide the case and finally ordered for compensation on 6 July 2002, but he died on 7 May 2001.\textsuperscript{93} Given such situations, a member of the Law Commission of Bangladesh observed that ‘[p]raying for justice, the parties become part of a long, protracted and torturing process, not knowing when it will end’.\textsuperscript{94}

Delay in delivering justice is one of the elements which contributes to the erosion of public confidence in the judiciary. In \textit{Daswani v HPA International}, the Indian Supreme Court expressed the view that a ‘long delay in delivery of the judgment gives rise to unnecessary speculation in the minds of the parties to a case’.\textsuperscript{95} In a landmark decision of the Indian Supreme Court in \textit{Rai v State of Bihar}, Sethi J strongly asserted that:

\begin{itemize}
\item against him until his bail: Z Hossain, ‘One and a Half Thousand Forgotten Detainees in Dhaka Jail’ The \textit{Prothom Alo}, Dhaka (3 Feb 2002) (translated from Bengali).
\item (1993) 45 DLR 643.
\item Hossain (2002) above n90.
\end{itemize}
Any procedure or course of action which does not ensure a reasonable quick adjudication has been termed to be unjust.... Whereas justice delayed is justice denied, *justice withheld is even worse than that* [emphasis added].

Mr Islam, a retired judge, observes from his prolonged experience working with the judiciary in Bangladesh, that ‘[d]elayed justice is the means of inflicting injustice through the judicial system’. Justice Naimuddin Ahmed, a member of the Law Commission, further observed that ‘[i]ke many other fields, values of the judges have also eroded. It is for them that the pending cases are being piled up...’.

The Law Minister as a veteran lawyer finds judges and lawyers to be equally responsible for the delay in the disposal of cases. He argues that ‘the lawyers often seek time without any valid reason’ and the judges grant them their request resulting in an inordinate delay in the delivery of justice generally.

The examples discussed above tend to support the proposition that the endless delay in the disposal of cases in Bangladesh has created a ‘deadlock’ in the administration of justice. The UNDP survey referred to earlier reveals that 70 per cent of the victims of the violation of law are reluctant to seek legal remedies due to the uncertainty of the completion of trial. More alarmingly, law enforcers themselves would normally attempt to shift the blame for their failure to maintain public order to the judiciary. The survey also states that 100 per cent of police personnel think that delay in the trial procedure is a cause of the lack of public confidence in the law enforcing agency. It is thus clear, the persistent judicial backlog has substantially contributed to damaging the public confidence in the judiciary. The problem has a

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100 UNDP (2002) above n82.
considerable harmful effect on the securities litigation and thereby on the IPO market in Bangladesh. The negative impact of delayed justice on securities litigation is discussed below.

8.6. State of Judicial Enforcement of Securities Litigation

Reports concerning securities litigation filed by and against the SEC since 1995 show that the filing of such cases began in 1997. Following the share scam of 1996, the SEC in early 1997 lodged a total of 15 cases on the basis of the report of the inquiry into the share scam. There had been a total of 17 cases including the 15 mentioned above until 30 June 1998. The number of cases reached 52 in June 1999. Because of the disposal of some minor cases, the number of cases pending decreased to 43 in June 2000, but increased to 54 in June 2001. As of June 2002, a total of 83 cases were pending in various courts.

Over the years, only some minor cases, for example, a certificate case for the recovery of penalty imposed by the SEC, have been disposed of. To date, none of the above-mentioned 15 sensational share scam cases have been finally adjudicated as alluded to earlier. Investors who lost their money during the 1996 share scam have been waiting for the penalties to be imposed on those responsible for the debacle in the market. Regulatory failure to convict and impose penalties on the offenders is regarded

102 The 1995-1996 Annual Report of the Securities and Exchange Commission (SEC) recorded no cases. The subsequent annual reports recorded all cases which would be mentioned shortly.
as one of the main reasons for the lack of public confidence in the market. The importance of a speedy disposal of these cases is so paramount in the interest of the market that the SEC is in favour of disposing of the cases ‘whatever be the judgments’.\textsuperscript{108} No one can appreciate this assertion by the SEC, because the SEC is the complainant of the cases and the regulator should have a firm commitment to win the court verdicts that penalise the violators of the securities law. It should be noted that merely disposing of the cases would not help restore investor confidence in the market. The situation may well be worsened if the real criminals are not punished. Having regard to the damaging effect of such court decisions on the public and the market, the SEC should vigorously pursue and seek to punish offenders who have fraudulently taken away the life savings of investors and extensively damaged the securities market.

For the development of the market, the SEC has vowed on several occasions to dispose of the pending cases in a short time. Recently, the Chittagong Stock Exchange formally urged the government for a quick disposal of these cases.\textsuperscript{109} In a sense, the whole nation has been waiting to see the judgments of the share scam cases ‘where thousands of small and first-time investors lost their shirts’.\textsuperscript{110} Despite an extreme erosion of public confidence in the market as well as in the judiciary, the pace of legal recourse against the violators of the securities law is very slow. The tardiness is evident from the following account of judicial treatment with the cases.


\textsuperscript{109} ‘CSE Urges Reform of Capital Market’ \textit{The Independent}, Dhaka (21 Mar 2002).

8.6.1. The Incidents of the Share Scam Cases

On 2 April 1997, on behalf of the SEC, its executive director lodged reports under s25 of the SEO’69 with the Chief Metropolitan Magistrate Court (CMM) Dhaka. This action was based on the report of the committee of inquiry formed to investigate the share scam 1996. The reports filed by the SEC executive director were basically the extracts of the report of inquiry. The allegation against the accused was the contravention of s17 of the SEO’69 which prohibits, inter alia, fraudulent acts in relation to securities trading. Section 24 of the SEO’69 provides for penalties for flouting s17. On the day of filing the reports by the SEC, the CMM took cognisance of the offence under s24 of the SEO’69 and 15 criminal cases were registered on the basis of the above reports. The CMM immediately directed the issuance of warrant for the arrest the accused.

To avoid being arrested, the accused moved to the HCD on 3 April 1997 and obtained anticipatory bail. Thereafter, the accused filed a criminal revision petition in the court of sessions, Dhaka, under s435 and 439A of the CrPC’98. In the petition, the accused sought to set aside the order of the CMM. The sessions judge on 1 June 1997 held that the criminal cases registered against the accused were liable to be quashed. The order of warrant of arrest was also inoperative. The judge did not have the jurisdiction to quash the cases and he made a reference to the HCD under s438 of the CrPC’98 for quashing the proceedings against the petitioners (the accused). The judge

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111 Section 25 of the SEO’69 provides that no court shall take cognisance of any offence punishable under the Ordinance except on the report in writing of the facts constituting the offence by an officer authorised by the SEC. The section also mentions that no courts which are below the rank of sessions court shall try any offence punishable under the SEO’69. In fulfillment of this requirement, the executive director of the SEC filed the reports to the CMM court concerning the facts of the fraudulent acts, etc allegedly committed by the accused of those cases.


113 The order in which the CMM court took cognisance of the cases and directed the issuance of the warrant of arrest.
substantiated his decision on the ground that the executive director who filed the reports to the CMM was not legally authorised to do so. The base of this argument was that the SEC chairman alone, without any resolution of the Commission, advised the director to file the reports. The judge argued that the SEC chairman did not have the authority to empower the director to go to the court and that the decision to file the reports should have been made in a meeting of the Commission. The judge also asserted that the warrant of arrest against the accused rather than the summons was contrary to the law of criminal procedure.

The HCD on 9 December 1997 rejected the reference made by the sessions judge and upheld the decision of the CMM in relation to taking cognisance of and the issuing of the warrant of arrest. The accused afterwards lodged leave-to-appeal petitions with the AD and on 13 May 1998 the AD dismissed all the petitions and reaffirmed the decision of the CMM. It then rejected the arguments of the sessions judge. Hence, it takes more than a year to settle just the maintainability of the 15 share scam cases registered against some 42 high-profile people of 15 listed companies. Following the verdict of the AD, the cases were returned to the trial courts and all the cases are still pending. Whatever may be the reasons for the erroneous decision of the sessions judge (be it inexperience or influence etc), it has but added to the backlog of securities cases. Special measures need to be considered to reduce the complexities associated with the trial of securities cases.

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8.7. Special Court for Securities Cases

The foregoing discussion of the judiciary of Bangladesh suggests that the existing courts and bars are, in general, inexperienced in dealing with securities cases. However, it is practically impossible to impart sufficient education and training to the members of the whole judiciary overnight. Nor is it possible for the judiciary to gather experience in respect of securities cases without the availability of a sufficient number of cases. There also exists a culture amongst the victims of the violation of the securities law to avoid courts for some plausible reasons. The reasons may be described, for example, as: corruption in the judiciary, delay in the disposal of cases, the inefficiency of the judiciary, the financial burden and mental sufferings of the litigants to run a litigation for years. In a situation of public confidence crisis, reliance on the existing courts for the efficient disposal of cases involving prospectus liabilities would be impracticable. Nevertheless, the efficient judicial settlement of securities cases is such a vital issue that it cannot be compromised.116 Moreover, emphasising the need for proper courts, Black’s recent empirical study argues that the first step for the development of securities market can be, inter alia, setting up honest courts.117 Similarly, it is also argued that ‘[a] specialised court is ideal’ for the enforcement of securities law.118 A recent study shows that judicial enforcement contributes to developing securities markets only in countries having an efficient judiciary.119 The establishment of special courts or tribunals is

118 Black (2001) above n52.
therefore needed in Bangladesh having regard to the importance of a quick, fair and efficient administration of prospectus cases.

At present, there are a number of special courts and tribunals in operation. For example, Family Courts, Financial Loan Court, Speedy Trial Courts, Administrative Tribunals and Speedy Trial Tribunals.\(^{120}\) The special courts have significantly contributed to expediting the trial of cases under their respective jurisdiction. Therefore, another type of special court may be established for the trial of securities cases with judges who should be, inter alia, trained in securities law. Alternatively, the purpose of efficient and expeditious trials of such cases could have been served by establishing a separate bench in the existing court system. But such a recommendation would seem to be unworkable since the existing lower courts including the Courts of District and Sessions Judges operate in a system of a single bench with a single judge. Thus the establishment of separate securities courts as courts of first instance is a necessity which has been lately recognised by the SEC as well as the Minister concerned.\(^{121}\) Initially, these courts could be set up in Dhaka and Chittagong where the country's two stock exchanges are situated.\(^{122}\)

In the establishment of special courts for securities cases, some important concerns, such as, the honesty and efficiency of the judiciary, are to be taken into account to avoid the problems persistent in the existing ordinary courts. In addressing the regulation of

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\(^{120}\) All of those courts/tribunals were established with a common objective which is said to be ensuring expeditious trial. Family Courts were established in 1985 to deal with family matters. The Financial Loan Courts were set up in 1990 to recover the classified loans. Speedy Trial Courts established in 2002 to combat the onslaught of certain crimes such as unauthorised toll collection; hindrance to normal road, rail, river and air traffic movement; vandalism on transport and properties; mugging, terrorism, snatching, theft, extortion, obstruction to and manipulation of tender bidding, etc. The establishment of the Speedy Trial Tribunals is underway and the tribunals aim to deliver a speedy trial of selected cases involving serious offences like murder, rape etc.


\(^{122}\) Dhaka is the capital and Chittagong is commercial centre of the country.
financial markets, a recent theory of incomplete law advanced by Pistor and Xu say that laws are 'intrinsically incomplete'. They argue that lawmakers cannot see a priori all future contingencies.\(^\text{123}\) Because of this incompleteness of law, the judges need to find out the complementary provisions of a given law for its optimal enforcement. In addition, the complexities of securities cases call for an honest and efficient dealing with them as has been canvassed before. An honest and sophisticated judiciary is taken for granted in developed countries, but they are often partly or wholly non-existent in developing countries.\(^\text{124}\) In view of the incompleteness of law, complex nature of securities cases, and the urgency of their speedy disposals, there is a good argument for the provision of specialised courts for securities.\(^\text{125}\)

8.7.1. Composition of the Securities Courts

As indicated in the foregoing discussion, the composition of securities courts requires the consideration of special characteristics of securities cases. The characteristics are: firstly, the ‘complex, contradictory and confusing’ nature of the cases;\(^\text{126}\) secondly, the involvement of huge amounts of money; and thirdly, the power of the violators in terms of money and political influence.\(^\text{127}\) The consideration of these issues becomes more important when the courts are seen to be inefficient and corrupt. Money can play a


\(^\text{124}\) Black (2001) above n52.

\(^\text{125}\) Ibid.


\(^\text{127}\) As will be shown soon that most of the persons who are involved in the formation or control of a company are affiliated with political parties in one way or another. At the same time, they pay subscriptions of big amounts of money to the funds of political parties. They are thus in advantageous position to seek undue political favours if they need. Recognising the lack of judicial
prejudicial role in the trial procedure of securities cases if the courts lack honesty and integrity. This is because, a recent research reveals that most of the companies pay to the funds of political parties. The researchers express their disappointment about the standard of companies. Taking the above features of securities cases and the persistence of corruption in the judiciary into account, the judges of the securities courts should be appointed from amongst the persons not below the rank of a District and Sessions Judge. These judges should be conversant with the securities law of the country as well as the relevant case law of the leading common law jurisdictions. Leading jurisdictions in this regard refer to those countries where significant development of securities laws has taken place as well as the neighbouring countries. In this respect, the judges should have access to the relevant case law of, inter alia, the US, the United Kingdom (UK), Australia, Canada, Malaysia and India, to enrich their knowledge of the proper application of securities laws. Special training should be arranged for those judges who are not adequately trained in securities laws.

8.7.2. Jurisdictions

The legislation creating the securities courts should clearly define the jurisdictions of the courts. The courts shall have both civil and criminal jurisdictions. These will be the courts of first instance for all securities cases irrespective of the amounts of money involved in a case. The courts should be empowered to work out the highest compensation and penalties in all cases brought before them as provided in the

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129 Independence in the country, it has been stated that the political government has a significant control over the lower judiciary: US Department of State (2002) above n50.
applicable laws. In addition, for the sake of justice, the courts shall have powers to grant injunctive relief as entrenched in the existing Specific Relief Act 1877. However, apart from the judicial enforcement, the SEC as well as self-regulators will settle those disputes which fall within the ambits of their respective authorities.\(^{130}\)

### 8.7.3. Trial Procedure and Timeframe

The securities courts will follow the existing *Code of Civil Procedure* 1908, the CrPC’98, the *Evidence Act* 1872 as adopted in Bangladesh and other pertinent laws which are appropriate in adjudication procedures. However, the concept of ‘speedy trials’ should be applied in the adjudication of all cases, with the exceptions of ‘hard cases’ where more time is required.

The courts may be primarily given 120 days from the date of filing a particular case to the delivery of judgment. Subject to reasonable grounds, the Chief Justice may extend the time limit for another 30 days. Finally, in ‘hard cases’, the Chief Justice may grant a further extension of 30 days. If the court in any circumstances failed to dispose of a given case within the above stipulations for any reason whatsoever, the case should be transferred to the HCD (special bench, discussed in section 8.7.5. below) without delay. The HCD would hear the case under its statutory original jurisdiction. Currently, the HCD enjoys such a jurisdiction over some company matters. For securities purposes, the *Companies Act* 1994 and other pertinent laws may be amended to empower the HCD to adjudicate ‘hard’ securities cases.\(^{131}\) The special bench of the

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\(^{129}\) District Judges are the most senior judicial officers in the lower judiciary. Thus these judges are more experienced than others as judges of courts of first instance. In addition, it is generally considered that these judges are relatively honest as compared to their junior colleagues.

\(^{130}\) The next chapter will explain the disputes to be settled by the regulators.

\(^{131}\) Currently, the HCD is entitled to try some company matters under its special and statutory original jurisdiction. The provisions concerning this jurisdiction may be amended to suit the proposal advanced in this thesis.
HCD which is referred to, will hear these cases and deliver its judgment in 45 days from the date of the transfer of the cases from the trial courts.

8.7.4. Appeal against the Judgments of the Securities Courts

An appeal may be made against the judgment of the securities courts to the HCD within 30 days from the date of the delivery of judgment.\textsuperscript{132} There should be a specific bench in the HCD for trying securities cases (transferred from securities courts) and hearing appeals against the judgments of the proposed securities courts. The judges of this bench should be sufficiently trained in securities laws. At the early stage, judges for the special bench for securities cases may be selected from the HCD on the basis of some specific criteria. These criteria may include, inter alia, their knowledge of securities laws, good performance record to ensure professional efficiency, personal integrity and honesty. There should also be a specific time limit for the HCD like the court of first instance. This duration may be 45 days from the date of filing an appeal.

Appeals shall lie to the AD against the judgments of the HCD. The decisions of the AD should be final. An appeal to the AD may be allowed within 30 days from the date of the judgment of the HCD. This right to appeal should be subject to the leave of the court (AD). The AD will be required to deliver its final judgment in 45 days from the date of lodging the appeal.

