

# **Legal Aspects of Underwriting Process**



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## FINAL APPROVAL

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**TITLE:**

***“LEGAL ASPECTS OF UNDERWRITING  
PROCESS”***

**THESIS STATEMENT:**

***“THE PROVISIONS OF UNDERWRITING  
PROCESS ARE RUSHED AND COMPLICATED,  
THAT NEEDS TO BE SIMPLIFIED.”***

### **DEDICATION**

*I dedicate this piece of work first of all to the Holy Prophet Muhammad (peace be upon him) and his Companions and then to my beloved parents and also to my teachers and to the Faculty of Shariah & Law International Islamic University Islamabad.*

## **ACKNOWLEDGEMENT**

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## **ACRONYM**

<i>Initial Public Offering</i> .....	<b>LP.O</b>
<i>Lead Manager</i> .....	<b>L.M</b>
<i>Stock Exchange</i> .....	<b>S.E</b>
<i>Securities and Exchange Commission of Pakistan</i> .....	<b>S.E.C.P</b>
<i>Gross Domestic Product</i> .....	<b>G.D.P</b>
<i>Book Runner</i> .....	<b>BR</b>
<i>Securities and Exchange Commission of Thailand</i> ...	<b>SEC</b>
<i>Karachi Stock Exchange</i> .....	<b>KSE</b>
<i>Lahore Stock Exchange</i> .....	<b>LSE</b>
<i>Islamabad Stock Exchange</i> .....	<b>ISE</b>
<i>Securities and Exchange Board of India</i> .....	<b>SEBI</b>
<i>Balloters Transfer Agents and Underwriters Rules 2001</i> ....	<b>BTAU</b>
<i>Securities and Exchange Commission of Pakistan Act, 1997</i> .....	<b>SECP Act</b>

# **Chapter # 1 Introduction**

## **Theoretical Background:**

### **1.1 Purpose /Scope of Thesis:**

The purpose of this study is to elaborate the underwriting process with emphasis on its legal aspects and to make comparison of underwriting process in Pakistan with other Jurisdictions like Indonesia, India and Thailand. In this study suggestions and recommendations are given which are followed by regulations drafted for existing legal system in Pakistan for its underwriting process, which will be beneficial for road map to effective legislation towards underwriting process in Pakistan.

### **1.2 Problem Statement:**

“The provisions of underwriting process are rushed and complicated, that needs to be simplified.”

### **1.3 Significance:**

In this research, legal aspects of Underwriting in Pakistan has been discussed, which so ever has never been studied in Pakistan. Then System of underwriting in other jurisdictions has been discussed in this study. Problems has been highlighted while discussing the comparison of underwriting with other jurisdictions.

Most importantly for the implication of this study in Pakistan, recommendations has been discussed at the end of this research for revamping of legal system of Underwriting Process in Pakistan.

## **1.4 Contribution:**

In this study following topics has been covered defining the Underwriting Process, Initial Public Offering Process , types of underwriters, Important Steps involved in underwriting process, role of underwriters, Legal Frame work of underwriting in Pakistan, Conditions for acting as underwriters in Pakistan, Laws dealing with underwriters in Pakistan, Book Building Process in Pakistan and Underwriting Agreement executed in Pakistan. Then Citations in Pakistan has been discussed.

After discussing the above areas in this research, laws governing underwriters in Indonesia, India and Thailand has been highlighted and then their comparison has been discussed in detail.

Valuable input to this study are recommendations in the form of a draft *“Code of Conduct for Underwriters”* in Pakistan and a draft regulations as *“Securities and Exchange Regulations for Underwriters”*.

## **1.1 What Is Underwriting Process?**

Underwriting is a process by which underwriter<sup>1</sup> offers new issues/securities of the issuer to the public. The underwriter in consideration for underwriting commission assures or guarantees to the issuer that he will sale a certain number of securities for a certain price to the public. Thus through this process the issuer is assured that a minimum amount would be raised from a issue. <sup>2</sup>There are three parties which are directly or indirectly involved in the process .The first is issuer (who is a company) intending to issue/sale the securities .The second is a underwriter, who assures the issuer to float the securities in the market for a minimum subscription price. Third is an investor (broadly speaking the general public) who invest their savings by purchasing the securities of the issuer.

What are the considerations involved in this process for the above three parties? The answer to this is issuer is in need of funds or capital for their existing on going or future projects and as a result of this process issuer gets capital from the public. The underwriter in consideration gets the underwriting commission/fee for providing his services for generating the capital by selling the securities to the public. The surplus of individuals (public) become secure, after making investment in securities and as a result of this investment the general public (Investor) became the shareholder of a particular company and got a share certificate from the issuer.

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<sup>1</sup> Underwriter <sup>1</sup> includes a person who has made a contract with an issuer to subscribe and pay in cash for those securities as are not fully subscribed by the public issue or a person who has initially bought the securities from an issuer for the purpose of selling such securities by means of a public offer.

<sup>2</sup> <http://www.vector.com.pk/Glossary.html>



The process of underwriting usually takes place in financial markets<sup>3</sup>. Financial markets are of two types, Capital market<sup>4</sup> for long term securities and Money market<sup>5</sup> for short term securities. Each of these securities involves a market for the new issues, the primary market and a market for trading in existing securities, the secondary market. Newly issued securities are usually traded in Primary markets. The key financial institutions<sup>6</sup> in the primary market is the investment bank, or underwriter, other financial institutions, such as certain large commercial banks and insurers, also engage in the underwriting function in various ways and have been increasingly active recently in this area. However, the primary market has traditionally been the lone province of the investment bank. Because underwriters is a broader term inclusive of any institution performing the underwriting function.

The basic notion of this study is to inform the general public and all those persons dealing with the securities that how the relationship works between issuer and underwriters, how they are agreed and what agreements they execute during the underwriting process, what is the enlistment requirements of the securities with regard to the concerned securities regulator and of stock exchanges. What are the civil and criminal liabilities for the parties involving the underwriting process who fails to observe the due process of law. The recommendations are also discussed for the enforcement of legislation and revamping of existing rules of underwriting.

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<sup>3</sup> [http://www.investorwords.com/1953/financial\\_market.html](http://www.investorwords.com/1953/financial_market.html) visited on 28.08.2009

<sup>4</sup> [http://en.wikipedia.org/wiki/Capital\\_market](http://en.wikipedia.org/wiki/Capital_market) 28.08.2009

<sup>5</sup> [http://en.wikipedia.org/wiki/Money\\_market](http://en.wikipedia.org/wiki/Money_market) visited on 28.08.2009

<sup>6</sup> Section 2(a), The financial institutions (Recovery of Finances ordinance), 2001.

Now we find how underwriting is defined in various scenarios<sup>7</sup>;

1.1.1 Securities Underwriting

1.1.2 Bank Underwriting<sup>8</sup>

1.1.3 Insurance Underwriting<sup>9</sup>

1.1.4 Real estate Underwriting<sup>10</sup>

1.1.5 Forensic Underwriting<sup>11</sup>

1.1.6 Sponsorship Underwriting<sup>12</sup>

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<sup>7</sup> <http://en.wikipedia.org/wiki/Underwriting> visited on 28.08.2009

<sup>8</sup> In investment banking, underwriting is defined as the transaction between the issuer of the instruments of debt or equity and the firm which has agreed to liquidate the instruments immediately upon their issuance. In investment banking underwriting, the government or private entity which issues the debt or equity instruments has an immediate need for cash (specie), and has no interest in waiting to locate buyers for the instruments at an indeterminate or specified date. The issuer also usually has no detailed knowledge of the individuals who are capable or interested in the present or future purchase of the instruments, and (most importantly) what the highest and most fair price for the securities may be.

In banking, underwriting is the detailed credit analysis preceding the granting of a loan, based on credit information furnished by the borrower, such as employment history, salary and financial statements; publicly available information, such as the borrower's credit history, which is detailed in a credit report; and the lender's evaluation of the borrower's credit needs and ability to pay. Underwriting can also refer to the purchase of corporate bonds, commercial paper, government securities, municipal general-obligation bonds by a commercial bank or dealer bank for its own account or for resale to investors. Bank underwriting of corporate securities is carried out through separate holding-company affiliates, called securities affiliates or Section 20 affiliates.

<http://en.wikipedia.org/wiki/Underwriting> visited on 28.08.2009

<sup>9</sup> Underwriting may also refer to insurance; insurance underwriters evaluate the risk and exposures of potential clients. They decide how much coverage the client should receive, how much they should pay for it, or whether even to accept the risk and insure them. Underwriting involves measuring risk exposure and determining the premium that needs to be charged to insure that risk. The function of the underwriter is to acquire—or to "write"—business that will make the insurance company money, and to protect the company's book of business from risks that they feel will make a loss. In simple terms, it is the process of issuing insurance policies.

Each insurance company has its own set of underwriting guidelines to help the underwriter determine whether or not the company should accept the risk. The information used to evaluate the risk of an applicant for insurance will depend on the type of coverage involved. For example, in underwriting automobile coverage, an individual's driving record is critical. As part of the underwriting process for life or health insurance, medical underwriting may be used to examine the applicant's health status (other factors may be considered as well, such as age & occupation). The factors that insurers use to classify risks should be objective, clearly related to the likely cost of providing coverage, practical to administer, consistent with applicable law, and designed to protect the long-term viability of the insurance program.

The underwriters may either decline the risk or may provide a quotation in which the premiums have been loaded or in which various exclusions have been stipulated, which restrict the circumstances under which a claim would be paid. Depending on the type of insurance product (line of business), insurance companies use automated underwriting systems to encode these rules, and reduce the amount of manual work in processing quotations and policy issuance. This is especially the case for certain simpler life or personal lines (auto, homeowners) insurance.

<sup>10</sup> In evaluation of a real estate loan, in addition to assessing the borrower, the property itself is scrutinized. Underwriters use the debt service coverage ratio to figure out whether the property is capable of redeeming its own value or not.

<sup>11</sup> Forensic underwriting is the "after-the-fact" process used by lenders to determine what went wrong with a mortgage.<sup>1</sup> Forensic underwriting refers to a borrower's ability to work out a modification scenario with their current lien holder, not to qualify them for a new loan or a refinance. This is typically done by an underwriter staffed with a team of people who are experienced in every aspect of the real estate field.

But here our concern is to discuss the underwriting with regard to the securities;

### **1.5.1 Securities Underwriting<sup>13</sup>**

The process by which business customers are assessed by investment houses for access to either equity or debt capital.

This is a way of placing a newly issued security, such as stocks or bonds, with investors. In this process, a syndicate of banks (the lead-managers) underwrite the transaction, which means they have taken on the risk of distributing the securities among the investors. There is the possibility that the underwriter not be able to find enough investors, and in that specific case underwriter will hold some securities themselves. Underwriters earn their income from the "underwriting spread".

The underwriting spread is the price difference between the price they pay to the issuer and the price they collect from investors or from broker-dealers who buy portions of the offering.

Underwriting Spread = The Price collected from the investor - The Price pay to the issuer

## **1.6 What Is Initial Public Offering (IPO)?**

A newly established company or smaller company which is in need of capital or want to raise its capital for its on going existing projects or future projects; it usually starts two

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<sup>12</sup>Underwriting may also refer to financial sponsorship of a venture, and is also used as a term within public broadcasting (both public television and radio) to describe funding given by a company or organization for the operations of the service, in exchange for a mention of their product or service within the station's programming. For more on underwriting in public broadcasting, please see underwriting spot.

<sup>13</sup> Ibid.[7]

types of projects (i) Loan based projects (ii) Equity Based Projects. When it starts loan based projects it gets either the loan from the financial institutions or issues debentures. The company invest their money in the loan based projects subject to pre determined fixed return/ interest. Alternatively company starts equity based projects. It issues shares to the public for the first time through the initial public offering and through this initial offering the company/issuer accumulates capital from general public. This is what we called initial public offerings (IPO)<sup>14</sup>.

The IPO is usually conducted by the smaller newly established companies seeking the capital to expand. The private company has to be enlisted in either of stock exchanges in order to become publicly traded company. In other words the private limited company seeking capital needs to become public company. Large privately owned companies after becoming the public company can also traded their shares in the public through IPO there is no restriction with regard to trading through IPO on newly established or existing companies.

In IPO an issuer obtains the assistance of underwriting firm, which helps issuer with regard to what type of security be issued either common<sup>15</sup> or a preferred<sup>16</sup> stock, the best offering price and the time to bring the offer in the market.

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<sup>14</sup> [http://en.wikipedia.org/wiki/Initial\\_public\\_offering](http://en.wikipedia.org/wiki/Initial_public_offering) visited on 29.10.2009.

<sup>15</sup> "Common Stock" Any shares that are not preferred shares and do not have any predetermined dividend amounts. An ordinary share represents equity ownership in a company and entitles the owner to a vote in matters put before shareholders in proportion to their percentage ownership in the company. Ordinary shareholders are entitled to receive dividends if any are available after dividends on preferred shares are paid. They are also entitled to their share of the residual economic value of the company should the business unwind; however, they are last in line after bondholders and preferred shareholders for receiving business proceeds. As such, ordinary shareholders are considered unsecured creditors. Source: [http://en.wikipedia.org/wiki/Common\\_stock](http://en.wikipedia.org/wiki/Common_stock) visited on 28.10.2009.

<sup>16</sup> Preference shares are issued to the existing shares holder in preference to the common or ordinary new share holders as it previously showed interest in investment in the company. Source: [http://en.wikipedia.org/wiki/Preferred\\_stock](http://en.wikipedia.org/wiki/Preferred_stock) visited on 28.10.2009.

All the trade of securities/shares should be conducted in a venue where the issuer and investors/share holders come close to each other and the transactions and the queries with regard to shares conducted in a smooth manner. In order to minimize any kind of dispute arising in future regarding the shares, between the issuer and the share holders, the issuer/offeree issuing the security should be enlisted on either of a stock exchange<sup>17</sup>, where it wants to issue shares.

When a company wishes to make public offering, its first step is to choose the investment bank/ Commercial bank to advise it and to perform the underwriting functions in connection with the issue. The selection process of investment bank relies on general reputation, expertise, quality of work in specific industry and its distribution expertise. The capital net worth of institution acting as an underwriter varies from country to country in Pakistan there is no restriction with regard to capital net worth for underwriters.

However in India minimum capital net worth for underwriters is 20 Lakh rupees<sup>18</sup>. This selection process is a two way affair; the reputable investment banker will have to be careful while choosing his client.

The most common type of underwriting arrangement involved with the securities is a "*firm commitment*"<sup>19</sup>. In a *firm commitment underwriting* the underwriter purchases all the issue of securities and then the underwriter resells it in the market. The difference

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<sup>17</sup> Investors guide; what is stock Exchange ? <http://www.kse.com.pk/investors-corner/introduction.php?id=5&sid=5.6>

<sup>18</sup> <http://www.sebi.gov.in/acts/uwregu93.html> visited on 28.10.2012.

<sup>19</sup> <http://financial-dictionary.thefreedictionary.com/firm+commitment> visited on 28.10.2012.

between the price at which underwriter purchases and subsequently sells the issue is called the 'Gross Spread'.

In Underwriting Spread the price paid to the underwriter is difference between price collected from investor and the price paid to the issuer. While the Gross spread is the price at which underwriter purchases the issue from issuer and subsequently sells the issue to the general public.

Public offerings can be managed by one or more than one underwrites. When there are multiple underwriters to the issue, one of them is selected as a Lead Manager or Book Running manager. The Lead manager plays a major role in the successful offerings.

Lead Manager<sup>20</sup> are responsible for the following acts:-

- i. For all the arrangements with the issuer.
- ii. Establishes the schedule of issue.
- iii. Responsible for the due diligence process<sup>21</sup>.
- iv. Pricing and distribution of stock.
- v. Assembling a group of underwriters known as syndicate underwriters.
- vi. To assist the syndicate underwriter in the sale of shares to the public.

The Lead Underwriter<sup>22</sup>, co-managers, and syndicate underwriters are paid for rendering their services on behalf of the issuer. They are usually compensated from gross spread according to the agreed percentage by the issuer.

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<sup>20</sup> [http://www.chittorgarh.com/newportal/ipo\\_manager\\_list.asp](http://www.chittorgarh.com/newportal/ipo_manager_list.asp) visited on dated.30.10.2009.

<sup>21</sup> "The process of careful investigation by an underwriter to ensure that all material information pertinent to a security issue has been disclosed to prospective investors." Source: <http://www.investopedia.com/terms/d/duediligencemeeting.asp> visited on 28.10.2012.

The first agenda item for lead underwriter is to execute a '*Letter of Intent*', before any significance expense has been occurred. The purpose of letter of intent is to protect the underwriter against any uncovered expense in the event that the offer is withdrawn by the issuer either in the due diligence and registration stage or during the marketing stage.

The Letter of Intent<sup>23</sup> contains the following points:-

- i. It contains a clause requiring the issuer to reimburse the underwriter for any out of pocket expense during the process.
- ii. It includes gross spread and underwriting discount.
- iii. It includes a commitment by the underwriter to enter into a firm commitment agreement.
- iv. It includes an agreement by the company to co-operate in due diligence efforts.
- v. It includes an agreement to make available all relevant record or information to the underwriters and to its counsel.
- vi. It includes a commitment by the company to grant a 15% over allotment option<sup>24</sup> to the underwriter.
- vii. The letter of Intent remains in force until the underwriting agreement is executed at pricing between the issuer and underwriter. Only then the underwriter is firmly committed to buy the securities from the issuer at pricing.

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<sup>22</sup> A investment bank or other financial outfit that has the primary directive for organizing an initial public stock offering, or a secondary offering for companies that are already publicly traded. The lead underwriter will usually work with other investment banks to establish a syndicate, and thereby create the initial sales force for the shares. These shares will then be sold to institutional and retail clients.

The lead underwriter will assess the company financials and current market conditions to arrive at the initial value and quantity of shares to be sold. These shares carry a hefty sales commission (as much as 6-8%) for the underwriting syndicate, with the majority of shares being held by the lead underwriter. Source: <http://www.investopedia.com/terms/l/leadunderwriter.asp#axzz2A72lqNn7> visited on 30.10.2009.

<sup>23</sup> [www.businesslist.com/forms/downloads/.../1731-letter-of-intent.rtf](http://www.businesslist.com/forms/downloads/.../1731-letter-of-intent.rtf)

<sup>24</sup> <http://www.investopedia.com/terms/o/overallotment.asp#axzz2A72lqNn7> visited on 31.10.2009.

viii. It is pertinent to mention here that this letter does not provide any kind of guarantee relating to the final offering price in the letter of intent.

The company issuing the security should be enlisted on either of stock exchanges existing in the country. It is for the purpose, the investors feel secure to invest in a company in the shape of purchasing shares.

Then the company and its counsel draft a registration statement for filing with the Securities Exchange Commission of Pakistan (SECP). The Securities and Exchange Commission of Pakistan is in fact a corporate body almost in every country which regulates the corporate sector in a particular country. In different countries it is working under different names, but the functions performed by them are identical to each other of that particular country. Its outline is prepared by the underwriter. It takes several weeks and many meetings with the working group<sup>25</sup> for preparing the registration statement. The registration statement consists of two parts:-

- (i) The first part of registration statement is the prospectus which is available to the every purchaser of securities or to the investors.
- (ii) The second part of the registration statement need not be available to the public by the company but this part is available to the public for inspection through the SEC.

The basic purpose of the prospectus/registration statement is to provide reliable information and proper disclosure to the public regarding securities that are offered for sale. To achieve this purpose the underwriters has to prepare a '*Due Diligence Report*',

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<sup>25</sup> The company management, its counsel, auditors, underwriters, the counsel of underwriters and accountants.



Wherein underwriter mentions that he has investigated and verified the information, which is provided to investors or public. SECP has no authority to prevent public offering based on the quality of securities involved. The thing which the SECP has to ensure is that the company issuing the securities is required to make proper disclosure regarding the issuing securities. If purchaser of securities sustained loss as a result of misstatement or error or omission of material fact in the registration statement, then the purchaser of securities has a remedy, he can sue the issuer for such damage caused due to him.

<sup>26</sup> When the registration statement is approved by regulator, the marketing of offering begins. For this purpose the underwriters organized the road shows and give presentations about the offering to the institutional investors and to the public. After the marketing progresses, the underwriter get the indications about the interest of the investors in the offering, if the investors show their interest in purchasing securities, underwriter books the order from the institutional investors or from retail investors or from the individual investors. However at this stage, prior to the effective date no shares can be sold officially, so any order submitted are only the sources of indication of interest and are not legally binding.

The registration and marketing process take several months to complete as it is impossible for the underwriter to include certain information (such as about the final price of shares and the names of all syndicate members) in its initial filing with

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<sup>26</sup> A Guide to the initial public offering; by Katrina Ellis, Roni Michaely, and Moureen O'Hara., 1999.  
<http://forum.johnson.cornell.edu/faculty/michaely/Guide.pdf>

regulator. After approval of the registration statement, the issuer request for effective date for the offering.

One day prior to the effective date for the offering the issuer and lead underwriter meets to discuss the two points (i) final price of shares (ii) total number of shares to be sold.

After the final terms are negotiated, the underwriter and issuer execute the underwriting agreement. Then the prospectus in abridged form is printed and published in one or more daily newspaper. Investors submit their applications for purchasing of shares along with the price of shares to be purchased, to the underwriters. Usually the initial offering for the investors remain open for one to three days. When the transaction completes, the company delivers its stocks and the underwriter's deposits the net proceeds in the firms account. The issuer then delivers the share certificate to its share holders.

When the IPO completes the responsibilities of underwriters does not end, even then the underwriter has to stabilize the market, by purchasing the shares.

The IPO process involves combination of tasks by the company, underwriter and the syndicate members. Throughout the process the issuer relies upon the underwriter's expertise to market, price, distribute, stabilize and support the issue, while the underwriter relies on the information provided by the issuer.

The completion of the process provides new capital for the company and a new investment opportunity for the public.

## **1.7 Types of Underwriters:**

During the IPO when new securities are issued by the issuer to the public usually three types of underwriters are involved:-

1.7.1 Syndicate Underwriter

1.7.2 Managing Underwriter

1.7.3 Selling Groups

Functions performed by the above mentioned underwriters:-

### **1.7.1 Syndicate Underwriter<sup>27</sup>:-**

The syndicate underwriter is which undertakes and guarantees to the issuer that he will subscribe the securities in the market. Here are three possibilities that the shares are (i) fully- subscribed,(ii) over- subscribed or may be (iii) under- subscribed. When the shares are fully subscribed it means that the underwriter receives applications for the purchase of shares not more than the number of shares offered, all the applicants participated in IPO able to become purchase of shares in the full subscription of shares. When the underwriters receives more applications than the number of offerings, it is called the over subscription and in this case the shares offered are less, while applicants are more in number. Thus the shares are distributed among the applicants/public through balloting. In case under subscription the applicants intending to purchase the shares are less than the number of shares offered to the public, thus in under subscription of shares some part of

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<sup>27</sup> Financial Markets, Instruments and Institutions, MC Graw Hill, International Edition By Anthony M.Santomero and David F. Babbel.

shares remained unsold. The unsold/unsubscribed portion is either purchased by the underwriter or it is offered again in future by the issuer for the purchase of public. In all three possibilities the syndicate underwriter guarantees that he will try to sell the securities in the public but if the shares are unsubscribed, he will purchase the securities from the issuer. Thus the syndicate underwriter gets underwriting commission for placing his capital at risk. Syndicate underwriters not only get the commission but underwriters also get the profit when issued the shares at the par value.

### **1.7.2 Managing Underwriter<sup>28</sup>:-**

The function performed by the managing underwriter is to manage the underwriting process; Managing Underwriter usually completes the documentation of the underwriting process. It fulfills all the statutory requirements of the concerned regulator and Stock Exchanges, with regard to newly issued securities. All the correspondence among the issuer, regulators and stock exchanges are done by the managing underwriter. The managing underwriter gets the underwriting commission for managing and administering the affairs of the process.

### **1.7.3 Selling Groups<sup>29</sup>:-**

How the Selling groups participate in this process? The selling groups are those, they provide their best efforts for selling the securities. For this purpose they perform the function of marketing only for selling the securities but they don't give any kind of

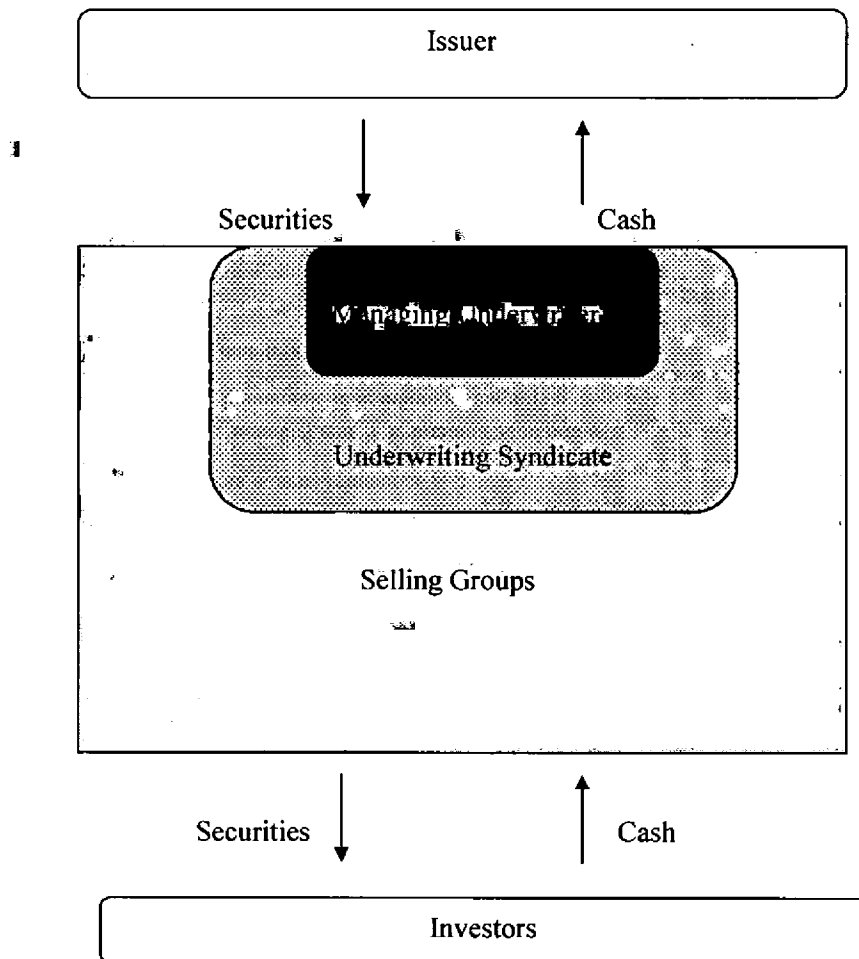
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<sup>28</sup> Financial Markets, Instruments and Institutions, MC Graw Hill, International Edition By Anthony M.Santomero and David F. Babbel .

<sup>29</sup> Financial Markets, Instruments and Institutions, MC Graw Hill, International Edition By Anthony M.Santomero and David F. Babbel .

undertaking nor guaranteed to issuer as given by the syndicate underwriter. The selling groups get the commission from the issuer for his best efforts for selling the securities.

Further they are elaborated through the following diagram;



*Figure<sup>30</sup> 1*

<sup>30</sup> Financial Markets, Instruments and Institutions, MC Graw Hill, International Edition By Anthony M. Santomero and David F. Babbel .Page.442,chapter#18

## **1.8 Three Important Steps Involved in Underwriting Process:**

Underwriting process has to pass through three important phases for every new offering or subscription of securities:

- 1.8.1 Valuation of a new instrument
- 1.8.2 Distribution of a new instrument.
- 1.8.3 Cost in underwriting

### **1.8.1 Valuation of a new instrument<sup>31</sup>:-**

When we talk about an issuer is going to subscribe the new issue, the question comes to our mind is, what will be the value/price of a new issue? It is easiest to determine the value of an asset by finding a similar asset that already exists in the market and using the price of that asset as a reference point for value. In the stock market the prices of new and existing owned shares of a given company are exactly the same. It can't be expected from a company, to issue new shares to acquire more capital at a price that will be any cheaper than that of its existing shares. Thus it becomes very easy to determine the value of new issues or shares of a company, if it already has existing shares traded in the market.

If the issuer has no previously owned issued shares in the market then the value of new issues shall be based on the comparables .It means than the price of new issue shall be fixed by the comparison of the price of same type of shares when it was first time subscribed in the market.

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<sup>31</sup> Financial Markets, Instruments and Institutions, MC Graw Hill, International Edition By Anthony M.Santomero and David F. Babbel. Page 442, Chapter # 18.

If there is no comparables in the market, then the value of issue shall be fixed which is reasonable and generally acceptable to the public as well as to the issuer. The underwriter knows that if he places too high or too low a price of an equity issue, the issuer may withdraw its offering. On the other hand, as the coupon rate of the issue is lowered or the issue price is raised, fewer underwriters will be willing to participate in the underwriting because of the difficulty they will have in selling the new securities. Thus the underwriters must set the issue price just high enough to induce investors to buy all of the issue that the issuer wishes to sell.

The syndicate underwriter can also help in the valuation process by marketing the issue to ascertain the investor interest in the issue and to determine probable prices at which it can be sold. The same functions are also performed by selling groups.

The price of new issues is also determined by the "*Book Building Process*"<sup>32</sup>, it is basically a process used in IPO for the efficient price discovery, it is a mechanism, where during the period for which IPO is open, bids are collected from investors at various prices, which are above or equal to floor price. The offer price is determined after the bid closing date. In this process 75% of issues are allocated for the institutional investors where 25 % of issues are reserved for the individual investors. Where the issues are allocated to the institutional investors price of offer/issue is determined by the process of book building, whereas for 25% of shares/issued reserved for the individual investors price is fixed for the issue/offer.<sup>33</sup>

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<sup>32</sup> <http://www.sharegyan.com/learn-stock-market/primary-market/what-is-price-discovery.php> visited on dated.30.01.2010.

<sup>33</sup> Book Building Process by Mukesh Kr Singh, Page .13, <http://d.scribd.com/docs/21g3lysudhhz623xqyog.pdf> visited on 02.02.2010.

### **1.8.2 Distribution of the new instrument<sup>34</sup>:-**

The distribution of securities is accomplished by syndicate and a selling group. Before six weeks of offering date the managing underwriter forms an underwriting syndicate and selling group. Thus managing underwriters perform the management of underwriting process.

The syndicate underwriters place their own capital at risk by agreeing to purchase any securities that can not be sold to the public/investors. Whereas the members of selling group agree only to use their best efforts to sell the securities. In that case unsold portion of securities is returned to the syndicate.

A day prior to the offering following things are finalized;

- a. Coupon rate
- b. Prices of issues
- c. Allotments to the underwriters

When these things are finalized, this information is placed in the prospectus and then it is sent to SECP for its approval. All reporting to SECP is published in the financial press; it serves as a public notification of the new issue and also method of marketing for the syndicate members. On the first day of public offering the selling members begins to start selling its allotment at the price guaranteed by the syndicate to the issuer.

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<sup>34</sup> Financial Markets, Instruments and Institutions, MC Graw Hill, International Edition By Anthony M Santomero and David F. Babbel .



### 1.8.3 Cost in Underwriting<sup>35</sup>:-

When the issues are sold out completely, the gross underwriting spread is divided among the participants. As participants managing underwriters, syndicate underwriters and the selling groups are involved. Each participant is paid for his part as compensation fee, managing underwriter for preparing the issue, the syndicate underwriter for placing his capital at risk and the members of selling group for his best efforts for selling the securities. The size of underwriting spread varies from country to country and jurisdictions to jurisdiction depending upon the negotiations between issuer and underwriter.

For Example:-

Three participants involved in underwriting get underwriting spread as follows;

Managing Underwriter = 0.5 % (For Its Services)

Syndicate Underwriters = 1.5 % (For risking their capital)

Selling Group = 2.0% (For his best efforts for selling the securities)

By elaborating the above spread, say 0.5% of the amount of the offerings purchased goes to the Managing Group, 1.5% of the mount of offerings purchased goes to the Syndicate group for placing his capital at risk, and major portion say about 2% of the offering amount goes to the selling group for selling the offerings with his best efforts and for performing the marketing function in the whole process.

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<sup>35</sup> Financial Markets, Instruments and Institutions, MC Graw Hill, International Edition By Anthony M.Santomero and David F. Babbel .

## **1.9 Role of Underwriters:**

In the underwriting of securities, the role of an underwriter is very important. The underwriter performs following major roles while participating in the IPO:-

- 1.9.1 Obtaining funds for private and public entities
- 1.9.2 Acts as a financial Intermediary
- 1.9.3 Evaluator of the IPO
- 1.9.4 Acts as a Lead Manager of the underwriting process.
- 1.9.5 Acts as the marketing agent for the issuer
- 1.9.6 Act as a Guarantor for selling the securities.
- 1.9.7 To provide best efforts for selling the securities.

### **1.9.1 Obtaining funds for private or public entities<sup>36</sup>:**

When an issuer is in need of funds for his existing on going or future proposed projects, then issuer have to consult an underwriter that how to raise the funds or capital from the public, while issuing the securities/ shares to the public. Hence an underwriter plays a pivotal role for the generation of funds for public entities.

### **1.9.2 Acts as a financial Intermediary:**

The underwriter serves as a financial intermediary between an issuer and the investors. Since the underwriter generates the funds for the issuer from the public and provide capital to the issuer. The institutional investors, individuals or households who have the

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<sup>36</sup> Financial Markets, Instruments and Institutions, MC Graw Hill, International Edition By Anthony M.Santomero and David F. Babbel .

saving or surplus and wants to invest their savings for future, through the underwriter they feel secure to invest their savings by purchasing the securities or shares of issuer. Through the underwriter the saving of the investors be invested in the projects of the issuer, and when the projects starts it creates employment for the youth and ultimately this investment effects the gross domestic product (G.D.P) of a country and a country progresses.

### **1.9.3 Acts as an Evaluator of the IPO<sup>37</sup>:**

This is one of the most important roles of underwriter as he appraises all the aspects of the initial public offering and advises the company accordingly relating to the price of issue and the number of the shares sold (Common or preferred stock). Its evaluation mentions all the risk factors involved in the initial offering. This appraisal tells us how much this IPO will be successful.

### **19.4. Acts as a Lead Manager of the Underwriting Process<sup>38</sup>:**

Where more then one underwriter is involved in the underwriting process, one of them acts as a lead manager. It becomes responsible for the whole process. Whole communication between the issuer and SECP relating to new issue is performed by the underwriter. Lead Manager is responsible for proper disclosure to the SECP and to the investors about the issue.

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<sup>37</sup> Financial Markets, Instruments and Institutions, MC Graw Hill, International Edition By Anthony M.Santomero and David F. Babbel .

<sup>38</sup> Financial Markets, Instruments and Institutions, MC Graw Hill, International Edition By Anthony M.Santomero and David F. Babbel .

### **1.9.5 Acts as the marketing agent for the issuer:**

The underwriter also acts as a marketing agent for selling the securities to the public. For marketing of the securities, the underwriters arrange road shows and give presentations about the offering to the individual investors and to the institutional investors.

### **1.9.6 Act as a Guarantor for selling the securities<sup>39</sup>:**

The syndicate underwriter acts as a guarantor for selling the shares of an issuer, as he gives undertaking to the issuer that he will sell the shares in the market and for an unsold shares an underwriter will purchase that unsold portion of securities.

### **1.9.7 Provide best efforts for selling the securities<sup>40</sup>:**

Selling groups has made commitment with the issuer that he will provide their best efforts for selling the securities but in such case he will not responsible for any unsold portion of shares.

## **1.10 Organizing this research:**

In this study, the steps usually involved in the IPO are discussed, but in subsequent chapters, focus will be on the Underwriting in the Pakistan and in other jurisdictions countries like Indonesia, India and Thailand. Thereafter comparative analysis will be discussed among Pakistan and above mentioned jurisdictions.

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<sup>39</sup> Financial Markets, Instruments and Institutions, MC Graw Hill, International Edition By Anthony M.Santomero and David F. Babbel.

<sup>40</sup> Financial Markets, Instruments and Institutions, MC Graw Hill, International Edition By Anthony M.Santomero and David F. Babbel.

Here is the brief gist of chapters comprising in this study. In second chapter work done so far all around the world is discussed. Third chapter is about legal frame of underwriting process in Pakistan, statutes dealing with the securities in Pakistan and listed regulations for the stock exchanges then citations relating to underwriting is discussed. In fourth chapter legal framework with regard to the underwriting process in jurisdictions Indonesia, India and Thailand is discussed, while in chapter fifth comparative analysis is discussed. Research is concluded in chapter sixth thereafter recommendations are given for the existing underwriting in Pakistan.

## Chapter # 2

### Literature Review

In this chapter existing research will be discussed around the world and is closely related to this ongoing research.

#### 2.1 Historical Background:-

Two centuries ago a man who wants to send the cargo to the Mediterranean have to faced risk of danger and destruction in the sea. In order to minimize the risk and to get rid of loss or destruction of ship. It was necessary to write out a statement of contract to which the guarantors subscribed; this was the first underwriting. Two men frequently visits the place in the town known as “Lloyd's coffee house in London”, where the traders meet to discuss their problems with regard to their business ,trade and make gossips, it was the favorite place of traders. Other traders immediately saw the advantage of the scheme, which their colleagues had devised, and thus on the next voyage the risk was parcel out among a large number of patrons of the coffee house. Through this small beginning a large European marine insurance company formed.<sup>41</sup>

In this Coffee House, businessmen would come for coffee and sit down to talk about their business and would exchange information about the movements of ships. Lloyds thought why not start short newsletter so that the people would have the latest

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<sup>41</sup> Underwriting Author(s): George Stevenson Source: *Annals of the American Academy of Political and Social Science*, Vol. 25, *Business Management and Finance* (Jan., 1905), pp. 61-66 Published by: Sage Publications, Inc. in association with the American Academy of Political and Social Science Stable URL: <http://www.jstor.org/stable/1010177> visited on dated: 27/03/2009 02:22

information about the movements of vessels. So, he issued the newsletter. When the demand for the newsletter increased, he thought why not open a common fund in which all businessmen would participate and deposit monies according to their resources. Edward Lloyd died in 1713 A.D, then this house was taken by his family. In this coffee house individuals, insurers, brokers and underwriters come together to do insurance business. In 1772, the underwriters set up the committee of Lloyd have to govern their affairs. In 1733, the proprietor of the above coffee-house began the publication of Lloyd's List, which gave the movements of ships and other matters of trading interest. Lloyd's List is still published as a daily newspaper from London.

The place where Edward Lloyd's Coffee house was situated was taken over by the government as a national asset and today one reads these words on the brass plaque "Lloyd's Coffee House 1691-1785".

Thus the Edward Lloyd's Coffee house has given the idea of underwriting.

In 1977 an article was published namely **"Investment Banking: An Economic Analysis of Optimal Underwriting Contract's"**<sup>42</sup> in America, in which underwriting contracts which are in practice discussed, major under contracts are of three types as elaborated in the article is as under:

#### **1. Firm Commitment:**

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<sup>42</sup> Investment Banking: An Economic Analysis of Optimal Underwriting Contracts Author(s): Gershon Mandelker and Arthur Raviv Source: The Journal of Finance, Vol. 32, No. 3 (Jun., 1977), pp. 683-694 Published by: Blackwell Publishing for the American Finance Association Stable URL: <http://www.jstor.org/stable/2326305> Accessed: 27/03/2009 01:

In this form of contract underwriter purchases the entire issue outright and thus assures the issuer of receiving a fixed amount of funds. If the issue does not sell well, the underwriter, and not the company, takes a loss.

## **2. Best efforts Contract :**

In the facilities of the investment banker are employed only for distribution and he does not underwrite the issue. He is contracted to provide his best efforts to obtain purchasers for the new securities. He does not commit himself to raise any fixed amount and the whole risk is born by the issuer.

## **3. Stand-by" Contract :**

A "stand-by" contract is one by which the banker binds himself to purchase all the securities which the issuing corporation may be unable to sell at a predetermined price. For this service the underwriter receives a flat fee plus a percentage of the value of the securities that he has to undertake. In the extreme case of complete failure by the firm to sell its securities, the firm is assured of receiving a predetermined amount. If the firm succeeds in selling some of the securities, in addition to this predetermined amount, it also obtains a proportion of the receipts it has generated on its own by saving part of the underwriter's share. In this form of agreement the risk is, in fact, shared by the issuer and the investment banker. In June 1936 an article<sup>43</sup> was published by **The Michigan Law review**, where it was discussed what are the federal securities law in U.S and what are blue sky laws. The

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<sup>43</sup> State "Blue-Sky" Laws and the Federal Securities Acts Author(s): Russell A. Smith Source: Michigan Law Review, Vol. 34, No. 8 (Jun., 1936), pp. 1135-1166 Published by: The Michigan Law Review Association Stable URL: <http://www.jstor.org/stable/1282195> Accessed: 27/03/2009 01:57



act regulated the securities is the securities act of 1933 and the securities exchange act of 1934. The blue sky laws are the laws of each state in the U.S which are for the regulation of security in, that particular security.

Issuer and underwriters of large issues have to observed the federal as well as blue sky laws. The issue must be in compliance with federal security laws.

Interstate transactions are the transactions between issuer and underwriter, between underwriter and dealer.

The nature and scope of state laws are also discussed in this article .Securities law has been enacted in this country in each state except the state Nevada. Various type of state laws has been classified as follows<sup>44</sup>:-

- i. The "fraud" type of law, which does not require either "qualification" (i.e., registration or approval) of securities or "licensing" of security dealers, in general, it provides penalties for fraud and authorizes injunctive proceedings to prevent fraud.
- ii. The "licensing" type of law, which, in general, requires dealers in securities to be licensed, but does not require that securities be qualified.
- iii. The "inspection" type of law, which, in general, requires that securities be qualified, but does not require that dealers be licensed.

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<sup>44</sup> State "Blue-Sky" Laws and the Federal Securities Acts Author(s): Russell A. Smith Source: Michigan Law Review, Vol. 34, No. 8 (Jun., 1936), pp. 1135-1166 Published by: The Michigan Law Review Association Stable URL: <http://www.jstor.org/stable/1282195> Accessed: 27/03/2009 01:57

iv. The "licensing and inspection" type of law, which requires both that securities be qualified and that dealers be licensed, and which is the most common type of law.

Then it is followed by the modifications and recommendations for the state laws.

In October 1996, an article namely **"Issuers Expenses and Legal Liability in Initial Public Offering"**<sup>45</sup> was published by the university of Chicago press, the myth of this publication is that an issuer has to face various decisions with regard to the selection and compensation of experts.(i.e. the legal counsel, auditors, underwriters, investment bankers). What are the functions performed by them and how legal liability arises against them.

The auditors, underwriters and legal council are called members of IPO coalition. Members of the IPO coalition prepare and disseminate information in the registration statement to potential investors in an IPO.