Apparently, these might seem to be exceptional provisions for the settlement of securities cases in such a short period. In practice, it is quite possible which is evident

\textsuperscript{132} A 30-day period is a standard time for filing appeal in the courts in Bangladesh.
from some recent judgments under some ordinary as well as special laws of the country.\footnote{For example, Speedy Trial Courts have been established in April 2002 in the district and metropolitan cities for the trial of some designated crimes under the \textit{Law and Order Disruption Crimes (Speedy Trial) Act} 2002. Under this Act, the courts must complete the trial within 30 working days if the accused is caught red-handed. In other cases the trial must be completed in 60 working days (s10). The performance report of the Speedy Trial Courts shows that in the first six months (April–September 2002), the courts disposed of 548 cases out of a total of 909 registered cases in compliance with the Act: \textit{The Daily Janakanth}, Dhaka (21 Sept 2002) (translated from Bengali). Further, recently, the trials of Shihab \textit{murder} case and Trisha \textit{murder} case have been completed in 27 working days\footnote{N Ashraf, ‘New Law for Speedy Trial of Six Major Offences’ \textit{The Daily Star} (25 Oct 2002) & ‘Speedy Trial Tribunal’ \textit{The Daily Jugantor}, Dhaka (26 Oct 2002) editorial (translated from Bengali).} and in 59 days respectively from the date of framing charges (in 74 days from the date of occurrence): ‘Judgment of Trisha Murder Case’ \textit{The Daily Janakantha}, Dhaka (3 Oct 2002) editorial (translated from Bengali).}

In another effort to ensure speedy trial, the President in October 2002 promulgated an ordinance entitled the \textit{Speedy Trial Tribunal Ordinance} 2002. Under this new law, initially six tribunals will be established in six divisional cities for the trial of six major offences which are punishable with death sentence. The trial must be completed in 90 working days. In special cases, the time limit may be extended first by 30 days and then by 15 days with the approval of the Supreme Court.\footnote{In addition to the above, there are more special laws under which special courts have been established for the purpose of speedy trials. Therefore, it is not a new phenomenon in Bangladesh to set up special courts in the interest of speedy trials. It is, albeit, a new idea for the securities cases.}

In addition to the above, there are more special laws under which special courts have been established for the purpose of speedy trials. Therefore, it is not a new phenomenon in Bangladesh to set up special courts in the interest of speedy trials. It is, albeit, a new idea for the securities cases.

\section*{8.7.5. Ensuring Independence and Accountability of the Judges of the Securities Courts}

The judges of the securities courts shall be independent and honest in the administration of justice as has been highlighted before. It is, of course, difficult to ensure the independence and integrity of judges, but not unattainable. Judicial independence
largely depends on the attitude of the executive branch of the government. First of all, the executive must have a firm commitment that it will not interfere with the functions of the courts. At the same time, the government should be sincere in restraining judicial corruption. On the other hand, the personal determination of the judges appointed to the Securities Courts to ignore all irrelevant factors and to work independently with utmost honesty in dealing with securities cases is equally important.

Judicial independence is, in deed, essential to the dispensation of justice. But in reality, independence itself is not a panacea for justice. A recent trend is that the accountability of judges has significant implications for the balance between the judicial independence and impartial justice. In this regard, Shetreet strongly argued that ‘[j]udicial independence cannot be maintained without judicial accountability for failure, errors or misconduct’. Despite the importance of accountability, it is beyond the scope of this thesis to work out a method for judicial accountability that can be applied in Bangladesh. However, to ensure judicial honesty in the enforcement of securities laws, some mechanisms may be suggested. These are: the periodic disclosure of assets owned by the judges, the disclosure of judge’s interests in the case on trial if there is any, subjecting them to a number of sanctions which involve disciplinary action including dismissal as well as penal sanctions.

135 Buscaglia defines the term ‘judicial corruption’ as ‘the use of public authority for the private benefits of court personnel when this use undermines the rules and procedures to be applied in the provision of court services’: E Buscaglia, ‘An Analysis of Judicial Corruption and Its Causes: An Objective Governing-Based Approach’ (2001) 21 International Review of Law and Economics 233 at 235.


In addition to the proposed measures applicable to all judges of the proposed courts, some specific actions should be considered for the judges who will fail to conclude a trial within the stipulated time limits without plausible reasons. For example, the failure of a judge to deliver a verdict within the stipulated timeframe should entail a departmental investigation into the functions of the judge in relation to the given case. Under Article 109 of the Bangladesh Constitution, the HCD is entitled to carry out such investigations. Depending on the investigation report, disciplinary actions shall be initiated against the judges if a significant lack of honesty, sincerity and deliberate inefficiency are proved. Actions under ordinary municipal law should be taken if a dishonest practice is found in the investigation.

As regards the accountability of the bench of the HCD which will be designated for hearing appeals against the judgments of the proposed courts and for the trial of the 'hard cases', the judges should be accountable to the Chief Justice. If the Chief Justice deems it necessary, the existing Supreme Judicial Council (SJC) may conduct an investigation into the apparent reasons for delay at the bench of the HCD.

As a mechanism of investor protection, the above suggestions aim to deliver justice to the victims of the violation of securities laws through competent courts in the true sense. It is submitted that if these suggestions are implemented, at least an acceptable level of efficiency, independence and honesty in the administration of justice in securities cases can be achieved.

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139 Article 109 of the Constitution of the People's Republic of Bangladesh 1972 states that: 'The High Court Division shall have superintendence and control over all courts and tribunals subordinate to it'.

140 Under Article 96(3) of the Bangladesh Constitution 1972, Supreme Judicial Council (SJC) is a permanent body which consists of the CJ and two other next senior judges of the AD. The primary functions of the SJC is prescribe a Code of Conduct to be observed by the judges and to inquire into the capacity and conduct about the allegations levelled against any judge of the Supreme Court.
8.8. Civil Suits by the Securities Regulator on Behalf of Investors

The SEC is not entitled to sue the violators of disclosure requirements for the recovery of loss or damage sustained by the investors on the one hand, and individual investors are generally either unable or reluctant to sue the wrongdoers on the other. As a result, innocent retail investors remain uncompensated and wrongdoers go unpunished. Until recently, this was the case in India and Malaysia too. The Companies (Amendment) Act 2000 has empowered the Securities and Exchange Board of India (SEBI) to administer s62 of the Companies Act 1956 (CA’56) which provides for compensation for the investors. Hence, the SEBI is now entitled to sue the violators of s62 of the CA’56. Similarly, Malaysia has recently enabled the Securities Commission (SC) to lodge civil suits on behalf of persons who suffered loss or damage as a result of the violation of disclosure requirements. In this regard, s155(1) of the Securities Commission Act 1993 (SCA’93) provides that:

The Commission may, if it considers that it is in the public interest to do so, recover on behalf of a person who suffers loss or damage by reason of, or by relying on, the conduct of another person who has contravened any provision of Part IV or any regulations made under this Act the amount of the loss or damage by instituting civil proceedings against the other person whether or not that other person has been charged with an offence in respect of the contravention or whether or not a contravention has been proved in a prosecution.

Part IV of the SCA’93 (mentioned in the quote) deals with, inter alia, the issuance of securities. Policies and Guidelines on Issue/Offer of Securities 1999 (Guidelines’99) outlines the requirements of disclosures in a prospectus in Malaysia. These disclosure

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141 Currently, there are no provisions for class actions in respect of securities cases in Bangladesh.

142 Companies (Amendment) Act 2000 s16.
requirements are applicable to the IPOs. The SC under the authority of the SCA ‘93 has promulgated the Guidelines ‘99. Section 155(1) is clearly applicable to the judicial enforcement of prospectus liability and the SC can sue the violators for the recovery of loss or damage of the investors in the IPO market in Malaysia.

There are good reasons for discouraging the filing of large amount of private litigation (litigation by individual investors) in emerging markets. One of the major problems for the enforcement of civil liabilities in such markets has been identified as the considerable weakness of the judiciary. The civil courts lack trained judges and lawyers leading to high costs of private litigation. The other negative aspect is that corporate governance in emerging markets is so weak that minority shareholders do not have a basis on which to sue the corporate wrongdoers. Having regard to these impediments, it is suggested that shareholders avoid civil litigation. The market in Bangladesh is a pre-emerging one where the above impediments are stronger as compared with many emerging markets. The inability and passivity of investors in suing the wrongdoers are evident from the fact that after the market crash in 1996, the SEC filed only the criminal cases against the offenders, the investors themselves could not afford to lodge civil suits.

In developed markets, the institutional investors usually play a significant role in enforcing the securities law. Wellons contends that it may be ‘very inappropriate’ to rely on the retail shareholders to enforce the law in an emerging or pre-emerging market which lacks ‘the institutions to support private litigation’. He also argues that the

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143 The guidelines describe the requirements of disclosures in a prospectus in Malaysia.
145 Ibid.
146 Wellons (2000) above n144.
147 Id at 40. In this respect, the term ‘institutions’ refers to, inter alia, institutional investors.
reliance of a regulator on investors to file private litigation 'recognizes that the securities regulator lacks the resources to police all securities markets itself'.\textsuperscript{148} The lack of regulatory powers to sue the wrongdoers on behalf of the investors is therefore regarded as a weakness of the securities regulator.

Finding a negative impact on the market from another point of view, Grundfest advocated for the curtailment of civil suits by the investors. He proposed that suits discourage people from investing in securities.\textsuperscript{149} However, Seligman refuted the Grundfest's arguments and argued, inter alia, that '[p]rivate litigation performs a significant role in maintenance of investor confidence by enforcing the mandatory disclosure system'.\textsuperscript{150} In response, Grundfest again defended his views and countered Seligman's arguments to justify the reduction of private litigation in relation to securities trading.\textsuperscript{151} In the wake of such a debate in the United States, both the Securities and Exchange Commission and the courts were rapidly focusing on the proposition that 'private securities litigation poses a serious problem'.\textsuperscript{152} In responding to the perceived threats to the securities market,\textsuperscript{153} the US Congress enacted the \textit{Private Securities Litigation Reform Act 1995} to restrict the use of class actions.\textsuperscript{154} In doing so, 'Congress concluded that too many shareholders' suits were designed to blackmail the

\textsuperscript{148} Id at 50.


\textsuperscript{152} Id at 743.


issuing companies into settling out of court.\textsuperscript{155} In many countries private civil suits concerning securities trading are unusual. For example, there is an extremely low private litigation rate in Japan.\textsuperscript{156} Even in the UK, there is reluctance to provide the investors with the right of private action.\textsuperscript{157}

The above discussion on the practice of private litigation shows that the reliance on investors to recover their loss by themselves is a regulatory weakness. The practice of commencing large number of court actions is detrimental to the market on two counts. Firstly, it discourages investors from investing in securities; and secondly, the large numbers of litigation impose a considerable expense on the issuing company. A company belongs to the shareholders and any expenses of the company in turn concern the investors. Therefore, the SEC should take the responsibility for bringing the violators of disclosure requirements to justice and recovering compensation for investors. A proactive regulatory approach will foster better investor protection in the IPO market in Bangladesh.

\section*{8.9. Summary and Conclusions}

It is essential to strengthen the legal rights of investors and make these rights enforceable.\textsuperscript{158} This is because investor protection cannot be provided through the incorporation of their rights in the law alone; the effective enforcement of those rights is

\begin{footnotesize}
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\item \textsuperscript{155} Wellons (2000) above n144 at 52.
\item \textsuperscript{156} Ibid.
\item \textsuperscript{157} Ibid.
\item \textsuperscript{158} Johnson (2002) above n7 at 11.
\end{itemize}
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imperative.\textsuperscript{159} The judiciary is the guardian of people's rights and 'courts play a central role in corporate governance' which primarily aims to protect external shareholders.\textsuperscript{160}

Despite the paramount importance of the enforcement of the legal rights of investors, the enforcement records are very poor in Bangladesh. Many reasons have been identified for the trend of inaction against the violators of disclosure requirements. The reasons in brief are: a lack of experienced, efficient and honest judiciary, the erosion of public confidence in the present courts and bars, chronic delays in the justice system, the financial and political superior position of the wrongdoers as compared to that of the victims; and a lack of regulatory powers to institute civil suits on behalf of investors.

It has been argued that it would be difficult to eradicate the above weaknesses from the existing courts system. The establishment of separate courts for securities cases has been suggested as a solution to the problems.

Although, the operation of separate courts is not a popular practice, a 'different national context' requires a different securities law regime.\textsuperscript{161} Some of the important factors that necessitate special measures are: the goals of securities law; the level of sophistication of securities markets and related institutions; the level of sophistication and credibility of legal institutions.\textsuperscript{162} These aspects of national context for the variation of corporate or securities laws support the special judicial enforcement of law in the interest of the securities market in Bangladesh. The situation also calls for a strong protective approach to investors.


\textsuperscript{161} See Black et al (1996) above n31 at 1920-29.

\textsuperscript{162} Id at 1920.
Generally speaking, the maximisation of profits of the firm is the central goal of corporate law from the economic point of view.\textsuperscript{163} But the corporate law of emerging markets 'must address a broader set of goals'.\textsuperscript{164} In emerging economies, corporate law should provide more investor protection, as compared to that provided in the developed economies.\textsuperscript{165} The same view has been found in the earlier discussion of goals of judicial enforcement of the disclosure regime. The arguments for more protective measures in emerging or pre-emerging markets are based on the prevalence of special characteristics of those markets. These characteristics are such as: the severity of informational asymmetries, less operational and economic efficiency of the markets because of the lack of standard professional services, the problematic enforcement procedure of law due to the weakness of courts, and the paucity of experienced market participants.\textsuperscript{166} The existence of these characteristics in the Bangladesh IPO market is evident from the discussion and analysis made in Chapter 5. In addition to the above shortcomings, there are some other concerns about the judiciary as explained in this chapter.

In view of the present situation, the establishment of special securities courts is long overdue for the sake justice in securities cases. However, the simple establishment of special courts will not be sufficient to address the problems concerning these cases. To facilitate the effective operation of the proposed courts, increased accountability of judges is essential. Otherwise, the proposed special courts will be engulfed in the old problems which have necessitated the introduction of special mechanism for the judicial

\textsuperscript{163} In brief, corporate law helps maximise the profits of a company by regulating the functions of the company management and protecting outside investors from the malfeasance of others who are involved in the fundraising process of the entity.
\textsuperscript{164} Black et al (1996) above n31 at 1921.
\textsuperscript{165} Ibid.
\textsuperscript{166} Id at 1924.
settlement of securities litigation. In Bangladesh, the practice of judicial accountability to protect the judiciary itself from the public confidence crisis is long overdue. More than ever before, the judiciary has in recent times lost its credibility to the public. In terms of the judiciary, public confidence should be considered to be an end in itself, whilst accountability can be seen as a means to that end. The arguments for the separate courts also rely on the need for independent and impartial judicial decisions. Judges should be independent from any sort of influence because an independent judiciary is essential for the effective judicial enforcement of securities laws.

Lawyers are an integral part of the administration of justice. A need for special measures has been argued to ensure the ethical and professional conduct of lawyers. Central to these measures is the need for the systemic regulation of lawyers by the existing statutory body and their respective associations. Imparting adequate legal education and training to the lawyers is also crucial.

Investors are either reluctant or unable to go to court for judicial remedies. As a result, the wrongdoers care little about flouting the law. Empowering the SEC to sue the violators of prospectus civil liabilities is an important issue for investor protection. Referring to several other jurisdictions, it has been argued that leaving the responsibility for the enforcement of civil liabilities with the investor alone is a regulatory weakness. The paucity of litigation, despite the allegations of the violations of civil liabilities,

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167 In 2000, the Prime Minister then in power expressed her dismay about the role of the judiciary when the courts granted bail to 500 known criminals. She asserted that not only the courts which grant bail but also who plead for the criminals should be held accountable. This assertion earned supports of 64 per cent respondents to a survey conducted by a newspaper, see Shariff, 'Legal System in Britain and Bangladesh: Of Independence of the Judiciary' The Independent, Dhaka (21 Aug 2000). This survey as well as recent public criticism published in various newspapers endured the popular demand to have an accountable judiciary.

168 Shetreet (1986) above n35.

169 Criminal prosecution is said to be ineffective in the absence of politically independent prosecution system because of 'close relations between business and politics': N L Wong, 'Easing Down the Merit-Disclosure Continuum: A Case Study of Malaysia and Taiwan' (1996) 28 Law and Policy in International Business 49 at 88.
proves that asking investors who lose their meagre savings in the market to bring the wrongdoers to book is completely futile in Bangladesh. In response to similar circumstances, India and Malaysia have already amended their respective legislation to empower their securities regulators for the recovery of investors’ loss or damage.

The enforcement of civil liabilities will not be sufficient to deter the offenders. Criminal liabilities should also be enforced with due emphasis. Recent cases in the UK and the US have precipitated a public demand for more vigorous enforcement of securities law. The people in these countries want greater use of criminal sanctions, with special emphasis on imprisonment. Similar to civil liabilities, the importance of the enforcement of prospectus criminal liabilities also entails the operation of competent and efficient courts to penalise the offenders in the securities market.

Good laws and efficient courts minimise the unfair benefits to corporate managers and in turn maximise the return to the external shareholders. The efficient judicial enforcement of securities laws provides investor protection and thus increases the availability of external equity finance which is essential for the development of securities markets. The present judicial enforcement of prospectus liability has proved to be ineffective to protect investors in the IPO market in Bangladesh. In addition to judicial enforcement, the administrative enforcement of the securities law is a complementary mechanism to the whole enforcement regime. The following chapter will analyse the issues of administrative enforcement.