In producing the necessary documentation and marketing of the IPO, the auditor, law firm and underwriter perform the following three separate functions:

The auditor performs an audit of the issuer's records and provides an auditor's opinion (required by the Securities and Exchange Commission [SEC] Regulation S-X) in the registration statement.

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<sup>45</sup> Issuer Expenses and Legal Liability in Initial Public Offerings Author(s): Randolph P. Beatty and Ivo Welch Source: Journal of Law and Economics, Vol. 39, No. 2 (Oct., 1996), pp. 545-602 Published by: The University of Chicago Press Stable URL: <http://www.jstor.org/stable/725716> Accessed: 27/03/2009 00:45

- i. The lawyer advises the issuer with regard to the disclosures requirements as mentioned in regulation S-K of the Securities and Exchange Commission [SEC] Regulation. These disclosures will be of management discussion and analysis, uses of proceeds, and risk factors.
- ii. Underwriters advise their clients on timing and pricing decisions and ultimately distribute the shares via a syndicate of underwriters to the general public.

**'Section 11' of the Securities Act of 1933,**<sup>46</sup> mandates that accountants (auditors), underwriters, issuers, persons signing the registration statement, and other experts (the IPO coalition) preparing any part of the registration statement are jointly and severally liable for damages resulting from false or misleading information presented in an initial public offering (IPO) registration statement. Whereas the defendants/experts, in litigation filled against them take plea of "due diligence".

**'Section 12' of the Securities Act 1933** act targets and it hold responsible the seller of securities who materially omitted facts or conveyed untrue statements in oral or written communication.

In 1938 university of Cambridge published an article namely as **"Securities legislation in Canada",**<sup>47</sup> which elaborates for the purpose of registration of company and trading the business of securities , Canada is divided in different jurisdictions, meaning thereby

<sup>46</sup> Section 11(f) of the Securities Act of 1933, 15 U.S.C. ? 77k(f) (1970), provides: All or any one or more of the persons specified in subsection (a) of this section shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

<sup>47</sup> Securities Legislation in Canada Author(s): K. B. Palmer Source: Journal of Comparative Legislation and International Law, Third Series, Vol. 20, No. 4 (1938), pp. 230-241 Published by: Cambridge University Press on behalf of the British Institute of International and Comparative Law Stable URL: <http://www.jstor.org/stable/755035> Accessed: 27/03/2009 01:51

in Canada there are nine provinces and a Dominion. Each provinces has its own securities law and the company incorporated in that particular province can conduct the business of securities in that particular province subject to the permission of securities and exchange commission of concerned province. A security offered by any company in the dominion wishing to trade in other province of Canada has to follow both the securities laws of dominion and that of the province.

The Ontario legislation was first enacted in 1928 as the "Security Frauds Prevention Act", 1928. This Act was replaced in 1930 by a new Act, which is subsequently amended from time to time, is the legislation now in force.

The Act establishes a Securities Commission to administer the Act and provides for the appointment of a Registrar and other officials. The Commission and the Registrar are appointed by the Lieutenant-Governor in Council. The Commission has a wide powers, including the power, subject to the approval of the Lieutenant-Governor in Council, to make and from time to time amend, alter or repeal Regulations, not inconsistent with the provisions of the Act, providing for the furnishing of information by brokers or sales men to the public, for the creation of offences under the Act, for the better carrying out of the provisions of the Act and the more efficient administration thereof and for other specified purposes. The main purpose and aim of the enactment of this legislation are as follows<sup>48</sup>:-

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<sup>48</sup> Securities Legislation in Canada Author(s): K. B. Palmer Source: *Journal of Comparative Legislation and International Law*, Third Series, Vol. 20, No. 4 (1938), pp. 230-241 Published by: Cambridge University Press on behalf of the British Institute of International and Comparative Law Stable URL: <http://www.jstor.org/stable/755035> Accessed: 27/03/2009 01:51

- i. To provide for the registration of persons trading or proposing to trade in securities and to prohibit trading in securities by unregistered persons, except in certain limited cases;
- ii. To regulate trading in securities;
- iii. To provide for investigation and action by the Commission in cases where it believes that any fraudulent act or any act which constitutes an offence under the Act or the Regulations has been, is being or is likely to be committed.

## **2.2 WHY THE NEED OF RESEARCH ON LEGAL ASPECTS OF UNDERWRITING?:**

While discussing literature and by reviewing it, prima facie it reveals that in the field of underwriting securities and an issuance of securities through IPO a lot of work has been made all around the world, but no plausible research is existing with regard to legal aspects of Underwriting Process in Pakistan. Since focus of this study is on the legal aspects of underwriting process, it's the reason, which distinguishes this research from the existing research in Pakistan.

## **CHAPTER # 3**

### **Legal frame work of Underwriting In Pakistan**

In this chapter of research the legal frame work of underwriting process in Pakistan has been elaborated. The steps involved in this process, the major issues relates to this process and how the underwriting process is governed in Pakistan will be discussed here.

This chapter of research is divided in four parts, in part-I, the provisions of various statutes dealing with securities (i.e. shares) and initial public offerings will be discussed followed by such provisions dealing with civil or criminal liabilities which arise directly or indirectly as a result of such offerings (underwriting). Furthermore rules, regulations of statutory bodies and laws of organizations, governing the underwriting process will be discussed concisely. Thereafter the conditions for acting as an underwriter, its mandatory and general obligations for the underwriters are elaborated in the first part.

In the Second Part of this chapter, Stock Exchanges(i.e. Karachi Stock Exchange, Lahore Stock Exchange & Islamabad Stock Exchange) working in Pakistan, and the listing regulations for these Stock Exchanges has been briefed.

In third part, steps requisite for offering through Book Building Process in Pakistan will be discussed. Furthermore in fourth part of this chapter the steps involved in the public offerings in Pakistan.

### **3.1 STATUTES CONCERNING WITH UNDERWRITING**

#### **ACTIVITY:**

The major statutes and enactments in Pakistan dealing with securities are given as under:-

3.1.1 Companies Ordinance 1984.

3.1.2 Securities and Exchange Ordinance, 1969.

3.1.3 Securities and Exchange Commission of Pakistan Act, 1997.

#### **RULES CONCERNING WITH UNDERWRITING ACTIVITY:**

3.1.4 Balloters, Transfer Agents and Underwriting Rules, 2001.

3.1.5 Issue of Capital Rules 1996.

Hereinafter, discussion has been made in few lines defining the underlying principle and purpose of the above mentioned enactments separately.

“Ballotter, Transfer Agents and the Underwriters Rules, 2001<sup>49</sup>”(BTAU) are enacted through the SRO 472(1)/2001, by the SECP with the approval of Federal Government on dated, June 27, 2001.

These rules explain who are the persons who can offer their services as balloters transfer agents and underwriters, and whom are restricted to act as balloters, transfer agents and underwriters. In other words the qualifications to act as underwriter are discussed in these rules which are identical as of the balloters and transfer agents. In these rules it is further discussed that any contractual arrangements made in writing by these persons

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<sup>49</sup> [http://secp.gov.pk/corporatelaws/pdf/BallotersTransferAgentsAndUnderwritersRules2001\(2\).pdf](http://secp.gov.pk/corporatelaws/pdf/BallotersTransferAgentsAndUnderwritersRules2001(2).pdf) visited on 02.05.2010.

with their client will be binding on them. Underwriters have to maintain the proper books and record of their client for the period of five years from the date of subscription of securities of such client.

**“Companies Ordinance 1984”<sup>50</sup>**, was enacted by the presidential order dated: February 01, 1984.

The main aim and object of this ordinance is that there should be such law which regulates the internal and external affairs of corporate entities. For the smooth running of the corporate business in Pakistan, any company (public or private) incorporated in Pakistan have to follow this ordinance. The companies’ ordinance, 1984 contains all provision from its formation till it’s winding up.

The important aspects of companies ordinance includes, registration of company, formation of its memorandum and articles of association, conversion of private company into public and vice versa, promoters of company, company prospectus, increase in share capital and reduction in share capital, shares and kinds of shares, statutory returns, annual general meeting and extra ordinary general meeting of a company, issues relating to the management( Directors, Chief Executive, Company Secretary ) of a company, Annual and quarterly returns filed by the company, underwriting commission (See Second Schedule Part-I, Section 01 of Companies Ordinance, 1984) & brokerage, auditors reports, winding up of a company, different offences under the ordinance and its punishments.

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<sup>50</sup><http://secp.gov.pk/corporatelaws/pdf/CompaniesOrdinance984-17-03-2011.pdf> visited on 19.06.2010.



**“Companies (Issue of Capital) Rules 1996”<sup>51</sup>**, promulgated on 10<sup>th</sup> of February 1996, through Statutory Regulatory Order No.110(I)/96, by SECP. These rules deals with (i) companies proposing to offer share capital to the public (ii) listed companies proposing to offer share capital to the public, (iii) all the companies proposing to issue shares for consideration otherwise then in cash and to (iv) certain persons offering shares for sale to the public. These rules elaborate policy for the company for raising the capital, either through Loan Based projects or through equity based projects.

Whoever contravenes the above mentioned rules is liable and responsible for such violation under these rules.

**“Securities and Exchange Ordinance, 1969”<sup>52</sup>**, is promulgated on 28 June 1969, through notification published in the official gazette. This Ordinance comes into existence to provide protection to investors, regulation of markets and dealing in securities and for matters ancillary thereto.

This ordinance provides that no stock exchange in Pakistan can be operated without being registered with SECP, it elaborates the conditions or requirements for the registration of stock exchanges in Pakistan, No broker or agents can transact the business of securities unless registered with SECP. SECP can cancel the registration of stock exchange if it contravenes the provisions of this Ordinance.

This Ordinance tells us the procedure for the registration/listing of a security with the stock exchange, if the stock exchange refuses to register the same, then the appellate

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<sup>51</sup> [http://secp.gov.pk/corporatelaws/pdf/Feb\\_02\\_1996.pdf](http://secp.gov.pk/corporatelaws/pdf/Feb_02_1996.pdf) visted on 12.08.2011.

<sup>52</sup> <http://secp.gov.pk/corporatelaws/pdf/SEORDINANCE1969-amended-%20till-2012.pdf> visited on 02.11.2012.

forum is provided to the issuer against such refusal which is described as SECP. Then the civil and criminal liabilities are discussed in this ordinance which arises if any one relating to the business of securities contravenes the provisions of this Ordinance. In this Ordinance no court can take cognizance of an offence under this ordinance except on an application in writing given by the commission.

The Court of Session shall try the offences under the Securities and Exchange Ordinance 1969.

**“Securities and Exchange Commission of Pakistan Act, 1997”<sup>53</sup> (SECP Act)** is promulgated through the act of parliament on dated: 19, December 1997, the purpose of SECP Act is to establish a regulatory body which regulates the corporate sector and business of securities in Pakistan. SECP Act elaborates the establishment and formation of SECP, in other words this act is known as the constitution of the SECP.

In SECP Act, it is mentioned that SECP comprises of five to seven commissioners in number, each appointed by the Federal Government, SECP is headed by a Chairman among the Commissioners of SECP which is elected by the consent of Federal Government.

The tenure of commissioners for the initial term is for a period of two years which can be further extended for another subsequent term of three years. The Federal Government shall appoint a Securities and Exchange Commission Policy Board consisting of ten members. There shall be at least four meetings of the board in a calendar year.

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<sup>53</sup> [http://secp.gov.pk/corporatelaws/pdf/secpact1997\\_2012.pdf](http://secp.gov.pk/corporatelaws/pdf/secpact1997_2012.pdf) visited on 02.11.2012.

The board can formulate any number of committees as it deems fit for the proper assistance and performance of its functions.

SECA informs about the disqualifications of the members and commissioners, when they can resign from their office and how they can be removed by the Federal Government. How any vacancy occurring in board or in the commission is filled.

Here relevant terminologies which are being the part of underwriting process has been discussed for the understanding the underwriting process in Pakistan.

### **3.2 IMPORTANT TERMINOLOGIES FOR UNDERWRITING OF SECURITIES are described as under:-**

#### **3.2.1 Book Building<sup>54</sup>:-**

“Book Building, means a mechanism of price determination which indicates interest for investment in the shares offered by an issuer/ offeror is collected from Institutional Investors and High Net worth Investors and a book is built which gives a picture of demand for the shares at different price levels. The strike price is determined based on the price at which demand for the share at the end of book building period is sufficient to raise the minimum capital required”.

#### **3.2.2 Book Building Offer<sup>55</sup>:-**

“Book Building Offer, means the offer made under the Book Building process”.

<sup>54</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> see regulation 02(1).iv visited on dated.02.11.2012.

<sup>55</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> see regulation 02(1).v visited on dated.02.11.2012.

### **3.2.1 Book Runner<sup>56</sup>:-**

“Book Runner, means a Corporate Brokerage House, appointed as Book Runner by the Issuer/Offeror

### **3.2.2 Commission<sup>57</sup>:-**

“Commission<sup>58</sup> means the Securities and Exchange Commission of Pakistan established under section 3 of the Securities and Exchange Commission of Pakistan Act, 1997 (XLII of 1997)”.

### **3.2.3 Financial Institution;**

“Financial institution<sup>59</sup> includes:--

- i. company or an institution whether established under any special enactment and operating within or outside Pakistan which transacts the business of banking or any associated or ancillary business through its branches;
- ii. a modaraba, leasing company, investment bank, venture capital company, financing company, housing finance company, a non-banking finance company; and
- iii. such other institution or company authorized by law to undertake any similar business, as the Federal Government may, by notification in the official Gazette, specify for the purpose”.

<sup>56</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> see regulation 02(1).vi visited on dated.02.11.2012.

<sup>57</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> see regulation 02(1).ix visited on dated.02.11.2012.

<sup>58</sup> Sec 2(1) sub clause 6-A of Companies ordinance 1984.

<sup>59</sup> Sec 2(1) sub clause 15(A) of companies Ordinance 1984.

### **3.2.4 Final Prospectus<sup>60</sup>:-**

“Final Prospectus/Offer for Sale Document, means the prospectus/offer for sale document containing all the information & disclosures as required under the Companies Ordinance, 1984 together with disclosure of the strike price and results of the Book Building process”.

### **3.2.5 Floor Price<sup>61</sup>:-**

“Floor Price”, means the minimum price set by the Issuer/Offerer for offer of shares”.

### **3.2.6 General Public<sup>62</sup>:-**

“General public, means all individual and institutional investors including both Pakistani (residents & non-residents) and foreign investors”.

### **3.2.7 Issuer<sup>63</sup>:-**

Issuer, means a public limited Company or a body corporate which intends to issue shares to the public through prospectus under section 57 of the Companies Ordinance, 1984”.

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<sup>60</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> see regulation 02(1).xiii visited on dated.02.11.2012.

<sup>61</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> see regulation 02(1).xiv visited on dated.02.11.2012.

<sup>62</sup> <sup>62</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> see regulation 02(1).xv visited on dated.02.11.2012.

<sup>63</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> see regulation 02(1).xix visited on dated.02.11.2012.

### **3.2.8 High Net Worth Individual Investor<sup>64</sup>**

“High Net Worth Individual Investors means an individual investor who applies or bids for shares of the value of more than Rs. 1,000,000/- in the Book Building process”.

### **3.2.8 Institutional Investor<sup>65</sup>:-**

“Institutional Investors; includes both local and foreign institutional investors”.

### **3.2.9 Listed:-**

“Listed<sup>66</sup> in relation to securities, means securities which have been allowed to be traded on a stock exchange”.

### **3.2.10 Listed Company:-**

“Listed company<sup>67</sup>, means a company or a body corporate or other body whose securities are listed”.

### **3.2.11 Lead Manager<sup>68</sup>:-**

“Lead Manager, means a Corporate Brokerage House, or a Schedule Bank or a Developmental Financial Institution or an Investment Finance Company appointed as Lead Manager by the Issuer/Offeror”.

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<sup>64</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> see regulation 02(1).xvi visited on dated.02.11.2012.

<sup>65</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> see regulation 02(1).xvii visited on dated.02.11.2012.

<sup>66</sup> Sec 2(1) sub clause 19 of companies Ordinance 1984.

<sup>67</sup> Sec 2(1) sub clause 20 of companies Ordinance 1984.

<sup>68</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> see regulation 02(1).xx visited on dated.02.11.2012.

### **3.2.12 listed Security<sup>69</sup>:-**

“Listed security” shall include any share, scrip, debenture, participation term certificate, modaraba certificate, Musharakah certificate, Sukuk Certificates, term finance certificate, bond, pre-organization certificate or such other instruments as the Federal Government may by notification in the Official Gazette specify for the purpose and which is accepted for listing on the Exchange in accordance with the Regulations.

### **3.2.13 Public Issue/Offer<sup>70</sup>:-**

“Public Issue/Offer, means issue/offer of shares by an Issuer/Offeror to the general public”.

### **3.2.14 Prospectus:-**

“Prospectus<sup>71</sup> means ‘any document described or issued as prospectus, and includes any notice, circular, advertisement, or other communication, inviting offers from the public for the subscription or purchase of any shares in, or debentures of, a body corporate, or inviting deposits from the public, other than deposits invited by a banking company or a financial institution approved by the Federal Government, whether described as prospectus or otherwise”.

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<sup>69</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> see regulation 02(1).xxiii visited on dated.02.11.2012.

<sup>70</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> see regulation 02(1).xxix visited on dated.02.11.2012.

<sup>71</sup> Sec 2(1) sub clause 29) of companies Ordinance 1984.

### **3.2.15 Preliminary Prospectus/Offer for Sale Document:**

“Preliminary Prospectus/Offer for Sale Document”<sup>72</sup>, means the preliminary offering document containing all the information & disclosures as required under the Companies Ordinance, 1984, approved by the Commission under Section 57 or Section 62 of the Companies Ordinance, 1984 as the case may be and issued to the Institutional Investors and HNWI for the Book Building process”.

### **3.2.16 Security:-**

“Security”<sup>73</sup> includes-

(i) Any stock, transferable share, scrip, [Modaraba Certificate], note, debenture, debenture stock, [Participation term certificate] bond, investment contract, [forward or futures contract], and pre-organization certificate or subscription, and, in general, any interest or instrument commonly known as a “security” and, any certificate of deposit for, certificate of interest or participation in, temporary or interim certificate for, receipt for, or any warrant or right to subscribe to or purchase, any of the foregoing but does not include currency or any note, draft, bill of exchange or banker’s acceptance or any note which has a maturity at the time of issuance of not more than twelve months, exclusive of days of grace, or any renewal thereof whose maturity is likewise limited;

(ii) Any Government security as defined in the Securities Act, 1920 (X of 1920);

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<sup>72</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> see regulation 02(1).xxvii visited on dated.02.11.2012.

<sup>73</sup> Sec 2 sub sec(1). Sub clause (L) of securities and exchange ordinance, 1969



(iii) Any bonus entitlement voucher issued by the State Bank of Pakistan in accordance with any scheme announced by the Commission; and

(iv) Commodity Futures Contract”.

### **3.2.17 Share;**

“Share<sup>74</sup> means share in the share capital of a company”.

### **3.2.18 Stock Exchange;**

“Stock Exchange<sup>75</sup> means any person who maintains or provides a market place or facilities for bringing together buyers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a Stock Exchange, as that term is generally understood, and includes such market place and facilities”.

### **3.2.19 Strike Price;**

“Strike Price or the Issue Price, means the price of share determined/discovered on the basis of book building process and is the price at which the shares are issued to institutional investors and HNWI”.

### **3.2.20 Sub Underwriter;**

“Sub-Underwriter<sup>76</sup> means a person who has made a contract with an underwriter to take up a part of the securities not fully subscribed by the public issue”.

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<sup>74</sup> Section 2(1).Clause (35) of Companies ordinance 1984.

<sup>75</sup> Section 2(1)Clause( m) of Securities and exchange ordinance 1969.

<sup>76</sup> Section 2(1) clause (q) of securities and exchange ordinance 1969.

### **3.2.21 Transfer Agent:-**

“Transfer Agent<sup>77</sup> means a person appointed by the issuer to assist in the maintenance of record for issuance and transfer of securities and to perform functions of persons commonly known as Registrar”.

### **3.2.22 Underwriter:-**

“Underwriter<sup>78</sup> includes a person who has made a contract with an issuer to subscribe and pay in cash for those securities as are not fully subscribed by the public issue or a person who has initially bought the securities from an issuer for the purpose of selling such securities by means of a public offer”.

### **3.3 Conditions For Acting As An Underwriter:-**

Any person cannot act as underwriter until he fulfills the following conditions<sup>79</sup> namely:-

- i. It is a company;
- ii. It employs persons possessing managerial experience for discharging functions offered by it;
- iii. It has on its pay roll a person who possesses a degree in law Recognized by the Pakistan bar Council, or who is a Chartered Accountant or a Cost and Management Accountant.

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<sup>76</sup> Section 2(1) clause (n) of securities and exchange ordinance 1969.

<sup>77</sup> Section 2(1) clause (o) of securities and exchange ordinance 1969.

<sup>78</sup> Section 2(1) clause (q) of securities and exchange ordinance 1969.

<sup>79</sup> [http://www.secp.gov.pk/corporatelaws/pdf/BallotersTransferAgentsAndUnderwritersRules2001\(2\).pdf](http://www.secp.gov.pk/corporatelaws/pdf/BallotersTransferAgentsAndUnderwritersRules2001(2).pdf), see rule (4) visited on dated.02.11.2012.

- iv. It owns computer hardware and software, and employs persons who are expert in the operation of such hardware and software to discharge the service offered;
- v. Its directors and employees have not been convicted of an offence involving fraud or breach of trust;
- vi. Its directors and employees have not been punished for an offence under the Ordinance, the Act any rules made or directive issued there under;
- and
- vii. Its directors and employees remain in compliance with the conditions aforesaid or any other requirements notified by the Commission generally or in any particular case.

### **3.3.1 Mandatory Obligations For Underwriter<sup>80</sup>:-**

An underwriter shall only perform the services mentioned in the agreement in writing; such agreement shall state the detail of:

- a. Services to be performed by underwriter;
- b. The compensation payable to him for performing such services;
- c. This agreement also contains a clause that any services performed by the underwriter under the said agreement on behalf of the client; such services performed by the underwriter do not substitutes or extinguish the obligations and responsibilities of the client.

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<sup>80</sup> [http://www.secp.gov.pk/corporatelaws/pdf/BallotersTransferAgentsAndUnderwritersRules2001\(2\).pdf](http://www.secp.gov.pk/corporatelaws/pdf/BallotersTransferAgentsAndUnderwritersRules2001(2).pdf), see rule (5).

### **3.3.2 General Obligations For Underwriter<sup>81</sup>:-**

A person working as underwriter shall keep and maintain:-

- a. Proper books and records;
- b. Agreements and documents to show transactions;
- c. Dealings receipt;
- d. Transmission of documents; and
- e. Applications and correspondence.

The above mentioned records shall be preserved in good order by the underwriter for a period of not less than five years and shall be open to inspection by any person appointed by the Commission for the purpose.

An underwriter shall be bound to comply with all general or special directives issued by the Securities and Exchange Commission of Pakistan.

### **3.4 Listing Regulations For Securities In Pakistan:-**

In Pakistan there are three stock Exchanges where the businesses of listed securities are being traded. These include (i) Karachi Stock Exchange (KSE), (ii) Lahore Stock Exchange (LSE) (iii) Islamabad stock Exchange (ISE).

#### **3.4.1 Karachi Stock Exchange (KSE):-**

KSE is the oldest Stock Exchange and is working as guarantee limited company since September 13, 1947, at the time of its incorporation there were only five companies listed

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<sup>81</sup> [http://www.secp.gov.pk/corporatelaws/pdf/BallotersTransferAgentsAndUnderwritersRules2001\(2\).pdf](http://www.secp.gov.pk/corporatelaws/pdf/BallotersTransferAgentsAndUnderwritersRules2001(2).pdf), see rule (6).

on it, as on 30 June 2012, 590 companies are listed on the KSE, In KSE six type of indices are working for the measurement of business traded in this stock exchange. The four indices include (i) KSE 100 Index (ii) KSE 30 (iii) KMI<sup>82</sup> 30 (iv) KSE All Shares Index (v) Oil and Gas Sector (vi) Banking Sector. Now the listed capital in KSE is U.S \$ 37.42 billion and the KSE has 200 members/brokers.<sup>83</sup>

### **3.4.2 Lahore Stock Exchange (LSE):-**

LSE was established in October 1970 and is the second largest stock exchange guarantee limited company in the country. As per annual report 2011-12 for Lahore Stock Exchange, LSE has 496 listed companies with total listed capital of Rs. 888.190 billion. LSE has 152 members of whom 113 are corporate and remaining are individual members.<sup>84</sup>

**3.4.3 Islamabad Stock Exchange (ISE):-** ISE was incorporated as a guarantee limited Company on<sup>\*</sup> October 25, 1989 in Islamabad. The purpose for establishment of the stock exchange in Islamabad was to cater to the needs of less developed areas of the northern part of Pakistan.<sup>85</sup>

Presently there is total 285<sup>86</sup> listed companies with ISE, with listed paid up capital Rs. 155,352.618 Million. Listed members in ISE include commercial and investment banks, deficit finance institutions and brokerage houses and individual persons who are well

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<sup>82</sup> Karachi Meezan Index

<sup>83</sup> <http://www.kse.com.pk/aboutus/introduction.php?id=7&sid=7.01>

<sup>84</sup> <http://www.lahorestock.com/Default.htm>

<sup>85</sup> [http://www.ise.com.pk/ise%20website/organization/organization\\_main.htm](http://www.ise.com.pk/ise%20website/organization/organization_main.htm)

<sup>86</sup> [http://www.findpk.com/yp/html/stock\\_exchanges.html](http://www.findpk.com/yp/html/stock_exchanges.html) visited on 05.11.2012.

educated, enterprising and progressive minded. In order to protect the interest of the investing public, an Investors Protection fund has been established by the ISE.

### **3.5 What Is A Book Building Process?**

Book Building is a capital issuance process used in the initial public offering, it helps in finding price and demand discovery.<sup>87</sup>

In the book building process the price of shares is determined on the basis of market demand and as such the chances of over/under pricing are minimized. Institutional investors and high net worth individuals will be eligible to participate in this process. Offer of shares to the general public will be at a price equal to or lesser than the price discovered through the book building process. The issuer company will also have the option to withdraw its offer from the market if demand for its shares is not sufficient.

SECP on March 6, 2008 approves book building process as a part of listing regulations of Karachi Stock Exchange (KSE).

#### **3.5.1 Issue/Offer Of Shares Through Book Building In Pakistan**<sup>88</sup>

##### **3.5.1.1 Eligibility:**

A body corporate or a listed company who wishes to sell its shares to the general public under sections 57 & 64 of Companies Ordinance 1984, and makes an application to the Stock Exchange for listing of such shares, and such company comply with listing

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<sup>87</sup> [http://www.secp.gov.pk/news/PDF/News\\_08/book\\_building.pdf](http://www.secp.gov.pk/news/PDF/News_08/book_building.pdf)

<sup>88</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> visited on 01.11.2012  
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regulations of Stock Exchanges is eligible for offering shares through book building process.

#### 3.5.1.2 Offer through Book Building:

A company or a body corporate who fulfills the eligibility criteria for offering shares and wishes to sell shares through book building, shall not more than 75 % of total offer is allocated to the institutional and high net worth investors through the book building process and not less than 25% of the total offer shall be allocated to the general public.

#### 3.5.1.3 Procedure of Offer under Book Building Process:

The Issuer/Offerer who wishes to offer shares through book building process to institutional investors and High Net Worth Institutional Investors (HNWI) appoints lead managers (LM) and book runners (BR). An issuer can appoint a single person as book runner and a lead manager or more person as a lead manager or book runners. The issuer in consultation with LM & BR issues preliminary prospectus to the selected institutional investors and to the HNWIs.

In the preliminary prospectus following disclosures shall be made:-

- a. Particulars relating to LM, BR, Share registrars and bankers to issue.
- b. Role and Functions of LM & BR.
- c. Financial Ratios should be disclosed.
- d. Time framework of opening and closing of bidding period.
- e. The method and process adopted for bidding process.

- f. Mechanism for determination of strike price.
- g. Basis of allotment of shares out of book building process.
- h. Contact Numbers and address of bid collection centers.
- i. Separate statements given by the issuer and LM , declaration by them that all the disclosure made by them are correct to the best and belief of their knowledge and nothing has been concealed.

The preliminary prospectus after clearance from the stock exchanges is sent to SECP for approval. After approval from SECP the copy of preliminary prospectus is circulated by the issuer through BR and LM to the HNWI and to the institutional Investors. The approved preliminary prospectus is published in one of leading daily Urdu or in a English newspaper inviting the institutional investors and HNWI to participate in the bidding. LM and BR conducts the road shows, meetings and awareness campaign for the marketing of offer. The LM and BR is entitled to the remuneration for arranging the book building process and their remuneration and expenses are mentioned in the preliminary prospectus. In case the Issuer/Offerer does not receive bids for the minimum number of shares offered at floor price or in the absence of the floor price, at any other price acceptable to the Issuer/Offerer, it may withdraw the offer.

### **3.5.2 Main Parties to the Issue/Offer and their role & responsibilities<sup>89</sup>:**

There are three main parties involved in book building process:-

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<sup>89</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> visited on 01.11.2012.  
Page No.72.



### 3.5.2.1 The Issuer/Offerer:

The issuer/offer shall be responsible for the following acts:-

- a. Appointment of LM and BR.
- b. Ensure that BR has adequate infrastructure to conduct the book building process.
- c. Obtain all approvals/NOCs/Clearance relating to issue/offer.
- d. Make ensure that all disclosures have been made in the prospectus and nothing has been concealed to the best of their knowledge and belief.
- e. It submit final report about issue/circulation/publication of the prospectus, subscription received, strike price discovered, basis of allotment, refund made and related matters within 30 days of the last date for public subscription to the Commission;
- f. Maintains the record of issue/offer for a period of three years after the closing dated of book building process.

### 3.5.2.2 The Lead Manager<sup>90</sup>:

The lead manager to the offer shall be responsible for the following acts:-

- a. It conducts awareness campaigns, road shows and presentations jointly with book runners.
- b. Make ensure that all disclosure has been made in the prospectus.

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<sup>90</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> visited on 02.11.2012  
Page No.73.

- c. To obtain all consents /NOCs/ Approval on behalf of issuer.
- d. Make ensure that all necessary electronic infrastructures have been obtained for the smooth and efficient book building process to collect the bid price.

### 3.5.2.3 The Book Runner<sup>91</sup>:

The book runner to the offer shall be held responsible for the following acts:-

- a. It conducts awareness campaigns, road shows and presentations jointly with lead managers.
- b. Vet the bidding application.
- c. Make ensure that all necessary electronic infrastructures have been obtained for the smooth and efficient book building process to collect the bid price.
- d. Collect bid applications, bid money, security, margin from institutional investors and HNWI's.
- e. Mark serial number, date, time at the time of collection of bidding applications from bidders.
- f. Build an order book.
- g. Discover the strike price at the closing of bidding period.
- h. Enter into underwriting agreements with the issuers /Offerer.
- i. Maintain records of bids received for the subscription of offer/shares.

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<sup>91</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> visited on 02.11.2012  
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### **Underwriting<sup>92</sup>:**

The offering of public offering should be compulsorily underwritten in the manner described as under:-

- i. Book Runner shall enter into underwriting agreement with the issuer /offeror indicating the number of shares to be underwritten at the strike price and the underwriting commission and fee to be paid to the book runner.
- ii. Book Building Offer shall be underwritten within two working days of the closing of the bidding period.
- iii. If Bidder backs out from his commitment then book runner shall be responsible for the amount involved in the subscription.

### **3.5.4 Publication of the Final Prospectus<sup>93</sup>:**

When the underwriting agreement is finalized, the lead manager shall on the same day or any other day but not later than third day of the closing of bidding period apply to the Stock Exchange(s) concerned for the dates of publication of final prospectus and for the dates of subscription of shares to the general public. The final prospectus in full form and in abridged form must be published within ten working days of the closing of the bidding period.

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<sup>92</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> visited on 02.11.2012  
Page No.74.

<sup>93</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> visited on 02.11.2012  
Page No.74.

Subscription of shares to the public will be held within thirty days of publishing of a final prospectus but not before seven days of such publication.

### **3.5.5 Bidding Form<sup>94</sup>:**

Bidding form shall be prescribed by the book runner, it can have from the designated bidding centers, and each bid form shall be in duplicate, one for the BR and other for the investor. Each form shall be in computer generated printed form. The bidding form shall be marked with serial numbers and when received by the bidding centre it carries the date and time of submission of form to the bidding center.

### **3.5.6 Procedure for Bidding<sup>95</sup>:**

Following conditions must be satisfied for the process of bidding:-

- a. Bids can be at a limit price or at a strike price or at a step bid.
- b. Institutional Investor and HNWI shall place their bids through the book runner.
- c. Institutional investors and HNWI shall have right to revise or withdraw their bids during the bidding period.

The book runner shall collect an amount to the extent of 100% of the application money as margin money from HNWI and an amount of at least 10 % of the application money as margin money from the institutional investors. The book runner can reject an application

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<sup>94</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> visited on 02.11.2012 .Page No.75.

<sup>95</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> visited on 02.11.2012 .Page No.75.

for the bids for the reasons to be recorded and his decision is not challengeable. Book runner shall maintain record of bids then he will maintain an order book showing the demand for shares at various prices. Then book runner shall approach and invite and circulate the preliminary prospectus to maximum number of institutional investors and HNWI's, but not less than ten in each category, for participation in bidding process.

When the bidding period is closed an issuer/Offerer shall in consultation with LM and BR determine the strike price. The offer price to the general public shall be equal to or at a discount to the strike price. When the strike price is once determined, all bidders whose bid have been found successful are entitled for the allotment of shares. Within one working day of closing of bidding period, it is intimated to the successful bidders about the strike price and the number of shares allotted to them, Institutional investors found successful in bid have to be deposited the balance money of shares within three working days of closing of bidding period, in case of default, the margin money paid by them shall be forfeited and the amount paid by unsuccessful bidders shall be returned three days of closing of such period. The issuer shall maintain two separate bank accounts (i) For book building offer (ii) For Public offer.

After receiving of full subscription money from successful bidders, final allotment of shares shall be made out of book building offer.

The issuer, book runner, lead manager and intermediaries attached to book building offer shall maintain the record of such subscription for a period of three years from the closing of subscription list. SECP can call issuer, lead manager, book runner and intermediaries and inspect the record of book building offer.

### **3.5.7 Relaxation<sup>96</sup>:**

The stock exchange if found that if any of above mentioned regulations can not be complied with, may give relaxation, by recording special reasons for doing this. For this purpose exchange has to get approval from the SECP, for giving the relaxation/exemption.

## **3.6 Steps Involved In Public Placement Offering:<sup>9</sup>**

Following are important steps which a company has to observe in Pakistan while offering securities through the initial public offerings:-

### **3.6.1 Preparation of a Prospectus**

A company offering the security has to prepare the prospectus for the purpose of giving the information to the general public about the portfolio of the company and it also contains the information about the securities offering the company/issuer. The contents of prospectus of a company are as follows<sup>97</sup>:-

- a. Approvals and listings on Stock Exchanges:-
- b. Book Building Procedure:-
- c. Share capital and related matter:-
- d. Underwriting , Commission , Brokerage and other expenses:-
- e. History and Prospects
- f. Financial Information

<sup>96</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> visited on 02.11.2012  
Page No.78.

<sup>97</sup> <http://secp.gov.pk/otherlinks/GuidelinesChecklist/Guidelines.pdf> visited on 02.11.2012

- g. Management
- h. Miscellaneous Information
- i. Application and transfer Instructions
- j. Bidding form.
- k. Signatories to the Prospectus
- l. Memorandum of Association
- m. Application Form

### 3.6.2 Appointment Of Underwriters<sup>98</sup>

The company issuing the securities appoints the underwriter, lead underwriter/managers and book runners for preparing and managing the issues and the initial public offerings. The underwriter may be scheduled banks, corporate brokerage house, development financial institution, or investment finance company.

### 3.6.3 Underwriting Agreements

The issuer and underwriters executes severally or individually underwriting agreements for securing his interest and for fixing his underwriting commission<sup>99</sup>. The important provisions of the underwriting agreements includes who are parties to the issue, issuer and underwriters (if more then one). These agreements relates to the allocation of offering to each underwriter participating in the underwriting process and the number of shares allotted to them for subscription and agreements related to underwriting commission and the commission for managing and selling the issues.

<sup>98</sup> <http://www.lahorestock.com/Regulations/Updated%20Regulations/Listing%20Regulations%2017.07.pdf> visited on 02.11.2012  
Pages 72-74

<sup>99</sup> Companies Ordinance 1984. Schedule II. Section. I.

#### 3.6.4 Approval from Stock Exchange & SECP<sup>100</sup>

Prior to the issuing of securities to the general public the issues must be approved from the stock exchange in which it will be traded and from SECP.

#### 3.6.5 Public Subscription<sup>101</sup>

The company issuing the securities or offering the shares has to be decided first what portion of their paid up capital has to be subscribed for the purchase of general public.

What will be the price of ordinary shares? What are the persons either individual or institutional investors, local or foreigners who can participate in the offering?

#### 3.6.6 Publication Of Prospectus<sup>102</sup>

When all the things relating to the approval from SECP and SE, , share capital , opening and closing of subscription list, investors eligibility, offer price, minimum amount of application, basis of allotment of shares, shares issued in preceding years, principle and purpose of the offer for sale, eligibility for dividend , withholding tax on dividends, underwriting, commission ,brokerage and other expenses, buy back and repurchase agreement , future prospects of a company, financial information, management and board of directors of a company and related matters.

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<sup>100</sup> Section 57 of Companies Ordinance 1984.

<sup>101</sup> Section 68 of Companies Ordinance 1984.

<sup>102</sup> Section 53-57 of Companies Ordinance 1984.



### 3.6.7 Listing On Stock Exchanges<sup>103</sup>

A company cannot issue the shares unless it is listed on the stock exchange. The securities offering by the company also be listed on the stock exchange where it wishes to trade the security.

### 3.6.8 Banker To The Issue

The offering document and prospectus will contain the names of the bankers to the issue; it may be more than one. Bankers to the issue means the designated banks where the applications for the purchase of new shares are given and duly filled are accepted.

### 3.6.9 Transfer Of Money To The Issuer

When the shares are allotted through balloting or when these are fully subscribed, the amount is transferred to the issuer. If the issues are over subscribed, the amounts of unsuccessful applicants are returned by the issuer.

## 3.7 Legal Documentation/Underwriting Agreement executed by Banks In Pakistan:-

### ANNEXURE-A

(Find the Underwriting Agreement executed between an Issuer and underwriter and submitted in Securities and Exchange Commission of Pakistan as

(Annexure-A at the end of this research at Page # 125)

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<sup>103</sup> Section 9 of Securities and Exchange Ordinance 1969.

### **3.8 CITATIONS ON UNDERWRITING IN PAKISTAN:-**

After describing the underwriting process in Pakistan, here the cases which were decided so far by Securities and Exchange Commission of Pakistan (SECP), against the issuers in contravention of *“Ballototers, Transfer Agent and Underwriters Rules; 2001”* are briefly elaborated hereunder:

#### **3.8. 1.2006 CLD 556<sup>104</sup>**

#### **SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN**

**Vs**

#### **M/S HAJARA TEXTILE MILLS LIMITED**

This case was initiated against the company for contravening the provisions under sections 83(3), 476& 492 of Companies Ordinance; 1984, Rule-5 of Companies Issue of Capital Rules; 1996 and Ballototers, Transfer Agent and Underwriters Rules; 2001 and later on decided by SECP.

Without going in detail of other provisions which were contravened by the company for which regulator penalizes separately by SECP, here we discuss the relevant rules of underwriters which were violated.

In this case law directors of the company himself acts as underwriters as they have not followed the due process of law while appointment of underwriter for the right issue. Thus they violated the *“Ballototers, Transfer Agent and Underwriters Rules; 2001*, by taking the plea that *“they were not having the knowledge of enforcement of these*

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<sup>104</sup> Corporate Law Decisions , Vol. V , 2006, Pages 556-565 ,

*rules*” and directors of the company were reprimanded, and they will remain careful in future. SECP while concluding this case does not take any serious action against the company for contravening the provisions of Balloters, Transfer Agent and Underwriters Rules; 2001.

**3.8.2 2006 CLD 627<sup>105</sup>**

**SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN**

**Vs**

**M/S MUKHTAR TEXTILE MILLS LIMITED**

This case was initiated against the company for contravening the provisions under sections 22(1)b of Securities and Exchange Ordinance; 1969, Rule-3 of Balloters, Transfer Agent and Underwriters Rules; 2001 and Sections 86(3), 231(1), 472 & 492 of Companies Ordinance; 1984 which later on decided by SECP.

Without going in detail of the provisions which were contravened by the company for which regulator penalizes separately, here we discuss the outcome for violation of relevant rules pertaining to underwriters.

In this case directors of the company jointly acts as underwriters in spite of observing the rules “Balloters, Transfer Agent and Underwriters Rules; 2001.

SECP while concluding this case does not take any serious action against the company for contravening the provisions of Balloters, Transfer Agent and Underwriters Rules;

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<sup>105</sup> Corporate Law Decisions, Vol. V, 2006, Pages 627-635.

2001 and these rules were not discussed while imposing fine by SECP under other provisions.

### 3.8.3 2006 CLD 635<sup>106</sup>

#### SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Vs

#### M/S SHAHPUR TEXTILE MILLS LIMITED

This case was filled against the company for contravening the provisions under Section 22 of Securities and Exchange Ordinance; 1969, Rule-5 of Companies Issue of Capital Rules; 1996, Balloters, Transfer Agent and Underwriters Rules; 2001 and Sections 86(3), 472 & 492 of Companies Ordinance; 1984 and the same was disposed off by SECP.

Without going in detail of the provisions which were contravened by the company for which regulator penalizes separately, here we discuss the outcome for violation of relevant rules pertaining to underwriters.

In this case directors and CEO of the company acts as underwriters in spite of observing the rules “Balloters, Transfer Agent and Underwriters Rules; 2001.

Thus they violated the “Balloters, Transfer Agent and Underwriters Rules; 2001, by taking the plea that *“they were not having the knowledge of enforcement of these rules”* and directors of the company were reprimanded, and they will remain careful in future.

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<sup>106</sup> Corporate Law Decisions, Vol. V, 2006, Pages 635-636.

SECP while concluding this case does not take any serious action against the company for contravening the provisions of Balloters, Transfer Agent and Underwriters Rules; 2001.

**3.8.4 2004 CLD 689<sup>107</sup>**

**National Bank of Pakistan Limited**

**Vs**

**S.G. FIBER PRIVATE LIMITED and Others**

The Civil Original Suit and Civil Miscellaneous appeal were referred to civil court while deciding the question of the jurisdiction by Honorable High Court Karachi acting as Banking Court.