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Chapter 9

Administrative Enforcement of Disclosure Regime

9.1. Introduction

Investor protection can never be provided in the absence of cogent domestic laws and an effective judiciary, or alternatively a tough but fair regulator.\(^1\) It is stated that a close relation exists between ‘the emergence of a credible enforcement rule’, designed particularly to protect minority shareholders and the development of a securities market.\(^2\) In enumerating the essential criteria for a successful regulatory regime, Ferran asserts that there is a strong correlation between ‘the preference for legal rules and the desire for effective enforcement’.\(^3\) Conversely, the inadequate enforcement of securities law is seriously detrimental to the credibility of capital markets.\(^4\)

The term ‘administrative enforcement’ refers to the enforcement of securities laws by the administrative or regulatory authorities.\(^5\) This enforcement is considered to be the key to regulatory success in the realm of securities. The administrative enforcement of disclosure regime is highly significant in Bangladesh because of a serious absence of judicial enforcement as discussed in the preceding chapter. When a court is weak in protecting investors, a strong regulator can provide this protection.\(^6\) Thus, a successful

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5. The terms ‘administrative/administration’ and ‘regulatory/regulation’ are used interchangeably.
Disclosure-Based Regulation (DBR) entails a strong regulatory framework. But there have been widespread allegations of ineffectiveness of the present securities regulation in Bangladesh. Over the years, regulators have failed to restore investor confidence because of a lack of success in protecting investors: be it in the way of ensuring full and fair disclosure in the IPO market, or remedying the violations of disclosure requirements. To address the situation, the government has misplaced its emphasis and offered some incentives to investors and issuers alike instead of bringing about reforms in the regulatory framework. Consequently, the governmental efforts ended in failure to promote the market. Therefore, the issues of administrative enforcement of the disclosure regime in Bangladesh need to be addressed with an objective to identify the underlying drawbacks of the existing administration of disclosure regulation and recommend measures to make the regulation effective.

The discussion begins with an introduction in section 9.1. Section 9.2 will briefly describe the present administration of the disclosure regime in Bangladesh. Section 9.3 will investigate the flaws in the current administration of the disclosure regime and explore the need for reforms to protect investors in the IPO market. Section 9.4 will focus on the fundamentals of regulatory functions as to the administration of the disclosure regulation. Section 9.5 will draw a summary and conclusions which will demonstrate that the present administration has been suffering from multifaceted deficiencies and some urgent reforms may be in order to afford protection to investors in the IPO market.

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9.2. Present Administration of the Disclosure Regime in Bangladesh

At present, there is a dual administration of the disclosure regime in Bangladesh. The main reason for such an administration is perhaps the absence of consolidated securities legislation. As is evident from the discussions in Chapters 6 and 7, the disclosure requirements in prospectuses are regulated by two different sets of laws, namely, company law and securities laws. Two different authorities, namely, the Registrar of Joint Stock Companies (RJSC) and the Securities and Exchange Commission (SEC) are responsible for the administration of these laws. Although the major liabilities for the violation of disclosures in prospectuses have been set out in the Companies Act 1994 (CA'94), the SEC does not have any authority to deal with the contravention of the CA’94 as asserted by the chairman of the SEC. The SEC is thus not entitled to register any suit or prosecution under the CA’94. On the other hand, the RJSC has not been seen to be concerned about the violation of disclosure requirements as set forth in the CA’94. However, the SEC at times interferes with the matters governed basically under the CA’94. Some of the important matters that fall within the extent of the SEC interference are: holding Annual General Meetings (AGMs), appointing auditors, and declaring and distributing dividends by listed companies.

The SEC interferes with these issues under the powers conferred on it by s2CC of the Securities and Exchange Ordinance 1969 (SEO’69). Section 2CC was inserted in

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8 See sections 4.3.5 and 4.3.4.
9 Details of these liabilities have been discussed in Chapters 6 and 7.
10 D N Saha, ‘SEC Not Responsible to Protect or Violate Company Act, Says Manir’ The Independent, Dhaka (22 Apr 2002).
11 To date, no case law has been found for flouting the prospectus liabilities under the CA’94.
12 Section 2CC was inserted in 1997 under s2 of Securities and Exchange (Amendment) Act 1997.
the SEO'69 in 1997 to entrust the SEC with the authority to impose conditions on the affairs of companies. The section provides that:

Notwithstanding anything contained in Company Act, 1994 [the CA'94]... or in any other law for the time being in force, or in any contract or any Memorandum and Articles of Association of any company, any consent or recognition accorded under section 2A, section 2B or section 2C [of the SEO'69], whether before or after the commencement of this section, shall be subject to such conditions, if any, as the Commission [SEC] may, from time to time, think fit to impose.13

Under the authority of the above section, the SEC, from time to time, imposes conditions on companies with a view to protecting investors and developing the market. Section 81 of the CA'94, for example, makes it clear that the regulation of AGMs is the responsibility of the RJSC, not of the SEC. In defiance of the CA'94, the SEC issued an order on 4 October 2001 imposing a condition that AGMs 'shall be held within 6 (six) months from the close of the financial year'.14 The pertinent provisions of the CA'94 are completely different from this order. With regard to AGMs, the CA'94 provides that the meeting will be held in accordance with the Gregorian calendar (January-December) and there should not be a gap of more than 15 months between two consecutive AGMs.15 In addition, the High Court Division of the Supreme Court (HCD) may grant a further extension of this gap under s81(2) of the CA'94. For example, the HCD in *Bengal Steel Works Limited v Registrar of Joint Stock Companies* condoned the delay in holding the adjourned AGM of the petitioner on the ground that balance sheet and profit and loss account were not ready to be placed in the meeting.16 When the company held its last AGM within the extended time granted by the HCD, the prescribed limitation of 15 months to hold the next AGM would be counted from the date of such last meeting,

13 *Securities and Exchange (Amendment) Act 1997 s2.*
14 *Securities and Exchange Commission (SEC), Order, No - SEC/CFD/2001/Admin/02-03 (Gazetted on 22 Oct 2001).*
15 *Companies Act 1994 s81(1).*
as it was held in *Bangladesh Chemical Industries Corporations v Registrar of Joint Stock Companies*.\(^{17}\) In this situation, the actual gap may be longer than 15 months between two consecutive AGMs. Not only the HCD, but also the RJSC is empowered to extend the above time limit for AGMs to a certain extent.\(^{18}\)

The SEC order regarding AGMs thus contradicts s81 of the CA’94 on two counts. Firstly, the order provides for a time limitation which is significantly different from that of the CA’94. Secondly, the duration of gap between two consecutive AGMs is required to be counted in terms of ‘financial year’\(^{19}\) under the SEC order, instead of Gregorian year as prescribed in the CA’94.

Further, the SEC issued another order on 3 January 2002 in relation to AGMs. This order imposes a fresh condition on the listed companies. It provides that:

> The issuer shall make continuous and uninterrupted audio visual recording of the entire proceedings of its annual general meeting and shall furnish a copy of the same in unedited form within the shortest possible time but not later than three working days from the date of holding of the said annual general meeting to the Commission and the Stock Exchange(s).\(^{20}\)

The requirement of recording AGMs is a completely new idea in the corporate governance in Bangladesh. The regulator made such an order in the wake of allegations that AGMs are ‘managed’ by the directors of companies by offering gifts or in any other undue manner.\(^{21}\) As a result, it has been said that the resolutions of AGMs do not reflect the desire of ordinary investors.

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\(^{17}\) 39 DLR 1. This judgment was delivered in relation to a similar provision of the *Companies Act 1913* (Bangladesh) which was replaced by the CA’94.

\(^{18}\) See, for details, *Companies Act 1994* s81(1).

\(^{19}\) According to s2(i) of the CA’94, the term ‘financial year’ refers to a year which ‘means, in relation to any body corporate, the period in respect of which any profit and loss account of the body corporate laid before it in the annual general meeting is made up, whether that period is a year or not; Provided that in relation to an insurance company, “financial year” shall mean the calendar year’.

\(^{20}\) SEC, Order, No - SEC/CFD-71/2001/Admin/02/53 (Gazetted on 30 Jan 2002).

\(^{21}\) See section 5.3.3.1.
Another recent order of the SEC concerning the appointment of the same firm of chartered accountants as a statutory auditor by a company for a consecutive period of more than three years. It has created controversy amongst the companies. The order, having retrospective effect, stipulates that this provision shall also apply in the case of auditors who have been auditing the same company for the last three years. The order purports to ensure transparency in the books of accounts of the listed companies. Subsequently, the SEC relaxed the prohibition by an order of 3 January 2002. Under this relaxation, the companies may appoint the same firm of chartered accountants for more than three years if they declare ‘at least 10 per cent dividend on the face value/paid-up capital or 7.50 per cent on the net-worth whichever is higher’ for the year which is immediately preceding to the year in question. Nonetheless, the HCD suspended the operation of the SEC order regarding the prohibition in relation to the appointment of auditors.

Further, the SEC order suspending the trading of 11 listed companies belonging to the Beximco Group once again gave rise to a controversy amongst the participants in the country’s security market. The HCD served a show cause notice on the SEC to show the legality of the order.

The Beximco Group also legally challenged the validity of the above-mentioned order of the SEC concerning the video recording of AGMs. Following the petitions of the Beximco, the HCD on 17 May 2002 suspended the operation of the SEC order.

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22 See section 5.3.1.
24 See section 5.3.1.
25 The SEC accused the companies of making inadequate disclosures in respect of the declaration of dividends: see, for details, sections 5.3.9.1- 5.3.9.10.
Currently, there has been a debate about the validity of enabling s2CC of the SEO’69 under which the SEC issues orders regarding corporate governance defying the exclusive authority of the RJSC. In April 2002, the president of the Bangladesh Association of Publicly Listed Companies (BAPLC) in its third AGM contended that s2CC of the SEO’69 is a violation of the CA’94. He asserted that ‘I, on behalf of the association reiterate that the rules and regulations of the SEC must not conflict with any provision of the Company Act, the mother law’.

Further, the BAPLC has been contemplating to challenge the legality of the SEC recent order regarding the restructuring of the management of companies belonging to the Z group. The continued poor performance of more than one-third of listed companies has a deleterious effect leading to the current stagnation of the securities market. The SEC issued a warning notice to the companies in November 2001 in which the regulator observed that the accumulated loss of some companies exceeded their paid up capital. Shareholders of these companies are unaware of the true state of affairs of their companies. After the repeated efforts of the SEC, no tangible results had been achieved. In such a situation, the SEC contemplated issuing orders for restructuring the boards of the companies. Finally in August 2002, the SEC issued a notification which provided for restructuring the boards of these companies in a prescribed manner.

Legal experts supported the allegation of the BAPLC in respect of the violation of the CA’94 by the above-mentioned order of the SEC concerning the Z group companies. The lawyers even went one step further by saying that s2CC of the SEO’69

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28 For details of the ‘Z’ Group, see section 3.4.5. More than one-third of the listed companies belong to the Z group.
30 For details, see SEC, Notification No. SEC/CMRRCD/2001-14/Admin/03/06 (1 Aug 2002).
is contradictory to the Constitution of Bangladesh. Because of the prevalence of constitutional supremacy, any law inconsistent with the Constitution shall be void to the extent of such inconsistency.\textsuperscript{31} They argued that the ‘SEC cannot function as the law-making body like Parliament’.\textsuperscript{32} Referring to the contradiction between the SEC orders and the CA’94, the lawyers opined that the SEC can promulgate rules in conformity with the enabling law, but cannot make rules that are contradictory to the legislation of Parliament (refers to the CA’94). They added that Parliament cannot delegate any power to any body to make law.\textsuperscript{33} Their arguments referred to the limitation of delegated legislation to make by-laws. The HCD in January 2003 eventually stayed the effect of the SEC order asking the reconstitution of the boards of companies belonging to the Z group, and questioned the very legal authority of the regulator to classify the companies under such a group. The HCD issued the order following a petition filed by Shinepukur Holdings Limited (a Beximco company) which challenged the SEC notice as being ultra vires of the SEO’69 and the CA’94.\textsuperscript{34}

The SEC has promulgated all of the above orders and notifications in the exercise of powers conferred on it under s2CC of the SEO’69. Arguably, the orders aimed at protecting the interest of investors as well as preserving the integrity of the market. But they have generated controversy because of their questionable legality. The SEC has been facing problems in enforcing those orders because of an alleged lack of authority of the SEC to promulgate them. A law does not bear any inherent power in itself. Rather, the force of a law depends on its proper enforcement. Voluntary compliance with laws is more desirable than their mandatory enforcement. For the public

\textsuperscript{31} Constitution of the People’s Republic of Bangladesh 1972 art 7(2).
\textsuperscript{32} Saha (2002) above n10.
\textsuperscript{33} Ibid.
acceptance of any regulation, the regulatory functions should be transparent. The International Organisation of Securities Commissions (IOSCO), in this regard, suggests that the regulatory powers should be exercised in a comprehensible and transparent manner.\(^{35}\) The IOSCO also proposes that the regulatory responsibilities should be stated clearly in the governing legislation in order to enhance the acceptance of regulation and to meet the needs of fairness and transparency which are basic principles of securities regulation.\(^{36}\) Shimomoto asserts that securities watchdogs ‘must have a legal base on which’ regulatory powers will be exercised.\(^{37}\) But this base of the SEC powers to promulgate by-laws for the regulation of the market is facing a legal challenge and public criticism in Bangladesh. This situation contributes to lowering the credibility of the SEC and thereby weakening the administrative enforcement of securities laws.

The importance of administrative enforcement of the disclosure regime has been increasingly stressed at the present time following the futile efforts at judicial enforcement. But the administrative enforcement of the regime is also very poor and this will be evident in the following discussion. In such a situation, a lack of the authority of the SEC to issue orders for the regulation of the market will further weaken the enforcement actions. The enactment of a securities code incorporating all securities laws currently in force with necessary reforms may provide a clarification of the alleged lack of SEC powers. Moreover, such a code, if legislated after bringing about the

necessary amendments in securities laws, can contribute to strengthening the existing legal framework of the regulatory regime.

Perhaps, a dilemma exists between the SEC and the RJSC as regards taking action against any violation of disclosure requirements. The RJSC is practically inactive in this regard, whilst the role of the SEC is not commendable either as will be seen later in this discussion. The present dual regulation of the disclosure regime is thus considered to be another cause of the regulatory problem.

9.3. Importance of an Independent and Honest Single Authority for the Administration of a Disclosure Regime

As mentioned above, two parallel authorities, the SEC and the RJSC, are currently charged with the responsibility for the administration of the disclosure regime in Bangladesh. This fragmented administration is unfavourable to the prudent enforcement of prospectus liabilities. The office of the RJSC is under the direct control of the government and the persons who hold this office have no expertise in securities regulation. The office discharges basically secretarial functions. To the best of this writer’s knowledge, it has never been said that the RJSC has expressed any concern about the violation of prospectus liabilities, although he or she is entrusted with the full responsibility for the administration of the CA’94. The securities regulators need to be proactive having expertise in their operational area and functional independence from the government. In this regard, the development committee of IOSCO recommends that:

Securities Commissions must be technical, specific entities specializing in their own scope, that is, the securities market. In other words, Commissions are to be independent, autonomous organizations, either from the Central Bank or the Ministry of Finance.39

38 The RJSC is a government officer placed under the Ministry of Commerce: see section 4.3.5.
39 Development Committee of IOSCO, The Role of Securities Commissions (Sept 1990) at 5.
The IOSCO committee argues that the securities regulator should be placed beyond the control of the Ministry of Finance 'due to the political independence that regulator must exhibit'.\(^{40}\) A recent survey supports this view and adds that the enforcement of securities regulation should be impartial and consistent.\(^{41}\) Bosch, a former chairman of the Australian securities watchdog strongly emphasised the need for the political independence of the regulator.\(^{42}\)

The need for political independence appears to be crucial in Bangladesh. This is because, the SEC was publicly criticised for playing a double standard in dealing with some identical cases in early 2002.\(^{43}\) It may be recalled here that the Vice-President of the Beximco Group is involved in opposition politics and he is the most prominent member of the group and a reputed industrialist in the country.\(^ {44}\)

Apart from the political independence, the honesty and efficiency of securities regulators are equally important. The importance of administrative authorities vested in a regulatory body lies in its accumulated expertise and market surveillance resources; its prominence in the minds of investors and its relationship with the self-regulatory organisations.\(^ {45}\) Black emphasises the need for an honest and specialised securities regulator on two premises. Firstly, specialisation is required to deal with complex securities cases, and secondly, defendants usually have financial strength to mount a

\(^{40}\) Ibid.


\(^{43}\) The SEC took regulatory action against some companies belonging to the Beximco Group for inadequate disclosures of price sensitive information, whilst some other companies, prior to the Beximco Group, were not questioned about committing the same wrong; see section 5.3.9.6.

\(^{44}\) For further details about Mr Salaman and the Beximco Group, see section 5.3.1.

\(^{45}\) T A Davis, 'A New Model of Securities Law Enforcement' (2002) 32 Cumberland Law Review 69 at 129.
powerful defence. This financial strength may also be used to convince the regulator in some unacceptable ways—offering bribes, for example.

Corruption repudiates the concept of independence. Corrupt officials are most unlikely to discharge their duties fairly. Black argues that corruption is a critical restraint to the development of a strong securities market. He also asserts that if corruption is entrenched once in securities regulation, dishonest people will look for the job of regulators whilst honest people will stay away.

Therefore, regulators entrusted with the responsibility for the reliable administrative enforcement of securities laws are required to be honest, expert and independent from political interference. These criteria for regulators are also important for restoring public confidence in securities regulation. This is because a state of unreliable enforcement ultimately impairs public confidence, the resultant effect of which is a weaker securities market. A regulator who lacks expertise, honesty and freedom from undue influence cannot adequately enforce the securities law. But the adequate enforcement of law is essential for the credibility of securities markets.

Referring to the markets in London and Hong Kong, Modigliani and Perotti observe that their success as international capital markets is attributed to a strong tradition of

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48 Ibid.