In present case relationship of issuer and underwriters were not established as financial Institution and customer under the definition of finance as defined under Section 2(d) of the Financial Institutions Recovery of Finances Ordinance; 2001.

The issuer company challenged the jurisdiction of the Court as Banking Court and taken the plea while arguments that as there is underwriting agreement or undertaking to repurchase doesn't not create any financial liability of defendant with regard to any finance facility, therefore this court lacks its jurisdiction.

To attract the jurisdiction of Banking Court there should be relationship of Financial Institution and Customer with regard to finance facility.

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<sup>107</sup> Corporate Law Decisions, Vol. V , 2006, Page. 689

High Court after hearing the arguments of the parties decided the matter of Jurisdiction and this case to be heard by the Civil Court of Original Jurisdiction and not by the Banking Court. Then the matter was referred to civil court for decision.

**3.8.5 2011 CLD 1783<sup>108</sup>**

**SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN**

**Vs**

**M/S AI HAMRA Hills PRIVATE LIMITED**

This case was filled against the company for contravening the provisions under Section 82, 84, 86, 196, 476 & 492 of Companies Ordinance, 1984 and the same was disposed off by SECP.

Without going in detail of the provisions violated by the company, here we discuss the violation in respect of underwriting.

In this case company while issuing shares does not reveal the Underwriting arrangements made with the underwriter and not disclose the underwriting commission to the SECP. Thus the penalty for the violation of above mentioned provisions were imposed by SECP accordingly.

Moreover in this Judgement terms “Underwrite”, Underwriter” and “Concept of Underwriting Commission are also defined.

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<sup>108</sup> Corporate Law Decisions, Vol. V, 2011, Page. 1783

## **Chapter # 4**

### **Underwriting Process In Different Jurisdictions**

In this chapter of research the legal frame work of underwriting in different jurisdictions with the gist about the securities regulator working in such countries and also the laws governing their Underwriting and corporate culture of those Jurisdictions will be discussed. Here focus will be on the countries (i) Indonesia (ii) India and (iii) Thailand.

The reason for choosing these countries for research is that the economy of these countries is closely related to the economy of Pakistan. Moreover these are developing countries.

#### **4.1 Underwriting Process In Indonesia:-**

In Indonesia the regulator for the Securities and Capital Market is Bapepam. In 1976 by the presidential Decree No. 52/1976, Bapepam was created by the President of Indonesia, this regulator was chaired by the chairman to be appointed by the President of Indonesia and Bapepam was answerable to the Ministry of Finance in Indonesia.

Capital Market Supervisory Agency (Bapepam) has following functions for the Securities Market:-

- (i) Drafting Capital Market Rules and Regulations;
- (ii) Guiding and supervising any person, granting licenses, Approval, Registration from Bapepam and other person related to Capital Marker.

- (iii) Establishing Disclosure principles for issuers and Public Companies;
- (iv) Settlement of the Objection by the Person imposed sanction by Stock Exchange, Clearing Guarantee Corporation, and Central Securities Depository;
- (v) Establishing Capital Market accounting Standards;
- (vi) Protecting technical implementation Bapepam main function according to the policy required by Ministry of Finance and based on the law.
- (vii) Bapepam has Authority to grant licenses to Individual and also to the Securities Companies for the Underwriters; Individual Licenses is granted to Underwriter Representative.

Till June 30, 2000, Bapepam has given Business licenses to 117 Underwriters for performing the function of Underwriter in Indonesia.

In Indonesia law governing Underwriters, Securities Markets and Governing Corporate Culture is **“The Republic of Indonesia Number 8 Year 1996 Concerning The Capital Market”**<sup>109</sup> Which enacted by the President of Indonesia with the approval of House of Commons in 1996.

In Indonesia Regulations dealing with Underwriting of Securities is **“A Government Regulation of The Republic of Indonesia Number 45 year 1995 Concerning Capital Market Organization”**<sup>110</sup>. In Indonesia Government Regulation No. 46 promulgated on December 30, 1995 which is known as **“A Government Regulation of the Republic of Indonesia Number 46 Year 1995 Concerning Capital Market Formal Investigative**

<sup>109</sup> [http://www.bapepam.go.id/old/old/E\\_Legal/law/index.htm](http://www.bapepam.go.id/old/old/E_Legal/law/index.htm) visited on 14.09.2011.

<sup>110</sup> [http://www.bapepam.go.id/old/old/E\\_Legal/regulation/gr45.pdf](http://www.bapepam.go.id/old/old/E_Legal/regulation/gr45.pdf) visited on 14.09.2011



**Procedures”<sup>111</sup>** describes the detailed Capital Market Formal Investigative Procedures , purpose of a Formal Investigation , Formal Investigative Standards and it also describes the Investigative Procedures.

#### **4.1.1 TERMINOLOGIES USED IN UNDERWRITING PROCESS IN INDONESIA:-**

(i) Securities Company<sup>112</sup>:-

“Securities Company is a Person that engages in the following business:-

(a)Underwriter;

(b)Broker-Dealer and/or

(c)Investment Manager”.

(ii) Underwriters:-<sup>113</sup>

“An Underwriter means a Person who makes an Agreement with an Issuer to conduct a Public Offering, with or without the obligation to purchase Securities that are not sold”.

(iii) Allotment/Managing Underwriter:-

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<sup>111</sup> [http://www.bapepam.go.id/old/old/E\\_Legal/regulation/gr46.pdf](http://www.bapepam.go.id/old/old/E_Legal/regulation/gr46.pdf) visited on 14.09.2011

<sup>112</sup> Art 1 item 21. Of the Capital Market Law .

<sup>113</sup> Art 1 item 17. of the Capital Market Law.

“An allotment manager is a managing underwriter that is responsible for the allotment of securities in a public offering or the issuer in the event that an underwriter is not appointed”.

#### **4.1.2 CODE OF CONDUCT FOR UNDERWRITERS IN INDONESIA<sup>114</sup>:-**

In Indonesia Code of Conduct for Securities Companies for acting as an Underwriter is prescribed by Bapepam(Capital Market Agency), Underwriter have to observe the following Code of Conduct and Ethics in order to get licensed as underwriter :-

1. Underwriter and Issuer must have a strong relationship which is to be based on high degree of business integrity.
2. In case of an undersubscribed Public Offering, Underwriters, Selling Agents or Affiliated Persons may not sell the Securities which they have bought or will buy based on the Underwriting Agreement, except through a Securities Exchange if it was stated in the Prospectus that the Securities are to be listed on a Securities Exchange.
3. When there is more than one managing Underwriter for a public offerings, the Underwriters may divide among themselves their responsibilities, but such division does not exempt the other underwriters from their own or joint responsibilities.
4. An Underwriter is responsible for the following activities in a Public Offering in accordance with the Schedule which included in the Prospectus:-

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<sup>114</sup> [http://www.bapepam.go.id/old/old/E\\_legal/rules/securities/VF1.pdf](http://www.bapepam.go.id/old/old/E_legal/rules/securities/VF1.pdf) visited on 02.11.2012.

- a. Offering the Securities;
  - b. Allotment of the Securities; and
  - c. Reimbursement of payments for orders that did not receive a full allotment.
5. The Underwriter(s) must pay the proceeds of Public Offering to the Issuer in accordance with the Underwriting Agreement executed between issuer and Underwriter(s).
6. An Underwriter Representative involved in Securities Underwriting must maintain all the Documents and relevant record pertaining to important aspects of the Underwriting to ensure that the Underwriting has been conducted in an appropriate professional manner.

#### **4.1.3 Responsibilities of Managing Underwriters Concerning IPO in Indonesia<sup>115</sup>:-**

The responsibilities of Managing Underwriters<sup>3</sup> as envisaged in the Rule No. IX.A.7 are as follows:-

- (i) There are two types of public offerings in Indonesia (a) General Public Offerings and (b) A Limited Public Offering. For a Public Offering there must be one appointed as an Allotment Manager/Managing Underwriter.
- (ii) The Allotment Manager is responsible for the Allotment Report, and for the Contents of Subscription Form to Bapepam.

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<sup>115</sup> [http://www.bapepam.go.id/old/old/E\\_legal/rules/Issuer/Rule%20IX.A.7%20\(rev45-00\).pdf](http://www.bapepam.go.id/old/old/E_legal/rules/Issuer/Rule%20IX.A.7%20(rev45-00).pdf) visited on 02.11.2012.

- (iii) For the subscription refunds if delayed more than two working days Underwriters will be liable to pay the compensation to the public , therefore its is the responsibility of the underwriters to specify the rate of compensation or interest thereon and the Procedure in Prospectus or in Summary Prospectus, and or in other Publications.
- (iv) If the Public offering is over scribed the Underwriters are prohibited from buying or holding the securities for their own accounts. And if the public offerings is Under Scribed the Underwriters are prohibited from Selling Securities which has been bought or will be bought ,due to Securities Underwriting Contract.
- (v) To ensure wide distribution of shares, the underwriters must utilize enough selling Agents to avoid difficulties.
- (vi) The Allotment Manager must appoint an Auditor or Accountant registered with Bapepam to conduct the Special Audit. The Allotment Manager is required to submit the Audit report to Bapepam within 30 Days following the Allotment date.
- (vii) The Allotment Manager is responsible to keep the record for five years after the Allotment process.
- (viii) Underwriters must disclose in the Prospectus Allotment Procedures and may use other Allotment methods with the prior approval of Indonesian Securities Companies Association and with the approval of Bapepam.
- (ix) Bapepam may impose sanctions on any violations of the above said rules, as well as on any other person that can causes the violation to occur.

#### **4.1.4 Provisions and Regulations dealing with Underwriters in Indonesia:-**

##### **4.1.4.1 A Law Of The Republic Indonesia Number 8 Year 1995 Concerning The Capital Market<sup>116</sup>:-**

The provisions dealing with Underwriters as envisaged in Indonesia Capital Market are as follows:-

##### **Article # 1**

- An Underwriter is a person who makes an agreement with an issuer to conduct a public offering, with or without the obligation to purchase the securities that are not sold.
- A Securities Company is a person who engages in the business of Underwriter, Broker Dealer, and or Investment Manager.

##### **Article # 5**

- Bapepam has authority to grant individual licenses to Underwriter Representatives.

##### **Article # 30**

- A Securities Company licensed may carry on the business as underwriter and any other business permitted by Bapepam.

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<sup>116</sup> [http://www.bapepam.go.id/old/old/E\\_legal/law/CAPMARKETLAW.pdf](http://www.bapepam.go.id/old/old/E_legal/law/CAPMARKETLAW.pdf) visisted on 19.09.2011

#### Article # 32

- Only individual licensed by Bapepam may act as Underwriter Representative.

#### Article # 33

- An Individual licensed as an Underwriter representative may also act as Broker Dealer Representative.
- An Individual licensed as an Underwriter Representative may only be employed by one Securities Company.

#### Article # 39

- An Underwriter must fulfill all the terms of the Underwriting Agreement disclosed in the Registration Statement.

#### Article # 40

- An Underwriter must disclose in the prospectus any affiliation or other material information/relationship with the issuer.

#### Article # 72

- Managing Underwriters are appointed by the issuers, when there is more than one managing underwriter all are jointly and severally liable for the conduct of public offering. Managing Underwriters and issuers

are Jointly liable for the correctness of registration Statement submitted to Bapepam.

#### Article # 80

- If the registration statement contains false or misleading information then managing underwriter jointly and severally responsible with all others having signed the registration statement, and will be responsible for losses that are consequence of such actions. However time limit prescribed for claim of such compensation is five years from date of filling registration statement.

#### **4.1.4.2 A Government Regulation Of The Republic Of Indonesia Number 45 Year 1995 Concerning Capital Market Organization<sup>117</sup>:-**

##### Article # 31

- Securities Companies before engaging in the Business of Underwriter must obtain approval and license from Bapepam.

##### Article # 33

- Securities Companies for acting as an Underwriter must meet the minimum having a 10 Billion Paid up Capital.

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<sup>117</sup> [http://www.bapepam.go.id/old/old/E\\_legal/regulation/gr45.pdf](http://www.bapepam.go.id/old/old/E_legal/regulation/gr45.pdf) visited on 19.09.2011

#### Article # 36

- Securities Companies acting as an Underwriter must have one director and one officer, that each has licensed as an Underwriters representative.

#### Article # 38

- An Individual licensed will be only granted to Underwriters Representative, if he has expertise in Underwriting.

#### Article # 61

- For any violation(s) of Capital Market Rules and Regulations by the Underwriters, following administrative actions can be taken by Bapepam against Underwriter:-

(i).A written warning;

(ii).A Fine or obligation to pay a certain amount of money;

(iii).Restrictions on Business Activity;

(iv).The Suspension of Business Activity;

(v).Revocation of a License;

(vi).Cancellation of an Approval and

(viii).Cancellation of Registration.



#### **4.1.4.3 A Government Regulation of the Republic of Indonesia Number 46 Year 1995 Concerning Capital Market Formal Investigative Procedures:**<sup>118</sup>

Bapepam has enacted on 30<sup>th</sup> December 1995 a regulation No. 46 which is for conducting the Investigation in matters relating for the violation of Capital Market Law or regulations in Indonesia. Its main object is to assure that the operations of the capital markets are in order, fair, efficient and public investors are protected from illegal and harm practices in Capital Market.

Ann investigation is usually conducted by Investigator who will be civil servant from Bapepam duly appointed by the chairman of Bapepam for conducting such investigation. An investigation is a series of process for collection, gathering, information and evidence in order to declare that any violation has been conducted of Capital Market rules and regulations.

In Chapter No.II, Article 2, the purpose of formal investigation is prescribed and why investigator conducts the investigation under these regulations.

In Chapter No.III, Article No. 3, 4, 5 & 6, the investigative standards are described for investigator(s), for conducting investigation and for the person who will be under investigation.

In Articles 7, 8, 9 and 10, It is described that an investigation guidelines consist of General Investigative Guidelines, Investigative Implementation Guidelines, and Investigative Reporting Guidelines.

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<sup>118</sup> [http://www.bapepam.go.id/old/old/E\\_legal/regulation/gr46.pdf](http://www.bapepam.go.id/old/old/E_legal/regulation/gr46.pdf) visited on 19.09.2011

No Investigation will be conducted or initiated without the authorization of Chairman of Bapepam. An investigation proposal must contain the purpose of investigation, scope of investigation and the time when investigation will be started.

During investigation, investigator can order or can collect any evidence/information from any person, enter into any place where record or books has been placed and he can also borrow record on giving the receipt. Investigator may adjourn the case for future day if on some date the representative or attorney of the person who is undergone the investigation remains absent and in the meanwhile investigator conveyed to the person whose inquiry is being conducted to keep in safe custody the accounts or books of the company .

If on future date the person under investigation obstructs or refuse to make his availability for the purposes of investigation, investigator completes his inquiry, by taking a statement in this regard from that person. Such obstruction or statement of non Cooperation may become the grounds for Criminal Investigation.

An Investigator shall submit the report of investigation to Chairman of Bapepam in order to declare the company or a person has been committed any offence or are in violation of Capital Market Law and Regulations.

#### **4.2 UNDERWRITING PROCESS IN INDIA:-**

In India the Basic law deals with corporate sector is Companies Act 1956, while the regulator for governing the corporate sector in India is Ministry of Corporate Governance is Securities And Exchange Board of India, which constituted on April 12, 1992 through

the legislation, which resulted due the provisions of the Securities and Exchange Board of India Act, 1992<sup>119</sup>, Although the formation of underwriters were little bit discussed in 1956 in the companies act 1956, But the proper By Laws governing the underwriters and underwriting process in India , come into existence on 08<sup>th</sup> October 1993 as “*Securities And Exchange Board Of India Underwriters) Regulations, 1993*”.These regulation were further amended on dated 30 September 1999, then on 10<sup>th</sup> December 2002, then 07<sup>th</sup> September 2006, and thereafter finally amended on 05<sup>th</sup> July 2011.

While the rules dealing with underwriters as Securities And Exchange Board Of India (Underwriters) Rules, 1993, were rescinded with the enforcement of amendment on 07<sup>th</sup> September 2006 in “*Securities And Exchange Board Of India( Underwriters) Regulations, 1993*”

#### 4.2.1 TERMINOLOGIES USED IN UNDERWRITING PROCESS IN INDIA:-

(i). Underwriter<sup>120</sup>:-

“Underwriter means a person, who engages in the business of underwriting of an issue of securities of a body corporate”.

(ii). Underwriting:-

“Underwriting means an agreement with or without conditions to subscribe to the securities of a body corporate when the existing shareholders of such body corporate or the public do not subscribe to the securities offered to them”.<sup>121</sup>

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<sup>119</sup> <http://www.sebi.gov.in/acts/act15ac.html> visited on 01.11.2012

<sup>120</sup> Rule No. 2 Sub Rule. (f) of Securities And Exchange Board Of India (Underwriters) Rules, 1993, [http://www.sebi.gov.in/Index.jsp?contentDisp=SubSection&sec\\_id=1&sub\\_sec\\_id=1](http://www.sebi.gov.in/Index.jsp?contentDisp=SubSection&sec_id=1&sub_sec_id=1) Visited on 07.08.2011.

<sup>121</sup> Rule No.2, Sub Rule (g) of Securities And Exchange Board Of India (Underwriters) Rules, 1993, [http://www.sebi.gov.in/Index.jsp?contentDisp=SubSection&sec\\_id=1&sub\\_sec\\_id=1](http://www.sebi.gov.in/Index.jsp?contentDisp=SubSection&sec_id=1&sub_sec_id=1) Visited on 07.08.2011.

#### 4.2.2 SECURITIES AND EXCHANGE BOARD OF INDIA :-

In India the regulator for the corporate industry is Securities and Exchange Board of India (SEBI), The Board constituted under the Securities and Exchange Board of India Act 1992, enacted by parliament on 30<sup>th</sup> January 1992. The Board is chaired by Chairman of the Board.

The Functions of Board Include:-

- i. To Protect the Interest of Investors,
- ii. To Promote the Development of Securities Market;
- iii. To Regulate the Securities Market;
- iv. To Register and regulate the working of the Underwriters, Stock Brokers, Bankers to the Issue.

#### 4.2.3 CODE OF CONDUCT FOR UNDERWRITERS:-<sup>122</sup>

In India certain code of conduct has been described for the underwriters which envisaged as in the securities and exchange board of India (Underwriters regulations):-

- i. Every Underwriter shall maintain high standards of integrity, dignity and fairness's.
- ii. It shall at all times render high standards of service, exercise due diligence and ensure proper care.
- iii. It shall not indulge in any unfair practices and unfair competition.

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<sup>122</sup> Schedule III Securities and Exchange Board OF India, (Underwriters) Regulations, 1993 [Regulation 13] Code of Conduct, [http://www.sebi.gov.in/Index.jsp?contentDisp=SubSection&sec\\_id=1&sub\\_sec\\_id=1](http://www.sebi.gov.in/Index.jsp?contentDisp=SubSection&sec_id=1&sub_sec_id=1) visited on 11.08.2011.

- iv. It shall not exercise any harmful act which results into harm to the other the interest of other underwriters.
- v. It shall not make any statement which misrepresents his underwriting commitments.
- vi. No underwriter shall leaks any confidential information relating to its issuer except to the board.
- vii. No underwriter shall suppress any material report to the Board.

#### **4.2.4 BOOK BUILDING PROCESS IN INDIA:-**

Book Building is a process usually used by companies for raising their capital either through Initial Public Offers (IPOs) or Follow-on Public Offers (FPOs) to determine the price and demand discovery. It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, these prices are must be within the price band as specified by the issuer. The book building process attracts both the institutional as well as the retail investors. The price of issue in this process is determined after the closure of Bid period, based on the demand generated in the process.

#### **4.2.5 BY LAWS FOR THE BOOK BUILDING:-**

The rules governing the “*Book Building Process*” in India are elaborated in Chapter-XI of the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines 2000.

#### 4.2.6 STEPS INVOLVED IN THE BOOK BUILDING:-<sup>123</sup>

The following steps have to be observed for making the Book Building Successful:-

- I. First of all the Issuer who is planning to offer/subscribe securities, nominates or appoints lead merchant banker(s) as 'book runners'.
- II. The Issuer specifically mentions the number of securities which is to be offered and the price band for the bids.
- III. The Issuer after the appointment of Book runner also appoints syndicate members with whom orders are to be placed by the investors.
- IV. The syndicate members input the orders of investors into an 'electronic book'. This process is usually called 'bidding' and It is just like to open auction.
- V. Normally the book remains open for a period of 5 days and within the specified time the Bids have to be entered within the specified price band.
- VI. The Bidders have a option to revise the bids before the book closes.
- VII. After the closure of the book building period, the book runner's starts evaluating the bids received on the basis of the demand at various price levels.
- VIII. The Book Runners and the Issuer finally decide the price at which the securities shall be issued.
- IX. Generally, the numbers of shares are fixed and the issue size gets frozen based on the final price per share.
- X. Finally securities are allocated to the successful bidders while the unsuccessful bidders get their refunds.

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<sup>123</sup> <http://www.bseindia.com/bookbuilding/about.asp#> visited on 11.08.2011.

#### **4.2.7 PROVISIONS DEALING WITH UNDERWRITING:-**<sup>124</sup>

##### **4.2.7.1 COMPANIES ACT ,1956:-**

The provisions deals with the underwriting process in India as envisaged in the Companies Act of 1956 are briefly discussed hereunder.

The Section 56 of the act is about the matters to be stated and the reports to be set out in the prospectus. Under this section no one can issue any form for shares or debentures, unless the form is accompanied with memorandum containing list of important features of a prospectus in compliance with the requirements of this section.

There is an exception to this condition and it shall not apply if the application form was issued either -

(a) In connection with a bona fide invitation to a person to enter into an Underwriting Agreement with respect to the shares or debentures; or

(b) In relation to shares or debentures which were not offered to the public.

The Section 68 of the Act deals with the penalty for fraudulently inducing persons to invest money. If any person who either by knowingly or recklessly making any statement or promise which is false, deceptive or misleading, or by dishonestly concealment of material facts, induces or attempts to induce another person to enter into an Underwriting

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<sup>124</sup> Companies Act, 1956, [http://www.mca.gov.in/Ministry/pdf/Companies\\_Act\\_1956\\_13jun2011.pdf](http://www.mca.gov.in/Ministry/pdf/Companies_Act_1956_13jun2011.pdf), visited on 02.08.2011

Agreement shall be punishable with imprisonment for a term which may extend to five years, or with fine which may extend to Rs. 0.1 Million or with both.

The company subscribing for shares, debentures or issues is required to disclose to the registrar of companies various commissions including underwriting commission in the prospectus or statement in lieu of prospectus under Section 76 of Companies Act 1956<sup>125</sup>. If default is made in complying with the provisions of this section, company or every office involved shall be punishable with fine which may extend to five thousand rupees.

The underwriting contracts or modifications in any other contracts for the company are discussed during the statutory meeting held under Section 165 of the Companies Act 1956. Under section 297 of the Companies Act, 1956, Board of Directors of the company approval is required for entering into underwriting contract for subscription of shares, in which particular directors are interested, In case company having a paid-up share capital of not less than rupees Rs.10 Million, no Underwriting Contract shall be entered into except with the previous approval of the Central Government.

Schedule-II of the Companies Act 1956 deals with matters, Which is to be set out in the prospectus, under its sub clause (k) following matters relating to underwriting shall be incorporated in the prospectus:-

- i. Underwriting of the issue,
- ii. Names and addresses of the underwriters ;
- iii. The amount underwritten by them,

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<sup>125</sup> [http://www.mca.gov.in/Ministry/actsbills/pdf/Companies\\_Act\\_1956\\_Part\\_1.pdf](http://www.mca.gov.in/Ministry/actsbills/pdf/Companies_Act_1956_Part_1.pdf) visited on 02.11.2012 Page No.49.



- iv. Declaration by Board of directors that the underwriters have sufficient resources to discharge their respective obligations and;
- v. Underwriting Commission and Brokerage.

#### **4.2.7.2 SECURITIES AND EXCHANGE BOARD OF INDIA (UNDERWRITERS) REGULATIONS 1993<sup>126</sup>:**

It is compulsory for the Underwriters to get a Certificate of Registration from the Securities and Exchange Board, Of India, for dealing in, or buying, or selling securities

The procedure for registration of Underwriter and for the grant of Certificate of registration with the securities Exchange Board of India has been discussed in the Chapter 2 of Securities and Exchange Board of India (Underwriters) Regulations. The renewal of certificate of registration with regard to the Underwrite is also dealt in these regulations.

The Code of conduct, general responsibilities, and maintenance of various record with regard to underwriting process is to be maintained by the underwriter under these regulations.

For keeping the check and balance on underwriter, compliance officer and auditor is to be appointed by the Board for the effective /proper functioning of underwriter.

In case of failure of default by the underwriter under these regulations Board may penalize the underwriter by canceling its certificate of registration or by suspension of its

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<sup>126</sup> <http://www.sebi.gov.in/acts/uwregu93.html> visited on 02.11.2012

certificate , can issue show cause to underwriter and Board after doing publish the order of such suspension .

The remedy available to underwriter is to file the appeal before the Appellate Tribunal against the order of the Board.

#### **4.2.7.3 SECURITIES AND EXCHANGE BOARD OF INDIA (DISCLOSURE AND INVESTOR PROTECTION) GUIDELINES; 2000<sup>127</sup>**

Now I discuss here provisions dealing with underwriters in the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines 2000.

Under regulation 5.3.2.2, in case of under subscription of securities, the Lead Merchant Banker shall be responsible for following:-

- i. Underwriting Arrangements
- ii. Invoke Underwriting obligations
- iii. Ensure that underwriters pay the amount of devolvement; and
- iv. The same shall incorporate in the inter-se allocation of responsibilities.

Under Guideline 5.5<sup>128</sup> The Lead merchant banker satisfy himself before issuing securities that underwriter are able to satisfy their underwriting obligations. Before issuing offering document Lead merchant banker incorporate that underwriter have adequate assets to meet their underwriting obligations and the name of underwriter is included in the prospectus after taking his written consent.

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<sup>127</sup> <http://www.sebi.gov.in/guide/dipamendguide.pdf> visited on 02.11.2012

<sup>128</sup> <http://www.sebi.gov.in/guide/dipamendguide.pdf> visited on 02.11.2012 Page No.41

Under guideline 6.8.2.14<sup>129</sup>, it is discussed details relating to the underwriting, the names, addresses, telephone numbers, fax numbers and e-mail addresses of the underwriters and the amount underwritten by them., Declaration by the Board of Directors of the issuer company that the underwriters have enough resources to fulfill their respective obligations relating to underwriting be incorporated in the prospectus.

### **4.3 UNDERWRITING PROCESS IN THAILAND:-**

In Thailand Statute regulating the corporate market is Securities and Exchange Act; 2535.

#### **4.3.1 TERMINOLOGIES USED IN UNDERWRITING PROCESS IN THAILAND:-**

Important terminologies being used in Underwriting Process in Thailand are as follows:-

(i) Underwriter:- <sup>130</sup> “Underwriter means any person who Underwrites the sale of securities to the public”.

(ii) Securities Underwriting :- <sup>131</sup> “Securities Underwriting means the underwriting of all or part of the securities from a company or owner of securities for sale to the public in consideration of a fee or other remuneration whether with or without any conditions”.

<sup>129</sup> <http://www.sebi.gov.in/guide/dipamendguide.pdf> Visited on 02.11.2011 Page No.54

<sup>130</sup> [http://www.sec.or.th/laws\\_notification/file\\_dw\\_en/Web\\_SEA.pdf](http://www.sec.or.th/laws_notification/file_dw_en/Web_SEA.pdf) Page No. 2, visited on 19.10.2011.

<sup>131</sup> [http://www.sec.or.th/laws\\_notification/file\\_dw\\_en/Web\\_SEA.pdf](http://www.sec.or.th/laws_notification/file_dw_en/Web_SEA.pdf) Page No. 3, visited on 20.10.2011.

#### **4.3.2 STATUTES DEALING WITH UNDERWRITING IN THAILAND:-**

##### **4.3.2.1 SECURITIES AND EXCHANGE ACT BE; 2535 (1992)<sup>132</sup>:-**

Section 4 of the Securities and Exchange Act BE; 2535 defines the terminologies Underwriters, Securities Underwriting and moreover it also defines the Securities Underwriting as Securities Business under this section.

In Section 116 of the Act, Securities Companies shall comply with the rules, conditions and procedures as specified by Capital Market Supervisory Board of Securities and Exchange Commission. In this section it is also incorporated that Capital Market Supervisory Board for Securities Companies may specify fee and service charges for performing the Underwriting Services to its customers.

Under Section 69 of the act registration with SEC must specify the Procedure for the Subscription, Underwriting and Allocation of Securities.

As per section 81 of the Act where the Securities are subscribed through underwriters after closing the sale of securities, the amount of securities, amount of money paid for the Securities which has been purchase by the Underwriters must specify in the statement by Company to SEC.

If the purchaser of Securities suffers any loss for the misrepresentation of any statement in prospectus or registration statement Under section 82 of the act, have a right to recover the compensation from the owner of Company and in this regard apart from other

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<sup>132</sup> [http://www.sec.or.th/laws\\_notification/file\\_dw\\_en/Web\\_SEA.pdf](http://www.sec.or.th/laws_notification/file_dw_en/Web_SEA.pdf) visited on 26.10.2011.

participants /organizers of Public Offering, Underwriters will be Jointly as well as severally liable Under Section 83 of the act for damages incurred by the purchaser for authenticating the misleading information and will pay the compensation to him unless proved contrary.

The time limit for claiming the compensation, available to purchaser of securities is one year from the effective date of filling the prospectus or registration Statement.

#### **4.3.2.2 Ministerial Regulation No.5 of BE; 2539 <sup>133</sup>:-**

Finance Minister hereby issues Ministerial Regulation as follows, wherein procedure and eligibility is described for getting Securities Underwriting License:

Any Securities Company which desired to obtain license as Securities Underwriting may file an application in accordance with rules and procedures prescribed in this Ministerial Regulation.

Securities Company eligible to file the application for license of Securities Underwriting shall not-

- a. Be Financial Institution established under other laws;
- b. Have another securities company held its shares in the amount equal to or exceeding ninety-nine percent of the total paid-up registered capital on the date on which the Securities and Exchange Act B.E. 2535 comes into force ;

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<sup>133</sup> [http://www.sec.or.th/laws\\_notification/Ministerial/Content\\_0000000532.jsp?categoryID=CAT0000109&lang=en](http://www.sec.or.th/laws_notification/Ministerial/Content_0000000532.jsp?categoryID=CAT0000109&lang=en)

- c. Hold shares of any securities company in the amount equal to or exceeding ninety-nine percent of the total paid-up registered capital on the date on which the Securities and Exchange Act B.E. 2535 comes into force;
- d. Be securities company established upon the separation of finance and securities businesses of Securities Company with disqualified characters under sub-clause (3);
- e. Have financial condition or result of operation which may be considered by the SEC that such Securities Company severely suffers loss.
- f. Be company failing to operate on date and in time specified without the SEC Office's approval under Section 110 of the Securities and Exchange Act B.E. 2535 when the application is filed;

Securities Company intending to apply for additional licenses shall file an application with the SEC via the SEC Office in Form 90-6, along with following documents altogether:-

- i. Three year operation plan of the securities company in applying categories;
- ii. Financial statements during three years prior to the year of filing application for securities business license (if any);
- iii. Copy of securities business licenses already obtained;
- iv. The most recent certificate of company registration issued by the partnership and company registrar, the Ministry of Commerce;
- v. Any relevant document specified by the SEC and published in the Government Gazette;

When the Securities and Exchange Commission receives the application in accordance with Clause 3 of this regulation and is of the view that the Securities Company filing such application has qualifications as specified above SEC shall recommend the Minister to issue securities business license within 90 (ninety) days from the date on which the SEC Office receives complete application and supplementary documents. The Minister shall complete his consideration for issuance of license within thirty days.

The licensee shall pay the license fee in accordance with this regulation it may choose to pay a lump sum on the date of receiving the license or pay not more than five annual installments divided equally.

Fees for the Securities Business license in the category of Securities Underwriting shall be prescribed as Baht 100,000,000.

#### **4.3.3 PENAL ACTION(s) FOR SECURITIES BUSINESS OPERATING IN THAILAND WITHOUT GETTING LICENSE**<sup>134</sup>:-

Any person or Securities Company operating as Underwriters or dealing with Underwriting Business in Thailand without getting a license from SEC shall be liable to imprisonment for a term 2 to 5 years, and a fine from Bt 200,000 to Bt 500,000 and a daily fine.

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<sup>134</sup>[http://www.sec.or.th/brokers\\_dealer/BROKERAGE/Content\\_0000000035.jsp?categoryID=CAT0000223&lang=en](http://www.sec.or.th/brokers_dealer/BROKERAGE/Content_0000000035.jsp?categoryID=CAT0000223&lang=en) visited on 26.10.2011.

#### 4.3.4. ADMINISTRATIVE MEASURES ADOPTED By SEC <sup>135</sup>:-

Any person i.e Underwriters licensed, approved or registered under the Securities and Exchange Act; 2535,(1992) must have qualifications and comply with the criteria specified under this act.

In cases where the above person lacks qualification or fails to comply with the specified criteria, the SEC office, the Administrative Panel, the SEC Board or the Finance Minister as the case may be may issue a rectification order or an administrative order which includes probation, suspension or revocation of license, approval or registration.

Underwriter aggrieved have a right to file an appeal in the office of SEC then appeal can be preferred to SEC Board, Appeal against the decision of SEC Board can be filled within 90 Days in the Administrative Court.

#### 4.3.5. CRIMINAL PROSECUTIONS By SEC <sup>136</sup>:-

In general, the SEC, as a regulator empowered by the Securities and Exchange Act B.E. 2535 (1992), It is assumed that it is prime responsibility of Securities and Exchange Commission for investigating into possible offences Under this law, and SEC deems fit a criminal violation has occurred, It will pursue the matter by filing a criminal complaint with the Royal Thai Police to further investigation according to the Thai Criminal Procedure Code.

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<sup>135</sup> [http://www.sec.or.th/enforcement/Content\\_0000000415.jsp?categoryID=CAT0000279&lang=en](http://www.sec.or.th/enforcement/Content_0000000415.jsp?categoryID=CAT0000279&lang=en) visited on 26.10.2011.

<sup>136</sup> [http://www.sec.or.th/enforcement/Content\\_0000000392.jsp?categoryID=CAT0000278&lang=en](http://www.sec.or.th/enforcement/Content_0000000392.jsp?categoryID=CAT0000278&lang=en) visited on 26.10.2011.



However, under Section 317 of the Securities and Exchange Act B.E. 2535 (1992), certain offences can be criminally tried and then fined by the Settlement Committee which is to be appointed by the Minister of Finance. In this connection, if the fine is fully received within the period specified by the Committee, the matter is considered settled.

On the contrary, for offence(s) which are not specified in the Section mentioned above, since the SEC has no power to prosecute in its own name, in order to criminally pursue the matter, a criminal complaint with the inquiry official of the Economic Crime Investigation Division (ECID), the Royal Thai Police or the special investigator of the Department of Special Investigation (DSI), Ministry of Justice is required. As a result, if it is believed that a contravention has occurred, the matter will be forwarded by the ECID or DSI to the Office of the Attorney General (OAG) for criminal prosecution.

## Chapter # 05 Comparative Analysis Among Different Jurisdictions

In this chapter of research, underwriting in Pakistan has been discussed in comparison with underwriting process of Indonesia, India and Thailand.

S NO.	PAKISTAN	INDONESIA	INDIA	THAILAND
5.1	<u>REGULATOR:</u>			
	<ul style="list-style-type: none"> <li>The Securities and Exchange Commission of Pakistan (SECP)<sup>137</sup> is the regulator for underwriting process in Pakistan.</li> </ul>	<ul style="list-style-type: none"> <li>In Indonesia BAPEPAM regulates underwriters and underwriting process in Indonesia.</li> </ul>	<ul style="list-style-type: none"> <li>In India Securities and Exchange Board of India regulates underwriter in India.</li> </ul>	<ul style="list-style-type: none"> <li>Capital Market Supervisory Board of Securities and Exchange Commission regulate Underwriters and Underwriting process in Thailand.</li> </ul>

<sup>137</sup> [http //secp.gov.pk/](http://secp.gov.pk/) visited on 17.08 2011.

5.2	<u>UNDERWRITER IN DIFFERENT JURISDICTION:</u>			
	<ul style="list-style-type: none"> <li>Underwriter<sup>138</sup> means and includes a person who has made a contract with an issuer to subscribe and pay in cash for those securities as are not fully subscribed by the public issue or a person who has initially bought the securities from an issuer for the purpose</li> </ul>	<ul style="list-style-type: none"> <li>In Indonesia underwriter means a person who makes an agreement with an issuer to conduct a public offering with or without the obligation to purchase securities that are not sold.</li> </ul>	<ul style="list-style-type: none"> <li>In India Underwriter means a person, who engages in business of underwriting of an issue of securities of a body corporate.</li> </ul>	<ul style="list-style-type: none"> <li>Underwriter means any person who underwrites the sale of securities to the public.</li> </ul>

<sup>138</sup> Section 2(1) clause (q) of securities and exchange ordinance 1969 visited on 17.08.2011.

	of selling such securities by means of a public offer.			
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5.3	<b><u>BOOK BUILDING PROCESS:</u></b>			
	<ul style="list-style-type: none"> <li>In Pakistan Book Building Process has been described by three Stock Exchanges.</li> </ul>	<ul style="list-style-type: none"> <li>N/A</li> </ul>	<ul style="list-style-type: none"> <li>In India Book Building process applicable and is regulated under the following regulations:-               <ol style="list-style-type: none"> <li>Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines 2000.</li> </ol> </li> </ul>	N/A.

5.4	<u>CODE OF CONDUCT:</u>			
	<ul style="list-style-type: none"> <li>N/A</li> </ul>	<ul style="list-style-type: none"> <li>In Indonesia Bapepam has prescribed the Code of Conduet for ensuring effective working of underwriter.</li> </ul>	<ul style="list-style-type: none"> <li>Securities and Exchange Board of India has prescribed the code of conduct for the underwriters in India.</li> </ul>	<ul style="list-style-type: none"> <li>N/A</li> </ul>

5.5	<u>SUBSTANTIVE LAW:</u>			
	<ul style="list-style-type: none"><li>• In Pakistan following is the substantive law dealing with underwriting :-<ol style="list-style-type: none"><li>a. Balloters, Transfer Agents and Underwriters Rules;</li><li>b. Companies Ordinance,1984.</li></ol></li></ul>	<ul style="list-style-type: none"><li>• In Indonesia applicable regulations/laws regulating the Underwriters are herewith:-<ol style="list-style-type: none"><li>a. The Republic of Indonesia Number 8<sup>th</sup> of Year 1996, concerning the capital Market.</li><li>b. Government Regulation of The republic of Indonesia Number 45 year 1995</li></ol></li></ul>	<ul style="list-style-type: none"><li>• In India following are the applicable law for underwriters :-<ol style="list-style-type: none"><li>a. Companies Act 1956.</li><li>b. Securities and Exchange Board of India (Underwriters), Regulations, 1993.</li><li>c. Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines; 2000.</li><li>d. Securities and Exchange Board of India</li></ol></li></ul>	<ul style="list-style-type: none"><li>• In Thailand following are the laws dealing with underwriters:-<ol style="list-style-type: none"><li>a. Securities and Exchange Act BE; 2535(1992).</li><li>b. Ministerial Regulation No.5 of BE; 2539.</li></ol></li></ul>

		<p>concerning capital Market Organization.</p> <p>c. Government Regulation of the Republic of Indonesia Number 45 Year 1995 concerning capital Market Investigative Procedures.</p> <p>d. Code of Conduct for Underwriters.</p>	<p>(Underwriters) Regulations.</p> <p>e. Code of Conduct for Underwriters.</p>	
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5.6	<u>LICENCE FOR UNDERWRITERS:</u>			
	<ul style="list-style-type: none"> <li>N/A</li> </ul>	<ul style="list-style-type: none"> <li>In Indonesia Securities Company is required to have a license<sup>139</sup> prior to engaging in the business of underwriting.</li> </ul>	<ul style="list-style-type: none"> <li>In India no one acts as underwriters unless they have a valid certificate of registration to act as underwriter.</li> </ul>	<ul style="list-style-type: none"> <li>In Thailand underwriters may obtain licenses for the category of securities underwriting.</li> </ul>

<sup>139</sup> Article 31 of The Republic of Indonesia Number 8<sup>th</sup> of Year 1996, concerning the capital Market, [http://www.bapepam.go.id/old/old/E\\_Legal/regulation/gr45.pdf](http://www.bapepam.go.id/old/old/E_Legal/regulation/gr45.pdf) visited on 17.04.2012.

5.7	PENAL ACTION FOR UNAUTHORIZED UNDERWRITERS:			
	<ul style="list-style-type: none"> <li>N/A</li> </ul> <p>(No Penal action can be taken against unauthorized underwriter in Pakistan)</p>	<ul style="list-style-type: none"> <li>In Indonesia underwriters doing business without getting license shall be imprisoned for a period of five<sup>140</sup> years and a fine upto the amount of five Billion rupiah.</li> </ul>	<ul style="list-style-type: none"> <li>N/A</li> </ul> <p>(No Penal action can be taken against unauthorized underwriters working in India)</p>	<ul style="list-style-type: none"> <li>N/A</li> </ul> <p>(No Penal action can be taken against unauthorized underwriter in Thailand)</p>

140 [http://www.bapepam.go.id/old/old/E\\_Legal/Law/CAPMARKETLAW.pdf](http://www.bapepam.go.id/old/old/E_Legal/Law/CAPMARKETLAW.pdf) visited on 17.04.2012.