49 Ibid.

50 Modigliani et al (1997) above n2 at 520.

Id at 521.
law enforcement.\textsuperscript{51} Similar evidence has also been presented in respect of the Polish securities market.\textsuperscript{52} Conversely, loose regulation results in a ‘moribund stock market’.\textsuperscript{53}

Further, it is generally understood that the securities regulation in Australian is more prudent than that in Bangladesh. Yet, referring to the Australian Securities and Investment Commission (ASIC), Tomasic observes that regulatory actions must ‘become more creative and broadly based so as to draw more effectively upon the strengths of the regulated as well as the regulator’.\textsuperscript{54}

An effective regulator is thus urgently required for the securities market in Bangladesh where judicial enforcement is in such a parlous state. A regulatory body can provide investor protection if the victims of the violation of law fail to seek and obtain judicial remedies. In this regard, Johnson strongly argues that in the absence of an effective judiciary, there is no way investors can be protected without a fair and tough regulator.\textsuperscript{55} For the sake of enforcement of securities law, the authorities charged with the administration of the law must have clear and unambiguous jurisdiction.\textsuperscript{56} All of the above requirements of a securities regulator suggest the need for the establishment of an independent and specialised single regulatory authority to achieve a vibrant securities market.

\textsuperscript{51} Id at 523.
\textsuperscript{53} Id at 853.
9.3.1. Establishment of a Single Regulatory Body

Until recently, there had been more than one regulator for prospectus regulation in India and Malaysia. Given the complexities as stated above, both of the two countries have already amended their respective legislation. In doing so, the regulatory parts of registrars of companies have been vested in their securities regulators so far as they relate to, inter alia, the issuance of securities. Unlike the SEC in Bangladesh, the Securities and Exchange Board of India (SEBI) and the Securities Commission (SC) in India and Malaysia respectively have been established as a single body to regulate IPOs.

In India, the administration of the Companies Act 1956 (CA’56) was beyond the ambit of the SEBI until 2000. The Working Group on Company Act realised in 1997 that the SEBI and the Department of Company Affairs had been administering some aspects of public companies. The Group found that this dual administration resulted in overlapping jurisdiction and conflicts in the administration of the company. To avoid this conflict and to establish more efficient regulation of the issue of securities, the Working Group submitted a number of recommendations to the authority concerned. The prominent recommendations pertinent to the issue of securities were as stated below.

i. The regulation and disciplinary control over listed public companies for the purpose of the issue of securities and matters related thereto ‘should be unified to the extent possible’. The SEBI should be entrusted with the sole authority to regulate and police the issue of securities and matters incidental thereto.

ii. Prospectuses ‘should be under the domain of the SEBI’. 57

Pursuant to these recommendations, the CA’56 has been amended by the Companies (Amendment) Act 2000. This amendment Act empowers the SEBI
exclusively to administer the provisions of the CA’56 so far as they relate to the
issuance and transfer of securities and non-payment of dividends in respect of public
companies.\(^{58}\) Hence, in India, there is no overlapping jurisdiction on the issue of a
prospectus and the securities regulator is entitled to regulate and police the aspects of
IPOs. However, the responsibility for the registration of prospectuses was left with the
Registrar of Companies (ROC) as it was in place before. Prior to these amendments in
2000, an offence against the CA’56 would be cognisable only on the complaints by the
ROC, shareholders and the Government under s621 of the CA’56. The s621 has been
amended in 2000 under the above amendment Act and the SEBI has been authorised to
file complaints for the offences concerning, inter alia, disclosures in prospectuses.\(^{59}\)
The SEBI actions will be complementary to the private actions that may be initiated by
investors.\(^{60}\) Now the SEBI is empowered to file both civil suits and criminal cases for
the violation of prospectus liabilities as envisioned in the CA’56. Lodging this litigation
was previously a concern of the Department of Company Affairs.

Similarly, in Malaysia, the responsibility of the Registrar of Companies (Registrar)
for the regulation of prospectuses has been shifted to the SC under the *Securities
Commission (Amendment) Act* 2000. This amendment was made in line with the SC’s
strategy of shifting from the Merit-Based Regulation (MBR) to the DBR. It was argued

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57 S Agarwal, Bindal C M & Jain V K, *Commentary on The Companies Act 1956* Vol-1 (Millennium
58 See, for details, *Companies (Amendment) Act 2000* (India) s16 and *The Companies Act 1956* (India)
s55A.
59 *Companies (Amendment) Act 2000* (India) s221.
that for the purpose of the DBR, the SC required an exclusive regulatory authority over
the issues of prospectuses.  

Some major changes have been brought about in the functions of the SC under the
Securities Commission (Amendment) Act 2000. The amendment empowers the SC to
file civil suits for the recovery of loss or damage sustained by investors as a result of a
defective prospectus. The SC has also the authority to prosecute offenders for the
contravention of disclosure requirements. In addition, the responsibility for the
registration of prospectuses has been shifted from the Registrar to the SC except for
those of unlisted recreational clubs. The SC has thus emerged as the single regulatory
body charged with the responsibility for the regulation of the IPO market in Malaysia.
However the Registrar will continue to be the repository for prospectuses.

In respect of the recovery of loss or damage, the SC can institute civil proceedings
regardless of whether or not the persons liable for the loss or damages have been
charged with a criminal offence for the same contravention.

Australia may be another example of the centralisation of authorities to regulate
IPOs. The ASIC is a single body to regulate the IPO market including the registration of

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61 Securities Commission, Amendments to the Securities Commission Act 1993: An Executive
62 Securities Commission Act 1993 (Malaysia) s155.
63 See Low (2001) above n36 at 284.
64 Section 155(1) of the Securities Commission Act 1993 provides that: ‘The Commission may, if it
considers that it is in the public interest to do so, recover on behalf of a person who suffers loss or
damage by reason of, or by relying on, the conduct of another person who has contravened any
 provision of Part IV or any regulations made under this Act the amount of the loss or damage by
instituting civil proceedings against the other person whether or not that other person has been
charged with an offence in respect of the contravention or whether or not a contravention has been
proved in a prosecution’. Part IV of this Act as mentioned in the quotation deals with, among other
things, the issues of securities.
prospectuses. The regulator is also entitled to sue as well as prosecute persons liable for defective prospectuses.65

Unlike the regulators in India, Malaysia and Australia, the SEC in Bangladesh is yet to become a single body for the IPO market. The SEC also lacks the authority to lodge civil suits on behalf of investors for the recovery of loss or damage resulting from a defective prospectus, although such an empowerment is long overdue to protect investors in the Bangladesh market. As a whole, the SEC should immediately be made the single regulatory body to oversee the IPO market.

9.3.2. Need for Reforms in the Securities and Exchange Commission

Making the SEC a single regulatory body for the regulation of disclosures in prospectuses will not be sufficient to address the problems associated with the current disclosure regime. More importantly, the SEC needs to be made quite competent to properly discharge its functions in relation to IPOs. The role of the SEC concerning the regulation of the securities market has been a subject of growing public criticism. Allegations raised by various market participants and commentators alike through the press media had the effect of demonstrating that the government watchdog lacks adequate knowledge, experience, efficiency and honesty in dealing with operations of the market.

As has been mentioned in Chapter 4, the concerned parliamentary committee strongly criticised the inefficiency of the SEC.66 Similarly, there are many allegations raised by the market analysts that the SEC enforcement actions adversely affect the interests of investors instead of protecting them. For example, the actions against the

11 companies of the Beximco Group for inadequate disclosure referred to earlier are alleged to have harmed the investors and all of the market participants solicited for the immediate withdrawal of the SEC suspension order. Referring to the continued poor performance of the market, regulatory measures to protect investors have been described as 'blunders one after another'. For example, in early 2001, the SEC issued a draft regulation in order to make compulsory listing of public companies with paid-up capital of at least 50 million taka (approximately US$88 million). The SEC had to withdraw its decision in the wake of protest demonstrated by the business communities who described the move as damaging to the market, because of the lack of mandatory disclosures and transparency as required under the IPO rules. In view of such activities and failure to boost the market, it has been argued that the SEC should be restructured with well-known professionals in the areas concerned.

In April 2001, market commentators censured the SEC for a sharp decline of share prices following the imposition of a new regulation in relation to the shifting of companies from A group to B and from B to Z group. The regulator ordered the shifting on the basis of the declaration of dividends and holding of AGMs by the companies. Recently, some directors showed their total disregard for this order of the SEC. The SEC summoned 10 directors of a listed company belonging to the Beximco

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66 See section 4.3.1.
67 O Khaiyam, 'Investors' Protector Affects Investors' Interests' The Financial Express (11 May 2002); M R Bari, 'A View of the SEC's Move' The Financial Express, Dhaka (17 May 2002). For greater details see sections 5.3.9.1- 5.3.9.10.
70 Alam (2002) above n68.
71 For details for 'A', 'B' and 'Z' groups, see section 3.4.5. The SEC introduced this grouping system in July 2000.
Group for submitting their explanation for an alleged violation of securities law. None of the directors complied with the summons.73

Showing concerns about the regulatory failures in the market, several recent editorials have remonstrated against the SEC role. One editorial describes the SEC as a body which failed to show much effectiveness,74 whilst another focuses on the lack of efficient manpower and irregularities in the SEC. The latter also mentions that the market is currently experiencing the lowest ever investor confidence due to regulatory failures.75 Yet another editorial focuses on the SEC’s lack of professional understanding of the market. It shows that the SEC acts against the interests of investors as well as the market and thus suggests an immediate restructuring of the SEC.76

Many companies have reportedly ‘looted’ funds raised from the public through defective prospectuses but the SEC failed to prevent these offers and to punish them after amassing money from the public.77 The leaders of the BAPLC have repeatedly expressed their dissatisfaction with the role of the SEC in developing the market.78 Pointing to the regulator’s role which is unfriendly to the market, a market analyst asserts that market players have become the victims of the ‘repression’ of the SEC. He also blames the watchdog for ‘expanding malpractice and destroying transparency’ in

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73 The alleged violation was regarding the provision of dividends. The company suddenly increased the declared dividend from 10 per cent to 15 per cent. The change affected the ordinary shareholders. For details, see ‘SEC Serves Fresh Hearing Notice on Beximco Pharma Directors’ The Financial Express, Dhaka (13 Oct 2002).
the market and so also making the market a 'completely manipulated one'. The analyst also opines that the acceptability of the SEC amongst the market participants remains at the lowest ever.

Academics in a seminar held recently criticised the SEC for its 'ignorance' of the reasons behind the present weak capital market. Evaluating the achievements of the SEC in the last 10 years since its inception, a market analyst observes that:

The time has come for the SEC to draw down its own management balance sheet. What it has achieved in the last ten years of its existence is more important for the public and the government than its ability to introduce senseless reforms in the market.

Another analyst maintains that the SEC has totally failed to enforce securities laws in the matter of redressing the tangible grievances of investors. To restore investor confidence, the violators of securities laws should be brought to justice and victims have to be adequately compensated.

The above discussion highlights the SEC’s lack of experience and efficiency. As regards transparency, the situation is equally undesirable. It has been argued that ‘[t]here are many, many instances of not good governance in the watchdog body’.

Iftekhar Gani Chowdhury, a member of the SEC and a university academic, had reportedly protested against irregularities in the regulatory body, and as a result, was

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81 ‘Give Info on Reasons for Weak Capital Market: Academics Urge SEC' *The Daily Star*, Dhaka (12 Jul 2002). The seminar was the first of its kind in which the SEC officials presented papers on 'Investor Education Program' attended by the students and academics of the Business School of the University of Dhaka.
allegedly forced to resign recently.\textsuperscript{85} With regard to transparency, an editorial enumerates some instances of irregularities in the SEC and refutes the claim of its chairman of ‘functioning with complete transparency’. The editorial, commenting on the assertion of the SEC chairman, affirms that ‘[t]here cannot be more travesty of truth than this statement’.\textsuperscript{86} It has been alleged that the investigators of the SEC ‘have often wrongly targeted people on the basis of private bias, hearsay, wrong assumptions about the market and political direction’.\textsuperscript{87}

In such circumstances, investors find no good reason to put their trust in the current securities regulator. Rather, they firmly believe that if once they lose their money, it will never be recovered and the SEC has failed to provide investor protection which is its principal mandate.\textsuperscript{88} Therefore, the reorganisation of the SEC is necessary for the development of the market and ‘[n]o option is left’.\textsuperscript{89}

\section*{9.3.3. Qualifications of Members of the Securities and Exchange Commission}

It is said that the only certainty in the securities market is that its behaviour is uncertain.\textsuperscript{90} As regards regulation, there is in place worldwide a quest of an orderly market. The effectiveness of regulation largely depends on the efficiency of the persons entrusted with regulatory responsibilities. One of the IOSCO principles pertaining to securities regulators provides that ‘[t]he regulator should have adequate powers, proper

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{85} Ibid.
\item \textsuperscript{86} ‘Where is the Complete Transparency in SEC?’ \textit{The Financial Express}, Dhaka (29 Aug 2002).
\item \textsuperscript{87} Husain, (2002) above n83.
\item \textsuperscript{88} K T Islam, ‘More Controversy over Mutual Funds’ \textit{The Financial Express}, Dhaka (8 Sep 2002).
\item \textsuperscript{89} S M Rashid, ‘Corporate Governance: “Z”-Share Issue Stirs up Troubles Putting the Cart before the Horse’ \textit{The Financial Express}, Dhaka (1 Sep 2002).
\item \textsuperscript{90} S Shah, ‘What Goes up Must Come Down’ \textit{The Weekly Holiday}, Dhaka (8 Nov 2002).
\end{enumerate}
\end{footnotesize}
resources, and the capacity to perform its functions and exercise its powers'. In the interpretation of this principle, the IOSCO underscores the need for 'experienced staff who have skills that are valuable to the private sector'. The IOSCO also stipulates that '[t]he regulator must ensure that its staff receive ongoing training as required'. It is thus clear that as per the IOSCO principle, the securities regulator should have experience in dealing with issues related to securities for providing effective regulation.

9.3.3.1. Professional Experience

Despite some instances of failure, the Securities and Exchange Commission of the United States (US-SEC) is considered to be the most successful securities regulator in the world. It was established in 1934 following the market crash in 1929 as complementary to state regulation. The underlying philosophy behind the appointments in the US-SEC implies that regulators should have practical knowledge of the complex matters involved in securities markets. President Roosevelt appointed Joseph P Kennedy to be the first chairman of the US-SEC to restore order in the market. Kennedy had been described as one of the masterminds of the 1929 market debacle and he had been characterised as 'the notorious stock-market swindler'. Refuting all objections against the Kennedy's appointment, Roosevelt declared that 'it takes a thief to catch a thief'. Similarly, Bosch, an experienced securities regulator contended that:

95 ‘The AFU and Urban Legend Archive Politics: Kennedy Fortune’, ibid.
[R]egulation in the business sector should not be thought of as something done to business by an all-wise government passing down its revelations on tablets of stone. It is something that is done for business and, as far as possible, should be done by business.96

In Bangladesh, there has never been a member of the SEC appointed from the professionals in private sectors since its inception in 1993. In the last 10 years, the SEC which is comprised of bureaucrats and academics has failed to redress the market problems. Instead, the watchdog has earned extensive public criticism for its inefficiency in performing the crucial functions for market regulation.

Apart from the US, the inclusion of private sector professionals in the regulatory body has been in place in many countries, for example, Australia97 and Canada.98 The need for professional skills is also evident from the experience in Malaysia. When the SC was created in 1993, it hired experienced people from its predecessor, the Capital Issues Commission, central bank and market professionals.99 This practice has been continued to date and the securities regulator has been able to attract market professionals who have broadened its efficiency. However, most of the management positions are still held by career bureaucrats in Malaysia. The Malaysian regulator and market participants alike have acknowledged that the lack of professionals in the senior positions has hindered market regulation.100

9.3.3.2. Legal Education

Regulation is to be carried out in accordance with the law of the land, in particular the securities law. Owing to the complex nature of securities laws, legal knowledge is

96 Bosch (1990) above n42 at 8.
regarded as ‘material’ for a qualified securities regulator. The qualifications of the regulators of different developed markets show that the possession of a law degree needs to be taken into account in the appointment of a securities regulator. For example, the last few years’ records of the securities regulators in Australia demonstrate that almost all members of the regulatory body had law degrees.\textsuperscript{101} In the New Zealand Securities Commission, ‘at least one Member must be a barrister or solicitor of not less than seven years’ experience’. In 2002, there were five out of 11 members including chairperson having law degrees in the commission.\textsuperscript{102} The chairman and five out of 10 members of the Ontario Securities Commission had law degrees as in 2002. Of these, four including the chairman were Queen’s Counsel (QC).\textsuperscript{103} Similarly, as at November 2002, the US-SEC composition showed that four out of five commissioners including the chairman had degrees in law.\textsuperscript{104} However, generally speaking, it can be said that legal qualification for securities regulators is absolutely crucial.