5.8	<b><u>PROCEDURAL LAW:</u></b>			
	<ul style="list-style-type: none"> <li>N/A</li> </ul> <p>(In Pakistan there is no procedural law for taking action against underwriters)</p>	<ul style="list-style-type: none"> <li>In Indonesia procedural law is provided for initiating investigation against underwriter under Government Regulation of the Republic of Indonesia Number 45 Year 1995 concerning capital Market Formal Investigative Procedures.</li> </ul>	<ul style="list-style-type: none"> <li>In India procedural law is provided in Securities and Exchange Board of India (Underwriters) Regulations, 1993 for the disposal of any investigation against the underwriter.</li> </ul>	<ul style="list-style-type: none"> <li>N/A</li> </ul> <p>(In Thailand substantive law is provided for underwriter's licenses, however no procedural law is prescribed in case an underwriter deviates from the substantive law or if any complaint is lodged against him.)</p>

5.9	<u>WHO CAN TAKE COGNIZANCE AGAINST MALADMINISTRATION BY UNDERWRITERS:</u>			
	<ul style="list-style-type: none"> <li>N/A</li> </ul> <p>(There is no prescribed authority in Pakistan who will take cognizance against underwriters, if they commit any maladministration with regard to underwriting.</p>	<ul style="list-style-type: none"> <li>In Indonesia Capital Market Supervisory Agency i.e BAPEPAM, can takes cognizance against the maladministration, if any by underwriters</li> </ul>	<ul style="list-style-type: none"> <li>In India securities and exchange board of India can take eognizance suo motto or on a complaint being received against underwater. Further Board may delegate its investigative powers to inquiry officer or can appoint audit officer. Disciplinary proceedings can also be initiated by the board against underwrites.</li> </ul>	<ul style="list-style-type: none"> <li>In Thailand SEC, Minister for finance and appellate authority may take cognizance against any offence as mentioned in substantive law by underwriter.</li> </ul>

After the above comparison, we find in Pakistan there is no direct regulator for the Underwriters, however in general Securities and Exchange Commission of Pakistan oversee the underwriting of securities. While in Indonesia, India and Thailand there are regulators mentioned for regulating the Underwriters.

While defining the Underwriter in Pakistan, it means a person who has paid in cash for those securities which are not purchased by the public or the person who initially bought the securities from issuer then sell it to public for a public offer. In comparison to Indonesia Underwriter are the person who enter into agreement with or without purchasing the unsold securities.

In Pakistan and India Book building process is defined for price determination of shares, there is no such process in Indonesia and Thailand.

There is no Code of Conduct for Underwriters in Pakistan and Thailand, however comprehensive point wise code of conduct is defined separately for countries Indonesia and India.

In Pakistan, Indonesia, India and Thailand Substantive law is defined for acting as an Underwriter, however after the comparison it reveals that in Pakistan and Thailand there is no procedural law for taking any serious action against the Underwriters.

In Pakistan separate Licenses for underwriters is not required for acting as underwriter, while for working of underwriters in Indonesia, India and Thailand license is required solely for its working as an underwriter.

No penal action is prescribed for un authorized underwriters working in Pakistan, India and in Thailand, however penal action can be taken against un authorized underwriters in Indonesia and can be fined up to the amount of 5.00Billion along with imprisonment up to 05 years.

In Pakistan there is no authority defined who can take cognizance against the maladministration committed by Underwriters, however in Indonesia, India and in Thailand the authority is defined who can take initiative against the maladministration by Underwriters.

## **Chapter # 6**

### **Conclusion & Recommendations:-**

#### **6.1 Conclusion:**

Keeping in view discussion made in earlier Chapter 3, 4 & 5, I come to conclusion that rules dealing with Underwriter in Pakistan is lenient and rushed, as there is no substantive and procedural law implemented in Pakistan pertaining to underwriters. No specified penal or civil remedy is provided in Pakistan for violation by the Underwriters.

Though the BTAU Rules; 2001, is issued by SECP for underwriters, however it lacks checks and balances on underwriters and does not provide any sanctity or binding force for enforcement of underwriting agreements executed between parties.

The Rule No. 7 of BTAU RULES 2001, under the hading relaxation of rules, can be interpreted in any way by giving relaxation to underwriters by SECP.

The Rule No.5, BTAU Rules; 2001 provides the only two requirements for the underwriting agreement i.e (i) Services to be performed by underwriter and (ii) compensation paid to underwriter.

BTAU Rules; 2001 comprises of seven rules and these rules are not only for Underwriters but same are also existed for Ballotters and Transfer Agents in Pakistan. While observing these rules Ballotters and Transfer Agents may also represent themselves as Underwriters, thus existence of same rules for BTAU Rules; 2001 reflects its complexity with regard to regulatory affairs of Underwriters.

While deciding the cases<sup>141</sup> SECP, took the lenient view and does not impose any penalty when the issuers violated the provisions of BTAU Rules; 2001 by acting himself as underwriter while making offerings to public.

In case law titled “**National Bank of Pakistan Vs S.G. Fiber (Pvt.) Ltd**”. matter was initially filed in Banking Court, by the plaintiff which later on was returned by banking court for its proper filing in civil court for adjudication, which justifies that there is no pre defined proper<sup>4</sup> forum for seeking remedy whether civil or criminal, if any dispute resulting from underwriting process. Therefore BTAU Rules; 2001 are also silent, either of which court have the jurisdiction to take cognizance in case of any dispute raised between the issuer and underwriter or in case, if any maladministration is committed by underwriters during the process.

While concluding this study on legal aspects of underwriting, I fully agree with statement that “**LEGAL ASPECTS OF UNDERWRITING PROCESS ARE RUSHED AND COMPLICATED**” therefore it needs to be simplified and in this regard, SECP should present a bill in national assembly, legislation should be made by Parliament at first stage by defining the modus operandi for underwriters and for governing the underwriting process. And at second stage there is need to ensure the effective implementation of such legislation through the regulator.

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<sup>141</sup> (a) Corporate Law Decisions , Vol. V , 2006, Pages 556-565 ,  
(b) Corporate Law Decisions, Vol. V, 2006, Pages 627-635.  
(c) Corporate Law Decisions, Vol. V, 2006, Pages 635-636.

## **6.2 Recommendations For Legal Framework In Pakistan:-**

While concluding topic of research, here is some recommendations for legal framework of Underwriting in Pakistan.

### **6.2.1 Recommendation No- I**

Like India and Indonesia, in Pakistan code of conduct for underwriters must be defined and to ensure its compliance by regulator in Pakistan.

### **6.2.2 Recommendation No.-II**

In Pakistan for acting as underwriters there must be compulsorily for underwriters to obtain a license before offering his services as underwriter to issuer, Likewise in India and Indonesia, Underwriters obtain licenses first for acting as underwriters.

### **6.2.3 Recommendation No.-III**

Like Indonesia, in Pakistan, must be legislation for penal action/punishment against un authorized underwriters in terms of confinement and also in terms of monetary punishment.

### **6.2.4 Recommendation No.-IV**

Like India and Indonesia, in Pakistan there is need of legislation for procedural law for prosecuting underwriters in case of any violation and maladministration commits by underwriter.



### **6.2.5 Recommendation No.-V**

Like India in Pakistan there is need to made legislation for defining the body who will take the cognizance against the underwriters, and simultaneously that body be authorized to take action against underwriters suo motto.

### **6.2.6 Recommendation No.-VI**

Like in India and Indonesia, in Pakistan there must be substantive law for regularizing the underwriters.

While concluding this research following recommended documents has been drafted, which needs to be implemented in Pakistan for working of Underwriters in systematic and effective manner:-

1. Code of Conduct for Underwriters in Pakistan. (A Proposed Draft for Pakistan)
2. Securities and Exchange (Underwriter) Regulation 2012. (A Proposed Draft for Pakistan).

## **6.3 CODE OF CONDUCT FOR UNDERWRITERS IN PAKISTAN.**

(A Proposed Draft)

S.R.No. \_\_\_\_\_ / 2012. In exercise of the powers conferred by section \_\_\_\_\_ of the Securities and Exchange Pakistan Act, 1997 ( \_\_\_\_\_ of 1997), the Securities and Exchange Commission of Pakistan, hereby makes and implement on this \_\_\_\_\_ day of July; 2012, following code of conduct for underwriters in Pakistan:-

1. An underwriter(s) under this code is required to maintain high standard of integrity, fairness in dealing with Issuers, clients and other underwriters, while conducting his business as underwriters.
2. Every underwriter ensures that he and his employees will act in ethical manners with his clients and issuers.
3. Underwriter(s) must pay the proceeds from Public Offering to issuer in accordance with underwriting agreement.
4. Every Underwriter shall provide high standards of service, ensure proper care and due diligence while exercising his duties as underwriter.
5. Every underwriter while offering his services shall make all necessary disclosures relating to areas of conflict of duties and interest.
6. No underwriter shall act in a manner, which is likely to create unfair competition among the Underwriter(s) or which is harmful for the interest of other underwriters doing the business of underwriting.
7. No underwriter shall act in a manner, which is likely to place other underwriters in disadvantageous position.
8. An Underwriter shall not make any statement oral or written which misrepresents that (i) Underwriter is able to perform services of underwriting or (ii) relating to information that he has performed

some services to the particular issuer company or (iii) Underwriting Commitments.

9. No Underwriter shall disclose to other issuer or press or any party, confidential information about his issuer except to the Commission.
10. No Underwriter shall hide any reports, material information or make untrue statement to Securities and Exchange Commission of Pakistan.
11. An Underwriter or his employee shall not give investment advice to public in media unless he has made disclosure of his interest and services to be performed for the issuer.
12. In case employee of underwriter is performing the services of Underwriting then that employee will disclose the interest of his family dependant in that security/offering.
13. When there are more than one underwriter for a public offering then each underwriter may divide the responsibilities among themselves, but such division of responsibilities does not exempt other underwriter(s) from their individual as well as joint responsibilities.
14. An Underwriter and his employee must maintain the record relating to Underwriting activity for a minimum period of 05-years, in order to ensure at any stage that underwriting was conducted in Professional manner.

## **6.4 SECURITIES AND EXCHANGE (UNDERWRITERS) REGULATIONS; 2012**

(A Proposed Draft)

S.R.No. \_\_\_\_\_ 2012. In exercise of the powers conferred by section \_\_\_\_\_ of the Securities and Exchange Pakistan Act, 1997 ( of 1997), the Securities and Exchange Commission of Pakistan with the previous approval of the Federal Government, hereby makes the following regulations, namely:-

### **CHAPTER I PRELIMINARY**

#### **SHORT TITLE, EXTENT AND COMMENCEMENT**

1. (i) These regulations may be called the Securities and Exchange (Underwriters) Regulations, 2012. **(A Proposed Draft).**
- (ii) They shall come into force on the date of their publication in the Official Gazette.

It extends to the Underwriters established or working in Pakistan under these regulations or any other law enforced for the time being in Pakistan.

#### **DEFINITIONS**

2. (1) In these regulations, unless the context otherwise requires:-

(a) **Commission** means the Securities and Exchange Commission of Pakistan.

(b) **Underwriter** means

and includes a person who has made a contract with an issuer to subscribe and pay in cash for those securities as are not fully subscribed by the public issue or

a person who has initially bought the securities from an issuer for the purpose of selling such securities by means of a public offer.

**(c) Enquiry Officer means**

any officer of the Commission, or any other person, having experience in dealing with the problems relating to the securities market, who is appointed by the commission under these regulations Chapter V.

**(d) Form means** a form specified by the Commission.

**(e) Inspecting Authority**

means one or more persons appointed by the Commission to exercise powers conferred under Chapter IV.

**(f) Principal Officer means: -**

(i) in relation to a company or an association of persons or any body of individuals or a body corporate, a secretary, treasurer, partner, manager or director of the company , association, or body corporate;

(ii)any person connected with the management or administration of the Company, association or the body corporate upon whom the commission has served a notice of its intention of treating him as the principal officer thereof.

**(g)Regulations means** Securities and Exchange (Underwriters) Regulations, 2012.

**(h)Registration means** the certificate of registration granted to Underwriters under these regulation.

**(i) Rules means** Balloters Transfer Agents and Underwriters; Rules 2001.

(2) All other words and expressions used in these regulations but not defined, and defined in the Securities and Exchange Ordinance 1969, Securities and Exchange

Commission of Pakistan Act 1997 and the rules shall have the same meanings respectively assigned to them in the Act or the rules, as the case may be or as defined by commission time to time in other regulations.

## **CHAPTER II**

### **REGISTRATION OF UNDERWRITERS**

#### **APPLICATION FOR GRANT OF CERTIFICATE**

3. (i) An application by an Underwriter for grant of a Certificate shall be made to the Commission in Form as prescribed by the Commission from time to time.
- (ii) Notwithstanding anything contained in sub-regulation (i), any application made by an underwriter prior to coming into force of these regulations shall be treated as an application is made in under the sub-regulation (i) and dealt with accordingly.

#### **FURNISHING OF FURTHER INFORMATION, CLARIFICATION, ETC.**

4. (i) The Commission may ask the applicant (For Underwriter) to furnish further information or clarification to consider his application for grant of a certificate.
- (ii) If the Commission, is of the opinion that the information so furnished is not sufficient or adequate to decide the fate of the application and may seek further information through correspondence, If this correspondence causes or is likely to cause any delay, Commission may require the applicant or its principal officer to appear before the Commission in person in order to give an opportunity to the applicant to give further clarifications on the application made under regulation 3.
- (iii) Any application, which is not complete in all respects shall be rejected summarily.

Provided that, before rejecting any such application, the applicant shall be given an opportunity to remove within one month such objections as may be indicated by the

Commission. However the Commission may, on sufficient reasons being recorded extend the time beyond one month enabling the applicant to fulfill the requirements as prescribed by the Commission.

#### **CONSIDERATION OF APPLICATION**

5. The Commission shall take into consideration for grant of a certificate following matters in particular, namely, whether the applicant -

- (a) has the necessary infrastructure like adequate office space, equipments, and manpower to effectively discharge his activities;
- (b) has any past experience in underwriting or has in his employment minimum two persons who had the experience in underwriting;
- (c) or any person, directly or indirectly connected with the applicant has not been granted registration by the Commission;
- (d) fulfils the capital adequacy requirements of rupees twenty lakhs;
- (e) any of its director, company secretary or principal officer is or has at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence.
- (f) is a fit and proper person.

#### **PROCEDURE FOR REGISTRATION**

6.(i) The Commission on being satisfied that the applicant is eligible, shall send an intimation within one month of such satisfaction to the applicant mentioning that he has been found eligible for the grant of certificate and shall forthwith grant a certificate in the form as prescribed by the Commission subject to fee within certain time as specified by the Commission.

- (ii) Where an underwriter fails to pay the fees as provided in sub- regulation (ii), the Commission may suspend the certificate, whereupon the underwriter shall forthwith cease to act as an underwriter.

### **RENEWAL OF CERTIFICATE**

- 7.(i) An underwriter may, make an application in the prescribed form for renewal of certificate before three months of the expiry of the period of earlier issued certificate.
- (ii) The application for renewal of certificate under regulation 7 sub-regulation (i) shall be dealt with in the same manner as if it were an application for grant of a certificate made under regulation 3.

### **PROCEDURE WHERE REGISTRATION IS NOT GRANTED**

8. (i) Where an application for grant of a certificate under regulation 3 or of renewal under regulation 7 does not fulfill the requirements set out in regulations 4 & 5, the Commission may reject the application, after giving an opportunity of being heard.
- (ii) The decision shall be communicated by the Commission within thirty days stating therein the grounds for rejection of application.
- (iii) An applicant aggrieved by the decision of the Commission may apply within a period of thirty days from the date of receipt of such intimation, to the Commission for review of its decision.
- (iv) On receipt of the application made by applicant the Commission shall review its decision and communicate its findings thereon as soon as possible in writing to the applicant. While reviewing the application Commission may accept reject or ask the applicant to fulfill further requirements.



## **EFFECT OF REFUSAL TO GRANT OR RENEW CERTIFICATE**

9. Any underwriter whose application for grant or renewal of a certificate has been declined or refused by the Commission, the applicant shall on receipt of the order cease to act as an underwriter.

Provided that if the Commission is satisfied that it is in the interest of the investors, it may permit the underwriter to undertake the underwriting commitments already entered into by him during the validity period of the certificate.

## **CHAPTER III GENERAL OBLIGATIONS AND RESPONSIBILITIES**

### **TO ABIDE BY THE CODE OF CONDUCT**

10. Every underwriter shall at all times abide by the Code of Conduct for Underwriters in Pakistan.(Proposed Draft).

### **AGREEMENT WITH CLIENTS**

11. (1) Every underwriter shall enter into an agreement with issuer on whose behalf he is acting as underwriter and the said Underwriting agreement shall, include the following clauses namely :-

- (i)Time period for agreement;
- (ii)Amount of underwriting obligations;
- (iii)The period within which the underwriter has to subscribe to the issue after being intimated by or on behalf of such issuer;
- (iv)The amount of commission payable to underwriter;
- (v)The details of arrangements made by the underwriter for fulfilling the underwriting obligations.

(2) The underwriter shall not earn any direct or indirect benefit from underwriting the issue other than the commission.

(3) The total underwriting obligations shall not exceed twenty times the networth referred to in regulation 5. or [ The Capital adequacy of Underwriter].

**BOOKS OF ACCOUNTS AND RECORDS TO BE MAINTAINED BY UNDERWRITERS.**

12.(i) Every Underwriter shall maintain the following documents and books of accounts namely:-

(a) balance sheet and profit and loss account ;

(b) auditor's report;

(c) records in respect of all sums of money received and expended by them and the matters in respect of which the receipt and expenditure take place; and

(d) their assets and liabilities.

(e) details of all agreements ;

(f) total amount of securities subscribed to in pursuance of an underwriting agreement;

(g) statement of capital adequacy requirements

(h) such other records as may be specified by the Commission for underwriting.

(ii) Every underwriter shall intimate to the Commission the place where the books of accounts, records and documents are maintained.

(iii) Every underwriter shall, after the close of each financial year but not later than six months furnish to the Commission (if so required) copies of the balance sheet, profit

and loss account, statement of capital adequacy requirement and such other documents as may be required by the Commission.

(iv) Every underwriter shall preserve the books of account and other records and documents mentioned under this chapter for a period of at least five years.

(v) The Commission may at any time call for any information from an underwriter relating to underwriting. It shall be the duty of the underwriter to furnish such information.

### **APPOINTMENT OF COMPLIANCE OFFICER**

13 (i) Every underwriter shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Ordinance, rules and regulations, notifications, guidelines, instructions, etc. issued by the Commission or the Federal Government and for redressal of investors' grievances.

(ii) The compliance officer shall directly report to the Commission any non-compliance or mal administration or violation of these regulation observed by him.

(iii) The pay and remuneration shall be paid by Underwriter.

## **CHAPTER IV**

### **INSPECTION AND DISCIPLINARY PROCEEDINGS**

#### **INSPECTION AUTHORITY AND INSPECTION PROCEDURE**

14. (i) Whenever Commission deems fit, it may appoint one or more persons as inspecting authority to undertake the inspection of the books of accounts, other records and documents of the underwriter for the following purposes, namely:-

(a) to ensure that the books of accounts and other records are being maintained in the manner required;

(b) that the provisions of the Act, rules and regulations are being complied with;

- (c) to investigate into the complaints received from investors, other underwriters or any other person against the activities of the underwriter;
- (d) to investigate suo-moto to protect the interest of securities business or investors' interest.
- (ii) Before starting any kind of an inspection the Commission shall give a reasonable notice to the underwriter.
- (iii) Where the Commission is satisfied that it is in the interest of the investors or in the public interest no such notice should be given, inspection may be proceeded without such notice.
- (iv) The inspecting authority shall undertake the inspection and authority shall be bound to discharge his obligations as prescribed by the commission. It shall be the duty of the underwriter to provide such books, accounts and other documents in his custody or control and furnish the statements and information relating to an underwriter within such time as the inspecting authority may require.
- (v) The underwriter shall allow the inspecting authority to have a full access to the premises occupied by such underwriter or by any person, on his behalf.
- (vi) The inspecting authority shall have the powers to record the evidence and statements in the course of inspection in the manner as provided in Qanun e Shahdat Order, 1984. It shall be the obligation of the underwriter to give to the inspecting authority all assistance during the inspection which the underwriter may reasonably be expected to give.
- (vii) The inspecting authority shall, as soon as possible, submit an inspection report to the Commission.

### **COMMUNICATION OF FINDINGS**

- 15 (i) The Commission shall after the submission of inspection report communicate the findings of inspecting authority to the underwriter to give him an opportunity of being heard before any action is taken by the Commission on the findings of the inspecting authority.
- (ii) When commission receives written reply, from the underwriter the Commission may call upon the underwriter to take such measures as the Commission may deem fit in the interest of the securities market and for due compliance with the provisions of the Ordinance, rules and regulations.

### **APPOINTMENT OF AUDITOR**

16. The Commission may whenever deems fit may appoint a qualified auditor to investigate into the books of account of the underwriter. The auditor so appointed shall have the same powers as of the inspecting authority.

## **CHAPTER V**

### **PROCEDURE FOR ACTION IN CASE OF DEFAULT**

### **LIABILITY FOR ACTION IN CASE OF DEFAULT**

17. (i) An underwriter or a stock broker or a merchant banker entitled to carry on business of underwriting without obtaining a separate certificate under rule 3 who, -
- (a) fails to comply with any conditions subject to which certificate has been granted;
  - (b) contravenes any of the provisions of the Act, rules or regulations; shall be liable to any of the penalties specified hereinafter mentioned.

(ii) The penalties referred above may be either:

(a) suspension of registration or

(b) cancellation of registration.

### **SUSPENSION, CANCELLATION OF CERTIFICATE**

18.(1) A penalty of suspension of certificate granted to an underwriter, who is entitled to carry on business of underwriting, may be imposed where an underwriter:-

(i) violates the provisions of the Ordinance, rules or regulations;

(ii) does not follow the code of conduct ;

(iii) furnishes wrong or false information,

(iv) does not submit periodical returns<sup>§</sup> as required by the Commission;

(v) does not co-operate in any enquiry conducted by the Commission;

(vi) indulges in manipulating ;

(vii) guilty of misconduct or unprofessional conduct;

(viii) fails to maintain the capital adequacy requirement

(ix) fails to pay the registration fees

(x) violates the conditions of registration;

(xi) fails to fulfill his underwriting obligations.

Provided that the commission for reasons to be recorded in writing may in case of repeated defaults of the type mentioned above impose a penalty of cancellation of certificate on the underwriter.

19. A penalty of cancellation of certificate granted to an underwriter, may be imposed where they.

(i)Indulge in deliberate manipulation or price rigging or cornering activities affecting the securities market and the investor's interest;

(ii)fail to fulfill the capital adequacy;

(iii)guilty of fraud, or is convicted of a criminal offence;

(iv)violate the provisions of the Ordinance, rules and regulations;

(vi)fails to fulfill more than once their underwriting obligations.

#### **MANNER OF MAKING ORDER OF SUSPENSION AND CANCELLATION OF CERTIFICATE**

20.Commission shall not impose any penalty of suspension or cancellation until and unless an inquiry in accordance with the regulations 21 and 22 has been conducted.

#### **MANNER OF ENQUIRY BEFORE SUSPENSION OR CANCELLATION OF CERTIFICATE**

21.(i)For Conducting an enquiry the Commission may appoint an enquiry officer.

(ii)The enquiry officer shall serve a notice at the registered office of the underwriter.

(iii)The underwriter may, within thirty days furnish to the enquiry officer a written statement supported by documentary or any other evidence relied on by him.

(iv)The enquiry officer shall, give a reasonable opportunity of hearing to the underwriter and summon him to enable submissions in support of his written statement.

(v)The underwriter may either appear in person or through the advocate or lawyer during the enquiry.

(vi)The enquiry officer shall submit a report to the Commission and recommend the penalty to be awarded and also the justification of the penalty proposed by him.

#### **SHOW-CAUSE NOTICE AND ORDER**

22. (i)The Commission shall on receipt of the report from the enquiry officer, issue a show-cause notice to underwriter explaining why the penalty should not be imposed.

(ii) The underwriter shall submit within thirty days of the receipt of the show-cause notice send a written reply to the Commission.

(iii) The Commission after considering the written reply to the show-cause notice, within thirty days from the receipt of the reply, if any, pass such order as it deems fit.

(iv)In every order passed reason & Conclusion shall be stated therein including justification of the penalty imposed by that order.

(v) The Commission shall send a copy of the order to the underwriter.

#### **EFFECT OF SUSPENSION AND CANCELLATION OF CERTIFICATE GRANTED TO UNDERWRITER**

23. (i) On and from the date of the suspension of the certificate or cancellation of certificate, the underwriter shall with immediate effect cease to act as an underwriter.

(ii)The order of the Commission passed shall be published in at least two daily newspapers widely circulated in Pakistan and also on the website of the Commission.



### **APPEAL TO THE CHAIRMAN**

24. Any person aggrieved by final order of the Commission made on and after the commencement of these regulations may prefer an appeal to The Chairman of Securities and Exchange Commission of Pakistan within 60 days of Order of the Commission. The decision of the Chairman shall attain the finality and no appeal can be preferred against its decision.

Provided that Chairman may delegate his powers for hearing the appeal to any one , however that appeal will be finalized not later then 60-days of filling of appeal before the chairman.

### **6.5 SUGGESTION/COMMENTS FROM STAKE HOLDERS:-**

The above drafted documents must be sent to stake holders like i.e Stock Exchanges, Underwriters, State Bank of Pakistan, Bankers, and federal government for comments and discussions. After seeking the comments from Stake holders on the drafted documents, it should be amended accordingly before presenting it as a bill for its enactment.

# **ANNEXURE-A**

## **(UNDERWRITING AGREEMENT)**

**THIS UNDERWRITING AGREEMENT (“Agreement”) is made at Lahore on March 06, 2008.**

### **BETWEEN**

**M/s ABC LIMITED**, a company incorporated under the laws of Pakistan and having its registered office at 103-C-II, Gulberg III , Lahore (Hereinafter referred to as the “Issuer”) of the **ONE PART**;

### **AND**

**M/S XYZ BANK LIMITED**, a banking company incorporated under the laws of Pakistan and having its office at 2<sup>nd</sup> Floor, Business and Finance Center, I.I Chundrigar Road, Karachi (Hereinafter referred to as the “Underwriter”) of the **OTHER PART**.

**WHEREAS** , the issuer requires finance by way of issuance of redeemable capital for the purpose inter alia, financing and refinancing the expansion plans of the Issuer (the “Purpose”) and is proposing issuance of redeemable capital up to an aggregate amount of Rs:-4,000,000,000/- (Rupees Four Billion Only) which shall comprise of :

- (i) a public offer up to the amount of Rs.1,000,000,000/- (Rupees One Billion Only) and

- (ii) a private placement up to the amount of Rs.3,000,000,000/- (Rupees Three Billion Only)

in the form of Term Finance Certificates ("TFCs") of the face value of Rs.5,000/-(Rupees Five Thousand Only) each (or such other denomination as the issuer may decide in consultation with any investor/ subscriber) (the "TFC Issue") to the general public by way of public offering and to eligible institutional and other investors by way of private placement pursuant to the provisions of section 120 of the Companies Ordinance 1984:

**AND WHEREAS** at the request of the issuer the Underwriter has agreed to underwrite 40,000 sets of TFCs of Rs.5,000/- per set amounting to an aggregate face value amount of Rs.200,000,000/-(Rupees Two Hundred Million Only) to be offered to the general public, as stated above on the following terms and conditions:

**NOW THEREFORE, THIS AGREEMENT WITNESSETH**

## **ARTICLE-1**

### **DEFINITIONS AND INTERPRETATION**

- 1.01 The recitals set out in this document shall form part of this Agreement and shall have the same force and effect as if expressly set out in the body of this Agreement and any reference to this Agreement shall include the said recitals.
- 1.02 The following terms shall in this Agreement have the meanings assigned hereunder , which meaning shall apply to both the singular and plural of the terms:

- (a) **“Prospectus”** shall mean the Prospectus in terms of which the Issuer makes an offer to the general public for subscription of the TFCs.
- (b) **“TFCs” ,”TFC” and Term Finance Certificate”** shall mean the term finance certificates in the form together with terms and conditions specified in Schedule(1) hereto having a face value of Rs.5000/- (Rupees Five Thousand Only) each { or such other denomination as may be agreed between the Issuer and the investor(s) /subscriber (s) } to be issued by the issuer by way of redeemable capital pursuant to the provisions of section 120 of the Companies Ordinance 1984 in sets of 10 (Ten) scrip's per set, to investors including the general public , with an aggregate face value of up to Rs.4,000,000,000/- (Rupees Four Billion Only).The term “TFC” shall also mean and include any and each scrip of the set of 10 (Ten) TFCs in a set held under a common Holding Certificate as per the structure and indicative redemption schedule as specified in Schedule (3) to the Trust Deed .If the TFCs are issued directly or induction in the Central Depository System (“CDS”) on account of the subscriber to the TFCs, without issuance of the physical certificates and the TFC scrips ( with the terms and conditions ), the term “TFC” , “TFCs” and “Term Finance Certificate” shall mean and include the TFC issued through the CDS which shall be subject the terms and conditions in the form as substantially specified in Schedule 1 attached hereto.
- (c) **“TFC Holder(s)”** shall mean the person(s) for the time being entered as the holders(s) of TFC(s) in the Register of TFC Holders maintained by the Issuer or a Registrar appointed by the issuer with the approval of the Trustee and if inducted

in the CDS, shown as such holders in the records of the CDS who shall be the beneficiaries under the Trust Deed.

(d) **“Registrar of TFC Holders”** means the Register of TFC Holders herein covenanted to be kept by the Issuer or a Registrar appointed by the Issuer with the approval of the Trustee.

(e) **“Security Documents”** shall have the same meaning as is ascribed to them in the Trust Deed;

(f) **“Stock Exchange”** shall mean the Lahore Stock Exchange (Guarantee) Limited;

(g) **“Trustee”** shall mean IGI Investment bank limited and shall include any replacement or successor Trustee.

(h) **“Trust Deed”** shall mean the Trust Deed dated March 03, 2008, executed between the issuer and the trustee for the benefit of the TFC Holder(s) containing the terms and conditions, inter alia, upon which the security comprised in the Security Document will be held by the Trustee and the Trustee will enforce the rights and remedies of the TFC Holders against the Issuer.

1.03 Any capitalized terms used herein, if not specifically defined in this Agreement, shall have the same meaning provided in the Trust Deed.

If the day on which any act, matter or thing is to be done under or pursuant to this Agreement is not a Business Day, that act, matter or thing shall be done no later than the immediate succeeding Business Day, except that in case of Payment of any amounts in respect of the TFCs, the same will take place on the Business Day immediately preceding such date.

## ARTICLE-2

### **THE PUBLIC OFFERING AND ISSUE OF TFC**

- 2.01 The Issuer shall offer for subscription by the general public TFCs of the aggregate face value amount up to Rs.1,000,000,000/- (Rupees One Billion Only) payable in cash upon application (hereinafter referred to as the “**Public Offering**”) by and in terms of the Prospectus in form and substance generally used previously for public issue of TFCs in Pakistan and approved by the Securities and Exchange Commission of Pakistan and the Stock Exchange for such purpose.
- 2.02 The Public Offering shall be in form and substance generally used previously for public issue of TFCs in Pakistan, not adverse to the scope of this Agreement, and with the approval of the Securities and Exchange Commission of Pakistan and the issue, circulation and publication of the Prospectus shall be in form and substance in accordance with the approval thereto granted by the Securities and Exchange commission of Pakistan and the stock Exchange. Furthermore the issuance, circulation and publication of the Prospectus shall be in accordance with the Companies Ordinance, 1984.
- 2.03 The Underwriter shall underwrite 40,000 sets of TFCs of Rs.5,000/- per set amounting to an aggregate face value amount of Rs. 200,000,000/- (Rupees Two Hundred Million Only) comprising 20% of the Public Offering.
- 2.04 The Prospectus shall be published in such newspapers (at least one in Urdu language and one in English language ) as would ensure adequate publicity of

the Public Offering on a date no later than December 21, 2008 or such other date as the Underwriter may agree with the Issuer in writing.

2.05 Prior to the publication of the prospectus the issuer shall have:-

- i. obtained any relevant approval of the Prospectus from the Securities and Exchange Commission of Pakistan;
- ii. obtained the approval of the Stock Exchange to the issuance , circulation and publication of the Prospectus and terms thereof;
- iii. received or made firm arrangements for any statutory and /or

corporate consents, permissions approvals and authorizations required by law to make the Public Offering, to publish the Prospectus and to discharge all its obligations hereunder and shall have filed all returns and statements required under law and fulfilled all requirements and conditions of the companies ordinance 1984, the approval of the Securities and Exchange Commission of Pakistan and the Stock Exchange;

- iv. Made any amendments in its Articles of Association if necessary so as to secure the objective of this Agreement.
- v. Furnished to the Underwriter satisfactory evidence of the completion and fulfillment of any and all of its obligations hereunder as the Underwriter may reasonably require including a report from the Issuer Auditors and a Balance Sheet and Profit and Loss Account reflecting the financial position as on the date of its last financial year end.

- vi. Obtain a written authorization from the Underwriter to publish the Prospectus ,which shall not be unnecessarily or unreasonably withheld;
- vii. Appointed the Trustee for the TFC Holders and executed the Trust Deed;
- viii. Executed the security Documents in favor of the Trustee; and
- ix. Procured commitments for the TFCs of the face value of Rs.3,000,000,000/- (Rupees Three Billion Only) in respect of Private Placement portion of the issue.

2.06 If and to the extent that the TFCs offered to the general public , by the Public Offering in accordance with terms hereof shall not have been subscribed for and paid in full by the closing of the subscription list , the Underwriter, within fifteen (15) days of being duly called upon by the issuer so to do, shall subscribe or procure subscribers to subscribe at the face value of Rs.5,000/- per set of TFCs and pay for in cash in full for the unsubscribed TFCs to the extent of 20% of the total unsubscribed TFCs subject to the maximum of the TFCs underwritten by the underwriter as specified in clause 2.03 above, against which payment delivery of the relevant TFCs by the issuer will be made to the Underwriter or subscribers procured by the Underwriter. The aforementioned request of the Issuer shall be supported by and a declaration by the Issuer as to the final result of the Public Offering .In the event that the Underwriter is not called upon to take up any unsubscribed TFCs within a period of 60 (Sixty) days from the date of Agreement shall terminate and the Underwriter shall stand fully discharged and released from any and all obligations hereunder.



### **ARTICLE-3**

#### **UNDERWRITING COMMISSION AND EXPENSES**

- 3.01 Upon approval of the issue by Securities and Exchange Commission of Pakistan, the issuer shall pay to the credit of the underwriter a commission at the rate of 0.15% of the aggregate face value of the TFCs agreed to be underwritten by the underwriter pursuant to clause 2.03.
- 3.02 The issuer shall, upon first demand in this regard being made by the Underwriter pay to the underwriter all reasonable legal fees and other reasonable out of pocket expenses incurred by the underwriter in connection with taking of any reasonable and justifiable action under or pursuant to this underwriting agreement by the underwriter ,necessary for its implementation.
- 3.03 The issuer shall pay to or reimburse as the case may be to the Underwriter all stamp duties or other taxes or levies arising in respect of this underwriting agreement and subscription of TFCs in terms hereof save for taxes and levies on the income of the underwriter and taxes and levies which are required to be borne by the Underwriter or required to be deducted from payment made pursuant to the TFCs as per the terms and conditions of the TFCs.

## **ARTICLE -4**

### **PARTICULAR COVENANT & REPRESENTATIONS**

4.01 The issuer during the existence of this agreement and thereafter so long as the Underwriter holds a minimum of 40,000 TFCs pursuant to the obligations of the Underwriter in terms of this Agreement ,shall and hereby undertakes to:-

- I. Conduct its business with diligence and efficiency and in accordance with sound business and financial practice and with the assistance of qualified personnel;
- II. Maintain its existence and right to carry on operation and takes all steps necessary to maintain and renew any and all rights , powers, privileges, concessions ,tax, advantages, licenses and franchises required by law in the conduct of its business;
- III. Keep its properties and business insured with a reputable insurance company(ies) against loss and damage in such manner and to such extent as generally accepted and customary in regard to property and business of a like nature;
- IV. Maintain books of account and other records in such manner as is adequate to truly and fairly reflect the financial position of the issuer and the results of its operations in conformity with generally accepted accounting principles consistently applied;
- V. Keep and maintain in good order and condition the lands , buildings , machinery and property used in connection with the business of the issuer;
- VI. Furnish to the underwriter as and when reasonably required, copies of the issuer's audited accounts ,cash flow statements, balance sheets and such other documents as may reasonably be required by the Underwriter from time to time;

- VII. Promptly inform the underwriter of any proposed changes, which may materially and adversely affect the carrying on of the issuers business;
  - VIII. Cause the TFCs to be listed on the Lahore Stock Exchange (Guarantee) Limited;
  - IX. Provide a copy of the final draft of the prospectus, as approved by the Securities and Exchange Commission of Pakistan and the Stock Exchange, before its publication in the press;
  - X. Apply the entire net proceeds of the Public Offering and subscription by Underwriter exclusively for carrying out the principal purpose as laid down in the Prospectus;
  - XI. Cause the name of the Underwriter to be entered in the Register of TFC holders in case the Underwriter subscribes and takes up TFCs.
- 4.02 The issuer shall furnish or cause to be furnished to the Underwriter sufficient evidence of the authority of the person or persons who will ,on behalf of the issuer take any action or execute any documents required or permitted to be taken or executed by the issuer under this Underwriting agreement and authenticated specimen signature of each such person.
- 4.03 The issuer represents and warrants to the Underwriter as follows:-
- I. The issuer has taken all corporate and other action to authorize the execution of this agreement and to perform the obligations hereunder which constitute valid and binding obligations of the issuer;

- II. The issuer has disclosed all material information , agreements, events and documents which may or could affect the decision of the Underwriter to enter into this Underwriting Agreement;
- III. There is no litigation , claim or action threatened or instituted or contemplated by the issuer which could in any way adversely affect the issuer's financial position in any material manner.

## **ARTICLE-5**

### **EVENTS OF DEFAULT AND TERMINATION**

5.01 If any one or more of the events specified in this Article-5 (Hereinafter referred to as

“Events of Default” shall have occurred before the publication of the prospectus and be continuing then the underwriter may by written notice to the issuer and without any further notice and without any presentment, demand or protest of any kind all of which are expressly waived by the issuer be entitled to terminate this Underwriting Agreement forthwith and shall not be required to subscribe to any TFCs which have not been subscribed by the general public, as a consequence of the Public Offering;

- I. The issuer shall have failed to pay the underwriting commission to the underwriter in accordance with the provisions hereof;

- II. Default shall have occurred in the performance of any covenant or agreement between issuer and the underwriter and such default shall have continued for a period of thirty (30) days after notice hereof has been given to the issuer;
- III. Any representation made by the issuer or its authorized representative under or in connection with this Underwriting Agreement shall be found to have been incorrect in any material respect and shall continue to be so incorrect for a period of thirty (30) days after written notice thereof shall have been given to the issuer by the Underwriter;
- IV. Any government or governmental authority shall have taken any action for the dissolution or winding up of the issuer or any action that would prevent the issuer or its officers from carrying on its operations or a substantial part thereof.
- V. The issuer shall have:-
  - a. Voluntarily or involuntarily become the subject of proceedings under any bankruptcy or insolvency laws or any other law or procedures for the relief of the financially distressed debtors; or
  - b. Been unable or admitted in writing its inability to pay its debts as they mature;
  - c. Had a receiver or administrator appointed of all or any part of its assets.

5.02 If the issuer is unable to make the Public Offering on or before December 30, 2008 or on or before such later date as may be agreed between the parties, this Underwriting Agreement shall automatically terminate on December 31, 2008 or such other date, as the case may be.

5.03 In the event that any political ,military, natural calamity or diplomatic crisis or situation occurs in Pakistan which in the reasonable opinion of the underwriter, arrived at in good faith, renders the Public Offering impracticable or inadvisable, the Underwriter may at any time prior to the publication of the Prospectus, by notice in writing to the issuer call upon the issuer to postpone the public offering from time to time subject to a maximum period of Ninety (90) days after the proposed date of Public Offering and the issuer shall at its option , either comply with the notice of the Underwriter or terminate this Underwriting Agreement by written notice .In the event of termination of the Underwriting Agreement by the issuer in accordance with this clause, the underwriter shall refund the underwriting commission to the issuer and all rights and remedies under this Underwriting Agreement shall cease and terminate.

## **ARTICLE-6**

### **MISCELLANEOUS**

6.01 Any notice or request required or permitted to be given or made under this agreement to any of the parties hereto shall be in writing. Such notice or request shall have been deemed to have been duly given or made when it shall have been delivered by hand, airmail, cable, facsimile or telex to the party to which it is addressed at such party's addresses or numbers specified below or at such other address or numbers as such party shall have designated by notice to the party giving such notice or making such request.

6.02 All notices and communications hereunder shall be made in writing

(by letter, telex, or fax) and shall be sent as follows:

**(a) If to the issuer: M/s ABC LIMITED**

**Address : 103-C/II, Gulberg III, Lahore**

**Fax : XXXXXXXXX**

**(b) If to the Underwriter : M/s XYZ BANK LIMITED**

**Address : 2<sup>nd</sup> Floor, business and finance centre,**

**Fax : XXXXXXXXX**

6.03 Unless earlier terminated under the provisions of Article-5, this underwriting agreement shall continue in full force and effect until the Public Offering has been made and all matters relating or incidental to such Public Offering have been fully and legally completed and TFCs have been issued and delivered to all successful applicants from the general public and any and all matters relating to the issue of such TFCs have been fully and legally completed and all commissions , costs or expenses due to the Underwriter have been paid hereunder.

6.04 The TFCs underwritten by the underwriter will be free from all liens, charges, encumbrances, equities, and right of any persons of any nature whatsoever attaching thereto.

6.05 No delay in exercising and no omission or failure whatsoever to exercise any right, power or remedy accruing to the underwriter under any provision of this Underwriting Agreement shall impair such right, power or remedy or be construed as a waiver thereof or be construed as an acquiescence by the Underwriter in any default or omission or otherwise howsoever or affect or impair any right, power or remedy of the Underwriter in respect of that or any other omission or default.

6.06 The Article headings are for convenience of reference and in no way affect the meaning of this Underwriting Agreement.

#### **ARTICLE-7**

#### **ARBITRATION**

7.01 Whenever any difference, dispute, issue or problem arises between the Underwriter on the one hand and the issuer on the other hand touching the true intent or construction or the incidents or consequences of this Underwriting Agreement or touching any breach or alleged breach of this Underwriting Agreement or any claim on account of any such difference, dispute, issue or problem shall be referred for decision under the Arbitration Act, 1940 for the decision of one Arbitrator appointed by the mutual consent of the Underwriter and the issuer. Upon failure of the Underwriter and the Issuer upon a mutually agreeable Arbitrator, two Arbitrators will be appointed of whom one shall be appointed by the Underwriter and one by the issuer and an Umpire will be appointed by the two Arbitrators.



7.02 The Arbitration shall be conducted in English and shall be held in Lahore under Pakistani Law.

7.03 The Award shall be final, conclusive and binding on all the parties.

**IN WITNESS WHEREOF** the parties hereto, acting through their duly authorized representatives have caused this Underwriting Agreement to be signed on the day, month and year first above written.

FOR AND ON BEHALF OF  
M/s ABC LIMITED

Name:

Designation:

WITNESSES:

1. \_\_\_\_\_

2. \_\_\_\_\_

FOR AND ON BEHALF OF  
M/s XYZ BANK LIMITED

Name:

Designation:

WITNESSES:

1. \_\_\_\_\_

2. \_\_\_\_\_

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