In Bangladesh, with the exception of the incumbent chairman, no persons with legal qualifications have been appointed members in the SEC until February 2003 as is known to this writer.\textsuperscript{105} This happened despite the statutory requirement of ‘special

\textsuperscript{100} The information revealed in interviews as mentioned in id at 111.
\textsuperscript{101} See Australian Securities Commission, \textit{Annual Report} 1996-97, Sydney at 10-12; ASIC, \textit{Annual Report} 1997-98, Sydney at 9-13 & ASIC, \textit{Annual Report} 1999-00, Sydney at 16. Previously, the securities watchdog was known as the Australian Securities Commission. It was renamed the ASIC in June 1998.
\textsuperscript{102} Securities Commission, \textit{Annual Report} 2002, Wellington at 4-5.
\textsuperscript{103} Ontario Securities Commission (2002) above n98.
\textsuperscript{104} A single member, Cynthia A Glassman, is a graduate of Economics having no law degree. She however has extensive previous experience in dealing with capital market legislation. For details, see US Securities and Exchange Commission <http://www.sec.gov/about/commissioner> (22 Nov 2002).
\textsuperscript{105} Mr Manir Uddin Ahmad, the incumbent chairman of the SEC, has a bachelor degree in law. Basically, he is a bureaucrat and a commerce graduate (M Com, LLB FCA). It may be noted that, with regard to the law degrees of the members, the Deputy Director of Legal Division of the SEC was consulted on the phone in February 2003.
knowledge of law as one of the requisite qualifications for a member of the SEC. The reason may lie in the shortage of persons knowledgeable in securities laws amongst both legal professionals and academics in the country. Nonetheless, the importance of SEC members being conversant with legal knowledge cannot be denied. Unlike Bangladesh, at least one of the two members who will be selected from the central government must be a person who deals with a service relating to law in India. There have been no such statutory requirements in Malaysia at present. Yet in practice, there are at least two out of nine SC members who have tertiary legal education and practising experience in the legal profession.

9.3.3.3. Representative of Market Participants

At present, there are no clear provisions for the appointment of representatives of market participants in the SEC in Bangladesh and similarly unclear provisions exist in the Indian legislation. However, there are no barriers to the appointment of such representatives to the SEC as some of the permanent four members.

Section 4 of the Securities Commission Act 1993 (SCA'93) of Malaysia provides that there will be four other members apart from the four who will represent the government. Unlike the legislation in Bangladesh and India, the Malaysian legislation

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106 Securities and Exchange Commission Act 1993 (Bangladesh) s5(4).
107 Securities and Exchange Board of India Act 1992 (India) s4(1)(b).
110 Initially there was a provision for appointing two full time members under s5(1)(b) of the SECA'93. This was amended in 1997 and the number has been increased to four: Securities and Exchange Commission (Second Amendment) Act 1997 s2.
does not specify government representatives. In practice, the SC in Malaysia has a private member who is currently the Managing Director of a company.

In addition to higher education in law, the members of securities regulators in Australia and the US gained experience in dealing with corporate management before their appointment to their respective regulatory bodies.

In Pakistan, the Securities and Exchange Commission is made up of between five and seven members, the majority of whom have come from the private sector.

9.3.3.4. Structure of the Securities and Exchange Commission

Given the present situation, a preferred policy may be to divide the number of members (currently seven including chairman) into three groups, namely, legal scholars, bureaucrats and market participants. Members have to be appointed on the basis of educational qualifications and relevant experience as outlined above, regardless of any other criteria such as political affiliation or any other irrelevant consideration. It is submitted that two members may be appointed from each group and the chairman should always be chosen from those who have law degrees. To select competent persons from each category, emphasis should be placed on investor protection and market development.

111 In Bangladesh, s5(1)(c) and (d) set criteria for government representatives. One representative has to be taken from the Ministry of Finance or Finance Department and the person must not be below the rank of joint-secretary. The other should be selected from the Bangladesh Bank, the central bank, and the persons must be of the rank of deputy governor at least. In the SEBI, there are two members from the Ministry of Finance and the reserve bank as well. In addition, the SEBI has one more member from the Ministry of Law as mentioned earlier.


114 Rashid (2002) above n89.
9.3.4. Disciplining the Securities Regulators

For providing effective regulation to the market, the SEC should be independent from governmental as well as any other external interference. Financial independence and the security of tenure of members should be ensured. These members should no longer be answerable for their decisions to the executive government. In the US, the SEC is answerable neither to the executive nor the Congress. However, there should be set in place some mechanism for their accountability to ensure that the commission acts fairly with utmost efficiency and honesty. This is especially significant in a country like Bangladesh where the allegations of corruption are widespread.

One way of disciplining the SEC members may be the holding of a judicial inquiry into any allegation raised against them. Based on the report of such an inquiry, legal actions in the ordinary court of law may be initiated against the member(s) concerned. If any of the members are found to be guilty of malpractice or ‘misconduct’, he or she may be removed on the basis of the court’s decision rather than at the whim of the executive. One writer has suggested (in the context of Malaysian experience) for the purpose of restoring and maintaining public confidence in the market and its regulation, there should be ‘some guard’ against regulatory malpractice. The issue of the accountability of the SEC will be further discussed in section 9.4.3. in this chapter.

9.4. Fundamentals of Regulatory Functions as to the Administrative Enforcement of the Disclosure Regime

The two core tenets of the administrative enforcement of securities law are the ability of investors to seek remedies against the infringements of disclosure requirements and the

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115 Mann (1993) above n56.
efficiency of the SEC in dispensing justice. Both of these are weak in Bangladesh as demonstrated earlier. Market malfeasance may be regulated in two different ways which can be identified as ‘preventive measures’ and ‘punitive measures’.

9.4.1. Preventive Measures

On account of the persistence of weak enforcement records, the preferred policy should be the prevention of infringements of the securities law. Preventive measures can be implemented through ‘investor education’ and ‘regulatory verification before consenting to a prospectus’.

9.4.1.1. Investor Education

It is conceded that regulators cannot provide a guarantee that investors will avoid losses. But it is important that regulators endeavour to raise investors’ awareness so that they invest in the market with a clear understanding of the risks and rewards of investment. The SEC should undertake an extensive program for investor education. Trained investors can obviously make better selection of IPOs than illiterate investors can. Proper investment education can also increase the number of new investors by generating self-confidence in them. The regulatory initiative to educate investors as has been described in Chapter 5 is insufficient and ineffective. In order to enable investors to make prudent investment decisions in the IPO market, they should be taught some basic aspects of the market with special emphasis. The most basic subjects for training should be: the issues of fundamental analysis as well as technical analysis of

116 See Low (2001) above n36 at 300-01.
shares. Similarly, in pursuance of the IOSCO suggestions, investors should be taught as to how they can assess an issuer and evaluate its issue in terms of its business potential. The technicalities of overpricing or underpricing of shares offered to the public should also be incorporated in the educational program.

The SEC should design an elaborate investor education program covering all aspects of IPOs to protect investors in the market. In the United Kingdom (UK), the regulator is obliged by statute to organise investor education program. In Mexico, a separate institution has been charged with the responsibility for providing investor education.

The SEBI in India has devised some mechanism to educate investors by launching specific training programs, distributing booklets, publishing information in the press media and broadcasting information concerning investor interests via the electronic media such as radio and television. In Malaysia, investor education programs are more organised than those in Bangladesh and India. The Securities Industry Development Centre has been established as a separate wing of the SC to educate different participants in the market. Its curricula cover various aspects of the securities market and it plays a crucial role in raising standards and skills of the market.

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120 IOSCO (2001) above n117 at 1.


122 Ibid.
participants including investors. In Bangladesh, there have been no separate institutions as such to date. The SEC should work out a ‘hybrid’ mechanism for investor education having regard to the Indian and Malaysian experience.

In Bangladesh, it is a statutory duty of the SEC to ensure ‘proper issuance of securities’. Although the term ‘proper’ is vague, it may imply that the regulator is charged with the responsibility for approving IPOs on the basis of sound economic fundamentals only, and disapproving those which are detrimental to investors’ interests. It is understood that the above provision for the proper issuance of securities was enacted during the period of the previous merit regulation regime. However, this remains operational in the current disclosure regime. Section 8(2)(f) of the SECA’93 clearly imposes a duty on the SEC, inter alia, to educate investors. The section provides that ‘promoting investors education and training of all intermediaries of securities market’ is one of the functions of the SEC. Therefore, it is not an ‘option’ but a ‘statutory duty’ of the regulator to educate investors in Bangladesh.

9.4.1.2. Regulatory Verification before the Issuance of Prospectuses

Ensuring that these be full and fair disclosures by issuers lies at the heart of the concept of investor protection. Therefore, the accuracy of disclosures made by the issuers is essential for investor protection in the market. The ability of investors to protect themselves essentially requires either their adequate knowledge of investment or proper advice from professional advisers. Neither of these two requirements is satisfactory in

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125 Securities and Exchange Commission Act 1993 s8(1).
the Bangladesh market. Unlike the securities regulators of developed markets, the regulators of the emerging markets are not just regulatory entities. They must facilitate the development and growth of the markets. In Bangladesh, the regulator should strictly deal with the issue of fair disclosure until the investors become trained and professional advisory service becomes readily available. It is also a statutory responsibility of the SEC to ensure fair disclosure for the purpose of ensuring the proper issuing of securities as mentioned above and to pursue its policy of ‘prohibiting fraudulent and unfair trade practices relating to securities’.

An alternative source of information to verify disclosures made in a prospectus is considered to be of much help for investors. This is because, currently, issuers are the sole source of information necessary to make an informed investment decision. Investors have no other source of information to verify the accuracy of disclosures made in a prospectus. The SEC as well as institutional investors can provide for such a source by their respective research units. The functions of the SEC also include ‘conducting research and publishing information’ for the purpose of IPOs. Section 8(2)(j) of the SECA’93 confers a function on the SEC to compile, analyse and publish information about the issuer. It is therefore clear that the responsibility for providing an alternative source of information to the market participants falls within the purview of the statutory regulatory functions of the SEC. But in practice, the SEC does not publish any information about issuers at the time of their public issues. Virtually, the research and

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126 Even there have been no registered professional advisers and no practice of seeking such advice in Bangladesh: see section 5.3.6.
128 Securities and Exchange Commission Act 1993 (Bangladesh) s8(2)(e).
129 Institutional investors in Bangladesh do not carry out retail research: see section 5.3.7.
publication of the regulator remain confined mainly to periodic reports (for example, annual and quarterly reports). The SEC should be staffed with qualified persons to conduct research about potential issuers so that the regulator can carry out an investigation into a prospectus submitted for its consent in a timely and cost efficient manner. If any minor anomaly is found between the draft prospectus and a SEC’s investigation, the regulator may make such disparity public so that investors can make informed decisions. In the case of major disparity, the SEC may refuse to give consent to the given prospectus. Such a measure for guarding the issuers before issuing their prospectuses will contribute to preventing unfair disclosures in the IPO market.

9.4.2. Punitive Measures

To remedy the violation of securities laws, the SEC is empowered to penalise the violators. These punitive measures may be imposed in the forms of suspension or cancellation of the licence of the participants who are required to obtain their licence from the SEC. In the IPO market, such participants include underwriters, issue managers, and investment advisers. The regulator may also impose a fine on these participants as well as the issuers concerned. The SEC has to follow a specified legal procedure to take these punitive actions against any of the above participants. Investigation into an allegation is to be made prior to the imposition of punitive actions.

9.4.2.1. Investigation by the Securities and Exchange Commission

All disputes should be resolved in accordance with due process of law. This process begins with investigation. The principal functions of investigations are threefold. These are: (i) to obtain information facilitating dispute resolution, (ii) to open up an opportunity for prosecution and conviction of an offender, and (iii) to restore public
In view of the importance of investigation in resolving disputes, it is argued that ‘investigations should be an integral part’ of company and securities regulation. In Bangladesh, the SEC derives its authority to conduct investigations into the irregularities in the securities market from the SECA’93 and the SEO’69.

Section 8(2)(i) of the original SECA’93 mentions that the SEC will have a function of undertaking investigation and inspection, and conducting inquiry into the affairs of various market participants including issuers. But it does not elaborate on the procedure for carrying out this investigation. Subsequently, s3 of the Securities and Exchange Commission (Amendment) Act 1997 provides for the details of this function and empowers the SEC to act as a civil court in some particular areas. Section 3 inserts, inter alia, ss17A and 17B in the SECA’93. Section 17A empowers the SEC to conduct investigation into the affairs of certain persons as mentioned in s10(1) of the SECA’93. Section 10(1) includes various persons involved in the securities market except for, amongst others, issuers. The section basically prohibits dealing with securities ‘except under and in accordance with the conditions of a certificate of registration obtained from the Commission…’. Issuers do not require to obtain any certificate of registration from the SEC. Issuers are however obliged to obtain consent of the SEC to their respective proposals for the issuance of securities. But, the RJSC grants registration to companies. Therefore, under the SECA’93, the SEC is entitled to carry out investigations into the different roles of some members of an IPO coalition such as issue

132 Id at 43.
133 The terms ‘investigation’ and ‘inquiry’ are used interchangeably in this discussion.
manager, underwriters and investment advisers; but not of the issuer. Hence, there is a clear inconsistency between the above ss8(2)(i) and 17A.

So long as the IPO market is concerned, issuers including their management are the main players who are primarily liable, inter alia, for a defective prospectus as has been discussed in Chapters 6 and 7. The reason for the above inconsistency between ss8(2)(i) and 17A of the SECA’93 or legal shortcoming in investigating the affairs of issuers may be that companies are governed under the CA’94 which falls outside the purview of SEC regulation, and is the domain of the RJSC. This regulatory fragmentation is unfavourable for securing an effective securities regulation. Pointing to the difficulties of such a separation between the regulations of companies and their securities, Arjunan observes that ‘[t]he regulation of companies and the regulation of securities cannot, in reality, be considered as separate and unconnected functions’. The main point is that the SEC is not entitled under the SECA’93 to investigate the role of an issuer in the issuance of a defective prospectus.

Unlike the SECA’93, s21 of the SEO’69 clearly entitles the SEC to cause an inquiry into the affairs of, inter alia, a listed company or a director or ‘officer’ thereof. But s21 of the SEO’69 is inapplicable to the issuers of securities which are yet to be listed on a stock exchange, although such new issuers are a great concern for investor protection in the IPO market.

The issuance of shares and their listing do not take place simultaneously. There is a specific procedure for listing of issued securities, but no timeframe has been worked out

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136 The SEO’69 does not define the term ‘officer’. However, the Securities and Exchange Rules 1987 (SER’87) provides the meanings of this term. Under rule 2(d) of the SER’87 officers in relation to an issuer include: ‘managing agents, manager, secretary, or accountant of the issuer and any other person who by virtue of his [or her] office may be in possession of any material information with regard to the affairs of the issuer’.
in the listing regulations.\textsuperscript{137} If allegations of issuing a defective prospectus are raised and the issuer becomes reluctant to be listed, then the SEC is not legally empowered to cause any inquiry into the affairs of the IPO issuer and of its directors or officers. This occurs at times. Keya Cosmetics, for example, published a prospectus for an IPO worth 25 million taka (approximately US$0.44 million). Its subscription period opened on 11 June 2001 and was due to remain open until 14 June 2001.\textsuperscript{138} The IPO was oversubscribed by 10 times within the first hour of the debut day of subscription. In accordance with an earlier rule issued by the SEC, the subscription was halted after this oversubscription. Meanwhile, a news item regarding an alleged tax evasion of 390 million taka (approximately US$6.84 million) was made public by the print media on the debut day.\textsuperscript{139} Pursuant to the direction of the SEC, Keya announced that the subscribers willing to withdraw their subscriptions would get full refund in five days.\textsuperscript{140} On 13 September 2001, Keya got listed on the official list of the Dhaka Stock Exchange after three months of its floatation on 11 June 2001.

Investigation under the SECA'93 is purported to be limited to the regulation of compliance with the conditions of licences issued by the SEC to various intermediaries and professionals in the market. On the other hand, inquiry under the SEO'69 is mandated to regulate the affairs of the stock exchanges and their members. This inquiry provision under the SEO'69 is also applicable to issuers and the directors, officers and beneficial owners of not less than 10 per cent of a listed company. Notably, neither the SECA '93 nor the SEO '69 investigation provisions include 'promoters' who are

\textsuperscript{137} Investor Information Cell, Chittagong Stock Exchange, Mr K U Jalal <iic@csebd.com> email (3 May 2003).
responsible for a defective prospectus under the CA’94. It implies that the above provisions of the SECA’93 and the SEO’69 for investigation are not applicable to IPOs. It appears to be a serious drawback of the administrative enforcement of the disclosure regime in Bangladesh.

The equivalent provisions in India and Malaysia are applicable to their respective IPO markets. Unlike Bangladesh, it does not specify any persons who can be the subject of such inquiry. Section 15I of the Securities and Exchange Board of India Act 1992 (SEBIA’92) deals with holding enquiry by the SEBI. The section does not specifically include prospectuses in the scope of its applications. It provides that an inquiry will be held for the purpose of adjudicating matters mentioned in ss15A-15H of the SEBIA’92. Of these provisions, s15A (a) provides for penalties for failure to furnish any documents, return or report to the SEBI as required by the SEBIA’92 or any rules or regulations made thereunder. It has been explained in Chapters 6 & 7 that disclosures in a prospectus fall within the ambit of the expression made in s15A(a). Therefore, the inquiry provision is applicable to the persons involved in the preparation of a prospectus. Since the disclosure in a prospectus has been placed within the purview of the SEBI inquiry, it is perceived that all persons involved in the preparation of a prospectus are subject to such inquiry. In this way, all participants in an IPO coalition including promoters and directors of the issuers fall under the authority of the SEBI inquiry before the listing of the issued shares takes place.

In Malaysia, s125 (1) of the Securities Commission Act 1993 (SCA’93) empowers the SC to appoint officers for the purpose of investigation into any offence under securities laws which include, inter alia, the SCA’93 and the Securities Industry Act 1983 (SIA’83). The latter is the equivalent of the SEO’69 in Bangladesh. As has been
mentioned in Chapters 5 and 7, the SCA’93 contains provisions regarding disclosures in prospectuses and also provides for civil as well as criminal liabilities for the violation of these requirements. It is therefore clear that the SC may appoint officers for investigating the allegation levelled against all the participants in an IPO coalition including directors and promoters of an issuer so far as the allegation relates to a defective prospectus.

It appears from the above discussion that the SEC lacks legal authority to investigate the role of an issuer and its management until the issuer is listed with a stock exchange. This legal lacuna may preclude the SEC from initiating an inquiry into a defective prospectus. As a result, the wrongdoers may escape their liabilities for a defective prospectus and, in turn, subscribers may be deprived of their right to have justice. Having regard to the importance of issuers and their management in respect of prospectus liabilities, they should be brought under the investigative authorities of the SEC even if they are not listed on a stock exchange at the time of raising complaints. It can be done by amending either the SECA’93 or the SEO’69 or both. The clarity of law is a significant consideration for its enforcement in a manner beneficial to the victims of violation of the law. For the protection of investors and development of a securities market, clear and reliable rules for fair play should be in place. In this regard, the first principle of the IOSCO (principle one) provides that ‘[t]he responsibility of the Regulator should be clear and objectively stated’.

9.4.2.1.1. Investigative Powers of the Securities and Exchange Commission

For the facilitation of the efficient operation of securities markets, investigations by

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regulators is a ‘vital cog’.\textsuperscript{142} Under s17A(2) of the SECA’93, the SEC may authorise a single person or a committee of more than one person to carry out an investigation into the affairs of the designated persons mentioned earlier.

Section 17A of the SECA’93 does not directly mention the powers of the SEC in relation to an investigation. However, s17A(3) of the SECA’93 expressly imposes obligations on persons who will be investigated under s17A that they must produce the necessary information and documents for the investigators. Under s17B of the SECA’93, the SEC is empowered to act as a civil court in relation to the issuing of summons for giving evidence or producing documents only.\textsuperscript{143} The section does not authorise the investigating officers to impose any penalties on a person who fails to comply with their directives. However, the SEC can impose penalties for such failure under s18(2) of the SECA’93 (to be discussed below). Thus the investigators under the SECA’93 enjoy very limited powers in conducting investigations. They need to call upon the SEC to remedy any obstacle in the performance of their investigative functions. The SECA’93 affords lower authority to the investigators as compared with their counterparts in India and Malaysia as will be seen later in this chapter.

An inquiry under the SEO’69 seems to be stringent in comparison with that under the SECA’93. Section 21 of the SEO’69 implies that the inquiry will be conducted by a single person instead of a committee of more than one person. As can be seen above, the SECA’93 entitles the SEC, instead of investigators to exercise powers as a civil court. On the contrary, s21(4) of the SEO’69 confers the powers of a civil court on the person holding inquiry as envisioned in its s21(1). Proceedings before the person holding the inquiry for the purpose of s21 of the SEO’69 shall be deemed to be a

\textsuperscript{142} Low (2001) above n36 at 289.
'judicial proceeding' within the meaning of s193\textsuperscript{144} and s228\textsuperscript{145} of the \textit{Penal Code} 1860. In addition, the person conducting the inquiry under s21(1) may enter into any premises belonging to or in the occupation of the persons (including companies) to whom the inquiry relates. Further, the person holding the inquiry is entitled to 'call for and inspect and seize books of accounts or documents in the possession' of the persons to be inquired into.\textsuperscript{146} All of these powers have been vested in a single person who will be selected by the SEC unilaterally. Thus, investigation provided in the SECA'93 sharply differs from the inquiry envisaged in the SEO'69. The differences are apparent as to the number of persons to be engaged in conducting the investigation, and their powers to find out relevant facts- this being an investigation which is judicially considered to be a fact-finding mission.\textsuperscript{147}

Indian provisions regarding an inquiry by the SEBI are different from those in Bangladesh. The inquiry by the SEBI is due to be carried out through an adjudicating officer. The SEBI shall appoint any officer from amongst its own staffs to act as an adjudicating officer for holding an inquiry. However, the officer must not be below the rank of a division chief of the SEBI. This inquiry can be conducted for the purpose of imposing any penalty for flouting securities laws including infringing prospectus requirements.

In India, s15I of the SEBIA'92 vests in the adjudicating officers more powers than those which have been conferred on their counterparts in Bangladesh. Unlike the

\textsuperscript{143} As a civil court in this respect, investigators shall apply all powers provided by the \textit{Code of Civil Procedure} 1908 to the courts. These include: issuing summons or warrant to attended and furnish statements on oath and submit necessary documents: s17B(1)(a) & (b) of the SECA'93.

\textsuperscript{144} Section 193 provides for punishment for false evidence.

\textsuperscript{145} Section 228 deals with punishment for intentional insult or interruption to public servant sitting in judicial proceeding.

\textsuperscript{146} \textit{Securities and Exchange ordinance} 1969 s21(3).
legislation in Bangladesh, the Indian provisions do not mention that the adjudicators shall have all the powers of a civil court. However, the articulation of powers of the adjudicating officer succinctly embraces all the basic powers of the civil court. Such powers can be described in the following terms:

...[T]o summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which in the opinion of the adjudicating officer, may be useful for or relevant to the subject matters of the inquiry and if, he [or she] is satisfied that the person has failed to comply with the provisions of any of the sections specified [describing the subject of inquiry] ..., he [or she] may impose such penalty as he [or she] thinks fit in accordance with the provisions of any of those sections.¹⁴⁸

There are some basic differences between the above two jurisdictions. In Bangladesh, the investigator is basically a reporting authority to the SEC,¹⁴⁹ whilst in India, the investigator is an adjudicator.

In Malaysia, the SCA'93 encompasses a comprehensive framework for investigations. A total of 11 sections (ss125-135) deal with investigations by the SC. The SC has the authority to appoint any number of investigation officers as it deems necessary.¹⁵⁰ This seems to be more reasonable as it allows the regulator to appoint a reasonable number of investigators in accordance with the specific needs of a particular case. A given case may involve financial, legal and some other technical issues, the inquiry of which may require persons who are well conversant with these issues. In the interest of justice, the discretion of securities regulators to decide on the number of investigators instead of appointing only a single person in all cases seems to be a feasible approach.

¹⁴⁸ Securities and Exchange Board of India Act 1992 s151(2).
¹⁴⁹ Securities and Exchange Commission Act 1993 s17A(2).
¹⁵⁰ Securities Commission Act 1993 s125 (1).
The investigating officers in Malaysia have been given enormous powers unlike those in Bangladesh. Most important of these powers can be seen in s128(c) of the SCA'93. Under this s128(c), an investigating officer can:

[S]earch any person who is in, or on, the premises and, for the purpose of such search, detain the person and remove him [or her] to such place as may be necessary to facilitate the search, and seize, take possession of and detain any object, article, material, thing, property, book, minute book, account, register or other document, including any travel or other personal document found on the person [emphasis added].

In order to exercise these powers, an investigating officer may enter any place or building.\(^{151}\) If necessary, the officer ‘may enter any place or building by force’.\(^{152}\) Further, like the securities investigators in Bangladesh and India, the investigating officers in Malaysia may issue summons for the physical appearance of persons who are under investigation to give evidence or to produce document before the officers.\(^{153}\) The investigating officers are thus armed with simultaneously the powers of the police, magistrates as well as civil courts. In addition, the officers may call upon a magistrate in case of uncertainty about the entitlements of a property to be seized under s128(c) of the SCA'93.\(^{154}\) These extensive powers of the Malaysian SC have been strongly criticised.\(^{155}\)

An ‘all powerful authority’ of investigation like the one in Malaysia appears to be inappropriate for the Bangladesh market. There is a possibility of misusing powers by the SEC investigators if such extensive powers are vested in them. There are reasons for such scepticism.

Firstly, as has been mentioned earlier, there have been numerous allegations that the SEC lacks experienced and sufficiently competent persons. Hence, the SEC

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151 Securities Commission Act 1993 s128(1).
152 Securities Commission Act 1993 s133.
154 Securities Commission Act 1993 s129(5).
investigators may not be able to aptly exercise all of the powers that are given to investigators in Malaysia.

Secondly, there has been a critical lack of public trust in the regulators about their honesty and neutrality as alluded to earlier. Excessive empowerment of the SEC investigators and the potential misuse of these powers may result in a further deterioration of public confidence in the regulatory authority.

Thirdly, although the investigators are not entitled to adjudicate any dispute, the SEC has the authority to decide on a dispute having regard to the investigation report. Thus an unfair investigation through the exercise of excessive powers may lead to the avoidance of liabilities by offenders or the imposition of penalties on innocents.

The above arguments do not intend to keep the SEC investigation weak, but purport to make the investigation fair and useful. To this end, the investigative powers of the SEC and its investigators should be increased to some extent. This is because the power of securities investigators is an important consideration and the investigators in Bangladesh have less power than those in India and Malaysia.

Unlike the SEBI and the SC, the SEC itself retains the basic powers of investigation. Under s17A of the SECA’93, the SEC itself may conduct such an investigation or authorise one or more persons to do so. This provision is vague on two counts. Firstly, it is not clear as to how the SEC itself will carry out investigations if some people are not authorised to discharge this investigative function. In practice, members usually do not conduct investigations. Such an ambiguous provision as s17A does not exist in India or in Malaysia. The SEBIA’92 and SCA’93 clearly mention that the regulators will appoint specified persons in order to carry out investigations. Similarly, the SEC usually authorises some of its officials to carry out investigations on

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155 For details, see Low (2001) above n36 at 289-308.
behalf of the watchdog, yet the confusing provision remains in operation. However, at least once in the past, an inquiry committee was formed with some people from outside the SEC along with a SEC member to inquire about the share scam 1996.

Powers of an investigator in Bangladesh are limited to the issuing of summons for giving evidence or producing documents under the SECA'93. At times, investigators may need to enter some premises for the purposes of collecting evidence in any form or interrogating some people who are unable to appear before the investigating authority. Therefore, the investigators may be accorded the power to enter such premises for the sake of fair investigation. Although s21(1) of the SEO’69 provides for similar powers, it is not applicable to the IPO market as argued earlier.

There should be a close connection between the investigative powers and the ability to efficiently exercise these powers to achieve the desired results. Hence, there should be a minimum threshold qualification for investigators in terms of their knowledge of the law generally and of investigation specifically. Personal attributes like honesty and dignity are also worthy of consideration for the purpose of maintaining integrity in investigations.

To deter any market players from flouting the authority conferred on the SEC and its investigators, penalties imposed should be made more stringent and in line with those in India and Malaysia. In case of failing to comply with the provisions concerning investigation in India, a person who infringes the law ‘shall be liable to a penalty not exceeding one lakh and fifty thousand rupees [approximately US$3,134] for each such

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156 For example, in 2001 two directors of the SEC were authorised as a committee to investigate the allegation of trading in fake shares. They submitted their reports in November 2002. For details, see ‘DU Teachers Among 3 Investors Accused in Fake Share Deal’ The Financial Express, Dhaka (26 Nov 2002).

157 The chairman of the three-member committee was Prof Amirul Islam Chowdhury, Vice-Chancellor, Jahangir Nagar University.

158 It has been argued in Chapter 7 that higher penalties work as deterrence.
failure\textsuperscript{159}. Its Malaysian counterpart, s128(7) of the SCA'93, provides for penalties which can be 'a fine not exceeding one million ringgit [approximately US$0.26 million] or imprisonment for a term not exceeding five years or both'. Further, if any person destroys, conceals, mutilates or alters any records etc, shall be guilty of an offence which is punishable with 'a fine not exceeding ten million ringgit [approximately US$2.63 million] or imprisonment for a term not exceeding ten years or both'.\textsuperscript{160} But in Bangladesh, this fine cannot exceed 0.1 million taka (approximately US$1,754) under 18(2) of the SECA'93. Thus the present fine in Bangladesh is significantly lower than those of the other two jurisdictions. This fine can be increased to 0.2 million taka (approximately US$3,509). The SEC instead of the investigators should impose this fine, as it is currently mandated.

9.4.2.1.2. Expeditious Investigation

To address investor grievances and restore public confidence in the market, there should be specific time limits within which the SEC shall have to complete an investigation into any allegation. The negative impacts of delay as mentioned in the discussion of judicial enforcement in Chapter 8 are equally applicable for administrative enforcement. Delay frustrates the ends of investigation. For example, a recent case shows that trading in fake shares of some companies took place during the period between April and September of 1999. The SEC in late 2001 formed an investigation committee which submitted its report in November 2002. The SEC filed a criminal case against three

\textsuperscript{159} Securities and Exchange Board of India Act 1992 ss151 & 15A.
\textsuperscript{160} Securities Commission Act 1993 s135.
persons based on the report of investigation, but one of them has, in the mean time, left Bangladesh.\textsuperscript{161}

It is submitted that the SEC may be required to complete an investigation in a period between 15 days to 60 days from the date of exposure of the alleged contravention of the disclosure requirements. It is submitted that the SEC should determine the time limit for the investigation of a case having regard for the facts of that case.

9.4.3. Remedies against the Decisions of the Securities and Exchange Commission

Remedies against the decisions of the SEC are very limited in Bangladesh. There are provisions for appeal and review under s21 of the SECA'93. Section 21(1) provides that a person aggrieved by the decision of any member or officer of the SEC may lodge an appeal with the SEC within a stipulated time. In such appeals, the SEC decision shall be final. However, as a last recourse, the SEC is entitled to review its decision either suo motu or upon any application. The decision in review is also final. The implication here is that there are two remedies against a decision of an investigator namely, appeal and review. But both these remedies have been placed in the hands of the SEC itself. Moreover, only a review petition may be lodged with the SEC to review a decision if it is made by the SEC itself. Thus the question-\textsuperscript{1}'[w]ho will guard the guards themselves?' - as expressed by Lord Denning in a similar context in Norwest Holst Ltd v Development of Trade has been overlooked.\textsuperscript{162}

\textsuperscript{161} For details, see 'DU Teachers Among 3 Investors Accused in Fake Share Deal' (2002) above n156.
\textsuperscript{162} (1978) 3 ALL E R 280 at 291.
Similarly, the SC itself can review the decision of the SC in Malaysia. However, the SC can do this only upon an application made by an aggrieved person, not suo motu, and the decision in review shall be final.\footnote{163}

Indian provisions in this regard are completely different from those in Bangladesh and Malaysia. The SEBI has nothing to do with the decision of the adjudicating officers. Appeal is allowed directly to the Securities Appellate Tribunal. It is important to note that the tribunal has been established for hearing appeals from orders made by the adjudicating officers alone. The tribunal is made up of a judge equivalent to a judge of a High Court in India.\footnote{164} Any persons aggrieved by the decision or order of the tribunal may lodge a further appeal with the High Court on any question of fact or law arising out of such a decision or order.\footnote{165}

Provisions as to the remedies against the decisions of securities regulators in Bangladesh, India and Malaysia show that the Indian provisions are more conducive to the pursuit of justice. Criticising the provisions of Malaysia, Low raises two issues. Firstly, the manner of drafting the provisions creates an impression that the SC need not provide reasons for its decisions. Secondly, such a manner of drafting appears to negate the idea that a party may be aggrieved by the decision of the SC and, as a result, the party may need to seek judicial scrutiny of the SC decisions.\footnote{166} Low also argues that a liberal reading of the provisions concerning powers of the SC may imply that the SC is beyond the jurisdiction of courts to a great extent in the administration of securities laws.\footnote{167}

\footnote{163} Securities Commission Act 1993 ss146-47.
\footnote{164} For detailed qualifications of a judge of the tribunal, see Securities and Exchange Board of India 1992 s15L.
\footnote{165} Securities and Exchange Board of India 1992 s15Z.
\footnote{166} Low (2001) above n36 at 296.
\footnote{167} Id at 298.
The review provisions in Bangladesh and Malaysia providing impunity to securities regulators from judicial scrutiny of their actions appear to be inconsistent with one of the core objectives of securities regulation set out by the IOSCO. The objective is ‘ensuring that markets are fair, efficient and transparent’. A lack of transparency and fairness in the regulatory machinery may worsen the already chronic crisis of public confidence in the market.

The existing review provisions also seem to contradict an IOSCO principle (principle 4) regarding regulators. This principle states that ‘the regulator should adopt clear and consistent regulatory process’. Further, its principle 2 clearly provides for the accountability of regulators in exercising their functions and powers. Furthermore, principle 10 of the IOSCO provides that the ‘regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers’. But its investigations can hardly secure public credibility if they are kept beyond the reach of the judiciary. Thus the existence and operation of an ‘all powerful securities regulator’ devoid of transparency and accountability appear to be inconsistent with a number of principles of the IOSCO.

Transparency and accountability are highly desirable in Bangladesh where allegations of irregularities against the SEC are often reported. It is generally believed that that it is easier to unduly influence the government regulator by political and other extraneous or unacceptable means than to influence a court. SEC decisions should therefore be made open to judicial scrutiny without undermining the value of the expeditious settlement of disputes.

Following the path taken by India, provisions may be inserted in the SECA’93 in relation to appeals against the final decisions of the SEC. The first appeal may be

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allowed to be heard by the proposed Securities Courts as mentioned in Chapter 8. The special bench of the HCD referred to in the preceding chapter may be entitled to hear the second appeal and its verdict should be final. In the interest of an expeditious trial, specified time limits as outlined in the preceding chapter in relation to the proposed Securities Courts and the special bench of the HCD should be followed in these appeals. It may be noteworthy that there are no provisions for third appeals in the present judicial system in Bangladesh.

The existing review petition by the SEC may remain in force for two reasons. Firstly, the SEC would be more cautious in making its final decisions as a result of the proposed provisions for appeals. Secondly, if the parties are satisfied with the decisions of the SEC, it could be implied that the existing review procedure is both time and cost efficient in the settlement of disputes.

It is therefore submitted that in the interest of transparency and accountability in the administrative enforcement of securities laws in Bangladesh, the regulatory decisions should be subject to judicial scrutiny in addition to the application of the present appeal and review provisions. Since the SEC has a significant authority to resolve securities disputes, the importance of the service of persons having knowledge of law and other related subjects in the regulatory body is reiterated.

9.5. Summary and Conclusions

Securities markets should be regulated in conformity with the regulatory objectives. Such objectives are stated briefly to be: market confidence, public awareness, investor protection and the reduction of financial crimes.\textsuperscript{169} A recent empirical study conducted by some scholars of the Harvard School of Economics suggests that the enforcement of
securities laws by regulators as alternative to judicial enforcement may be more useful to protect investors in emerging markets. In support of their findings, they gave an example of the tremendous success of the market regulation in Poland. They argue that the markets 'where the cost of verifying the circumstances of specific cases and interpreting statutes are high, judges may not be sufficiently motivated to enforce legal rules'.

Pistor supports the increased powers of regulators for an effective enforcement of securities law. She describes the regulators as a 'proactive' and courts as 'reactive' enforcers of law. This is because regulators 'can initiate actions and exercise enforcement rights where courts by design must be passive and wait for others to bring action'. Therefore, she prefers regulators to courts for the enforcement of securities law.

Prior to Pistor, one study on the securities law mentions that 'regulatory enforcement presents attractive alternative to judicial enforcement'. Similarly, Mann argues for the increased enforcement powers of the SEC. He observes that there is an important interrelationship between regulators and enforcers. He identifies regulation as 'the first line defence against wrongdoing' and argues that, for an effective enforcement, 'an enforcer must have the mind of a regulator, understanding the market whose rules he [or she] is enforcing to ensure that enforcement is responsive and appropriate'. In this regard, the IOSCO principle solicits for comprehensive enforcement powers of regulators (prin 9). It is thus convincing to recommend that the

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169 Financial Services and Markets Act 2000 (UK) s2(2).
173 Id at 36.
175 Mann (1993) above n56 at 185.
SEC in Bangladesh should be empowered with adequate enforcement authorities and also capabilities to ensure an effective regulation of the country’s IPO market. The establishment of a competent securities watchdog should precede this increased empowerment to secure the proper enforcement of the law. With this end in view and in the interest of the effective administrative enforcement of securities laws, suggestions have been provided for making the role of the SEC useful for investor protection in the IPO market.

Although some provisions of the CA’94 are directly related to prospectuses, the SEC currently does not have responsibility for policing the infringements of the company law. The SEC has already sent a proposal to the Ministry of Commerce for the amendment of the relevant provisions of the CA’94. In this proposal, the SEC has sought to assume full responsibility of company supervision which has thus far been the responsibility of the RJSC. This reform measure, as witnessed in other jurisdictions, highlights the importance of shifting the role of supervisory responsibility from the RJSC to the SEC.

As can be seen from the foregoing discussion, the SEC is, at present, structurally weak because of the lack of adequately experienced and efficient members in it. Recommendations have been made to lessen the present dominance of bureaucrats in the SEC. Qualifications in law, finance, economics, accounting and related disciplines should be the criteria used in the appointment of members of the SEC. Practical experience, honesty, integrity and the record of personal skills in previous positions held should also be important criteria for such appointments. There is no alternative to

176 Sections relating to prospectus (ss 134-51), commission and discounts (ss152-56) etc directly concern the IPO market. Some other provisions also indirectly affect the securities market, such as inspection and auditors (ss 195-221) meetings (81-89) etc.
showing the ability of providing credible regulation to restore investor confidence and revitalise the market.

Regard has been paid to the proverb that ‘prevention is better than cure’, even though achieving a complete prevention is thought to be impossible. Investors can be protected from the affliction of unfair disclosures by educating the unsophisticated investors and ensuring fair disclosures at the initiative of the SEC. The present investor education program undertaken by the regulator has been shown to be inadequate and ineffective in terms of the needs of the market. It has been submitted that investor education program should be enriched in respect of its curricula and regularity. In addition, the number of seats in a batch needs to be increased. The training of the educators should be emphasised in order to produce prudent investors. The establishment of a separate centre entrusted with the sole responsibility of educating investors and other market participants is recommended.

A system of administrative verification of the fullness and fairness of disclosures made in a draft prospectus is vital for a viable securities market. Such a system may well prevent the issuance of a defective prospectus and should be a useful way of protecting investors.

An alternative source of information to verify the disclosures made in a prospectus is helpful for investor protection. The regulator as well as institutional investors may provide such a source. Institutional investors can also play an important role in initiating enforcement action against any violation of the securities law. The number of such investors and their activism to protect investor interests is insignificant in the

Bangladesh market.\textsuperscript{181} Therefore, the SEC in Bangladesh should assume the responsibility for providing an alternative source of information as well as initiating enforcement action for ordinary investors. The availability of alternative sources of information will provide investors with an opportunity to compare the prospectus disclosures with the relevant information supplied by such other sources.

There is an ambiguity in the law concerning the authority of the regulator to investigate into the matters of an issuing company and its involvement in the preparation of a prospectus. Such an ambiguity exists until an issuer is listed on the official list of a stock exchange. This is considered to be a grave concern for the regulation of the IPO market. Complaints against unfair disclosures usually arise before such a listing occurs. This ambiguity also favours the wrongdoers in the way they avoid administrative sanctions that may be imposed by the SEC. A recent study carried out by the World Bank points out that the SEC regulates only the listed companies and 'unlisted public companies are an uncontrolled sector'.\textsuperscript{182} Suggestions have been advanced to improve the situation by enabling the SEC to carry out investigation into the role of persons involved in the preparation of a prospectus regardless of the listing status of the issuer concerned.

Increasing the SEC’s powers in conducting investigation has also been suggested for the purpose of resolving disputes. On the other hand, a time limitation (between 15 and 60 days) has been recommended to expedite investigations by the SEC. To facilitate smooth investigation, a suggestion has been made for a twofold increase in the fine for


\textsuperscript{181} See section 5.2.1.

failure to comply with the lawful directives of the investigators. The present amount of the fine is significantly lower compared to those of India and Malaysia.

The absence of provisions for appeals to courts against the SEC decision has been found to be a legal flaw which has been argued as being harmful to transparency in the regulatory functions and the accountability of the regulator. More importantly, this may be detrimental to the interests of investors because the violators of the law may use undue influence, for example, to convince the regulator to escape their liabilities in the absence of judicial scrutiny of administrative actions. Hence, for the sake of protecting investors, it has been suggested that there should be transparency in the regulatory regime and public accountability of the SEC through the courts. The first appeal shall lie to the Securities Courts proposed in Chapter 5, whilst the second appeal can be lodged with the HCD referred to earlier. The decision of the HCD shall be final. The urgency of expeditious settlement of disputes is also an important reform proposal.

Taking the importance of the administrative enforcement of securities laws into account, the US disclosure regime is comprised of both detailed requirements as to the contents of disclosure and strong enforcement mechanisms to ensure that the issuers comply with the requirements. The US-SEC has been armed with extensive enforcement powers.\(^{183}\) Some other jurisdictions like Australian, Malaysia and India have also given their respective securities regulators considerable powers of enforcement of disclosure requirements. The SEC in Bangladesh remains a weak regulator. One reason for this is that the SEC has been given less authority as compared to equivalent regulators in other jurisdictions. Another reason is its lack of having members who are sufficiently experienced and who are experts in the corporate areas.

\(^{183}\) See Mann (1993) above n56 at 184-87.
Highlighting the failure of the SEC in protecting investors, the market has been described as an ‘orphan’. The need for the reorganisation of the SEC and the strengthening of its role to restore investor confidence is a recognised fact. In February 2000, the Parliamentary Standing Committee on the Ministry of Finance was in favour of restructuring the SEC. Similarly, a meeting of the national experts (comprising heads of regulators, stock brokers, commercial and investment bankers, analysts and chambers of commerce officials) with Mr Francis Narayan, acting head of the Dhaka Office of Asian Development Bank, found, inter alia, that the SEC is a weak regulatory body. On the basis of this finding, the meeting resolved that the SEC needs to be strengthened to enforce laws and punish wrongdoers. A study conducted by the United Nations Development Program (UNDP) in 1998 suggested strengthening the SEC. A recent World Bank study emphasises the need for trained personnel in the SEC. Despite these findings, nothing significant has been done so far to reorganise the SEC except for an increase in the number of full time members from two to four in 1997. In reality, it is not likely that there would be four members in the SEC at any one time. In November 2002, for example, there were only two members including the

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185 For detail, see F Ahmed, ‘Sub-Committee Set Up to Study Reorganisation of the SEC: JS Body Disappointed over Failure to Revive capital Market’ The Independent Dhaka (2 Feb 2000).
186 The national experts meet with the ADB official to discuss the affairs of the capital market, because the ADB has financed the US$80 million Capital Market Development Program (CMDP). For details of the meeting, see T I Khalidi & N Alam, ‘Experts Identify Regulatory, Legal and Institutional Reforms as Major Tasks: SEC Pledges to Keep a Vigil on Manipulators’ The Daily Star, Dhaka (16 Mar 1998).
189 Securities and Exchange Commission (Second Amendment) Act 1997 s 2.
Similarly, the numbers of full-time members including the chairman were two and three on 30 June 2000 and 30 June 2001 respectively.191

Because of the above underlying weaknesses in the SEC, the efficiency of the securities watchdog has been questioned several times by the market analysts, who blamed the regulator’s role for the huge loss of investors.192 Recently the Federation of Bangladesh Chambers of Commerce and Industry (FBCCI), the supreme body representing business people, suggested that the government reorganises the SEC with skilled professionals to address the stock market problems.193

It is thus evident from the above observations that active policing and effective administrative enforcement of securities law do not exist in the Bangladesh IPO market.194 Steinberg asserts that each market ‘should adhere to an approach compatible with its own culture and reflective of the costs and efficiencies implicated’.195 Emerging markets need not adhere to any fixed agenda because of their distinctive cultures, political climate and access to different sources of capital.196 The reforms in the SEC have been suggested in view of the needs of the IPO market in Bangladesh. The proposals emphasise both enabling the investors to make informed investment decisions and inhibiting issuers from issuing defective prospectuses. To achieve these goals, reforms in the regulatory regime should be brought about which are in line with the proposals made in this discussion. It is to be noted that a successful enforcement

194 See also Chapter 5.
program can contribute to encouraging compliance with the law and stimulating public confidence in government regulators.\textsuperscript{197}

\textsuperscript{196} Id at 258.

Chapter 10

General Conclusions

10.1 Introduction

A vibrant stock market can promote economic growth, but the creation of such a market is hard. Black asserts that regulation is essential for the establishment of a strong securities market.\(^1\) The development of a healthy market requires complex supportive institutions which cannot be achieved overnight. Some of these can exist in the early stage, whilst ‘[o]thers will grow only as the market itself grows’.\(^2\) This assertion came true to the market for initial public offerings (IPOs) in Bangladesh. The chairman of the Securities and Exchange Commission (SEC) took pride in introducing the Disclosure-Based Regulation (DBR) by replacing the previous merit regime in 1999.\(^3\) But the market, in the meantime, proved the decision to be wrong and premature.\(^4\) Of late, the stock exchanges have identified the DBR as one of the major impediments to the revitalisation of the securities market.\(^5\) This study endeavours to identify the weaknesses of, and the ways in which the DBR is not workable in the Bangladesh IPO market. The analysis in this thesis adheres to the proposition that the securities laws of those jurisdictions which are striving to develop their markets should be more

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4 As is evident in Chapter 4, the DBR has failed to bring about any positive changes in the market despite the governmental offers of various incentives and benefits to the investors and issuers alike.
supportive of investor protection than those in the developed markets.\textsuperscript{6} Thus the study proceeds with specifying the legal shortcomings and loopholes in respect of investor protection in the IPO market in Bangladesh, and concludes with appropriate suggestions for intensifying this protection. In doing so, the thesis elaborates on the requirements for promoting investor confidence which is a sine qua non for the development of the market.

The study appreciates the strengths of the market that currently exist. The main strengths are two. Firstly, the government realises that an active securities market is essential for achieving national economic development and thus the administration is very keen to accelerate the market growth. Secondly, thousands of potential general investors and many institutions are waiting for an investor friendly securities market.

10.2. Findings in Conceptual and Descriptive Accounts

The conceptual framework for the present topic is discussed in Chapter 1. It explains the general concepts of the key issues and terminology involved in this study. The discussion attempts to clearly ascertain the concerns of the present study and the considerations relevant thereto. It is evident in the account of the advantages and disadvantages of going public that the decision of floatation is a complex dilemma for a company. The discussion of the methods of going public identifies the persons involved in the preparation of a prospectus for an IPO. The purposes and objectives of securities regulation greatly emphasise investor protection. Upon finding a correlation between this protection and the development of the stock market, the brief discussion of the

methods of providing investor protection indicates that the DBR is still a feasible regulatory approach for developed markets alone.

Chapter 2 presents the general introduction of the study. It introduces Bangladesh as an independent country which belongs to the common law family. It identifies the major problems which have engulfed the IPO market and impeded its growth over the years. The foremost weakness of the market is concerned with the lack of investor protection in terms of both legal provisions as well as enforcement measures. The cumulative effect of these impediments results in a moribund market. As an effort to boost the market, the chapter attempts to justify the need for this study and works out its focuses and research questions. The research methodology followed in this study explains the way of collecting and treating the data. Two central arguments of the thesis have been devised in line with the findings of the existing literature on the topic. One is that the investor confidence is the most vital cog in the development of the IPO market, and the other is that the legal protection of investors is imperative for the restoration and maintenance of this confidence. Finally, it points out that the current legal and regulatory regimes are not worthy of protecting the investors in the IPO market in Bangladesh.

The chronicle of the gradual growth of the securities market in Bangladesh during the last 32 years is demonstrated in Chapter 3. It shows that the reforms made by the authorities concerned from time to time to accelerate market growth did not receive any sustainable positive response from the market. As a result, the age-old market remains gravely underdeveloped. The main reasons for such passivity and inactivity of the market are identified to be the wrong priority of the governmental authorities. This is so because, only some incentives were offered to the market in which investor protection becomes a dire need. Further, the regulator gave up its responsibility to review the
merits of IPOs after the disastrous share scam 1996 when the market seriously called for a strong paternalistic regulation in the interests of the dominant investors who lost their confidence in the market. Furthermore, the failure in the enforcement of some regulatory reform measures such as the compliance with the International Accounting Standards (IAS) and International Standards on Auditing (ISA) has also been marked as a cause of the market shyness of investors.

In reviewing the legal and regulatory framework of the IPO Market in Bangladesh, Chapter 4 canvasses some legal flaws in the current framework. It finds that although the Securities and Exchange Commission Act 1993 (SECA’93) replaces the Capital Issues (Continuance of Control) Act 1947 (CIA’47), the former has a significant influence of the latter. As a result, the SECA’93 does not have much room for the provisions of meeting the growing needs of investor protection which is the primary objective of the SEC. Even the SECA’93 does not contain any provisions relating to the issuance of capital. Rather, such provisions were inserted in the Securities and Exchange Ordinance 1969 (SEO’69) in 1993. The reasons for such an insertion are unclear.

The chapter also exposes the regulatory fragmentation in the market. In this regard, the most important point seems to be the dual regulation of public companies as well as public offers. These authorities are the SEC and the Registrar of Joint Stock Companies (RJSC). Although a great deal of the administration of public companies (existing and potential issuers of securities) falls within the ambit of company law, the securities regulator does not have any concern for the non-compliance with this law by the

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7 This is because a total of 14 sections out of 27 of the SECA’93 are similar in content to those of the CIA’47. A total of 12 sections of the remaining 13 are actually concerned with the various aspects of the SEC itself. The section which is left over (s11) shifted the rights and liabilities of the Controller of Capital Issues (CCI) to the newly created regulator, SEC.

8 See Chapter IA of the Securities and Exchange Ordinance 1969.
companies. On the other hand, auditors and lawyers play vital roles in the floatation of a company, and are beyond the regulatory authority of the SEC. The self-regulatory authorities for auditors are largely passive in penalising the auditors involved in the reported violation of securities law. The trend of accusing lawyers of their involvement in the preparation of defective prospectuses is yet to develop in Bangladesh.

10.3. Major Findings in the Thesis

In analysing the applicability of the DBR in the Bangladesh IPO market, the level of structural and infrastructural development of the market demonstrates that it is far behind the readiness to absorb the disclosure regime. The imposition of the DBR on this infant market is considered to be 'putting the cart before the horse'. All of the elements of market developments that call for the adoption of the disclosure philosophy are non-existent in the market. These are, for example, the abundance of institutional investors; the trading of innovated financial products; and the striving for market globalisation. Similarly, virtually none of the elements on which the success of a disclosure regime relies exist in this market. These elements highlight, inter alia, the practice of good corporate governance, the ability of investors to make prudent investment decisions, and the availability and affordability of professional investment advisory services. The analysis provides evidence that investment games are being played in the market by unequal players in a serious informational asymmetric environment. There has been no code of corporate governance in Bangladesh. Many issuers, in collaboration with their selected market professionals and intermediaries, are taking advantage of the innocence of investors who are basically investment illiterate. No substantial efforts have been

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9 For details, see section 5.2.
10 For a detailed discussion, see section 5.3.
made thus far to educate investors. The profession of investment advisers could not
grow simply because the investors are generally small savers who are not able to afford
to pay for professional services and thus make their investment decisions by themselves.
Institutional investors are very negligible and foreign portfolio investment is almost
‘nil’.

Although the RJSC is primarily responsible for the regulation of issues concerning
corporate governance, this office is considerably inactive in this regard. On the other
hand, the authority of the SEC to govern public companies generated a severe public
criticism in recent times and is currently facing legal challenge in the Supreme Court. A
case study of the Beximco Group of Companies exposes, inter alia, the disputes
concerning market regulation, the powerfulness of companies, and the indolence of
institutional investors in relation to solving a major crisis in the market.11

In such a situation, the DBR has proven to be prejudicial to the market. The
adoption of a code of corporate governance is long over due. Corporate governance has
significant implications for ‘the development and functioning of capital markets’.12 In
formulating such as a code, the principles devised by the Organisation for Economic
Co-operation and Development have (OECD) been recommended to follow as
guidelines.13 To induce institutional investment, the fund-holders of some selected funds
such as pension funds, provident funds as well as financial companies need to be
properly trained so that they can realise the benefits of investment in securities. All of
the self-regulators should be motivated to put more emphasis on the interests of the
market than those of their members.

11 The case has been discussed in details in section 5.3.9.
12 M Maher & T Andersson, ‘Corporate Governance: Effects on Firm Performance and Economic
Growth’ in J A McCahery, P Moerland, T Raaijmakers & L Renneboog (eds), Corporate
411.
Chapter 6 reveals two important findings. Firstly, the civil liability for a defective prospectus of the persons involved in its preparation except for directors and promoters is unclear because of legal ambiguities. Secondly, a wide range of defences favour the escape of potentially liable persons from their liabilities. In addition to these, a discriminatory approach is observed in relation to the disclosure of the withdrawal of consent by a person to be a director of the issuer. Such a withdrawal by an existing director is required to be made public. But the withdrawal of consent to be a director is exempted from publication, even though the consent was included in the prospectus but was withdrawn after the publication of the prospectus (including his or her name on it as a director). This sort of concealment of a material fact may well make the prospectus misleading and untrue. But the existing law imposes no liabilities on anyone for this non-disclosure or untrue disclosure.

Recommendations are submitted that civil liability should be imposed on all persons involved in the preparation of a prospectus in clear terms. Directors and promoters should be liable for the whole prospectus, whilst the other members of the IPO coalition should be held responsible for their respective roles only.

Defences should remain in place for the sake of justice, but these should not be allowed to be relied on as straightforward means of escaping liability. There should be some requirements to be proved for taking advantage of such defences. For example, due diligence defence should be subject to reasonable care and personal inquiry into the truth of the fact in question. Simple personal trust, for example, in the claim that the defendant had a personal belief or had reasonable grounds to believe that the statement in question was true should no longer be a valid defence. The burden of the executive directors of knowing the truth of the information provided in the prospectus should be

13 For a discussion of the *OECD Principles of Corporate Governance* 1998, see section 5.3.3.
regarded as much more onerous than that of the non-executive directors in respect of this defence.

As regards the expertisation defence, it has been argued that the qualification and honesty of the expert must be investigated properly before using any expert opinion in the preparation of a prospectus.

The onus of proving the reliance of investors on the defective prospectus should be omitted. The existence of misstatement or material omission in the prospectus should be regarded as conclusive evidence to assume/presume this reliance. This is so because, it would be very difficult for the investors to prove that they made their investment decisions depending entirely on disclosures in the prospectus. In many cases, investors who are mostly investment illiterate are tempted to invest in IPOs on the basis of the reputation of persons named in the prospectus such as promoters, directors, underwriters and audit firms. The brand image of the issuer also influences general investors to invest their resources in IPOs. Hence, the possibility of making uninformed investment decisions in the Bangladesh market is higher than that in developed markets.\textsuperscript{14}

In the backdrop of the soft liability provisions in the relevant legislation, the difficulties in proving the case against defendants under the common law of torts have but added to the deficiencies of the civil liability regime in Bangladesh. However, the common law has significant implications for redrafting the statutory liability provisions by imposing liability on all persons involved in the preparation of a prospectus. This is so because, the common law imposes liability on all of them.

In reply to scepticism that the proposed liability provisions may chill the issuance of securities, it has been argued that only the persons involved in potential IPOs of high

\textsuperscript{14} The reason is obvious and it is that unlike the latter, the former is overwhelmingly dominated by retail investors.
risk may be discouraged. Such a cooling effect has been found to be beneficial to the legitimate interests of the investors as well to the integrity of the market.

It may be noted here that the issue of the liability of the companies has been kept outside the ambit of this study, because it has been briefly shown that their liability has implications for saving the real wrongdoers at the expense of the investors’ interests. Thus the liability of the issuers does not favour the efforts to protect investors.15

The foremost need is to make clear provisions of law by naming the potential liable persons by their designations. The defences and conditions attached to the liability provisions should also be clearly documented.

The flaws of the prospectus criminal liability are evident in Chapter 7. Similar to the civil liability provisions, uncertainties and ambiguities also exist in the provisions of criminal liability. First of all, the articulation of law imposing prospectus criminal liability should be redrafted to clearly enfold all persons who participated in disclosures in prospectuses. Any benefit of doubt will, of course, save the offenders and preclude the victims of the violation of law from seeking justice, and harm the market in the end.

Currently, the onus of proof lies on complainants that they were induced to invest in the IPO in question by the disclosures in the prospectus. This is a bar for the victims of the flouting of the law from getting justice. As argued in respect of civil liability, the inclusion of an untrue, false, deceptive or misleading statement in the prospectus is recommended to be sufficient to presume the occurrence of inducement attracting criminal liability. However, the accused should be allowed to rely on reasonable defences.

Defences such as ignorance, due diligence and personal honesty appear to be ‘absolute’ in the present law, and they should be made conditional. In respect of any of

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15 See section 6.3.
these defences, the accused’s reasonable care for, and personal inquiry into, the truth of the statement must be proved in order to take advantage of such a defence.

Higher penalties work as a deterrent to combat crimes including corporate misfeasance as it is evident from the research referred to in the discussion. The range of penalties in Bangladesh is very low as compared to that of other countries. In addition, the judge has some substantial discretion of making it even lower. Such penal provisions can hardly work as deterrent. Therefore, suggestions are advanced to increase the terms of imprisonment as well as of fines.

Any liability regime is inoperative without a corresponding efficient enforcement mechanism. Justice and deterrence are established through the proper enforcement of the law. Having regard to this proposition, the enforcement regime of securities laws in Bangladesh has been reviewed with due care. Chapter 8 concludes with the solutions to the problems that persist in the judicial enforcement regime. Central to the findings is that the bench and the bar in Bangladesh lack sufficient training and experience in dealing with securities cases. The main reasons for such a scarcity of well trained judges and lawyers are of course the paucity of securities cases and the non-availability of courses on securities law in the country’s law schools. In addition, there have been widespread allegations of corruption in the judiciary and unprofessional practices by some lawyers. As a result, the judiciary or the judicial system as a whole has been suffering a public confidence crisis. Nonetheless, the efficient disposal of securities cases requires honest, trained and experienced benches and bars because of their (cases) complex nature and the impact of their adjudication on the public confidence in the market. In the interest of justice, ‘a strongly held view’ which is in place in the business

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16 See section 7.2.
community propounds that such cases should be adjudicated by judges skilled in dealing with securities laws and disputes thereunder.\textsuperscript{17} It has been argued that it would be impracticable to train all judges and lawyers all at once. But, at present, the importance of the efficient disposal of securities cases which are pending in several courts for years is paramount to revitalise the ailing securities market. Having regard to this importance and the need for the restoration of investor confidence in the market, the establishment of two special courts namely, securities courts, is recommended. Initially, the proposed courts are to be set up in Dhaka and Chittagong where two bourses are situated. All important aspects of these courts such as their composition, functions, jurisdictions and limitations have been specified.\textsuperscript{18} At the same time, suggestions have been advanced to train up a special bench of the High Court Division of the Supreme Court (HCD) which should be charged with the responsibility for adjudicating securities cases. However, such a court can hear the cases under other laws as well with a preferential treatment for securities cases. This bench should be empowered to hear appeals from the proposed securities courts and to act as the court of first instance when the securities courts fail to dispose of a particular case within the stipulated timeframe.

Another major suggestion for the effective judicial enforcement of prospectus liabilities is that there should be the introduction of courses on securities laws in the country’s law schools at the tertiary level. This would help produce competent persons for dealing with securities cases in the long run.


\textsuperscript{18} See for details, sections 8.7 - 8.7.5.
Evidence is provided that securities regulators are entitled to lodge civil suits for the recovery of investors’ compensation in some jurisdictions. But the SEC in Bangladesh lacks this authority. Clear provisions for class actions are absent in Bangladesh and investors are extremely passive in seeking judicial remedies for some obvious reasons outlined in the discussion. As a consequence, the wrongdoers go unchallenged and investors remain uncompensated after losing their life savings in the securities market. It has also been argued that the practice of private litigation has a discouraging effect on investors and issuers alike and it does not ultimately help market development. Taking all these factors into account, it is submitted that the SEC needs to be enabled to bring the wrongdoers to book for the recovery of investors’ compensation.

Recent literature advocates increased enforcement powers of the securities regulators. Proponents of this view argue that a regulator is a proactive enforcer, whilst the role of the court is reactive. Despite this recognition of the usefulness of regulatory enforcement, some criticisms are in place regarding an ‘all powerful securities regulator’. In this study, attempts are made to strike a balance between the two extreme edges, such as, all powerful and powerless regulators. Two fatal shortcomings are identified in respect of the existing enforcement powers of the SEC. Firstly, the authorities of the SEC to investigate the irregularities of an issuer and its directors and promoters are questionable until the issuer becomes listed on any stock exchange. The regulator is required to have a clear legal force in support of its authorities. Secondly, a committee of inquiry rather than a single person should carry out investigations. The committee must have a representative of the person(s) to be investigated.

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19 See section 8.8.
20 See section 8.8.
21 For details, see section 9.5.
Recommendations are made to increase the enforcement powers of the SEC during the course of investigations. For example, the investigators should be allowed to enter any property for the purposes of collecting evidence in any form required for the investigation at hand. The amount of the penalty for a failure to comply with investigation requirements needs to be increased to double the present 0.1 million taka (approximately US$1,754).

To guard the guardian, some measures are also suggested. The accountability of the regulator helps underpin public confidence in the market regulation. Currently, an appeal is allowed to the SEC itself against the decision of any of its members or officers. The decision of the SEC is final. However, the SEC can review its decision. The judicial scrutiny of administrative functions is a common practice for a transparent administration. Provisions for the first appeal to the proposed Securities Court and the second appeal to the special bench of the HCD (securities bench) are recommended in order to provide for a judicial appraisal of the decisions of the SEC.

Apart from the arguments for the increased regulatory powers of enforcement, existing literature shows that a strong administrative enforcement mechanism and a credible judicial enforcement regime should go hand in hand. The prudent exercise of enforcement power greatly depends on the members of the SEC. The composition of the SEC is a matter of growing concern to the market participants. There are several allegations against the SEC for making imprudent reforms and issuing irrational orders which eventually damaged the market.\footnote{For the discussion of this issue, see section 9.3.2.} It is submitted that the SEC is to be made up of lawyers, market professionals, and bureaucrats. The importance of the combination of these people of different categories in a securities watchdog is enormous.\footnote{J W Hicks, ‘Securities Regulation: Challenges in the Decades Ahead’ (1993) 68 Indiana Law Journal 791 at 803.} In most of
the developed markets, the majority of members are appointed from amongst the lawyers (practising or non-practising) to their securities regulators. In line with these regulators, it is suggested that one-third of the members of the SEC should be appointed from persons having law degrees and preference should be given to those who possess special training in securities law. In appointing members of each category, personal integrity, professional efficiency and impeccable honesty should be taken into account.

Regulatory independence is a crucial factor for effective regulation. The SEC should be an independent body and the security of the tenure of its members must be ensured. Before the expiry of their tenure, a member can only be removed in pursuance of a prescribed way. Any fatal allegation against a member of the SEC should be judicially inquired into by a judge of the Supreme Court. On the basis of the report of the inquiry, legal proceedings should be initiated if necessary, and administrative action against such a member should be taken in accordance with the final verdict of the court.

Investor protection can be provided by preventing the occurrence of the violation of securities law and remedying the violations which could not be prevented beforehand. Prevention is generally considered to be a preferred approach to address wrongdoings. It is more important in a market where the enforcement of law is considerably weak. Prevention can be achieved in two ways: firstly, educating investors; and secondly, verifying prospectuses by the regulator. For the purpose of educating investors, the establishment of a separate centre or institute under the administration of the SEC is recommended. Alongside the education program for investors, this centre should be charged with the responsibility for imparting training to other market participants. The training program should focus on the ways and importance of fair play in the securities market. The significance of the training of the educators has also been canvassed. A

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24 See section 9.3.3.2.
useful curriculum of this education program encompassing the aspects of the basic knowledge of investment for making a prudent decision should be prepared first and then the educators should be trained in it. Electronic and press media can be used to create public awareness of investment in securities. Specific programs on television channels may be most effective in this regard. Apart from these, the proposed courses on securities law will help produce educated investors.

The regulatory verification of the information furnished in a draft prospectus is another means of prevention of malfeasance in the IPO market. The SEC must have competent persons to accurately verify prospectuses. Retail research by the SEC would be of enormous use to compare the information provided in prospectuses.26

The SEC should be made a single authority to regulate the IPO market. Any fragmentation of regulatory responsibilities creates a regulatory dilemma amongst the parallel regulators. A simple way of doing this is by incorporating all the relevant securities laws in a single piece of legislation, and vesting its administration in the SEC. In making the SEC such a sole authority, it is to be taken into account that, in the interests of effective regulation, the regulator 'must be afforded adequate resources and authority to monitor the market, investigate possible abuses and punish offenders'.27

10.4. Conclusions and the Way Forward

It is a fact that capital markets are increasingly considered to be the 'preferred medium'

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25 See, for details, section 9.3.
26 See section 9.4.1.2.
for corporate fund raising worldwide. But the development of such a market is a gradual process. According to Black '[t]he effort can begin with honest courts, regulators, and prosecutors, which are critical whatever form a country’s capital markets take'. First of all, a securities code should be enacted covering all business and regulatory aspects of the IPO market (along with the aspects of other forms of primary issues and the trading in the secondary market). The code should be drafted in a clear and simple manner outlining the rights and liabilities of all market participants. Because of having weak enforcement institutions, the law needs to be simpler and easily administrable in a country like Bangladesh. The jurisdictions of the SEC should be unambiguous to enforce the code. This code would work as an implicit force for the consistent regulation of the market and it must be effectively enforced to optimise the benefits of the law. The efficient enforcement of securities law and the independence of its regulator have to be ensured and corruption should be combated to reap these benefits. According to Mann, securities regulation 'can help a market flourish by promoting investor confidence in the safety, honesty and basic fairness of the market'.

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30 To make it a complete code, laws relating to other forms of primary offers and the secondary trading of securities should be included. It is footnoted because, this study is confined to the IPO market alone. For an example of such unification of securities laws, the Corporations Act 2001 (Cth) of Australia can be seen.
32 Mann (1993), above n28 at 181.
In addition to the above code, a separate code of good corporate governance should be adopted soon. This code should resemble ‘a strong balance sheet in that it is a stock concept which effectively delineates the rights and responsibilities of each group of stakeholders in the company’.

Since the market is still in a stage of its infancy, the preferred policy would be to return to the Merit-Based Regulation (MBR). Shifting from the merit regulation to the disclosure philosophy should be made gradually in response to, and depending on, the market readiness. Initially, a 10-Year Master Plan may be made mapping out the way of such shifting. Over this period, all necessary reforms in the IPO market, as suggested in this study, should be accomplished as early as possible and it should not take more than five years. This way the potential institutional investors should be motivated to invest in securities. The operation of a credible Central Depository System is vital for investor confidence. Self-regulation for the market intermediaries and professionals should be made effective.

To promote investor confidence in the market, the necessary structural and infrastructural development and credible enforcement of securities law for a period of at least a few years are required. Black letter laws alone would not be sufficient to attract the market-shy investors to assume further risks in the market. After the accomplishment of the above reforms and their good enforcement records for a number of years, the securities regulator should embark on studies of the market readiness, and

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36 L C Keong, ‘The Corporate Governance Debate’ in L C Keong, Corporate Governance: An Asia-Pacific Critique (2002) Hong Kong: Sweet & Maxwell Asia 3 at 3. As defined by Keong, the stakeholders of a company refers to all persons ‘who may be affected by the activities of the company, including its management, shareholders, creditors, employees, consumers and the public at large’. He also adds that the companies and securities regulators are also considered to be stakeholders ‘insofar as the regulation of the companies, and its fund raising activities, come within the ambit of the regulatory framework’.

37 In this respect, the Capital Market Master Plan 2001 of Malaysia may be taken into account. For the text of this plan, visit <http://www.sc.com.my/html/cmp/CHAPTER1.PDF> (10 May 2003).
any major changes in the regulatory philosophy should be made in accordance with the results of such investigative studies.

Reforms in the IPO market are necessary but not sufficient for the development of the Bangladesh securities market. The performance of the primary and the secondary markets is correlated. Thus, laws governing other primary issues of securities and trading in the secondary market need to be investigated in depth. Such investigations may be the topic of future research.


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